

## **Application for Authorisation**

**Wattyl (Australia) Pty Limited  
Courtaulds (Australia) Pty Limited  
Taubmans Industries Limited and  
Pinchin Johnson (Australia) Pty Limited**

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## Summary

In April 1995 Courtaulds (Australia) Pty Limited, the owner of Taubmans Industries Ltd (Taubmans), which carries on an architectural and decorative paint manufacturing and supply business, sought bids for Taubmans architectural and decorative paint manufacturing operations in Australia, New Zealand, Fiji and Western Samoa. On July 27 1995, Wattyl (Australia) Pty Limited (Wattyl), advised the Australian Competition and Consumer Commission, (the Commission) of its interest in acquiring the Australian assets of Taubmans offered for sale.

The Commission formed the view that there was a strong prospect that the proposed acquisition would be likely to have the effect of substantially lessening competition in breach of section 50 of the *Trade Practices Act 1974* (C'th.) ('the Act'). The proposed acquisition was announced publicly in October 1995 and the Commission undertook extensive market inquiries.

On 6 December 1995 the Commission again considered the matter and decided that in its view the proposed acquisition would be likely to breach s.50 of the Act. The parties were informed of the Commission's view. In subsequent discussions the parties raised a number of arguments citing public benefit from the proposed acquisition. Such arguments are not relevant under s.50 of the Act and can only be considered in the context of an authorisation application. Wattyl indicated a preference for a Federal Court determination rather than seeking authorisation.

Wattyl and Taubmans signed a contract for the purchase and sale of the Taubmans' Australian business on 16 December 1995. Following discussions with the Commission, the parties agreed not to complete the sale until 14 March 1996. The parties refused to extend these undertakings and the Commission filed an application in the Federal Court on 11 March 1996 seeking an interlocutory order restraining the acquisition. Wattyl and Taubmans decided not to contest the interlocutory hearing and provided undertakings not to complete the transaction until the conclusion of the trial.

On 3 April 1996 the parties lodged an Application for Authorisation (Authorisation No. A30175).

## Relevant provisions of the Act

Since January 1993, Section 50 of the Act has prevented mergers that would have the effect, or likely effect, of substantially lessening competition in a substantial market. The test replaced the previous 'dominance test'. Under that test, mergers were prevented that would, or would be likely to, create or enhance a position of 'dominance' in a substantial market.

The dominance test restricted the number of mergers that would be subject to the Act. For example, under a dominance test, it may be difficult to prevent a merger that creates or maintains a domestic duopoly even though such a merger may be likely to substantially lessen competition. Under the substantial lessening of

competition test, such a merger would be subject to considerable scrutiny and may only be allowed to proceed if barriers to entry and/or import competition are low, or if sufficiently significant public benefits can be demonstrated through the authorisation process.

Subsection 50(1) of the Act provides:

A corporation must not directly or indirectly:

- (a) acquire shares in the capital of a body corporate; or
- (b) acquire any assets of a person;

if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market.

Section 50(3) sets out factors which must be taken into account by the Court when assessing whether an acquisition is likely to have the effect of substantially lessening competition. Section 50(3) provides that the following non-exhaustive list of factors must be taken into account in the evaluation of the effect or likely effect of particular acquisitions:

- (a) the actual and potential level of import competition in the market;
- (b) the height of barriers to entry to the market;
- (c) the level of concentration in the market;
- (d) the degree of countervailing power in the market;
- (e) the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins;
- (f) the extent to which substitutes are available in the market or are likely to be available in the market;
- (g) the dynamic characteristics of the market, including growth, innovation and product differentiation;
- (h) the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor; and
- (i) the nature and extent of vertical integration in the market.

The parties application for authorisation is pursuant to subsection 88(9) of the Act. This section provides a statutory exemption from the operation of s.50 of the Act which might otherwise prevent the proposed acquisition.

The Act provides a mechanism whereby acquisitions which breach the Act can be authorised. Subsection 90(9) of the Act provides that the Commission shall not grant authorisation unless it is satisfied in all the circumstances that the proposed acquisition would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to take place. The Commission considers public detriment as well as public benefit in its evaluation and gives considerable emphasis to any negative effect on competition arising from the acquisition.

Subsection 90 (9A) gives some indication of what is to be considered as a benefit. It specifically notes that a significant increase in the real value of exports and/or a

significant substitution of domestic products for imported goods must be regarded as benefits to the public. The Commission is also required to take into account those factors which relate to the international competitiveness of any Australian industry.

The Commission, on evaluation of the public benefits and any detrimental effects, including detrimental effects on competition, may grant authorisation or authorisation subject to conditions.

## **The relevant market/s**

Section 50 of the Act refers to a substantial lessening of competition in a market. An assessment of public benefit and detriment must be undertaken in the context of a market. Market definition is relevant in determining the effect of the acquisition on competition.

It is the Commission's view that the relevant product market is the market for the manufacture of architectural and decorative paint. Industrial paints are not considered to be substitutes. They are formulated for specific uses and would not be appropriate for use on broadwall surfaces.

While there is a possibility of supply side substitution between manufacturers of industrial paint and manufacturers of architectural and decorative paint, it is the Commission's view that the likelihood of such substitution in response to a significant increase in price or the equivalent exercise of market power in the architectural and decorative paint market is low. The possibility of supply side substitution is considered later in this summary.

The geographic context of the market is also relevant. The three major producers, Dulux, Wattyl and Taubmans provide nationally distributed and promoted brands. The three leading manufacturers have a national focus and compete within the framework of the national market.

Substantial regional variations also exist. A number of smaller competitors such as Bristol, Henry Haymes, White Knight and Asian Paints compete in specific regional areas and consequently the structural characteristics of the market may vary from State to State.

The Commission has considered all of the statutory factors set out above and all other relevant factors in assessing this application. Each of these is discussed below.

## **Import competition**

In some markets, market shares and concentration statistics may understate the competitive restraint provided by imports because of the potential to expand the supply of imports rapidly in response to higher prices.

Paint imports are low. Based on Wattyl estimates it is likely that imports of architectural and decorative paints represented less than 3 per cent of the architectural and decorative paint market in 1995. Further, imports of water based



paints, of which architectural and decorative would be the dominant part, have actually fallen over the past few years.

Transportation costs are high relative to the value for paint. Significant volumes of architectural and decorative paints are unlikely to be sourced from countries other than those geographically close to Australia. New Zealand would be the most likely source of imports, yet its exports to Australia were only 766 000 litres, insignificant in a market of 119 million litres. Further, Dulux and Wattyl represent a major share of the New Zealand market and it is unlikely that significant imports would come from these companies to compete against their domestic operations.

## Entry barriers

If the market is characterised by low barriers to entry the market power of the incumbent firms is likely to be constrained by the threat of entry. However, should the barriers to entry be high, incumbents may be unconstrained in their behaviour.

The applicants' economic advice, claims that barriers to entry are not high as evidenced by recent cases of new entry and the expansion of small firms within the market. The advice cites entry by Benjamin Moore via imports and the new Asian Paints plant.

The Commission rejects the claim that entry barriers are not high. Benjamin Moore is currently importing small volumes of paint (as evidenced from paint import statistics) for exclusive supply to the Your Local Paint Place group. It is difficult to see how such limited entry could constrain any anti-competitive behaviour of major paint producers.

Asian Paints has established a small manufacturing plant in north Queensland. As far as the Commission is aware, this is the only new manufacturing entrant in the past decade. The Commission understands Asian Paint's capacity is minute as a percentage of current Australian production. Consequently its ability to influence the behaviour of the major producers would be very limited.

The emergence of Bristol has been cited by Wattyl and Taubmans as evidence of low entry barriers. However the Commission understands that it has little excess capacity, and that its financial capacity is limited.

While capital costs are not substantial for limited entry, entry at a level sufficient to be a competitive threat to the duopolists is likely to involve considerable capital outlay. Further, large scale entry would increase supply to an extent likely to lower prices and thereby make large scale entry non-viable.

Product differentiation barriers are substantial. While Wattyl has claimed that brand recognition is not a significant barrier to entry, market evidence and internal records of the parties convince the Commission otherwise.

In the DIY retail market, market evidence suggests that consumers are very hesitant in using a generic or housebrand.

In internal reports to the Board of Wattyl, its managers have stated that one of the main reasons for Wattyl's interest in Taubmans is its established brand name and reputation. It further states that the cost of advertising to establish brand identity will limit the number of competitors in the market.

The Commission's report has identified a large number of reports and informed opinions all of which state unequivocally that brand identification is extremely important in the paint market.

Brand recognition is of considerable importance to resellers. Small resellers concentrate on sales of nationally advertised brands to the extent that non branded

or poorly imaged products will have little opportunity of access to retail outlets. Mass merchandisers stock almost exclusively the brands of the three national manufacturers.

Any new entrant or existing small firm would have considerable difficulty contesting the market segment supplied by the branded manufacturers, a segment representing the majority of the market.

## **Level of Concentration**

The three major manufacturers, Dulux, Wattyl and Taubmans account for around 90 per cent of sales by value. In 1995 Dulux had 45 per cent, Wattyl 30 per cent and Taubmans 16 per cent. The fourth largest firm Bristol, had 6 per cent.

There is some disagreement among the parties as to whether Dulux is dominant in the market. A submission on behalf of the applicants by KPMG Management Consulting Pty Ltd states that small paint manufacturers have the most important role in constraining the conduct of the larger manufacturers. Wattyl however argues that a merged Wattyl/Taubmans is necessary to provide effective competition to the market leader Dulux, an indication that the smaller firms do not provide competitive restraint.

Such a view is critical to the Wattyl/Taubmans argument that the acquisition is necessary to provide effective competition to the 'dominant' Dulux.

The Commission is not convinced of the claim that Dulux dominates the market. Dulux's market share has fallen since its acquisition of British Paints in 1988 while the market share of Wattyl has increased from 15 per cent to 28 per cent since 1988.

The parties assert that further analysis of market shares indicate that Wattyl and Taubmans produce complementary rather than competitive products. They note that Taubmans' market strength is in interior paint while Wattyl has the larger share of exterior paint.

Such a claim is not supported by market evidence. While Wattyl has a significantly greater share of exterior paint than Taubmans (27 per cent and 15 per cent respectively), its share of interior paint at 17 per cent is identical to that of Taubmans. There is substantial evidence of head to head competition between Wattyl and Taubmans.

