

Anticipated acquisition by Fossil, Inc of Skagen Designs

ME/5357/12

The OFT's decision on reference under section 33(1) given on 28 March 2012.
Full text of decision published 11 April 2012.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. **Fossil, Inc ('Fossil')** is a global design, marketing and distribution company specialising in consumer fashion accessories. Its main offerings include an extensive line of watches as well as other accessories such as leather goods, sunglasses, shoes, clothing and jewellery. Fossil's products are sold under its own brands, including Fossil, Michele and Zodiac. In addition, Fossil holds the rights to produce and market watches of eight other internationally recognised fashion brands, under licence from the brand owners, namely Adidas, Armani Exchange, Burberry, Diesel, DKNY, Emporio Armani, Marc by Marc Jacobs and Michael Kors. Fossil supplies its full range of products in the UK to third party retailers and direct to consumers through its own retail outlets and over the internet.
2. **Skagen Designs ('Skagen')** markets and sells watches, clocks, jewellery and sunglasses, all under the Skagen brand. Skagen supplies its products in the UK to third party retailers and direct to consumers through two of its own retail outlets in London as well as over the internet. Skagen's UK turnover for the year ended 2010 was £[] million of which £[] million was derived from the sale of its watches.

TRANSACTION

3. Fossil, directly and through its subsidiaries, proposes to acquire the entire issued share capital of Skagen Designs, Limited. (a Nevada corporation), Skagen Designs Limited (a Hong Kong company) and Skagen Designs Holding A/S (a Danish company) for consideration of US\$225 million together with shares in Fossil (the '**Transaction**').
4. The Transaction was notified to the Office of Fair Trading ('**OFT**') on 6 February 2012 and the administrative deadline is 2 April 2012.

JURISDICTION

5. As a result of this Transaction Fossil and Skagen will cease to be distinct. Skagen's UK turnover does not exceed £70 million. However, the parties overlap in the wholesale supply of affordable watches in the UK where the merging parties submitted their combined share of supply is [35-45] per cent and therefore exceeds 25 per cent. As such, the share of supply test in section 23 of the Enterprise Act 2002 (the '**Act**') is met.
6. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

FRAME OF REFERENCE

7. The merging parties overlap in the wholesale and retail supply of watches. The parties submitted that Skagen's watches and the majority of Fossil's watches are non-luxury watches. More specifically, Skagen only sells watches which are described as affordable watches.
8. Both parties have 'bricks and mortar' stores located in London at Westfield London and Westfield Stratford City shopping malls. However, the merging parties' presence in the retail sale of watches (including the retail sale of affordable watches), in either of these shopping malls, is small given the number of retail competitors at each of these locations.¹ As such, the OFT

¹ Fossil also has 22 Fossil-branded stores in the UK, a Watch Station International store as well as concessions to run the watch counter in 43 House of Fraser department stores. Only [] per cent of all of Fossil's sales are made through its own retail outlets.

does not discuss 'bricks and mortar' retail sales any further. Both parties also sell their watches online. However, given the merging parties' online presence is minimal,² the OFT does not discuss retail online sales of watches any further.

9. The merging parties both supply branded spare parts and warranty and non-warranty repair services for their own watches only. However, given their minimal activities with respect to these services, the OFT does not consider these further as it is of the view that they would have a negligible impact, if any, on the competitive assessment.
10. The merging parties also both make de minimis sales of costume jewellery and sunglasses.³ As such, these products are not considered any further below.

Product scope

11. The merging parties submitted that the relevant product market is the production and sale of non-luxury watches (wholesale supply of non-luxury watches) whose primary function is as a timepiece by contrast to luxury watches, which are typically made in Switzerland and incorporate precious metals and gemstones and are therefore viewed primarily as jewellery.⁴
12. The parties submitted that non-luxury watches are comprised of:
 - premium watches, which typically incorporate a Swiss movement although they are manufactured outside of Switzerland. Premium watches are seen as aspirational items and are typically priced between £200 and £5,000 (at the retail level)

² Fossil's online UK watch sales in 2011 were around £[] million out of its £[] million total UK watch sales in 2011. Skagen's online UK watch sales in 2011 were only around £[]. The parties also submitted that there are over 100 online retailers of watches.

³ The parties submitted that sales of sunglasses accounted for less than [] per cent of their turnover and less than [] per cent for Skagen and less than [] per cent for Fossil with respect to costume jewellery.

