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MERGERS PANEL

DECISION

MEETING DATE: 15 October 2002

MATTER: **Proposed acquisition of Budget Group by Cendant Corporation (Avis Australia)**

MERGERS PANEL NO.: MP2002/171

STAFF PAPER NO. MP2002/171

TITLE:	**Proposed acquisition of Budget Group by Cendant Corporation (Avis Australia)**
Catchwords:	Car rental market – substantial lessening of competition?

File No.: C2002/1259 Date:

◆ **SUBMISSION TO COMMISSION:**

Paper is for -

[X] Consideration at Mergers Panel meeting on **15 October 2002**

[ ] Urgent consideration on ....

[ ] Information only

◆ OFFICER & OFFICE: Paul Hutchison (x 1235) and Damien Kelly

◆ SUPERVISOR: ____________ CEO: Brian Cassidy

Matter has been reviewed by: (complete only if relevant)	Relevant Committee
	Nominated Commissioner
Media Release proposed:	Yes
	Attached? Yes

◆ SECRETARIAT INSTRUCTION:

[ ] Commission	[ ] Energy Committee
[ ] GST Committee	[ ] Telecommunications Committee
[ ] Transport Committee	[ ] Mergers Committee

Date of Meeting: **15 October 2002**

◆ DISTRIBUTION

[ ] Chairman	[ ] Deputy Chairman	[ ] McNeill	[ ] Bhojani
[ ] Martin	[x] Jones	[ ]	[ ]
[x] Cassidy	[ ] Smith	[ ] Pearson	[ ]
[ ]	[ ]	[ ]	[ ]

EXECUTIVE SUMMARY

Background:	Cendant Corporation is a global company operating in travel and real estate. It owns the car rental company Avis Australia and has other Australian transport, travel and vacation operations. Budget Group is a global vehicle rental company, which operates the Budget Rent A Car business in Australia.
Market inquiries:	Market inquiries were undertaken with competitors and customers.
Relevant market:	The relevant market would appear to be the national market for motor vehicle rentals, particularly car rentals.
Market concentration:	The proposed acquisition would not exceed the Commission's concentration thresholds, based on information from the parties. Some competitors argued for a narrow market definition and higher market shares. The parties state that Budget and Avis will continue to compete as separate businesses and brands post-acquisition.
Barriers to Entry:	There are hundreds of local car rental businesses across Australia due to the low cost of entry as a small operator. There are greater barriers to establishing a national operation in terms of airport space, brand, infrastructure and franchise arrangements; however, there has been successful entry at the national level in recent years.
Countervailing Power:	Leisure renters account for about 57% of market revenue and are very price sensitive. Corporate accounts (43% revenue) can tender their business and achieve volume discounts and service extras.
Availability of Substitutes:	The parties state that Avis and Budget will continue to compete as two separate entities. In addition there are various national and local car rental companies that will be able to compete effectively with the merged entity. Companies operating nationally include Hertz, Thrifty, Europcar Australia, Ascot and Red Spot.
Vertical integration	Access to partnerships with airlines, hotel chains, customer loyalty schemes or computer reservation systems should not be adversely affected by the proposed acquisition. Avis/Budget may have greater purchasing power when negotiating car fleet deals.
Vigorous and effective competitor:	Due to Budget Group's financial difficulties overseas, Budget Australia may not be an effective competitor in future. It is generally not seen as a competitive price setter in Australia.
Dynamic Characteristics:	The recent downturn in travel/tourism and car rental profitability should reinforce competition for market share.
Competition Analysis:	The parties will remain separate competitors and will face strong competition and customers even in the corporate segment.
Conclusion:	The market will remain competitive due to vigorous rivals, countervailing power of customers and the possibility of new entry.
Recommendation:	Staff recommend that the Mergers Panel form the view that the proposed acquisition will not substantially lessen competition.