The parties have placed considerable emphasis on their claim that the acquisition of Taubmans by Wattyl will lead to two evenly matched competitors such that the merged entity will be sufficiently large to vigorously compete against Dulux.

The acquisition would give Wattyl/Taubmans about 46 per cent of the market (as compared to Dulux' 45 per cent). The next largest competitor, Bristol, would have a market share of less than one fifth the share of either of the major players.

## **Countervailing power**

Countervailing power may exist in the industry if buyers are sufficiently large to provide a credible counterweight to the bargaining strength of the paint producers. In this situation the credible counterweight would have to come from the ability of the buyers to acquire product from alternative sources. Typically this would mean importation or integration back into paint production.

The Commission is of the view that there is no substantial countervailing power in the industry. No single paint seller is likely to have more than three per cent of the market. As discussed earlier, importation is not seen as a credible threat. Further, the likelihood of hardware stores or mass merchants integrating backwards into paint production is most unlikely.

Paint represents a fairly small proportion of total sales for any retailer other than specialist paint stores. Consequently such retailers would have little incentive to integrate backwards into paint manufacture. This would be reinforced by the previously discussed problems associated with brand recognition.

Independent paint specialists would be the only group likely to even consider integration backwards into manufacturing and as a group they account for only 30 per cent of the market, so any individual specialist is likely to have a market share too small to contemplate production.

Consequently the Commission considers that countervailing power is insufficient to be any competitive threat.

### **Availability of substitutes**

The applicants' economic advice claims that there are many alternative materials to paint including wallpaper, timber, bricks and glass. The Commission found no evidence that these products were substitutes in the economic sense and observed with no surprise that the applicants' advice did not provide any indication at all as to how such products might impose a constraint on paint prices.

Some regional paint manufacturers do have the capacity to expand production. However, their success in doing so is likely to be limited by the brand recognition of existing players. Difficulties in accessing retail shelf space combined with the network of company owned stores and trade depot agreements also places significant constraints on the ability of smaller market participants to expand output quickly. On the demand side, the significant differentiation of products between the minor and major manufacturers also reduces the ability of the small manufacturers to expand quickly.

## **Removal of a vigorous and effective competitor**

The parties submitted that if Taubmans is not sold it would not remain an effective competitor.

Market information indicates that while Taubmans has lost market share in recent years, retailers consider it to be a viable business. Its market share is still higher than it was a decade ago. It has strong brand recognition and widespread distribution. It recently won the account to supply Target at the expense of Wattyl.

Internal documentation from Wattyl indicates that it continues to see Taubmans as a strong and viable competitor and the Commission has no reason to disagree with this view.

The evidence before the Commission clearly indicates a range of options for the continuation of the operation of the Taubmans' business.

## **Vertical integration**

The major paint manufacturers have established a range of vertical agreements which in the Commission's view restrict competition in the industry. The acquisition will re-enforce such agreements and reduce external competitive pressures.

The vertical agreements established between Dulux, Wattyl and Taubmans and the various paint resellers vary considerably. However, generally they tend to restrict the opportunity of resellers to sell competing brands by imposing conditions such as minimum sales targets and/or floor/shelf space requirements, prohibition on competition for certain customers, and prohibitions on the sale of competing brands.

It is the Commission's view that the acquisition will strengthen the anti competitive effects of these arrangements. Trade painters receive substantial discounts by purchasing their requirements through trade depots vertically linked to the major manufacturers by exclusive supply arrangements. The acquisition will reduce the number of such vertically integrated depots from three to two competing suppliers. Trade painters will not switch to the non vertically linked resellers because their wholesale paint prices would be substantially greater. Therefore the vertical links and the consequent trade discounts remove the non integrated retailers as a competitive threat for the business of trade painters.

## Higher prices and profit margins

The Commission has given considerable attention to the claim that competition will be enhanced by a duopoly market structure and finds such an argument implausible.

The duopolists will quickly recognise their interdependence. Should either firm engage in price competition to increase market share, it would quickly face a similar response from its competitor. Given the relatively inelastic demand for the product, price competition is likely to result in lower revenues and profits for both firms.

Wattyl and Courtaulds' economic advice questions whether it can be inferred that price collusion or any form of conscious parallelism in pricing is likely to occur merely by looking at market shares. The Commission agrees that duopolistic market structures may exhibit a variety of behaviours and that examples of competitive behaviour do exist.

However, the Commission is of the view that there is a wide range of structural and behavioural factors which would lead it to conclude that competition is likely to be reduced rather than enhanced by the acquisition.

Wattyl and Courtaulds' economic advice argues that the likelihood of cooperative behaviour, implicit or explicit, between Dulux and Wattyl/Taubmans, is remote because the structure and strategic approaches of the two groups appear to be quite different, and the products of the two firms are differentiated, and there is excess capacity in the industry.

The Commission does not accept such claims. Wattyl has stated that its objective in the merger is to achieve a compatibility with Dulux in terms of costs, market share product range and quality. Consequently it is reasonable to expect that the approaches of the two firms will converge rather than diverge.

Further there is little evidence that there is substantial differentiation between the products of the three leading suppliers. All are recognised in the market as suppliers of the quality premium priced paint. While Dulux brands may attract a slight price premium which may suggest some differentiation from the products of its competitors, this differential, particularly between Dulux and Taubmans, is not substantial.

With regard to the economic advice provided to Wattyl and Taubmans which claims that excess capacity may inhibit co-operative approaches, Wattyl/Taubmans plan to close plants if the merger goes ahead. This will reduce capacity and enhance opportunities for cooperation.

Similar market shares combined with similar cost structures would enhance the likelihood on non competitive behaviour. Large variations in market size between firms has often enhanced competition as smaller size players compete vigorously for market share by cutting prices. As such firms expand market share the cost of price cutting increases to an extent sufficient to reduce such activity.

Wattyl argues that the acquisition by Dulux of the Cabots brands and the subsequent aggressive marketing of the brands by Dulux has forced Wattyl to reduce margins on competing products. They argue that this is a likely outcome should they acquire Taubmans.

However, in the Commission's view, prior to its acquisition by Dulux, Cabots was not an effective competitor. Extensive advertising by Dulux enabled Dulux to reposition the brand as a premium competitor to the equivalent Wattyl range forcing Wattyl to respond by decreasing its price-cost margin. The key difference between the current acquisition and that of Dulux/Cabots is that both Wattyl and Taubmans are currently effective competitors to Dulux and with each other. Furthermore, there is a substantial difference between competition for one product and competition across a full range of products by two large, evenly matched players. Finally, in the woodstains segment, smaller manufacturers represent a far larger share of the segment than is the case for the architectural and decorative paint market as a whole. Therefore there is no reason to expect that price competition will increase following the acquisition. Indeed, a reduction in price competition is more likely to be the case.

The Commission is concerned that a substantial number of retailers who support the merger do so because they see it as a way to end destabilising price competition. Most retailers did not expect prices to fall.

Recent activity by Taubmans indicates a recognition that the major players can take steps to reduce price competition and increase retail margins. The decision by Taubmans to withhold supply to retailers who advertised the prices of Taubmans products was considered by retailers to be an attempt to increase retail margins. This view is supported by internal Taubmans correspondence.

The evidence regarding price effects after a previous merger in the industry is not supportive of the applicants' case. The acquisition by Dulux of British Paints was followed by significant price increases. The applicants' economic advice notes that this occurred after prices had been kept low for a number of years due to the existence of substantial excess capacity.

The Commission notes that this proposed acquisition would also lead to capacity reductions and may therefore also, similar to the Dulux/British Paints merger, lead to price increases.

The reduction in capacity and equalisation of market share is likely to facilitate price increases. Price-cost margins are likely to rise rather than fall as market share stabilise. The Commission concludes that the claim that equal market shares between the merged Wattyl/Taubmans and Dulux would enhance competition is unsupported by the evidence.



## **Conclusions on anti-competitive detriment**

The Commission has assessed the impact on competition in light of the statutory factors identified above. The proposed merger rates poorly on nearly all factors:

- Actual and potential import competition is low;
- Barriers to entry and expansion are high;
- Concentration is already high and will be increased substantially if the merger proceeds;
- There is no substantial countervailing power;
- There are no close substitutes for paint and smaller manufacturers are constrained in their ability to quickly expand production;
- The merger would remove a vigorous and effective competitor from the market;
- Vertical links restrict competition in the industry and act as a barrier to entry; and
- Given the above, the proposed merger is likely to lead to higher prices and/or profit margins.

It is the Commission's view that barriers to entry are substantial, imports provide little constraint, and resellers have no countervailing power. Consequently these factors together with the substantial rise in concentration are likely to lead to anti-competitive behaviour.

The Commission does not accept the argument of Wattyl and Taubmans that the acquisition will be pro-competitive by enabling the merged entity to have market strength commensurate to that of the market leader Dulux. The Commission's view is that the acquisition will be conducive to the exercise of unilateral market power and greater co-ordination of activity between two very similar competitors with similar market shares and cost structures.

## **Public benefit**

While the Commission is of the view that the acquisition will have the effect of substantially lessening competition, it is required to assess the public benefit from the acquisition.

Taubmans and Wattyl have argued that there are substantial cost savings from lower production costs, rationalisation of manufacturing sites and warehouse and distribution facilities, raw material savings, administration advertising and promotion savings and reduction in employee numbers.

The parties supplied the Commission with some confidential information in support of the cost savings claim. The Commission accepts that efficiency gains of the magnitude indicated, if realised, would be a substantial public benefit from the merger. However, the Commission doubts that even if such savings are realised, these lower costs would be passed on to the consumers in the form of lower prices. The reduction in competition from the acquisition is likely to lead to some of the efficiency gains being distributed to share holders and employees rather than consumers. While such distributions still provide some public benefit, the Commission considers that the weight attached to such gains should be reduced. Furthermore, the Commission considers it likely that some of the benefits could be achieved absent the merger as a result of the market rationalisation that would otherwise occur.

## **Research and development**

The parties claim that the acquisition will lead to a substantial increase in research and development (R&D) activity and that the Wattyl/Taubmans combination will be of a size sufficient to encourage ongoing R&D. Such an argument assumes that there are economies of scale in R&D and that a duopolistic market structure will encourage R&D.

Empirical research is not conclusive with regard to the claim that economies of scale exist in R&D. However, Taubmans has had a reputation for being innovative in the past at a scale less than that of the proposed merged parties. The Commission accepts that R&D output provides public benefit and that this acquisition may lead to increased R&D input. Whether the concentration of R&D in fewer, larger facilities leads to increased R&D output remains an open issue.