⁴ The merging parties referred to a number of EU cases which dealt with luxury watches as part of luxury products namely Case No. IV/M.1534 Pinault-Printemps-Redoute/Gucci, 22 July 1999, Case No. COMP/M.1780 LVMH/Prada/Fendi, 25 May 2000 and Case No. COMP/M.6212 LVMH/Bulgari, 29 June 2011. These cases distinguish luxury products from 'mass-market' goods and 'other products falling within other segments of the same sector'.

- affordable watches, which are priced from around £20 to £500 and are mainly manufactured in the Far East
- mass market watches, which are priced up to around £40 and consist of both digital and analogue watches made in the Far East.

The majority of third parties broadly agreed with this segmentation.

13. The merging parties submitted that whilst Fossil also supplies premium watches, such as its Burberry, Michele and Zodiac watches, and mass market watches to retailers (through the design and production of private label watches for [] and []), Skagen is only active in the supply of affordable watches to retailers.
14. The OFT's approach to product market definition is generally to consider first if narrow candidate markets can be widened through substitution on the demand-side.⁵ The OFT has considered the available evidence on whether the wholesale supply of affordable watches can be widened through demand-side substitution below.

Wholesale supply of affordable watches

15. The merging parties submitted that affordable watches include a range of different watches which could be classified as:
 - fashion (these watches bear fashion brands and reflect fashion trends in accessories and clothing and are typically viewed as fashion accessories as well as timepieces)
 - classic (these watches are known for their reliability and classic appearance and are known as watch brands only)
 - design (watches that are more traditional, lean and minimalistic in the way they look)
 - lifestyle (such a brand applies to a range of accessories and evokes a lifestyle the customer wishes to emulate).
16. The merging parties submitted that Fossil considers its licensed brands to fall within the fashion watch brands category and its own brands to be

⁵ See the OFT/CC *Merger Assessment Guidelines*, September 2010 (OFT1254), paragraphs 5.2.6 to 5.2.19.

classified as lifestyle watch brands, whereas Skagen stated its watches are design watches.

17. The large majority of third parties (customers and competitors) confirmed that Skagen's watches are considered design watches and that Fossil's watches in general are fashion watches. Moreover, these third parties also generally agreed that the brands licensed to Fossil are also fashion brands. Nevertheless, there was not universal agreement among third parties, a small number considered that Skagen watches could be classified as either fashion or classic and some of the brands licensed to Fossil could be classified as premium, mass market, design or lifestyle.
18. Given there is minimal overlap between the merging parties with respect to the wholesale supply of design affordable watches and the wholesale supply of fashion affordable watches and the evidence as to whether these constitute separate product markets is not sufficient to reach a firm conclusion, the OFT adopts a cautious approach and considers the wholesale supply of affordable watches to be the narrowest relevant candidate market.
19. The parties submitted that affordable watches are part of a wider non-luxury watches market given that whilst mass market watches do not compete directly with premium watches; chains of substitution mean all non-luxury watches would form part of the same market.⁶ The parties further submitted which watch segment a brand falls into is entirely subjective. The merging parties argued that it is not appropriate to segment watches by price given mid-market customers may find brand more influential than price alone.

⁶ In support of all non-luxury watches forming part of the same market, the merging parties referred to the following UK cases: ME/3242/07 Anticipated acquisition by Luxottica Group S.p.A. of Oakley Inc., 12 October 2007 (where the OFT ultimately left the market definition open but assessed the merger on the basis of the wholesale supply of all sunglasses, the wholesale supply of prescription glasses and the retail supply of sunglasses with possible further segmentation), ME/4814/10 FGX Europe Limited of Framed Vision Limited, 17 February 2011 (where the OFT assessed the merger on the basis of the wholesale and the retail supply of sunglasses and readers separately) and P&O Princess Cruises plc and Royal Caribbean Cruises Limited: A report on the proposed merger, Competition Commission, 19 June 2002 at paragraph 5.45.

