Anticipated acquisition by United Biscuits (UK) Limited of the Jacobs Bakery Limited

The OFT's decision on reference under section 33 given on 10 September 2004

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

PARTIES

1. **United Biscuits (UK) Limited** (UB) is primarily active in the manufacture and sale of biscuits, cakes and savoury snacks. **The Jacobs Bakery Limited** (Jacobs) manufactures and sells biscuits, savoury snack products and other food products. It is currently owned by Groupe Danone. Its UK turnover in 2002 was approximately £[ ] million.

TRANSACTION

2. Following an auction process, UB has signed an agreement with Groupe Danone to acquire Jacobs together with its subsidiaries, including the Jacobs Northern Ireland Companies (W&R Jacobs & Co (Northern Ireland) Ltd and Irish Biscuits (N.I) Ltd). The merger was notified by merger notice on 29 July 2004 and the statutory period was extended on 20 August 2004. The statutory deadline expires on 10 September 2004.

JURISDICTION

3. As a result of this transaction UB and Jacobs will cease to be distinct. The UK turnover of Jacobs exceeds £70 million, so that the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) would be satisfied. Furthermore, the parties overlap in the supply of biscuits in the UK and the share of supply test in section 23 of the Act would be met. 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.

RELEVANT MARKET

Product market

4. The parties overlap in the production and sale of biscuits. The portfolios of the two firms are to a large extent complementary with Jacobs stronger in the sale of savoury biscuits and UB stronger in sweet biscuits. Marketing classifications tend to divide the range of biscuits available into a number of segments: chocolate biscuit bars (CBBs), children's biscuits, everyday biscuits, everyday treats, special

treats, seasonal biscuits and healthier biscuits (together sweet biscuits); and savoury biscuits and crackers and crispbreads (together non-sweet biscuits).

Demand-side

5. On the narrowest basis, there is clear evidence supporting the notion that the closest competing product for any given biscuit product will be one which falls within the same narrowly defined biscuit segment. In many cases this closest competitor is a retailer own label equivalent of a branded product, indicating that such products are competing strongly with branded sales. All third parties supported the notion that biscuits sold under the retailer's own label brand compete strongly with their branded equivalents (even though these are often manufactured by a branded competitor).

6. The extent of the constraint between different biscuit segments varies by segment. Sweet biscuits have seen stagnant revenues over the past few years, whereas the savoury and healthier segments are growing, suggesting that it may be appropriate to consider sweet and non-sweet biscuits separately. Furthermore, products are often marketed in different ways broadly depending on the segment in which they are classified: for example, crackers/crispbreads and savoury biscuits are typically marketed alongside each other, or interspersed, in stores. In contrast, CBBs are often marketed alongside chocolate bars. Generally, the various sweet and non-sweet segments are likely to provide a closer constraint for each other than combinations of segments which cross the sweet/non-sweet boundary.

7. There is also considerable evidence to suggest that individual biscuit products face competition from a wider range of both biscuit and non-biscuit snacking products. In *Nabisco/United Biscuits*,[1] the European Commission (EC) found that biscuits face competitive constraints from snacks, confectionary, cakes and breads. 'Needs based snacking' research commissioned by UB, found that for a given 'need state' individuals may see a wide range of food products, both biscuits and non biscuits, to be alternatives. In addition, revenues from biscuit sales have stagnated in contrast to the rest of the grocery and snacking segments as a whole, suggesting that other products are winning a higher share of consumers' spend. Mintel argued that 'biscuits compete alongside fruit and crisps as options for the 'snack moment'' and that 'the boundaries between sweet biscuits and the confectionary markets simply do not exist anymore...'[2].