## **International competitiveness**

Wattyl has claimed that in the paint industry there is a direct correlation between domestic size and international success such that exports will increase as a consequence of the acquisition.

Given that Dulux already has the size which Wattyl considers to be necessary for export success, the Commission would expect to see some evidence of international competitiveness in Dulux's performance. Given that Dulux is not a significant exporter it may be that export success is more related to motivation than size. It may well be the case that Wattyl is more export oriented than Dulux and that exports

will increase. However, such an outcome may not be particularly dependent on the acquisition. Nevertheless the Commission accepts that there is potential for public benefit.

### **Australian ownership**

Wattyl has argued that its acquisition of Taubmans provides public benefit via acquisition of a foreign company operating in Australia. The Commission accepts that Australian ownership is a benefit. Its significance, however, in this case is not so large as to outweigh the Commission's other concerns about the acquisition, in particular its likely effect on paint prices. The purely economic benefits of Australian ownership in this case do not appear to be large. Even the claim that this acquisition would increase the degree of Australian control of a business is somewhat equivocal given that there were indications from Taubmans that the funds acquired as a result of the sale would quite likely be reinvested elsewhere in Australia thereby increasing the extent of foreign participation elsewhere in the economy.

### **Environmental benefits and health and safety**

The Commission accepts that plant rationalisation may provide environmental benefits and that such benefits will benefit the public. However it is of the view that any benefits in terms of improved health and safety standards are benefits which can and should be achieved independently of the merger.

### **Conclusion**

The Commission is of the view that the proposed acquisition of Taubmans by Wattyl will lead to a substantial lessening of competition in the market for architectural and decorative paint. While accepting that there are some public benefits from the acquisition the Commission is of the view that such benefits are not sufficient to outweigh the anti-competitive detriment. The Commission therefore rejects the Authorisation.

# 1. Introduction

## The proposed acquisition

1.1. In April 1995 Courtaulds (Australia) Pty Limited ('Courtaulds'), the owner of Taubmans Industries Ltd (Taubmans), which carries on an architectural and decorative paint manufacturing and supply business ('the Taubmans business'), sought indicative bids by 31 July 1995 for Taubmans' architectural and decorative paint<sup>1</sup> manufacturing operations in Australia, New Zealand, Fiji and Western Samoa.

1.2. Bids for the Australian business were received from Wattyl (Australia) Pty Ltd and Bristol Paints Pty Ltd ('Bristol').

1.3. Wattyl (Australia) Pty Limited made a non-binding indicative bid of \$ million for Taubmans' Australian operations. The assets for which the offer was made included the *Taubmans* brand name and intellectual property rights, the manufacturing plant at Villawood, and various trade centres. The bid submitted by Bristol was considered inadequate by Courtaulds.

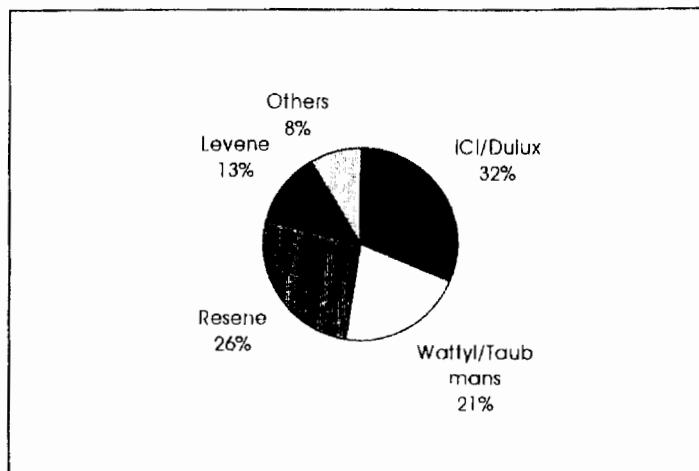
1.4. On 16 December 1995 Wattyl (Australia) Pty Limited, Courtaulds (Australia) Pty Limited, Taubmans Industries Limited and Pinchin Johnson (Australia) Pty Limited ('Pinchin Johnson') entered into an agreement for the purchase and sale of the Australian portion of the Taubmans business. The contract is conditional on approval by the Australian Competition and Consumer Commission ('the Commission') and is operative until 30 June 1996.

1.5. Wattyl (Australia) Pty Limited had already acquired Courtauld's New Zealand operations in late 1995. In November 1995 the New Zealand Commerce Commission decided not oppose the proposed acquisition. The main reason for their decision was that there would be four significant competitors post-acquisition. It is also important to note that the threshold test in New Zealand is one of 'dominance'. Figure 1.1. provides the New Zealand Commerce Commission's assessment of post acquisition market shares. The 'others' category includes Benjamin Moore Pacific Limited ('Benjamin Moore') which entered the New Zealand architectural and decorative paint market approximately five years ago.

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<sup>1</sup> The Australian Paint Manufacturers' Federation has indicated that paint manufacture can be divided into two main categories: Industrial (automotive, heavy duty coatings, wood stains, general industrial, powder coatings, marine, yacht and protective coatings operations and architectural and decorative (essentially interior and exterior housepaints, including varnishes and lacquers) - APMF submission, 1995.

Figure 1.1.: **Post Acquisition Market Shares, New Zealand**



Source: New Zealand Commerce Commission

## **The applicants**

### **Watty (Australia) Pty Ltd and Watty Limited**

1.6. Watty (Australia) Pty Limited is a wholly owned subsidiary of Watty Limited which is a company listed on the Australian Stock Exchange with a market capitalisation of approximately \$400 million. In this section Watty (Australia) Pty Limited and Watty Limited will be described collectively as Watty. Watty is engaged primarily in the manufacture and supply of a variety of paints and related products such as stains, varnishes, thinners, aerosols and rust protectors.

1.7. Watty has paint manufacturing facilities in Australia, New Zealand, Indonesia, Singapore, Malaysia, Thailand and the United States. Its sales in the 1994/95 financial year were \$442 million with consolidated profit of \$33 million.

1.8. Watty started business in 1915 with a revival for French polished furniture. It later expanded into paints and other surface coatings as well as products for speciality industrial applications. The company grew and broadened its product range over the years.

1.9. In 1959 Watty became a public company. Since 1963 Watty has acquired a large number of paint manufacturers, both in Australia and overseas:

1963	Taffel-Shone (Aust.)
1967	Kaylo Pty Ltd (Aust.)
1970	Solway Products (NZ)
1971	Davison Paints Limited (Aust.)
1977	National Paints Pty Ltd (Aust.)
1981	Pioneer Chemicals (Aust.)
1985	Spartan Paints (Aust.)
1987	Dimet Group (Malaysia, Singapore, Indonesia & Thailand)

- 1988 Precision Paint Corporation (USA)  
Pascol Paints (Aust.)
- 1989 Samson, Goldex, Polycell brands (NZ)
- 1994 WP Crowhurst Pty Limited (Aust.)
- 1995 Coronado paint Company (USA)  
Granosite (Aust.)  
Taubmans (NZ)

1.10. Wattyl has also established a series of license agreements with overseas companies, including manufacturing licences with AKZO (one of the world's largest paint manufacturers), Sigma and Muralflex.

1.11. In Australia, Wattyl supplies architectural and decorative paint and industrial paint. Its brands in the architectural and decorative paint segment, include Solagard (exterior), Estapol & Wattyl (wood finish), Ceramacoat (interior), Pascol (interior/exterior), Solver (interior/exterior), Granosite (textured), Killrust (metal treatment), and Pammastic (interior/exterior).

1.12. Wattyl's architectural and decorative paints are supplied by Wattyl (Australia) Pty Limited, W.P. Crowhurst Pty Limited and Pascol Paints Australia Pty Limited. W.P. Crowhurst Pty Limited is a wholly owned subsidiary of Wattyl (Australia) Pty Limited and supplies paints under the Solver brand. Pascol Paints Australia Pty Limited is a wholly owned subsidiary of Wattyl Limited and supplies paints under the Pascol brand.

1.13. Australian sales of architectural and decorative paint by volume in 1995 for each of Wattyl's operating divisions are shown in Table 1.1.:

Table 1.1: Sales of architectural and decorative paints, Wattyl operating divisions

	Architectural 000's litres	Decorative 000's litres	Total 000's litres	% of Total
Wattyl				
Solver				
Pascol				
<b>Total</b>				<b>100%</b>

Source: Wattyl submission

1.14. Wattyl currently has nine paint manufacturing plants located in several states. The location of the plants, the type of paint manufactured at each plant and current manufacturing output is shown in Table 1.2.

Table 1.2.: Paint manufacturing plants: Wattyl

Location	Paints manufactured	Production figures - ('000 litres)		
		A & D	Industrial	Total
<b>New South Wales</b>				
Blacktown				
Botany				
Kogarah				
<b>Queensland</b>				
Rocklea				
<b>Victoria</b>				
Moorabbin				
Footscray				
<b>South Australia</b>				
North Plympton				
Devon Park				
<b>Western Australia</b>				
Bayswater				

Source: Wattyl submission

1.15. Wattyl operates full warehousing and distribution facilities at each of its manufacturing sites. Table 1.3. outlines distribution from each of these warehouses. Chapter 3 contains a more detailed discussion of these facilities.

Table 1.3.: Wattyl's warehouse and distribution network

Warehouse	Distribution
NSW	NSW & ACT
QLD	QLD & NT
Victoria	Victoria & Tasmania
SA	SA
WA	WA

Source: Wattyl submission

1.16. Wattyl also operates company owned trade centres and supplies trade depots under supply agreements. Trade depots sell paint directly to professional painters (trade painters).<sup>2</sup> In Australia, Wattyl currently operates 93 company owned trade centres as well as 184 trade depots.<sup>3</sup>

1.17. Wattyl employs 1514 people in its Australian operations; 492 in manufacturing, 227 in warehouse and distribution activities, 156 in administration and the remaining 639 in sales.

<sup>2</sup> A *trade centre* is a dedicated trade supply outlet which is equipped to handle large volume orders from trade painters. Trade centres are owned by the paint manufacturer. A *trade depot* may be a dedicated trade supply or mixed trade/retail supply store. These stores are not owned by the paint manufacturer. Rather the store owner enters into a trade depot agreement with the manufacturer. Under these agreements the paint reseller agrees to sell paint to trade painters on the paint manufacturer's account.