20. In this case the OFT has assessed whether premium or mass market watches directly constrain the prices in the affordable watches segment.
21. The majority of retailers who responded to the relevant OFT third party market enquiries question indicated that they would not be likely to substitute cheaper mass market watches or more expensive premium watches for affordable watches in response to a five per cent price rise in the wholesale price of affordable watches.
22. While the evidence would tend to support a conclusion that the wholesale supply of affordable watches is the relevant frame of reference, it is not necessary for the OFT to come to a firm conclusion given that no competition concerns arise under either the wholesale supply of non-luxury watches or the wholesale supply of affordable watches. Therefore, on a cautious basis and for the purposes of this assessment, the OFT considers the impact of the Transaction on both the wholesale supply of non-luxury watches and the wholesale supply of affordable watches.

Segmentation by men's and women's watches

23. The merging parties submitted that men's and women's watches form part of the same product market because from a demand-side point of view, it can sometimes be difficult to determine which watches will appeal to men and women and, even when the manufacturer intends a watch to be a man's, it may be purchased by a women and vice-versa. From a supply-side point of view, the merging parties submitted that most watch manufacturers produce both men's and women's watches and there are no differences in the pricing, methods of marketing and distribution channels for men's and women's watches.
24. However, third party responses to the OFT's third party market enquiries suggested that there is little demand-side substitution between men's and women's watches as the majority of retailers (who responded to the relevant question) indicated that they would not switch from men's to women's watches and vice-versa following a five per cent increase in the wholesale price of the other. Further, some brands appeal more to men or women and it is difficult to shift this appeal.
25. The OFT has not found it necessary to conclude on the precise product scope in this case since the competition assessment does not depend on it.

On a cautious basis and for the purposes of this assessment, the OFT therefore considers the impact of the Transaction on the narrowest plausible basis of men's and women's watches separately.

Geographic scope

26. The merging parties submitted that the relevant geographic market for the wholesale supply of watches is national from a demand-side point of view, given that retailers negotiate with suppliers to purchase products for resale throughout the United Kingdom ('UK') and there are no regional price variations. However, from a supply-side perspective, the merging parties submitted that the geographic scope was EEA-wide, if not global, given watches are manufactured in a single location and shipped worldwide, there are no national variations between products and guarantees for the watches are valid internationally.
27. On a demand-side, the OFT received evidence from third parties which suggests that retailers usually seek watch brands that are known to UK consumers.
28. The OFT received no evidence to suggest that the geographic scope is narrower than the UK. On the contrary, the third party market enquiries conducted by the OFT indicated that the location of a sales office or service centre is the least important in terms of parameters of competition between suppliers. One competitor indicated that there is no need for a local presence at all.
29. The OFT has not found it necessary to conclude on the precise geographic scope in this case since the competition assessment does not depend on it. On a cautious basis, the OFT has therefore considered the Transaction on the narrowest plausible basis, which is UK-wide.

Conclusion

30. The OFT has considered the impact of the Transaction on the narrower frame of reference, namely the UK wholesale supply of affordable watches to both women and/or men as well as on the UK wholesale supply of non-luxury watches to men and/or women.

HORIZONTAL ISSUES

Shares of supply

Wholesale supply of non-luxury and affordable watches

31. The merging parties submitted that their combined wholesale shares of supply of non-luxury watches and affordable watches are [10-20] per cent and [35-45] per cent, respectively. These estimates and those of their competitors listed below (see paragraphs 33 and 34) were based on GfK data for the 2011 calendar year.⁷
32. With respect to both the wholesale supply of non-luxury watches and the wholesale supply of affordable watches, the increment is low with Skagen's shares of supply being [0-five] per cent and [0-five] per cent, respectively.
33. The merging parties will continue to face a number of competitors in the affordable watches segment, namely Citizen which has a [10-20] per cent share, the Binda Group (which includes the Seiko brand) which has a [10-20] per cent share as well as the Movado Group (which includes the Hugo Boss, Lacoste, Juicy Couture and Tommy Hilfiger brands) and the Timex Group (including the Guess brand) to name the largest.