AUSTRALIAN COMPETITION & CONSUMER COMMISSION MINUTE

OFFICE:	**Canberra**
FILE REF.:	C2002/1259
DATE:	10 October 2002
TO:	**Ross Jones**
C.C:	**Mark Pearson**
FROM:	**Paul Hutchison, Damien Kelly**
SUBJECT:	**Acquisition of Budget Australia by Cendant Corporation (Avis Australia)**

PURPOSE

The purpose of this staff paper is to seek the decision of the Mergers Panel on whether the proposed acquisition of certain assets and subsidiaries of Budget Group Inc (specifically Budget's Australian business) by Cendant Corporation (which owns Avis Australia) is likely to breach section 50 of the *Trade Practices Act 1974* ("the Act").

BACKGROUND

The parties met with Mergers and Asset Sales staff on 2 September 2002 and provided a detailed submission on 4 September.

THE PARTIES

Budget

Budget Australia operates the Budget Rent A Car business, which rents vehicles (including cars, trucks and passenger vans) through corporate owned, agency and franchised operations throughout Australia. Budget owns and operates 12 corporate owned sites, and has 5 agencies, in Queensland and NSW/ACT. About 67% of its outlets (47 in 230 locations) are owned and operated by franchisees. In total, Budget and its agencies and franchisees manage a fleet of approximately 7780 vehicles. Budget recorded after-tax losses in 2000 and 2001 but is said to be profitable at an operational level.

Budget Australia is a subsidiary of Budget Group Inc, which is based in the USA and is active in 120 countries and territories. Budget Group is in serious financial trouble and filed for bankruptcy in the USA in July 2002.

Cendant Corporation (Avis Australia)

Cendant provides business and consumer services worldwide primarily in the travel and real estate sectors. It is based in the USA and listed on the NYSE. It is the parent of Avis Inc (a USA company) which owns Avis Management Pty Ltd (Avis Australia) which runs the Avis car rental business in Australia.

Avis is the leading car rental company in Australia with over 200 locations around the country, including all major airports. Avis Australia's corporate owned and agency businesses make up approximately 80% of its Australian operations, generate revenues of about $170 million per year and manage a fleet of around 10,000 vehicles.

In Australia Cendant also owns the Galileo global distribution booking system, operates a travel, freight and logistics company (Show Group Enterprises) and is involved in timeshare vacation businesses. The Commission gave informal clearance to Cendant's acquisition of the Galileo system in August 2001.

THE PROPOSED TRANSACTION

As indicated, Budget Group Inc filed for bankruptcy. Subsequently in August 2002 Cendant and Budget Group announced that Cendant would acquire all the assets Budget Group for US$107.5 million and assume US$2.7 billion in debts. As a result, Cendant will acquire Budget's operations in the USA, Canada, Australia, New Zealand and Latin America, and seek buyers for Budget's operations in Europe, the Middle East and Africa. According to the parties, Budget will continue to operate as a separate and independent brand post-acquisition.

MARKET INQUIRIES

Letters were sent to Avis' and Budget's major competitors as well as several of the large customers (corporate and government contracts). Ten responses were received.

MARKET DEFINITION

Product and functional markets

The product market appears to be the rental of motor vehicles at the retail level. There are economies of scale and scope available to large operators in terms of fleet and account management, booking systems, customer schemes etc which would cover cars, vans, trucks etc (ie both passenger and freight), whereas smaller firms may tend to specialise (either cars or trucks). Niche operators provide minibuses, campervans, motorhomes or 4 wheel drives.

On the demand side the market is more fragmented - indicating sub markets for passenger vehicles (mostly cars) and for freight, as customers rent for different purposes. There are also different market segments for large customers (eg government, corporates, wholesalers) and leisure/individual customers. Large customers place their bulk business with the major rental companies who have the required airport network, booking systems, reputation, reliability and service levels. There are fewer providers servicing these customers than those supplying the leisure/individual segment.

Hertz argued that there are two markets: a corporate account market focused on business travellers (particularly at airports) and a general leisure/individual customer market. However other competitors and corporate customers saw it as a single car rental market, with definite segments. They also saw Avis and Budget targeting different segments, the former focusing on corporate travellers, the latter on leisure and discount customers. The parties also point out there are no car rental companies that service only corporate customers.