<sup>3</sup> 67 under the Wattyl trading name, 111 under Solver, 6 under Pascol - Wattyl submission.

## Taubmans

1.18. Courtaulds (Australia) Pty Limited is Taubmans' parent company. It is a wholly owned subsidiary of Courtaulds plc, which is incorporated in the United Kingdom.

1.19. Taubmans is primarily engaged in the manufacture and supply of architectural and decorative paints and related products in Australia. Taubmans markets products under its own name. Total sales revenue in the 1994/95 financial year was \$ million with an operating loss of \$ million.<sup>4</sup>

1.20. Taubmans began in Sydney in 1897 as a manufacturer of the final coat of protective varnish. The company expanded in the 1920s as a producer of ready made paint, which was then a new product. In 1929 the British paint manufacturer Pinchin Johnson acquired the majority share holding in the previously family owned company and provided the capital base for further expansion. In 1960 Pinchin Johnson was acquired by Courtaulds plc and Taubmans diversified into industrial paints, coil, automotive and packaging coatings.

1.21. In 1989 Courtaulds acquired the minority share holding of Taubmans and became the sole owner of the company.

1.22. Courtaulds' Australasian coatings business operates in Australia, New Zealand, Papua New Guinea, Fiji, and Western Samoa. This business is currently divided into three operating divisions:

- **Architectural and Decorative** - interior and exterior architectural and decorative coatings operations trading as Taubmans;
- **Industrial** - automotive, coil, packaging, general industrial, and powder coatings operations trading as Courtaulds; and
- **Heavy Duty** - marine, yacht and protective coatings operations trading as Courtaulds.

1.23. Taubmans operates a single architectural and decorative paint manufacturing site at Villawood NSW. It produced 18 million litres of architectural paint (with one shift operation) in the last financial year and has the capacity to produce between 40 and 45 million litres per annum with additional capital expenditure of \$ to \$ . The site is equipped with automated manufacturing facilities and a modern warehouse, incorporating the latest in information technology. Taubmans Villawood site is quality certified to the international standard ISO9002 and to the equivalent local standards.

1.24. The manufacturing economies of scale at the Villawood plant make Taubmans one of the industry's lowest cost producers. The industry average cost

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<sup>4</sup> Unlike Watty!, Taubmans is not a publicly listed company.



per litre is approximately \$A0.44 whilst the manufacturing costs of Taubmans are approximately \$A0. per litre. Therefore Taubmans' manufacturing costs are almost per cent below the industry average.

1.25. Taubmans distributes nationwide from its central Villawood warehouse. Accordingly, its lower manufacturing costs are at least partly offset with higher freight costs incurred through its centralised distribution of products.

1.26. Taubmans currently operates 33 trade centres (13 in NSW, 3 in Victoria, 12 in Queensland, 1 in Adelaide, 1 in Darwin, 3 in Western Australia) and has agreements to supply at least 83 trade depots.

1.27. As at July 1995 Taubmans employed 356 people in its Australia operations; in manufacturing, in warehousing and distribution activities, in administration and the remaining in sales.

1.28. Taubmans' major brands are the Living Proof Range and Easy Coat (interior) SunProof and All Weather (exterior), TimberProof and TimberTop (wood finish), UnderProof and UltraPrep (undercoats), Rust Proof (roof and metal treatment paints), Tradex (trade paint range), Raffles (interior and exterior).

1.29. Taubmans has a long history of innovation within the paint market.<sup>5</sup> Taubmans' early developments of enamels opened up a new market for architectural paint in the interior decoration sector. It was at this time that Solpah and Silvafros, two of Taubmans speciality paints, were developed. Revelite, an interior enamel later developed by Taubmans, which was based on revolutionary new synthetic alkyd resins, was a forerunner of modern paint technology.

1.30. In the 1950s, as a result of a technological breakthrough which lead to the development of new product called Butex, Taubmans pioneered the development of durable exterior enamels. At the same time the company was responsible for developing water based paints which have revolutionised interior paint.

1.31. In the 1970s and 1980s, Taubmans in-house research lead to the development of many new products including the Living Proof range. Taubmans successfully incorporated the Dupont chemical Teflon into the paint formulation. As claimed by Taubmans, the superior brushability, silken appearance and texture and excellent opacity of the Living Proof products has provided Taubmans with a major competitive advantage.

1.32. The Sun Proof range of exterior paints includes zinc oxide which is resistant to ultra violet light, giving the paint increased durability. Indeed, a Rhom and Haas

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<sup>5</sup> The following information history of Taubmans' product innovation has been extracted from the *Information Memorandum* prepared by Potter Warburg & Co Pty Ltd for the sale of Taubmans, p. 11. (Information Memorandum)

Australia Pty Limited ('Rhom and Haas') report stated that Taubmans' 'Sunproof Gloss outperforms every other self priming gloss acrylic in the world'.<sup>6</sup>

1.33. The development of Ultraprep was a major breakthrough in interior broadwall paint technology. As a base primer/undercoat, its notable improvement in opacity and filling qualities enabled the successful use of one undercoat and one top coat, where previously three coats were required. Immediate market success was achieved, particularly through the trade and project home builders, and Ultraprep remains the major selling undercoat in this segment.

## **History of the proposed acquisition**

1.34. On 27 July 1995 Wattyl advised the Commission of its interest in acquiring the architectural and decorative paint manufacturing and paint supply business of Taubmans. It sought the Commission's view on a confidential basis.

1.35. The Commission formed the view that, on the basis of information provided by the parties, there was a strong prospect that the proposed acquisition would be likely to have the effect of substantially lessening competition in breach of section 50 of the *Trade Practices Act 1974* (C'th.) ('the Act'). The parties were advised of the Commission's preliminary view on 9 August 1995.

1.36. The Commission reconsidered the proposed acquisition, on 6 September 1995, after seeking additional information from the parties, and reiterated its view that there was a strong prospect that the proposed acquisition would be likely to have the effect of substantially lessening competition in breach of section 50 of the Act.

1.37. The proposed acquisition was announced publicly on 23 October 1995. The Commission commenced market inquiries at this time.

1.38. On 6 December 1995 the Commission again considered the matter after completing extensive market inquiries. The Commission formed the view that the proposed acquisition was likely to have the effect of substantially lessening competition in breach of section 50 of the Act. The parties were advised of this view.

1.39. In subsequent discussions, the parties raised a number of public benefit arguments in support of the acquisition. The Commission pointed out that such arguments were not relevant under section 50 of the Act and could only be considered in the context of an authorisation application. Wattyl indicated that they would prefer the Federal Court to determine the issue rather than seek authorisation as this would result in the Commission having the burden of establishing that the acquisition would breach section 50 of the Act.

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<sup>6</sup> Kennedy Rea Advertising Agency, Taubmans' Advertising Strategy Discussion November 1995 - January 1996. (Kennedy Rea)

1.40. Wattyl and Taubmans signed a contract for the purchase and sale of the Taubmans business on 16 December 1995. The parties did not advise the Commission at that time.

1.41. Following further discussions with the Commission, Wattyl and Taubmans provided undertakings to the Commission not to complete the sale until close of business on 14 March 1996. The parties refused to extend these undertakings and the Commission was forced to file an application in the Federal Court on 11 March 1996 seeking an interlocutory order restraining the acquisition pending a final hearing. In support of its application, the Commission obtained 14 affidavits from industry participants and other witnesses which were filed and served on Wattyl and Taubmans.

1.42. On 14 March 1996 Wattyl and Taubmans decided not to contest the interlocutory hearing and provided undertakings to the Court not to take any step to complete the transaction until the conclusion of the trial. Since that time the parties and the Commission have been preparing for a final hearing.

1.43. Wattyl and Taubmans, after having foreshadowed an authorisation application, lodged this application on 3 April 1996. At this time preparation for trial continues with a view to a hearing commencing in August 1996.

## **2. Relevant provisions of the Act**

### **Prohibition against anti-competitive mergers**

2.1. Watty, Taubmans, Courtaulds and Pinchin Johnson lodged this application for authorisation (A30175) pursuant to subsection 88(9) of the Act. An authorisation granted pursuant to s.88(9) provides a statutory exemption from the operation of section 50 of the Act, which may otherwise prevent the proposed acquisition.

2.2. Subsection 50(1) of the Act provides:

A corporation must not directly or indirectly:

- (a) acquire shares in the capital of a body corporate; or
- (b) acquire any assets of a person;

if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market.

2.3. Section 50(3) sets out factors which must be taken into account by the Court when assessing whether an acquisition is likely to have the effect of substantially lessening competition. Section 50(3) provides that the following non-exhaustive list of factors must be taken into account in the evaluation of the effect or likely effect of particular acquisitions:

- (a) the actual and potential level of import competition in the market;
- (b) the height of barriers to entry to the market;
- (c) the level of concentration in the market;
- (d) the degree of countervailing power in the market;
- (e) the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins;
- (f) the extent to which substitutes are available in the market or are likely to be available in the market;
- (g) the dynamic characteristics of the market, including growth, innovation and product differentiation;
- (h) the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor; and
- (i) the nature and extent of vertical integration in the market.

2.4. Sections 50(4) and (5) provides a mechanism for application for authorisation of existing contracts for the acquisition of shares or assets provided the contract is conditional on authorisation being granted.

2.5. Where an acquisition is found to breach section 50, the Federal Court can order divestiture of shares or assets acquired in contravention of section 50 (section 81(1)) or set aside the transaction (section 81(1A)) and, in addition, impose pecuniary penalties on the acquirer, or any other party who is knowingly concerned

in the contravention, of up to \$10M. If an acquisition has not proceeded and the Federal Court is satisfied that it breaches the Act, it can restrain the parties from proceeding with that acquisition (section 80(1)).

## **Authorisation of potentially anti competitive mergers**

2.6. The Act contains a process whereby certain conduct, including acquisitions, which may breach the restrictive trade practices provisions in Part IV of the Act, can be authorised if there is sufficient public benefit in allowing the conduct.

2.7. The current application is made under sub-section 88(9) of the Act which provides that:

...the Commission may, upon application by a person -

- (a) grant an authorisation to the person to acquire shares in the capital of a body corporate or to acquire assets of a person...

2.8. The Commission shall only grant authorisation if the applicant satisfies the relevant test in sub-section 90(9) of the Act.