8. The closest non-biscuit competitor for any biscuit product within a narrowly defined product segment will vary, as will the strength of the constraint it imposes. Crackers for example are likely to compete more closely with sales of breads and other savoury snacks: for example, many third parties argue that the 'Snack-a-Jacks' rice-based cracker product in its mini format is a substitute for crisps. On the other hand, CBBs bars compete much more closely with chocolate confectionary sales than with crisps: for example, CBBs such as Kit Kat and Twix are marketed on a confectionary feature. Therefore, whilst certain biscuit segments may face competition from products outside the biscuit sector, any such

[1] Case No. COMP/M.1920 –*Nabisco/United Biscuits*
[2] Mintel: Sweet Biscuits – UK – October 2003.

constraint would need to be examined on a product-by-product basis. In addition, the extent of this constraint on the biscuit sector as a whole is not clear.

Supply-side

9. Conflicting evidence has been received on the possibilities of supply-side substitution between biscuit segments. There does, however, appear to be a consensus that it is generally cheaper to switch to the production of a plainer product than to do the reverse, as the production of more elaborate products may require the installation of value added equipment such as 'enrobing' machines for covering the biscuit with chocolate.

10. The parties submitted that the fundamental process of mixing and baking a biscuit is the same for all biscuit types, whether sweet or savoury, and that converting a line to the production of a cracker would cost approximately £75,000-150,000. The parties provided examples of [ ]. Evidence provided by the parties also showed that there is a considerable supply of second hand manufacturing equipment available which could be purchased, often at a substantial discount, thereby reducing the costs of converting a line.

11. In contrast, competitors submitted that supply-side substitution is costly and time-consuming. For example, one competitor submitted that to convert an existing line to manufacture crackers would cost around £750,000, whether that line was currently producing mallow biscuits, plain biscuits or CBBs. It had no examples of a line being converted from sweet to savoury biscuit production over the past three years and estimated that a conversion from sweet to savoury would take 2-3 years to repay the investment cost and repayment for a conversion from savoury to sweet would take 3-4 years.

Conclusions

12. Previously, both the MMC[3] and the EC[4] have previously considered an 'all biscuits' frame of reference. However, the EC left open the question of whether it was appropriate to segment between the individual biscuit types.

13. The competitive constraints acting on each individual biscuit product differ such that classifying biscuits into narrow segments is, at best, a crude method of identifying the competitive constraints acting on the individual biscuit product. On the demand side, the closest constraint for an individual product is exerted by products within the same narrowly defined biscuit segment. At a broader level there is evidence that some biscuits face competitive constraints from beyond the biscuit sector. However, given the uncertainties regarding the constraint acting on any particular biscuit product it would not appear appropriate to include all snack products in the relevant frame of reference, though it is important to remember that the biscuits sector as a whole is competing for share of spend with alternative snacking products.

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[3] Nabisco Brands Inc and Huntley & Palmer Foods PLC: A Report on the Proposed Merger MMC 1982

[4] Case No. COMP/M.1920 –*Nabisco/United Biscuits*

14. On the supply side, the parties provided evidence to indicate that substitution between the production of different biscuit types was feasible. However, this conflicted with evidence provided by competitors.

15. In light of the above, the competitive effects of the merger have been examined on the basis of (i) all biscuits; and (ii) each of the narrowly defined biscuit segments. Moreover, for the reasons explained below, there is no need to reach a firm view on the precise parameters of any product market (or markets).

Geographic market

16. Approximately 18 per cent of biscuits consumed in the UK are imported[5] and similar levels of domestic UK biscuit production are exported. In addition, numerous examples exist of foreign producers selling in the UK, either under their own brand names or as contract manufacturers of own label product for retailers.

17. Differences in taste between the UK and other European countries and the importance of national brands (for example McVitie's sells its Digestives in Spain under a local brand name) suggest limits to the extent to which foreign branded biscuits are substitutable for locally produced ones. In its *Nabisco/United Biscuits* decision[6], the EC considered that even though transport costs were not material, national preferences relating to the texture, taste and appearance of biscuits appeared to constitute a barrier to cross border trade.