⁷ GfK data sets out sales by major retailers. Although not covering every retailer the OFT considers that the data set provides a good proxy for the wholesale supply of watches in the UK. In order to test the robustness of the data set, the OFT received evidence from the merging parties and third parties about the retail mark-up so as to check the upper bound levels the OFT considers these shares of supply could reach and this was taken into consideration by the OFT as part of the competitive assessment. The OFT also received evidence, from the merging parties and a third party, to suggest that the combined shares would not be higher if these included sales to all retailers. The shares of supply on the affordable frame of reference were calculated using the merging parties' classification of each watch brand. However, the OFT received evidence from the merging parties and third parties to suggest this classification was reasonable. The GfK data did not include revenues from Fossil's Zodiac, Starck, Avia and Michele watches. Fossil sells its Michele watches through its own stores or concessions and did not supply Michele watches wholesale in 2011. Fossil made [] wholesale sales in 2011 of its Zodiac, Starck and Avia watches although it discontinued supplying the Avia brand in 2011. However, out of caution, the OFT recalculated the shares of supply incorporating all of these sales into the non-luxury and affordable frames of reference and these did not affect the combined shares set out above.

34. With respect to the wholesale supply of non-luxury watches, the merging parties will face strong competition from the Swatch Group which has a [10-20] per cent share as well as competition from the Binda Group, Citizen and the Movado Group to name the largest.

Segmentation by men's and women's watches

35. The merging parties did not have GfK data which split revenues by men's and women's watches. However, they submitted that their combined share of men's watches in the non-luxury segment is [15-25] per cent with a [0-five] per cent increment and their combined share of women's watches in the non-luxury segment is [10-20] per cent with a [0-five] per cent increment.
36. With respect to affordable watches, the merging parties submitted their combined shares are [40-50] per cent for men's and [40-50] per cent for women's, with an increment of [0-five] and [0-five] per cent, respectively.⁸
37. The OFT notes that in each case both the men's and women's shares are higher than the equivalent shares mentioned at paragraph 31. This suggests that the merging parties have taken a cautious approach to calculating their share estimates for the wholesale supply of men's and women's watches.
38. Whilst certain brands may appeal more to men or women, the OFT has no reason to believe that the competitors listed above at paragraphs 33 and 34 would not constrain the merging parties on both the men's and women's watch segments. The OFT received no evidence that Fossil or Skagen are much stronger in either segment.

⁸ The merging parties converted the GfK data into wholesale revenues using a retail mark-up of [] per cent and then based their estimates on a 45:55 revenue split between men's and women's watches. One of the competitors corroborated this split with respect to affordable watches. In any event, as noted above, based on the evidence it received, the OFT calculated various upper bound levels that the OFT considers these shares of supply could reach. This was taken into consideration by the OFT as part of the competitive assessment.

Closeness of competition

39. Where products are differentiated, for example by branding or quality, unilateral effects are more likely where the merging firms products compete closely because the merged firm will recapture a significant share of the sales lost in response to the price increase, making the price rise less costly.⁹ The OFT therefore considers the closeness of competition between Fossil and Skagen below.
40. The merging parties argued that their brands do not compete closely and submitted an internal document that Fossil prepared two years ago on brand positioning, which evidences that Fossil considers Skagen [] compared to its own brands, which are more or less contemporary.
41. The majority of third parties confirmed that Fossil and Skagen are not close competitors. A number of third parties stated that Skagen has a unique and very different look and style to Fossil watches and appeals to a different type of customer. Skagen submitted it considers its watches to appeal to an older target market of between 35 and 50 years, whereas Fossil considers that its customers are generally younger (in their late twenties and thirties).
42. The merging parties submitted Skagen's closest competitors include [] and others. This was supported by third party comments received by the OFT with respect to Obaku and Bering. Fossil submitted its closest competitors are []. Third parties corroborated that Fossil's brands mainly compete with Hugo Boss, Guess and Police.
43. The merging parties' submitted that they only supply [] common customers out of approximately [] Fossil and [] Skagen customers, which in the OFT's view also supports their argument that they are not close competitors. In addition, the OFT is of the view that the breakdown of the merging parties' sales by retail channel suggests that they do not compete that closely to supply the same type of retailer. Fossil primarily sells to large chain retailers whereas Skagen primarily supplies independent stores.

⁹ See the OFT/CC *Merger Assessment Guidelines*, September 2010 (OFT1254), paragraphs 5.4.6 to 5.4.9.

44. On the basis of the available evidence, the merging parties are not close competitors in the wholesale supply of watches in the UK. Fossil's watches are predominantly classified as fashion watches and Skagen's as design. Where the merging parties do overlap the increment to their combined share of supply is small. Moreover, the OFT has identified a number of competitors who will remain to constrain the merged entity after the Transaction. The OFT therefore considers that the Transaction does not give rise to a substantial lessening of competition ('**SLC**') in the wholesale supply of affordable watches and non-luxury watches whether to men, women or both in the UK.