2.9. Subsection 90(9) provides that the Commission shall not grant authorisation unless it is satisfied in all the circumstances that the proposed acquisition would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to take place. In making its determination the Commission gives consideration to both the claimed public benefits and any public detriment, particularly any negative effect on competition, that the proposed acquisition is likely to have.

2.10. Subsection 90(9A) provides that in determining what amounts to a benefit to the public for the purposes of subsection (9):

- (a) the Commission must regard the following as benefits to the public (in addition to any other benefits to the public that may exist apart from this paragraph):
  - (i) a significant increase in the real value of exports;
  - (ii) a significant substitution of domestic products for imported goods; and
- (b) without limiting the matters that may be taken into account, the Commission must take into account all other relevant matters that relate to the international competitiveness of any Australian industry.

2.11. Should the Commission be satisfied as to the requisite degree of public benefit attributable to the proposed acquisition in all the circumstances, including in particular, the effect of the proposed acquisition on competition, the Commission may grant authorisation or grant authorisation subject to conditions. If this is not the case, the Commission may refuse authorisation or alternatively, in refusing authorisation, indicate to the applicant how the application could be constructed to change the balance of detriment and public benefit so that authorisation may be granted.

## **Conditional authorisation and enforceable undertakings**

2.12. It is open to the Commission, in granting an authorisation, to do so on certain conditions. Such conditions could include a condition that certain relevant undertakings are provided to the Commission by the parties to the application. Previously such undertakings were of questionable enforceability. However, pursuant to section 87B of the Act, the Commission is now able to accept written undertakings. Section 87B of the Act provides for enforcement in the Federal Court of written undertakings accepted by the Commission in connection with a matter in relation to which the Commission has a power or function under the Act. Where the Commission believes that a term of such an undertaking has been breached it may apply to the Court for:

- an order directing compliance; and/or
- an order to pay the Commonwealth up to the amount of any financial benefit that can be reasonably attributed, directly or indirectly, to the breach; and/or
- any order the Court considers appropriate to compensate a third party for loss or damage resulting from the breach; and/or
- any other order the Court considers appropriate.

## 3. The paint industry

### Types of paint

3.1. Paint can be classified according to various categories. With regard to the *production process* one can distinguish between water based and solvent based paints. The production of solvent based paint is more capital intensive due to the higher standards concerning safety, in particular fireproofing.

3.2. With regard to *usage* the industry distinguishes between two main categories: architectural and decorative paints<sup>7</sup>; and industrial paints.

#### Industrial paint

3.3. Industrial paint is very specialised paint designed for specific industrial uses. This high degree of specialisation also translates into special requirements in the production process. The two main types of industrial paints are automotive paints and heavy duty paints.

#### Architectural and decorative paint

3.4. The distinction between architectural and decorative paints is based primarily on marketing differences rather than any substantive difference.

- *Architectural paint* is sold to professional trade painters. Architectural (trade) paint accounts for approximately 55 per cent of total sales by volume of architectural and decorative paints. Professional trade painters acquire their paint supplies mainly through company owned trade centres or through trade depots.
- *Decorative paint* is sold to retail customers, do-it-yourself (DIY) painters, for use in their own home. Decorative (retail) paint accounts for the remaining 45 per cent of paint sales by volume.<sup>8</sup> Decorative paint is generally sold by retailers such as BBC, Mitre 10, paint specialists (such as the 3D group) and mass merchandisers (eg: K Mart, Big W and Target).

3.5. Architectural and decorative paints include interior, exterior, preparatory or wood finish paints. These paints are either solvent based or water based. The former have an oil base. The major advantages of the water based paints are that they can be rinsed out in water and their application is easier. The trend in the industry is for greater use of water based paints as the technology associated with such formulations improves. However there are some applications for which water based paints are not yet able to duplicate the finish provided by a solvent based

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<sup>7</sup> Taubmans does not distinguish between architectural and decorative paints but refers instead simply to architectural paints.

<sup>8</sup> Taubmans submissions.

paint; for example interior wood surfaces such as skirting boards, windows and doors (or trim paint).

## **History of the Australian paint industry**

3.6. Since the 1960s, there have been a large number of acquisitions in the paint industry.

3.7. The Commission reviewed the acquisition in 1988 by ICI Dulux Australia Limited of Berger and British Paints from Lewis Berger (Overseas Holdings) Limited. The Commission did not oppose this acquisition. At that time the relevant test under section 50 of the Act for the assessment of the competitive effects of a merger or acquisition was whether the merged firm would achieve or enhance dominance in a market.<sup>9</sup> This is a significantly different test to the current substantial lessening of competition test, and has a substantially higher market power threshold.

3.8. In its assessment of the ICI/Dulux acquisition, the Commission identified the architectural/decorative paint (or building paint) and automotive paint markets as the relevant markets. At the time, Dulux's share of the architectural and decorative paint market was 44 per cent followed by Taubmans and Wattyl with 13 per cent and 12 per cent market shares respectively. Therefore the three largest paint manufacturers accounted for 69 per cent of the architectural and decorative paint market. There were a number of other smaller competitors in the market including Bristol, Crowhurst (Solver), Pascol and Raffles.

3.9. The Commission later argued before the Cooney Committee that the merger of Dulux and British and Berger had resulted in a substantial lessening of competition. In support of this view, the Commission noted the merger was followed by substantial price increases. Since then three of the competitors active in the market at that time have been acquired; Solver and Pascol by Wattyl and Raffles by Taubmans. ICI/ Dulux also acquired Cabots, a wood stains producer, in 1993. The history of Wattyl's acquisitions were discussed in Chapter 1.

3.10. As a result of these acquisitions, the Australian paint industry now has three large national manufacturers, Bristol and a number of small, mainly regional participants.

## **Industry participants**

### **Raw material suppliers**

3.11. The main raw material suppliers are A.C. Hatrick Chemicals Pty Ltd ('AC Hatrick'), Rhom and Haas, National Starch and Chemicals Limited, SCM Limited and Titanium Dioxide Pty Ltd.

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<sup>9</sup> With effect from 22 January 1993 section 50 of the Act was amended such that the dominance test was replaced by a substantial lessening of competition test.



3.12. Raw material suppliers provide the basic ingredients for the manufacture of paint such as alkyd and polyurethane resins, PVA copolymers latexes, acrylic latexes, dispersing agents, titanium dioxide, and pigments. These raw material suppliers also provide a range of technical services such as new product development, product modification, formulation and problem solving advice.

3.13. However the level of technical product support provided by the raw material suppliers is limited to fairly simple formulations. No separate charge is levied for these services; rather they form part of the total package supplied to paint manufacturers.

3.14. Joint project work is often undertaken with large companies such as Wattyl, Dulux and Taubmans. Specific confidentiality agreements are signed by both parties defining objectives, responsibilities and ownership of the findings or developed products / formulations.

### **Manufacturers**

3.15. There are a large number of paint manufacturers of varying size in Australia. These paint manufacturers range from the market leader Dulux, with six paint manufacturing plants and an output of million litres of architectural and decorative paint per year; to smaller, single plant, manufacturers which produce less than 200 000 litres of architectural and decorative paint per year.

3.16. Wattyl's and Taubmans' operations were described in Chapter 1. Other manufacturers include:

#### ***ICI/Dulux***

3.17. Dulux Holdings Limited (Dulux) is a subsidiary of ICI Australia Limited which in turn is a subsidiary of ICI plc. Dulux forms part of the ICI Paints Group which is the largest paint manufacturer in the world. Dulux markets the Dulux, British, Berger, Walpamur and Cabots brands. ICI also owns Selley Chemicals Pty Ltd which manufactures Selley and Poly products.

3.18. Dulux products have a high degree of brand and product recognition. Not only is the Dulux name almost synonymous with paint but 'Weathershield' and 'Wash and Wear' are amongst the best recognised paint products.

3.19. Dulux is a major supplier of housebrand paints and currently manufactures the Paint Place Brand for the Your Local Paint Place Group and the 3D Brand for the 3D Group as well as a number of brands for the mass merchants.

3.20. Dulux has six paint manufacturing plants in Australia. It currently manufactures million litres of architectural and decorative paint with a total capacity of million litres. It has a trade centre network consisting of 95 company owned stores and 111 tied trade depots.

### ***Bristol***

3.21. Bristol has been supplying paint in Australia for 20 years. It operates a 100 store network of company owned 'Decorator Centres'. These stores currently sell only Bristol branded paint, a range of paint accessories and wallpaper. Bristol does not supply paint to other retailers for resale.

3.22. Bristol's operations are limited to the east coast of Australia. The company has manufacturing plants located in both Victoria and Queensland. Its current production output is      million litres per year, with total capacity of      million litres per year.

3.23. Thorley Industries Pty Ltd ('Thorley'), a subsidiary of Pratt Industries Pty Ltd, has recently made a takeover offer for Bristol's parent company, Lanes Limited ('Lanes'). This offer will be discussed in more detail below.

### ***Henry Haymes Pty Ltd ('Haymes')***

3.24. Haymes is a privately owned family company with a manufacturing plant in Victoria. Its products are marketed under the brand name 'Haymes'. Haymes has been particularly successful in the manufacture and sale of speciality heritage milled paints. Its Heritage Range has been approved for use on heritage buildings by the Australian Trust.

3.25. Haymes has focussed its activities on supplying paint specialists and is currently a core product supplier to the 3D Group on a national basis. This agreement with 3D is exclusive except in Victoria where Haymes is free to sell its paint on its own behalf or to retailers other than 3D.

3.26. Haymes' pricing strategy

3.27. Haymes has a production capacity of      million litres a year and is currently operating at      per cent capacity.

3.28. Haymes offers limited discounts and advertising rebates; however it does provide free distribution Australia-wide for volumes in excess of 200 litres. Haymes does not currently supply any housebrand paints.

### ***White Knight***

3.29. White Knight commenced operations in 1982 importing specialist products from the United States. In 1984 it established manufacturing facilities for metal treatment paints, with its major brand being Rustguard. It established a niche market in this area and distributed these products nationally. In 1988 White Knight acquired Hi-Qual Paints and commenced manufacturing architectural and decorative paints.

3.30. White Knight has been successful in winning the tender to supply MasterStroke housebrand paint to the Mitre 10 chain. MasterStroke is a trade brand paint. It has also entered into a toll arrangement with Benjamin Moore for the toll manufacture of a trade paint.