18. In relation to own label biscuits, where brand is not important, evidence suggests that it may be appropriate to consider competitive constraints from manufacturers outside the UK. Foreign producers are in a position to compete strongly for contracts for the manufacture of retailer own label products.

19. Overall, given the strength of national preferences and brands, the appropriate geographic frame of reference for examining this merger is considered to be the UK.

HORIZONTAL ISSUES

All biscuits

20. Post-merger, the parties will account for [30 - 40] per cent of UK biscuit manufacturing. However, this figure does not represent a good guide to the dynamics of competition in the biscuit sector since it does not reflect the importance of inter-brand competition at the retail level, and in particular the strength of competition from retailer own label products. Nor does it reflect the extent of competition among manufacturers to produce own label products for retailers.

21. At the retail level, the transaction does not raise concerns as this appears to be a highly competitive marketplace. The parties' post-merger sales of branded biscuits will account for approximately 27 per cent (increment 7 per cent) of the retail supply of all biscuits in the UK, thus strengthening UB's position as the largest

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[5] British Cakes Chocolate and Confectionary Alliance figures
[6] Case No. COMP/M.1920 –*Nabisco/United Biscuits*

branded supplier of biscuits in the UK. However, the parties will continue to face competition from other branded biscuit products.

- perhaps most importantly, retailer own label biscuits account for the second largest share of all biscuit retail sales in the UK with a share of approximately 22 per cent

- there will remain a large number of other suppliers of branded biscuits, three of which have shares of supply in excess of 7 per cent

- key brand names are owned by a variety of competitors. The supply of biscuits is comprised of a huge number of brands, with each individual product responsible for a relatively small proportion of total sales

- there has been continued growth of the 'non-core biscuit' manufacturers, such as Nestle (Kit Kat), Kellogg's (Nutri-grain cereal bars), and PepsiCo (Snack-a-Jacks rice crackers), which have used their financial resources and ability to develop innovative products to leverage their brand from neighbouring markets. Given that total spend on biscuits has not been growing, these new entrants have been gaining share at the expense of some of the traditional biscuits manufacturers

22. The extent of competition from retailer own label products that would be faced by the merging parties could be undermined if the merged entity were to be such an important supplier of own label products to retailers that it could raise the price of such products and so reduce the competitive pressure from own label products at the retail level. At present, the parties manufacture around [ ] of retailer own label products sold in the UK. As noted below, retailers can and do switch among biscuit manufacturers, including using manufacturers located outside of the UK. Moreover, the major retailers possess a degree of buyer power that allows them to resist attempts by biscuit manufacturers' to increase price. In these circumstances, the parties' combined [30-40] per cent share of UK biscuit manufacturing probably overstates UB's post-merger competitive position.[7]

23. Overall, therefore, post merger, the parties would still be expected to face strong competition in the all biscuits segment from both the remaining branded competitors and retailer own label products.

Sweet biscuits

24. Examining sweet biscuits separately, the parties' combined share of supply is approximately 25 per cent (increment 3 per cent). Share of supply data were also

[7] In the *Nabisco/United Biscuits* case, the EC found that the merger would give rise to a dominant position at the production level for all biscuits in the UK, due to the parties' high combined share of supply ([35-45] per cent) and the correspondingly low shares of competitors. However, these combined shares of supply, and the finding of dominance, were based on the inclusion of the parties' production of own label products. The EC analysis indicated that if own label sales were attributed to the retailer rather than the manufacturer, then competition concerns did not arise in the UK. As noted above, if in the present case sales of retailer own label products are attributed to the parties rather than to the retailer, the parties' combined share of supply increases to approximately [30-40] per cent: a figure significantly below that observed in the *Nabisco/United Biscuits* case.

provided for each biscuit category within the sweet segment which showed that, where the parties were both active in a particular category, in most instances their shares were relatively low, and/or the increment was low. In addition, the parties provided evidence to show that in most categories there are a large number of other branded products available, as well as retailer own label products.