The Commission briefly considered the issue in its 1999 determination to reject a collective bargaining scheme between Hertz, Avis, Thrifty and Budget at Sydney Airport. In that decision, the Commission noted the low substitutability between taxis, public transport and rental cars but also commented that "substitution between on-airport and off-airport locations is possible". The major airports now issue desk and non-desk licences, the latter granting smaller firms advertising and pick up/delivery/parking spaces within the airport.

Geographic and temporal markets

On the supply side, in terms of the distribution and number of outlets and franchises, fleet management etc, there seems to be a national market for car rentals, yet many smaller rental firms operate at the local/regional level. The major providers have additional advantages through their airport presence, but this seems to be more a segment than a separate market. The major firms compete overseas through links and advertising to attract inbound tourists.

Demand may be more regional, given the spread of population centres. It is not clear if demand characteristics support a breakdown into airport and non-airport car rentals in terms of the location and level of service. There seems to be plenty of choice for price sensitive customers from the national brands and local firms active in each area. There is variation in weekly and seasonal demand, which would influence fleet sizes and management.

In the 1978 TPC v Ansett Transport Industries case (where Ansett sought to acquire Avis), the Federal Court recognised that there were local and national, as well as airport and non-airport, operators but found that the relevant market was the Australian car rental market.

Conclusion on market definition

Staff consider that the relevant market is a national market for passenger vehicle rentals, particularly car rentals (with segments for airport/corporate and individual customers).

MERGER FACTORS

Market concentration

The figures below provide market shares (estimated by the parties) [redacted] Other figures available to the Commission indicate that the five major franchise networks conduct about 75% of rentals.

Other participants' views of market share varied widely, with most attention on the airport/ corporate segment. [redacted] Network Rentals suggested 25% and 17% (42%). Europcar foresaw a share of 44% of airport traffic.[1] Hertz

[1] Based on year-to-date figures. 47% immediately post acquisition, based on monthly figures.

stated that the parties would have about 53% of the corporate market, 47% of the airport traffic and 46% of the total market. In contrast, submissions from corporate customers expressed less concern about market share. Bayswater Rentals stated "with three remaining players in the segment, it is unlikely that competition would be stifled."

Notwithstanding their combined market share, the parties state that Avis and Budget will be run as separate businesses and Budget will remain an active competitor of Avis on price and non-price terms as an independent brand. They do not intend to reduce the number of service counters of either company at airports or in city, suburban or regional areas. However, several submissions were concerned about opportunities for the parties to be privy to each other's strategy and to coordinate their behaviour in bidding for large accounts.

Barriers to entry

In TPC v Ansett (1978), the Federal Court commented on the 'relative ease of entry' into the national car rental market and the potential to operate at a national level, despite only Avis having an airport licence and only two or three companies having nationwide operations.

In contrast to taxis and hire cars, there is little regulation or legislation restricting entry into the car rental market. There are hundreds of local and regional rental businesses due to the low cost of entry as a small operator. The use of car leasing and franchise arrangements since the 1980s, and more recently call centres and the Internet, has enabled several previously local/regional firms to cater to a wider national and international customer base.

Nevertheless there are greater barriers to entry in establishing a national operation in terms of the cost of fleet size, airport space or presence, brand/advertising and network arrangements. Hertz and Europcar emphasised the need for airport licences, a large modern fleet, the ability to bid for large accounts and integrated management systems.

New national entry has occurred in recent years. Europcar entered the market (in partnership with Delta) in October 2000, has increased its business to about 9% of market revenues with 10% of the national fleet and is now one of the five major networks. It has linked in with Virgin Blue and also acts for four other international brands servicing inbound tourists.

Countervailing power and the availability of substitutes

There seems to be scope for the different types of customer to respond to changes in price or service post acquisition. Individual and leisure renters account for about 57% of market revenue and are seen as very price sensitive. Corporate accounts (43% revenue) tender their business regularly and achieve fixed volume discounts and additional services over a period.

Hertz argued that any countervailing power of business customer would be suppressed by switching costs (in terms of time and convenience). The parties state that most corporate customers use more than one provider (hence no switching costs), and it is worth noting that the Department of Defence, the largest corporate account in Australia, recently switched its accounts to Europcar and (through Flag Choice Hotels) Thrifty.