3.31. White Knight's manufacturing facility is located in NSW and it is currently manufacturing      million litres of architectural and decorative paint and      million litres of speciality metal treatment paint. Its total manufacturing capacity is      million litres.

#### ***Asian Paints***

3.32. Asian Paints is a subsidiary of one of the largest paint manufacturing companies in the world, the Indian based Asian Paints. It has established a manufacturing plant at Townsville and supplies paint locally. Its current output is      litres per year.

3.33. Asian Paints has stated that it is experiencing retailer and consumer resistance due to the lack of a widely known brand name in Australia. The company does not currently supply any housebrand paint in Australia.

#### ***Crown Paints Pty Ltd (Crown Paints)***

3.34. Crown Paints is located in Brisbane. Distribution of its products is limited to Queensland and Northern NSW. Its current production output is      litres with a total production capacity of      litres per annum.

3.35. Crown Paints does not provide on-site promotional equipment or special volume discounts or other rebates. It does not currently supply any housebrand paints and does not tender for these accounts on a regular basis.

### ***Benjamin Moore***

3.36. Benjamin Moore is the subsidiary of a large US paint manufacturer. It imports into Australia from manufacturing facilities in New Zealand to Your Local Paint Place on an exclusive basis.

3.37. Benjamin Moore entered the New Zealand market approximately five years ago and has achieved a market share in architectural and decorative paint of less than 5 per cent.

3.38. As indicated above, Benjamin Moore has also entered into a toll arrangement with White Knight for the supply of a trade paint.

### ***Other manufacturers***

3.39. In its defence to the Commission's Statement of Claim, Wattyl listed some 20 other small paint manufacturers. They do not appear to be significant and little, if any, reference to these companies appear in the internal records of Wattyl and Taubmans. Some of the listed companies appear to be defunct.

### **Resellers - retail and trade**

3.40. Throughout the last 20 years there have been significant changes in the type of paint resellers and their organisational structures. In the hardware sector both hardware corporations and hardware buying groups have grown larger through acquisition and amalgamation. Discount department store groups have expanded and independent paint speciality groups have emerged.

3.41. The major categories of resellers of architectural and decorative paint are:

- **Corporate Hardware** - such as BBC, Bunnings, Hudsons Hardware, Hardware and General;
- **Hardware Groups and Independent Hardware Stores** - such as Mitre 10, True Value, Home Hardware and Timber, Thrifty Link;
- **Mass Merchants** - such as K-mart, Big W, Target;
- **Manufacturer Owned Stores** - Dulux, Wattyl, Taubmans, Bristol; and
- **Paint Specialists** - such as 3D Group, Your Local Paint Place, Amazing Paints, Paint Spot, Painters Pot.

3.42. Table 3.1. shows the number of stores in the various categories. It indicates that there are nearly 6000 paint outlets in Australia.

Table 3.1.: Paint outlets in Australia

Type of paint outlet	No. stores	% of total
Corporate hardware	678	11.3
Groups, franchises & co-ops	1561	26.1
Independent hardware & mass merchandisers	3042	50.9
Paint manufacturer owned stores	369	6.2
Paint specialists	628	10.5
<b>Total</b>	<b>5976</b>	

Source: Sales Makers 1995

Tables 3.2. and 3.3. show Taubmans' estimate of the volume of retail and trade sales accounted for by the various categories of resellers.

Table 3.2.: Paint outlets in Australia, volume of retail sales

	m litres					
	ICI/Dulux	Wattyl	Taubmans	Bristol	Other	Total
Corporate Hardware	3.08	1.1	0.8	-	1.0	6.7
Independent Hardware	4.3	3.9	3.0	-	3.3	14.5
Mass Merchants	4.6	1.1	0.9	-	-	6.6
Specialist Stores	5.5	2.2	1.8	0.5	1.7	11.7
Company Owned/Other	0.8	1.2	-	3.5	-	5.5
<b>Total</b>	<b>19.0</b>	<b>9.5</b>	<b>6.5</b>	<b>4.0</b>	<b>6.0</b>	<b>45.0</b>

Source: Taubmans submission, Attachment 9.

Table 3.3.: Paint outlets in Australia, volume of trade sales

	m litres					
	ICI/Dulux	Wattyl	Taubmans	Bristol	Other	Total
Company Stores	18.0	11.2	9.8	6.3	0.7	46.0
Dealers	2.0	1.8	1.5	0.7	6.0	12.0
<b>Total</b>	<b>20.0</b>	<b>13.0</b>	<b>11.3</b>	<b>7.0</b>	<b>6.7</b>	<b>58.0</b>

Source: Taubmans submission, Attachment 9.

### **Corporate hardware**

3.43. *Corporate hardware stores* are specialist suppliers of hardware products. Paint comprises a significant part of total sales from these outlets.

3.44. The two main corporate hardware groups are BBC and Bunnings. These companies both have a large network of company owned hardware stores throughout Australia.

3.45. BBC has 200 stores in Australia, nine of which are Hardware Houses. The standard BBC store is approximately 10 000 sq. feet. Hardware Houses are much larger warehouse style hardware stores which are approximately 100 000 sq. feet in size.

3.46. Bunnings have approximately 70 stores throughout Australia including a number of Hardware Barns (similar to BBC's Hardware House). Bunnings acquired the McEwans hardware chain in Victoria approximately two years ago.

3.47. Both BBC & Bunnings only stock paints which have an established brand name. BBC currently stocks the full range of Dulux decorative paints, selected Taubmans products (ie: the Living Proof range), Wattyl timber finishes and White Knight metal treatment paints. Bunnings stocks a similar range of products.

3.48. It is expected that the warehouse hardware concept will continue to develop in Australia. Current examples are Hardwarehouse and Bunnings Hardware. Such resellers have a preference for national brands in order to convey a price/quality image to their customers. If this expected trend eventuates, the importance of brand recognition will be enhanced.

#### ***Hardware groups and independent hardware stores***

3.49. *Hardware groups* are independently owned hardware outlets which have formed a loose association to take advantage of volume buying benefits and pooled promotional activities. They sell the same product mix as the corporate hardware stores, namely hardware products.

3.50. The largest hardware group is Mitre 10, which also trades under the name 'True Value'. Mitre 10 is a buying cooperative of 700 independent hardware stores throughout Australia. Approximately 470 of these stores are 'Mitre 10' branded stores whilst the remaining 230 are 'True Value' stores.

3.51. Mitre 10 carries a broad range of paint products. At the national level the Mitre 10 Group deals with Dulux, Wattyl and Taubmans. The national organisation negotiates deals with these paint manufacturers which are then offered to individual members throughout Australia. However individual members are free to deal with other paint manufacturers outside this national deal structure.

3.52. *Independent hardware outlets* are smaller chains or independent hardware stores. These stores sell hardware products.

### ***Mass merchants***

3.53. *Mass merchants* are general retailers which sell a more varied mix of products including clothing, electrical products, and food, as well as a limited range of hardware products. Mass merchants include stores such as K-mart, Big W and Target.

### ***Manufacturer owned stores***

3.54. As discussed above, the larger paint manufacturers such as Dulux, Watty and Taubmans each operate a trade centre network. These stores supply paint directly to trade painters who usually have an account with the particular paint manufacturer. The paint manufacturers' trade stores generally only sell paint to trade customers. These trade stores are usually located in industrial areas and are set up to handle large volume mixing of paints for commercial application. The largest trade customers generally buy their paint directly from the trade centre or a trade depot.

3.55. Bristol Paint supplies paint through its network of 100 company owned retail stores in NSW, Queensland and Victoria to the general public and trade customers.

3.56. Dulux, Watty and Taubmans do not operate retail stores themselves, with the exception of Solver. However many paint specialists and an increasing number of hardware stores act as trade depots for the major paint manufacturers. A total of 599 trade centres and trade depots are collectively operated by Dulux, Taubmans and Watty.

### ***Paint specialists***

3.57. *Paint specialists*, as the name suggests, generally specialise in the sale of paint and painting accessories. The paint specialists service both retail and trade customers. Buying Groups have formed to take advantage of volume buying benefits and pooled promotional and branding activities. The two largest paint specialist organisations are the 3D Group and Your Local Paint Place ('YLPP'), which include some hardware stores.

3.58. The 3D Group is a cooperative buying organisation with approximately 150 stores throughout Australia. YLPP is also a cooperative buying group with over 100 stores mainly in Queensland and NSW.

3.59. The members of the 3D Group are required to sell particular volumes of core products, which are currently a number of selected Dulux and Haymes products. YLPP operates a similar system with Taubmans traditionally being the major branded product.

## **End users**

### ***Trade painters***

3.60. Trade painters obtain their supplies directly from trade centres or trade depots. Purchases may be on a contract or one off basis. Larger trade painting organisations with more than 100 trade painter employees, such as Programmed Maintenance Services, Gardner Perrott Property Services and the Higgins Group, negotiate contracts with the major paint manufacturers for the supply of paint over a specified contract period. All purchases of paint during the contract periods are at the negotiated price, other than special deals which may be negotiated for special projects. Paint supplies are either delivered directly to the site or picked up from the trade centre.

3.61. Trade depot/centre sales to trade painters are almost always by way of sale by a price agreed between the painter and the manufacturer with the paint depot operator receiving a commission on sale.

3.62. Project home construction companies are significant trade customers. Exclusive paint supply contracts are negotiated with the major paint manufacturers or are paid a fee for each house painted solely with a particular manufacturers product.

### ***DIY painters***

3.63. DIY or 'Do-it-yourself' painters usually purchase paint for use on the family home. DIY painters purchase paint in small volumes on an occasional basis, usually at intervals of five to seven years.

## **Local production**

3.64. There are few official statistics on the paint industry. The information that has been provided to the Commission in relation to this matter has often been contradictory. The following discussion relies on material derived from a number of sources.