25. The largest increments were observed in the children's and seasonal segments. However seasonal sales are likely to reflect the position of the manufacturer within the other segments. The children's sector as a whole is relatively small and competition from other segments is likely to be intense, as a substantial proportion of all biscuits are bought for consumption by children. In addition, the Jacobs' share is largely due to the ownership of one branded product, Iced Gems, which would not appear to represent a substantial addition to the existing UB portfolio. The best selling children's biscuit is Jammie Dodgers, a Burton's product.

26. In sum, the available evidence shows a variety of constraints acting on any individual product from competing products (i) within the same narrow sweet biscuit segment, (ii) in the broader biscuit sector and (iii) from the wider range of snacking products available. These constraints will remain strong post-merger.

Non-sweet biscuits

27. In relation to non-sweet biscuits, the parties combined share of supply is approximately 36.6 per cent (increment 7.5 per cent). There is virtually no increment to shares of supply with respect to savoury biscuits, but the overlap in crackers/crispbreads gives rise to a combined share of supply of 32.5 per cent (increment 9.9 per cent) in that segment. The increment to the existing Jacobs' portfolio is relatively limited in extent, as UB adds only the Carrs and Krackawheat brands. However, the parties appear to have some of the most closely competing products within the sector, and third parties are divided as to the extent to which rice-based products of competitors PepsiCo and Kallo compete with the traditional cracker products of the parties. However, the available evidence suggests that post-merger competitive constraints will remain sufficiently strong to discipline the parties' commercial conduct.

- first, own label crackers/crispbreads account for 14.7 per cent of sales in the sector. Some of these products are direct replicas of their branded equivalents, whereas others are innovative. As noted above, all third parties agreed that own label and branded products compete strongly. In addition, retailers will not be dependent on the merged entity for the supply of own label crackers/crispbreads

- second, competition from other branded products will remain strong. The Ryvita range was noted as a 'must-stock' – along with Cream Crackers – by a number of retailers. In addition, there is a range of smaller branded cracker producers and suppliers of competing products such as oat cakes and melba toast

- third, evidence also suggests there is a degree of competition from rice-based products, especially those that are typically eaten with toppings such as 'Snack-a-Jacks Jumbo'. Growth within the sector appears to be driven by the rice-based segment, which is benefiting strongly from its 'healthy'

credentials. Mintel argues that traditional cracker products risk losing shelf space to rice-based products if they do not succeed in generating additional custom. An indication of the seriousness of this threat can be found in Jacobs's response, which was to develop and launch 'Thai Bites', its own rice-based cracker product

- fourth, the degree of similarity between many of the cracker/crispbread products and savoury biscuits products suggests that it may be appropriate to consider the constraints acting in the non-sweet biscuits segment as a whole, including the neighbouring product category of 'savoury' biscuits. This does not substantially affect the parties' combined share of supply, due to Jacobs' comparatively similar share in both categories. There is also competition from outside the biscuits segment. Research indicates that customers see a wide variety of snacks to be competing with 'cheese and biscuits' and other consumption opportunities for crackers

28. Overall, therefore, the merged firm would appear to continue to face competitive constraints in the sale of crackers/crispbreads post-merger from (i) within the same segment (particularly from rice based products); (ii) within the wider non-sweet biscuit segment; and (iii) a broader range of snacking alternatives.

Own label biscuits

29. As discussed above, all third parties supported the view that retailer own label biscuits competed and should therefore be included in the same product frame of reference as branded biscuits. Some third parties raised concerns that the merger would strengthen the parties' position in the supply of own label biscuits to retailers. The parties currently account for [25-35] per cent (increment [0-10] per cent) of the manufacture of retailer own label biscuits.

30. There are two main reasons why this merger does not raise competition concerns in relation to the supply of retailer own label biscuits. First, the parties will face post-merger competition from a number of existing manufacturers in the UK (such as Rivingtons and Burtons) and abroad (such as Continental Bakeries of Holland and Bahlsen). Already, retailers can and do switch business among the competing suppliers of own label products. In addition, third parties agreed that there is substantial excess capacity in the industry that could meet retailers' demand in the event that the parties sought to raise prices.