There are various national and many local car rental companies able to compete effectively with the parties. Companies operating nationally as car rental competitors to Avis and Budget include Hertz, Thrifty, Europcar Australia, Ascot and Red Spot. Hertz, Thrifty and Europcar will continue as key competitors for corporate and airport business.

In terms of capacity, the parties state that neither Avis nor Budget has excess fleet, which is common across the industry. Fleet sizes vary seasonally, with larger fleets in summer to meet demand. Fleets are also adjusted monthly and can vary between 15% to 25% over a year. They comment that companies with the demand and financing can readily adjust their fleet. Large changes in volume may take two months, but smaller purchases or leases of 100-200 cars might take a few weeks.

There is a significant difference in the fleet sizes and distribution of the five majors (each with 7000-15000 vehicles) and smaller rivals (700-2000). [redacted]

Overall this would indicate that customers, including corporate customers, would be able to negotiate a better price/deal. In addition, competitors should be able to increase capacity either locally or nationally in relatively short time to meet demand, if they decided to undercut an exercise of market power initiated by the parties.

Vigorous and effective competitor

The parties claim that Budget Australia has not been a competitive price setter (compared to Thrifty, Europcar or Red Spot) and may not be a vigorous and effective competitor in future, due to Budget Group's financial difficulties. While Budget Australia has been operationally profitable in recent years, it has recorded losses after tax and royalties. Budget Australia considers that both its declining profitability and Budget Group's troubles will affect it through potential loss of major wholesale and corporate accounts and of financial backing. While Hertz and Europcar see Budget as a significant competitor, most customers do not.

Vertical integration

Several of the major rental firms have integrated with car manufacturers: Hertz/Ford, Thrifty/Mitsubishi, Europcar/Volkswagen. The major firms also have partnerships with airlines, hotels and travel companies as well as links to customer loyalty schemes.

It is unlikely that the proposed acquisition will have a major effect on continuing opportunities for rivals to form these relationships. For example, following the demise of Ansett, Qantas opened its frequent flyer program to all car rental companies; at the same time, Europcar chose to team up with Virgin Blue. Similarly, despite the integration with car manufacturers, most competitors source their vehicles from a range of suppliers.

Competitors raised the prospect that, with a common owner, Avis and Budget will possess increased resources, opportunities for co-ordinated bidding and greater bargaining power in negotiating deals with car manufacturers (or finance with banks) in fleet acquisition. The resultant cost savings would be a basis for undercutting competitors, especially for major accounts. However, against this, the car manufacturers have a degree of bargaining power and, as one large customer stated, "it is possible that significant [cost] advantages have dissipated before the volumes in question have been reached."

Avis/Budget may gain advantage through preferential access to the Galileo computer reservation system (CRS). However, AFTA informed the Commission last year that rental car and hotel bookings on CRS were very small (the main business being airline bookings). This has not been raised as an issue in market inquiries.

Dynamic characteristics of the market

There has been a significant downturn in airline travel and tourism since September 2001, which has adversely affected car rental turnover. For example, Europcar commented that there had been negative market growth, with profitability suffering because of competition for market share in a declining market. It also saw the existing arrangements preserving competitive tension between the major players.

These conditions are likely to reinforce the already vigorous price and advertising competition in the Australian market post acquisition.

COMPETITION ANALYSIS

The parties will remain separate businesses post acquisition. Some competitors saw this as a key issue in how they regarded the competitive consequences of the deal. In addition, it appears that Budget and Avis target different customer groups and so compete to a lesser extent against each other than against other firms.

That said, the most significant impact on competition would appear to be in corporate rental business, whether this is a segment or a separate market. Access to airports and the ability to bid for and service large accounts through a nationwide system are key barriers to entry here. However, smaller off-airport operators viably compete for this business and the segment will still have three other strong competitors that are well known to customers, who in turn can exercise countervailing power through long-term contracts.

CONCLUSION

Staff conclude that, even if the parties were to merge operations at a later date, the possibility of new entry, the continuing presence of vigorous rivals, the purchasing power of corporate customers and ongoing market dynamics should constrain the merged entity from exercising any increase in market power. Should the parties remain separate (as announced), then these market forces should be sufficient to counter any co-ordinated behaviour or market power.