3.65. Table 3.4. shows total Australian paint production since 1940 and forecasts to 2010. It shows that paint production has increased at an average annual rate of 3.8 per cent over the last 55 years. It is forecast to increase at less than half the historic rate over the next 15 years:



Table 3.4.: Total Australian paint production

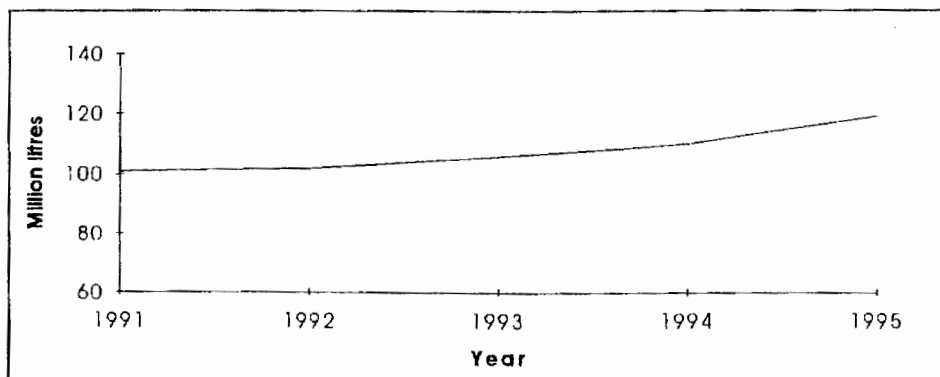
Year	Million Litres
1940	30
1950	60
1960	105
1970	140
1980	175
1995	195 *
2000 (F)	230
2010 (F)	300

Note: (F) is forecast figures

Source: IBIS 1995; \* APMF 1995

3.66. Estimates of total production of architectural and decorative paint indicates steady growth over the last five years as shown in Figure 3.1.

Figure 3.1.: Production growth for architectural and decorative paints



Source: APMF

3.67. Architectural and decorative paints represent approximately 60 per cent of total paint production. The current breakdown of industrial and architectural and decorative paint production is shown in Table 3.5.

Table 3.5.: Current volume of paint production

Category	'000 Litres per annum	% of Total
<b>Industrial</b>		
Automotive	16 374	8.4
Heavy duty	14 094	7.2
Wood stains	1 854	0.9
Other industrial	48 952	25.0
<b>Total industrial</b>	<b>79 420</b>	<b>40.6</b>
<b>Architectural and decorative</b>		
Solvent thinned	21 715	11.1
Water thinned	94 594	48.3
<b>Total a&amp;d</b>	<b>116 309</b>	<b>59.4</b>
<b>Total paint manufacturing</b>	<b>195 729</b>	

Source: APMF submission, 1995

## Demand

3.68. Market demand generally parallels home building and commercial construction growth. It therefore tends to have a cyclical component. There are no close substitutes for paint. Therefore the overall price elasticity of demand for paint is low.

3.69. The demand for an individual paint manufacturer's product will be influenced by a number of factors. For retail customers, aggregate demand for paint will be influenced by the relative cost of DIY painting compared with the cost of contracting a professional. Once a consumer has chosen between DIY and a professional painter, the two key influences on demand are likely to be price and quality.

3.70. Paint is a fashion product and heavily dependent on colour for effect. The choice of colour is often undertaken in the home, so that paint can be matched with furnishings. DIY painters generally derive considerable satisfaction from completing the task and receiving favourable comments from family and friends. Therefore, their demand for an individual manufacturer's paint will be influenced by the availability of a wide range of colours, including colour cards and samples that can be taken home.

3.71. DIY painters are likely to have limited direct knowledge of paint quality and are highly dependent on advertising and promotion in forming their view as to paint quality.

3.72. The demand of trade painters for paint is also influenced by price, quality and service (eg: site delivery, distribution, availability, etc). Due to experience a trade painter may be in a better position to assess quality than a DIY painter, which is important for them as well. Trade painters will be dependent on quality paint, manufacturers' support and guarantees to ensure a good quality job. Trade painters

are however more likely to be able to assess price and quality trade-offs, (ie, which products are value for money,) and hence the price elasticity of demand within this segment is likely to be somewhat higher than that of the DIY segment. Nevertheless, in some instances, the trade painters' choice of paint is dictated by the client.

## **Distribution and vertical arrangements**

### **Distribution**

3.73. Distribution networks differ considerably between paint manufacturers. The three largest paint manufacturers have an extensive national distribution network consisting of manufacturing sites, warehousing facilities and trade centres. Dulux and Wattyl manufacture architectural and decorative paint from a number of locations throughout Australia. It is from these manufacturing sites and associated warehousing that the bulk of paint is distributed to resellers. Dulux has however centralised some aspects of its distribution.

3.74. Taubmans manufactures all of its architectural and decorative paint at Villawood and distributes it nationally from that site. Its stated rationale for this approach is that it is able to offset the higher distribution costs with greater utilisation of a highly efficient manufacturing facility.

3.75. Apart from Dulux, Wattyl and Taubmans there are no paint manufacturers with a national distribution system. Bristol has east coast mainland distribution. Most other manufacturers have only one manufacturing site, limited warehousing and few, if any, trade centres. The paint manufacturers which have achieved national distribution have done so in less bulky niche products such as woodstains (Feast Watson) and metal treatment paints (White Knight). Only the majors have nationwide distribution for the full range of products.

### **Vertical arrangements**

3.76. The major paint manufacturers operate a large number of trade centres for the sale of trade paint. Taubmans has scaled back the number of trade centres it operates over the last two years largely by converting them into trade depots. None of the major paint manufacturers operate any retail outlets (ie: outlets for the sale of paint direct to DIY customers).

3.77. In addition Dulux, Wattyl and Taubmans have an extensive network of trade depots. These depots are independent paint stores which have entered into a distribution agreement with one of the major paint manufacturers. Under these agreements the trade depot agrees to sell paint to trade painters on account for the major manufacturers. For providing this service the trade depot operator is paid a commission on sales.

## **Government regulation**

3.78. The main environmental risks in paint manufacturing are ground contamination from accidental spills and general losses during manufacture. Contamination of waste with heavy metals is also a concern as is the release of volatile compounds at plants which manufacture solvent based paints. Because of these environmental risks, the paint industry is subject to a number of regulatory restrictions. The following licences are needed to operate a paint manufacturing plant:

- Dangerous Goods Licence; and
- Environmental Protection Agency Licence.

3.79. To obtain these licences the applicant must demonstrate that construction and operation of the plant conforms to all applicable Australian codes, that emissions from the site are within state authorities' guidelines and that waste disposal procedures exist which exclude the likelihood of classified waste damaging the environment.

3.80. In addition to the above, a new manufacturing site needs local planning permission requiring:

- Hazardous Operation Study;
- Hazard Analysis (separation distances);
- Fire Safety Study;
- Emergency Planning (procedures); and
- Construction Safety Study.

3.81. The above approvals must be obtained from Local Council, Fire Brigade, Department of Labour and Industry, Environmental Planning Authority, and the relevant authority for stormwater and effluent collection and disposal (eg: the Water Board in NSW).

3.82. Regulatory requirements have increased over recent years.

## **Australlan Paint Approval Scheme**

3.83. Approval from the Australian Paint Approval Scheme (APAS) is required before a formulation can be used on government paint contracts.

3.84. Before granting approval, the APAS requires that a number of tests be carried out to demonstrate, amongst other things, the durability of the paint (through

exposure tests of between 2 to 3 years) ultraviolet effect and brushability. Any subsequent alteration to the formulation must also be approved by the APAS.

3.85. The laboratory used by paint manufacturers for APAS approval purposes must be approved by the National Association of Testing Authorities (NATA). NATA conducts regular audits of these laboratories and ensures that standards are policed.

## Prices

3.86. There are a number of price points for branded paints within the architectural and decorative paint market. These price points are intended to convey information about the relative quality of a particular paint brand. There are price points, for example, for ultra premium, premium/mid and budget brands. Smaller manufacturers have generally positioned themselves at the mid to budget end of the pricing spectrum.<sup>10</sup>

3.87. Manufacturers typically maintain price lists from which various discounts are negotiated (see below). Separate price lists are maintained for retail and trade sales and the different states. Trade prices are generally lower than retail prices. This partly reflects cost differences.

3.88. Various discounts and rebates are then negotiated between the manufacturer and the reseller. Non-aligned specialist resellers generally receive a reduction of around 25 per cent off list price. Buying groups and major painting contractors are usually able to negotiate higher reductions.<sup>11</sup>

3.89. The reseller's margin is then added to arrive at the final product price. The size of the retail margin varies across products and resellers. The gross margin for paint specialists is around 33 per cent. As other resellers are generally able to negotiate higher discounts from list price, it is probable that their gross margin would be higher than that of paint specialists. Housebrands offer higher margins because they are not supported by similar levels of advertising or promotion by the manufacturer, if at all. The retail margin on housebrand paints is around 60 per cent.<sup>12</sup>

3.90. The ultimate price paid by consumers varies according to the type of reseller and the extent of retail price competition. The gross selling price of sales to retail varies according to the particular price point. Indicative prices, however, are around \$40 for a four litre can of premium paint, between \$30 to \$36 for the equivalent volume of mid range paint, and between \$24 and \$28 for four litres of budget paint. The relativities that are apparent at the wholesale level are generally reflected in

<sup>10</sup> SBS-Schafer Business Services, Report to Courtaulds-Wattyl on the impact of the corporate hardware sector of the proposed merger of the Decorative and Architectural Coatings Businesses of Taubmans and Wattyl, November 1995. (Schafer Report)

<sup>11</sup> Salemakers, Report to Clayton Utz for Wattyl Limited and Courtaulds (Australia Ltd) on the National Market for Architectural Coatings, November 1995, p. 10. (Salemakers Report)

<sup>12</sup> Wattyl's submissions.

retail prices. Taubmans advised that the price of housebrand paints is around half that of the premium product.<sup>13</sup>

### **Rebates, discounts and incentives**

3.91. The paint manufacturers offer a wide range of rebates and incentives to stock their particular brands of architectural and decorative paint. Each paint manufacturer generates price lists for different categories of customers. Some paint manufacturers have more than 50 different price lists.

### **Retailers**

3.92. Paint manufacturers offer retailers *discounts* off the list price. These range from 10 per cent to 30 per cent. The discount is paid on the basis of total purchases. The purchase is usually invoiced at the listed price less the percentage rebate applicable to a particular retailer.

3.93. A further *volume rebate* is offered to retailers. This rebate is paid when a retail customer's purchases exceed certain predetermined thresholds either of total volume or value of paint sold. The effect of the incentive rebate is to increase the overall rebate available to retailers when they achieve a certain level of sales. This creates the advantage for the retailers through being able to consolidate their purchasing and stocking of products from fewer paint manufacturers.

3.94. The paint manufacturers also provide a range of *special promotional discounts* on certain products. These types of discounts are provided as part of a marketing strategy or to reduce stock holdings of particular lines of paint. The promotional rebate can be as much as 10 per cent higher than the list price rebate.