31. Second, the principal customers for own label products are major retailer groups, which can exert significant buyer power. This will continue post merger.

Barriers to entry and expansion

32. The biscuits sector as a whole has seen stiff competition over recent years and there has been capacity reduction on the part of some of the traditional biscuit manufacturers. This has been precipitated by the entry of a number of new biscuit products, including for example Bisc & and Snack-a-Jacks, offered by 'non-core' biscuit manufacturers. Nor are these isolated examples of competitive new entry; AC Nielsen data shows a significant number of new entrants to the biscuits sector over the past year. Furthermore, as noted above, 'non-core biscuit' manufacturers

appear to have been gaining share at the expense of some of the traditional biscuits manufacturers.

33. Estimates of the cost of *de novo* entry at the factory level vary, but given the presence of excess capacity in the industry as a whole such entry appears unlikely. New entry is more likely to occur at the product level, through the launch of a new product line. This could be undertaken by sub-contracting the production.

34. Branding is important in this differentiated products industry, and many of the successful product launches have been undertaken by major manufacturers with substantial marketing budgets and brands to leverage from neighbouring sectors (such as Kellogg's and Mars). There have also been examples of more incremental entry and expansion, such as Rivington Foods (producer of the Ainslie Harriott Heaven Bar and Pink Panther Wafers).

35. With respect to the crackers/crispbreads segment, there have been 142 new SKUs (stock keeping units) launched in the two years to July 2004 with the most important recent entry the highly successful launch of Snack-a-Jacks by PepsiCo. This segment is also one of the few growing segments in the wider biscuits sector and in which, pre-merger, there was considerable interest in expansion from a variety of manufacturers.

36. Overall, there are numerous examples of recent entry and/or expansion into the biscuits sector, including the crackers/crispbreads segment. There is no evidence to suggest that this record of entry/expansion is likely to slow in the future. As a result, provided, the merger does not make it significantly more difficult for manufacturers to gain listings for new products (discussed further below), new entry and expansion would be expected to provide a constraint on the parties' behaviour post merger.

Portfolio power

37. Some competitors have raised the concern that as a result of the merger UB will be in a stronger position relative to retailers due to its extensive portfolio of brands covering the full range of biscuit segments. It could profit from this by leveraging its entire range to customers, to the detriment of smaller rivals which do not possess such a full range.

38. Typically a firm benefiting from portfolio power would leverage its position in a market where it is stronger into a market where it is less strong. In this case, given that UB's highest shares are in the non-sweet segment and this is where the greatest increment has arisen, this would involve UB tying sales of its sweet biscuits to sales of its savoury lines so that, in order to gain UB's range of cracker products the retailer would also have to agree to take UB's other products, including any less popular sweet biscuit products. This would crowd out smaller suppliers producing competing sweet biscuits. However, since the sweet biscuits segment is significantly greater in size than the non-sweet segment, which accounts for only 15.7 per cent of all biscuits sales, such a strategy would not appear to have any chance of success.

39. An alternative argument is that UB might leverage its position as an own label supplier to force retailers to take branded products. However, as noted above, there appear to be a number of active own label manufacturers both in the UK and

abroad and only one (relatively small) customer has raised concerns regarding the availability of own label suppliers.

40. No retailer raised any concern that UB might seek to exercise portfolio power, with all indicating that ranging decisions were taken on a product-by-product basis with profit as the primary criterion for selecting the offer.

41. Therefore, on the basis of the evidence available and the absence of customer concerns, the extension of UB's portfolio of biscuits as a result of the merger is not considered to give rise to a substantial lessening of competition.