RECOMMENDATION

Staff recommend that the Mergers Panel form the view that the proposed acquisition will not substantially lessen competition in either the motor vehicle rental or car rental markets.

Paul Hutchison and Damien Kelly
10 October 2002

ATTACHMENT 1: Summary of market inquiries

Company	Comments
[redacted]	
Bayswater	• Transaction is unlikely to affect their niche. • Competition is unlikely to be stifled with 3 other players.
Europcar	• Relevant market definition is the Australian car rental market. • Merged entity will have 47% market share (based on airport data). • Of 5 national players, the merged entity will account for 61%. • Present market structure maintains competitive tension. • Transaction will result in an SLC due to the economies of scale and cost savings (60% of costs are fleet and labour). • SLC due to the fact that the merged entity will become a price leader and relegate remaining players to price takers.
Hertz	• Relevant markets are corporate rental services; and leisure rental services (with little substitutability between the two). The transaction will result in an SLC in both markets. • Hertz argues that the market definition adopted by Northrop J in *TPC v Ansett* is inappropriate due to its brief analysis of rental car demand and significant industry changes since 1978. • This acquisition creates an opportunity for the Commission to conduct a detailed analysis of the product market. • Based on Hertz management estimates, the transaction will result in a post acquisition market share of 47%. • Significant barriers to entry exist in the corporate market. • Countervailing power of business customers is suppressed by switching costs (in terms of time and convenience).
Network Rentals	• Will have concerns if they do not continue as a separate brand
Queensland Purchasing	• Merged entity will have a market share of 41%. • Competition will be reasonably strong post-merger. • Does not believe that the acquisition will impact on competition significantly.
Red Spot	• Curious about the continued operations of the merged entity – in regional areas where only the merger parties operate.
Thrifty	• Sees serious competitive concerns • Will provide greater response next week [not provided]
WA Dept Industry & Technology	• Deals with major companies through common use contracting. • A range of strong rental brands in the market. • Regional presence of brands is variable, and DoIT's ability to negotiate discounts in those areas may be lessened.

ATTACHMENT 2: Draft press release

ACCC clears acquisition of Budget by Avis parent company

The Australian Competition and Consumer Commission today gave informal clearance to the acquisition of Budget Australia (trading as Budget Rent A Car) by the Cendant Corporation, the parent company of Avis Australia. The acquisition is a result of Cendant's purchase of the Budget Group and related assets in the USA and elsewhere overseas.

"Having regard to market conditions, the continuing presence of strong competitors and the possibility of new entry, we do not believe the transaction will result in a substantial lessening of competition for car rental services," Mergers Commissioner Ross Jones stated.

Careful consideration was given to the effect of the acquisition on different parts of the car rental market, and views were sought from both customers and competitors.

"Individual and leisure customers will still be able to shop around for the best deal, and corporate customers can still exert bargaining power through their contracting" he said.

Mr Jones noted that large national contracts had gone to new entrants in the industry.

"In addition, the Commission notes that Cendant has publicly stated that it intends to maintain and operate Avis and Budget as independent networks and brands across Australia, which should mean continuing competition between them."

ATTACHMENT 3: Draft letter to the parties

Our Ref:
Your Ref:
Contact Officer: Paul Hutchison
Contact Phone: 02-6243 1235

12 February 2013

Dear

Re: Proposed acquisition of Budget Australia by Cendant Corporation

Thank you for your letter of 4 September 2002 and subsequent submissions and assistance concerning the proposed acquisition.

The Commission has considered the information provided by you and other information it has before it and, based on that information, the Commission does not propose to intervene in the matter pursuant to section 50 of the *Trade Practices Act 1974*.

Nevertheless, should new information come to the Commission's attention, or should it become aware that some of the information that has been provided by you is incorrect or incomplete, it reserves the right to reopen the matter.

Thank you for your cooperation to date.

Yours sincerely

Mark Pearson
General Manager
Mergers and Asset Sales Branch