Barriers to entry and expansion

45. Third party responses to the OFT third party market enquiries suggest that barriers to entry could be high as establishing a new watch brand in the UK could involve a significant amount of expenditure and take a number of years.¹⁰ However, a number of third parties also noted recent entry, for example, ICE watches, although it is not clear how long lasting the presence of this brand will be compared to the more established brands.
46. However, as the Transaction does not give rise to concerns over unilateral effects, there is no need for the OFT to reach a firm conclusion regarding barriers to entry and expansion.

VERTICAL ISSUES

47. The merging parties have a vertical relationship. Fossil runs the watch counter under a concession in 43 House of Fraser department stores across the UK where Fossil sells its own and competitor watches.¹¹
48. The OFT considers that the Transaction does not lead to any credible vertical competition concerns given the merging parties' minimal retail presence (see paragraph 8 above) and that the House of Fraser concessions are in 43 stores out of a minimum of 1,200 stores in which watches are sold. As such, even if Fossil were to sell its watches exclusively in the House of Fraser stores, the OFT considers that the

¹⁰ This would be even more difficult for a completely new brand than for an existing fashion brand that is new to watches or a watch brand that is new to the UK market.

¹¹ Fossil may also sell competitor watches in its Watch Station International store.

Transaction would not result in an ability to foreclose watch competitors from the market given the numerous other retail outlets open to them.

49. Similarly, the Transaction would not result in input foreclosure given that Skagen only has two retail stores and Fossil a small number of retail outlets through which it currently only makes [] per cent of its sales.

THIRD PARTY VIEWS

50. Third party comments have been taken into consideration and discussed above where relevant. Other concerns raised by third parties about potentially anti-competitive practices are discussed below.
51. Third parties raised concerns about non-coordinated effects over non-price factors, including Fossil asking for exclusivity, better display or giving less time to pay invoices. As discussed above, the OFT considers that there is no realistic prospect of non-coordinated effects. The OFT is of the view that there are also a number of other reasons specific to non-price coordinated effects. Fossil does not currently ask for exclusive supply of its watches. The OFT's third party market enquiries indicated that retailers seek to provide a range of brands, often from competing watch suppliers so as to draw in more customers and increase sales. Fossil's incentive to ask for exclusive supply is therefore weakened. The OFT also received evidence from the merging parties which suggests it would be difficult for them to enforce any requests to promote their brands over that of other watch suppliers.
52. In addition, a number of third parties expressed concern that following the Transaction, Fossil would stop supplying them with Skagen watches or diminish the range it supplies. The OFT is of the view that given the number of competitors present in the wholesale supply of non-luxury and affordable watches post-merger, these retailers would, in any event, not be foreclosed.
53. Third parties also raised concerns about Fossil bundling and tying products. In this respect, the OFT did not receive any evidence which suggests Fossil and Skagen watches are strong complements. The merging parties also submitted that they only share [] customers out of a total of [] customers for Fossil and [] for Skagen. In addition, each of the merging parties' main source of revenue comes from different types of retailers, namely small

independent retailers for Skagen and large department and chain stores for Fossil. On the basis of no strong complementarity between Skagen and Fossil watches and no large pool of common customers, the OFT considers that anti-competitive conglomerate effects are not credible.

ASSESSMENT

54. The merging parties overlap, as far as material for the competitive assessment, in the wholesale supply of non-luxury and, more specifically, affordable watches to both men and women.
55. The merging parties' submitted their shares of supply in the wholesale supply of non-luxury watches and affordable watches are [10-20] and [35-45] per cent, respectively and not significantly higher for the wholesale supply of men's or women's watches. The increment in each case is small. Following the Transaction, there will be a number of other competitors operating in the wholesale supply of both non-luxury and affordable watches including Citizen, the Binda Group and the Movado Group. Further, the OFT received strong evidence that the merging parties are not close competitors.
56. The OFT considers that the Transaction does not lead to any credible vertical competition concerns since the competition in the wholesale supply of watches together with merging parties' minimal retail presence means that they have neither the ability to engage in customer foreclosure, nor the incentive to engage in input foreclosure.
57. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a SLC within a market or markets in the UK.

DECISION

58. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.