Category management

42. Some competitors raised concerns about the power of the merged firm to further its own sales at the expense of those of its rivals using its control over the supermarkets through the category management process. Currently, UB provides category management services for [ ] of the [ ] supermarkets chains which use this service and Jacobs [ ]. Following the merger, the parties will hold a wider range of products across the different biscuit segments which may enhance the parties' ability to provide category management services.

43. Category management involves a leading supplier providing expertise to the retailer to help it to maximise the profitability of each of its product ranges. This may involve providing research on the best way to market products and at what time, and information on high and poor performers within the product range. Any recommendation made by the suppliers is non-binding and there is no payment for providing this service – the supplier undertakes it to try to increase its standing with the retailer and to ensure that no other supplier has the opportunity to perform the role in its place.

44. At present, supermarkets use the category manager as a provider of free research and expertise and appear to be equally capable of taking this activity in-house. In the context of this merger, the OFT would not expect a retailer (particularly a major supermarket chain) to permit itself to be disadvantaged by its choice of category manager, or adherence to its recommendations, such that it resulted in a failure to provide an optimum product mix, maximising the overall profitability of its biscuits range.

Buyer power

45. UB argues that there is countervailing buyer power from the supermarket chains, which account for 80 per cent of sales of branded biscuits in the UK, and 84 per cent of crackers and crispbread sales. Biscuits manufacturers are highly dependent upon the major supermarket chains to ensure distribution of their products: [ ] alone is responsible for [ ] per cent of UB's biscuit revenue. Generally, of those contacted, both large and small customers considered that they possessed some degree of buyer power. One customer noted that all retailers benefit from some buyer power as suppliers want to get their products on to retailers' shelves.

46. Crackers/crispbreads will represent only a very small proportion of the total UB biscuit portfolio: as noted above, these products account for 15.7 per cent of all biscuit sales. It is considered that this will place some competitive constraint on UB when it is undertaking negotiations with customers, on the basis that the need

to maintain good relations for sales of the bulk of its portfolio will limit any attempts to take advantage of a relatively strong position in the crackers/crispbreads segment.

47. It should also be noted that retailers can also exercise buyer power through the positioning of equivalent retailer own label products.

48. Overall, the larger supermarket chains, would appear to be able to exert some degree buyer power on the merged entity. Smaller customers, such as symbol groups and wholesalers, may also be able to exert some buyer power on the merged entity although the extent to which they will be able to do so is unclear.

VERTICAL ISSUES

49. Vertical issues may arise with regard to the manufacture of own-label products. UB is a significant manufacturer of own label products, as well as competing against these products downstream. However, the market structure does not change as a result of the merger, as Jacobs also manufactured own label, and there are a range of alternative producers in the UK and abroad.

THIRD PARTY VIEWS

50. Generally, customers were unconcerned. A number of competitors raised concerns, principally about the possibility of the merged firm benefiting from portfolio power which would be strengthened through its role in category management.

ASSESSMENT

51. Although UB and Jacobs will together account for a relatively high post-merger share of UK biscuit manufacturing, this is not a good guide to the dynamics of competition across the entire biscuit sector and in individual narrow segments (including crackers/crispbreads).

52. At the retail level, the parties will continue to face competition from a wide range of branded biscuit products, from strong retailer own label products, and to some degree from non-biscuit 'snacking' products. The numerous examples of new entry, particularly by 'non-core' biscuit manufacturers which appear to be gaining share at the expense of traditional biscuit manufacturers, will also constrain the parties' behaviour in the future. Finally, customers, especially the supermarket chains, also appear able to exert a degree of buyer power through their control of a key distribution channel for biscuit manufacturers and through the use of retailer own label products as a competitive discipline.

53. At the supply level, no concerns emerge that the merged entity would be able to raise prices to retailers of own label products. There remain a number of alternative biscuit manufacturers in the UK and abroad that can be – and are – used by retailers.

54. Finally, some competitors raised concerns regarding portfolio power and category management. However, no customers raised such concerns, indicating stocking decisions were made on a product-by-product basis.

55. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

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