3.95. *Settlement discounts* for payments received within a set period of time, usually 30 or 45 days, are also offered. These discounts are usually between 2.5 per cent and 3 per cent off the invoice price of the paint products purchased.

3.96. *Marketing allowances* or *rebates* are paid on the total invoice value of the products purchased. These rebates are generally in the range of 3 to 5 per cent and are usually retained by the manufacturer and paid by agreement as a contribution to the cost of promoting the product in the retailer's catalogue. Some manufacturers limit this rebate to premium brand products rather than applying it to the entire range of products. Such allowances are generally not paid for purchases of housebrand paint.

3.97. Other allowances and rebates which are paid to retailers include *group purchase rebates* and *administration allowances*. The former are additional rebate provided to group buyers on the total invoice value of products purchased by the members of the group. Administration allowances are an allowance granted with regard to the total invoice value designed to help defray the administration costs of

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<sup>13</sup> Taubmans submissions.

the retail customer. These allowances are paid to the group and not the individual member.

3.98. Some paint manufacturers also provide a *range support allowance*. This rebate is paid by paint manufacturers to retailers for displaying a certain amount of their paint on the shop floor. For example if the retailer displays 80 per cent of a particular manufacturer's paint product in the display area of the store they are paid an additional rebate of 2 per cent. Paint manufacturers check on the amount of paint in the display area on a periodic basis before paying the additional rebate.

3.99. The net effect of the above rebates and allowances is to provide most retailers with a price reduction off the list price of between 25 and 45 per cent.

### **Trade Painters**

3.100. The variety of rebates and allowances available to trade painters are not as extensive as those available to retailers. However, the list price rebates available to trade painters are generally higher than those available to retail. They are as high as 40 to 45 per cent off the list price. Furthermore the list prices used to calculate the rebates for trade painters are, in most cases, lower than those used for retailers.

3.101. Large project home construction companies may be provided with payments for each new house they build and that is painted exclusively with a particular paint manufacturer's product. These payments range from between \$20 to \$150 per new house or specified number of litres.

3.102. The major paint manufacturers often provide project home construction companies with free paint jobs for new houses. For example, on a larger contract the paint manufacturers may agree to supply free paint for a set number of houses over the course of a year.

3.103. Payments are also made to the major construction companies for the exclusive use of a particular manufacturer's product on all sites for which the construction company has been retained.

3.104. Depending on the type of trade customer, a marketing allowance may also be paid. For example an allowance is sometimes paid to housing construction companies to support their marketing efforts in relation to a new development. This may take the form of a rebate, cash payment or promotional offer.

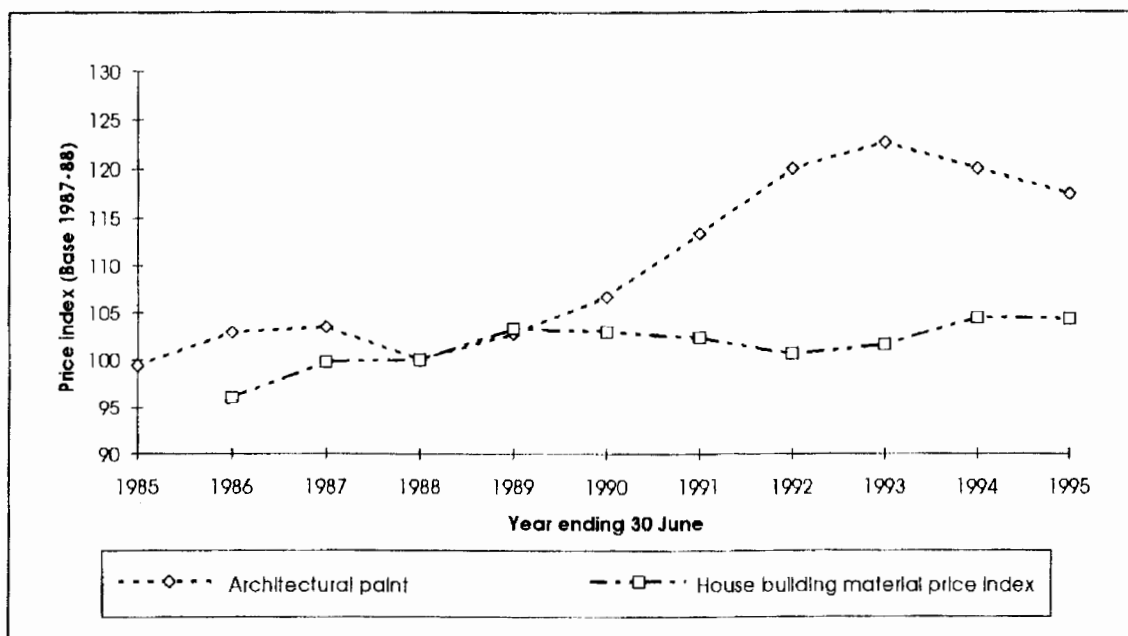
### **Movements in prices**

3.105. Two price indices obtained from the Australian Bureau of Statistics (ABS) which are relevant to this determination are: Architectural Paint and Materials used in Building. These indices are based on price information supplied by the paint manufacturers. They show changes in prices from period to period rather than the actual level of prices. The architectural paint series corresponds most closely to the architectural and decorative paint market.

3.106. Dr. Cousins has criticised<sup>14</sup> the data used by the ABS. In response a number of issues need to be addressed. Firstly, the ABS data covers the last ten years. It is irrelevant to the reliability of the data that it covers a period when prices were reduced to low levels. Price levels are set by the paint industry not ABS. Secondly, assuming there has been a relative shift of sales (away from higher priced premium brands to lower priced mid-range and economy brands) it is not a factor that will affect the ABS price indices. By definition, price indices reflect changes in price, not shifts in sales. It may be that sales will affect prices, but it is prices not sales that a price index measures. Thirdly, rebates are discounts which are specific to individual customers and would only serve to distort the actual level of prices.

3.107. The indices supplied by the ABS were deflated according to the Consumer Price Index (CPI) series which uses 1989-1990 as the base year. Accordingly, the indices, as represented in figure 3.2, show how architectural and house building material prices have changed relative to the CPI. ie: 'real' price changes.

Figure 3.2. Real paint price indices (constant dollars), base 1987/88 = 100



Source: ABS

<sup>14</sup> Statement by Dr David Cousins, in relation to the proposed acquisition of Taubmans Architectural and Decorative paint business by Wattyl Limited, paragraph 14.8.



3.108. Between 1985 and 1995, real prices for 'architectural paint' increased at an average annual compound rate of 1.73 per cent. Between 1986 and 1995, real prices for 'house building material' grew at an average annual compound rate of 0.94 per cent.

3.109. However between 1988 and 1993 real prices for 'architectural paint' increased at a substantially greater rate of 4.17 per cent. This increase greatly outstripped the increase in real prices for 'house building material' which grew at an annual average compound rate of 0.33 per cent over the corresponding period.

3.110. The real price for architectural paint fell by 4.3 per cent between 1993 and 1995 while the real price for 'house building materials' rose by 2.7 per cent over the corresponding period.

3.111. It may be more appropriate to compare the change in the real price for architectural paint with the house building materials index than with the CPI. It can be seen from the 'housebuilding materials' index that prices of architectural paint declined around 1988/89 and increased until about 1993, after which time they declined again.

## **The relevant market/s**

### **Market definition**

3.112. Section 50 of the Trade Practices Act refers to a substantial lessening of competition in a market. Section 50(6) limits the application of s. 50 to a substantial market.

3.113. For the purposes of authorisation the Commission is not required to express an opinion as to whether the proposed acquisition would breach s. 50 of the Act. However, the assessment of the competitive effect of the proposed acquisition, the public benefits and public detriment, must take place within the concept of a market.

3.114. Section 4E of the Act provides that a market for goods or services includes other goods or services that are substitutable for, or otherwise competitive with, the first goods or services. The courts have established that both demand and supply side substitution is pertinent in determining the relevant market. The relevant market can be identified by determining the smallest area over which a profit maximising monopolist could impose a small but significant and non-transitory increase in price (SSNIP), or equivalent exercise of market power. The process of market definition identifies all those sources of close competition to the merged entity by including all substitution possibilities. It is only necessary to precisely define the relevant market to the extent that it is necessary to determine the effect of the acquisition or other conduct on competition.

3.115. This application relates to a proposal by Watty to acquire Taubmans' architectural and decorative paint business. This will involve bringing together the

architectural and decorative paint manufacturing, distribution and retailing activities of Wattyl and Taubmans. Furthermore, the application claims that there will be several sources of public benefits arising from the acquisition. Accordingly, it is necessary to consider the relevant markets in which these activities are conducted and in which the claimed public benefits are to be achieved or delivered.

## **Commission evaluation**

### ***Product market***

3.116. In relation to the product dimension of the market, the areas of overlap between Wattyl and Taubmans are the manufacture of architectural and decorative paint.

3.117. As discussed earlier, industrial paint is another paint category. There is no *demand side substitutability* between architectural and decorative paints on the one hand and industrial paints on the other. The latter are formulated for specific surfaces and would be too expensive and not appropriate for use on broadwall surfaces.

3.118. On the *supply side* there are differences between the production techniques of architectural and decorative paints and industrial paints. In particular, the production of the latter categories requires flame-proofed specialised processes. Furthermore, the ability to produce in-house resins is often needed for the production of industrial paint. This requires specialised knowledge to avoid cross contamination and is environmentally sensitive. Despite this, manufacturers of industrial paint may be able to switch production to architectural and decorative paint in response to a SSNIP. However, the brand image and marketing, as well as distribution mechanisms inherent in architectural and decorative paints would generate high sunk costs for a potential entrant such that supply side substitution by automotive and industrial paint producers would be unlikely.

3.119. In addition, industrial paints are considerably more expensive than architectural and decorative paints. Consequently, a SSNIP in the price of architectural and decorative paint is unlikely to cause supply side substitution even though the production processes may be technically substitutable.

3.120. In conclusion, while there is possible supply-side substitution between architectural and decorative paint manufacturing on the one hand and industrial on the other, the likelihood of such substitution in response to a SSNIP appears to be low. Furthermore, there is virtually no demand side substitution between these categories. Therefore, the extent of substitutability is not considered to be sufficiently close for industrial paints to be included in the same product market as architectural and decorative paint.