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## Anticipated acquisition by Woodbridge Foam (UK) Limited OF certain business and assets of Fehrer Great Britain Limited

The OFT's decision on reference under section 33 given on 20 August 2003

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### **PARTIES**

**Woodbridge Foam (UK) Ltd (Woodbridge)** is a subsidiary of the Canadian Woodbridge Group which specialises in the manufacture of moulded polyurethane foam components for use in car seats. The group has 57 manufacturing facilities in 15 countries. In the year to 31 October 2001 Woodbridge made a pre-tax profit of approximately £1.8 million on turnover of £28.9 million. **Fehrer Great Britain Ltd (Fehrer)** is the UK subsidiary of F.S Fehrer International Holding GmbH, a German group specialising in the manufacture of polyurethane foam components for use in car seats. In the year ended 31 December 2001 Fehrer made an operating loss of £1,511 on turnover of £12.5 million.

### **TRANSACTION**

The majority of Fehrer's UK plant was destroyed by fire in July 2002 and it has decided not to invest in rebuilding the plant in view of the expected stagnant nature of car production in the UK. Woodbridge proposes to acquire the remaining production carousel, and three supply contracts, for a consideration of around £700,000. The remaining two contracts will be retained by the Fehrer Group and serviced from production facilities outside the UK.

The 40 day administration deadline expires on 20 August 2003.

### **JURISDICTION**

As a result of this proposal arrangements are in progress or in contemplation which if carried into effect will result in the creation of a relevant merger situation pursuant to sections 33(1)(a) and 23 of the Enterprise Act 2002 (the Act). The OFT believes that the assets and contracts to be acquired by Woodbridge are sufficient to constitute an 'enterprise' for the purposes of section 23 of the Act. The parties overlap in the supply

of moulded polyurethane foam for use in car seats in the UK and the share of supply test in section 23 of the Act is met.

## **RELEVANT MARKET**

### **Product market**

The parties overlap in the production of foam 'sets' which form the base of car seats. Chemicals are poured into a model-specific mould, later setting to provide the finished foam product. The completed car 'set' is then shipped to the seat manufacturer for finishing before reaching the production line of the OEM (Original Equipment Manufacturer or car manufacturer). The largest supplier of foam in the UK is Johnson Controls Automotive (UK) Ltd (Johnson) which is vertically integrated with the capability to produce at some or all of these stages.

### Demand-side substitutes

On the demand side there are no alternatives to the use of moulded polyurethane foam. 'Slab' foam (non-moulded foam such as that used in mattresses) does not have the same properties and is not currently in use in any car model.

### Supply-side substitutes

Following the fire which destroyed a large proportion of Fehrer's production facilities, work was outsourced to a number of suppliers including Johnson, Fehrer Group factories outside the UK, and to Kay-Metzler. Kay-Metzler had previous experience of supplying moulded car foam but made a strategic decision to withdraw from the automotive sector and focus on the furniture sector. This suggests that Kay Metzler may be a potential entrant but might need to up-grade capacity if it wished to bid for new contracts and re-enter the market.

### **Geographic market**

The bulky nature of moulded foam products results in high transport costs relative to product value: Woodbridge estimates transport costs from Belgium account for around 13 per cent of delivered price and for imports from Germany this is around 22 per cent. Customers also place great reliance on just-in-time delivery deadlines so the further the product is transported the greater the risk this could be missed. For these reasons Woodbridge has a general policy of not transporting foam over distances greater than 300km, though it has serviced a French contract from its Bedford factory. It will shortly open a new production facility in France, near to the relevant seat manufacturer, which will replace supplies from the UK. Johnson also serves a UK contract from France and a

Belgian contract from the UK in order to maximise the use of its operating plants. Foam for the Peugeot 206 is imported from Spain: the high transport costs are offset by cost savings in the production process.

Imports are estimated to currently account for between 4.5 per cent and 20 per cent<sup>1</sup> of moulded foam consumption within the UK automotive sector. There are a large number of pan-European contracts, but these tend to be serviced by a series of local plants. This would tend to suggest that the UK forms a separate geographic market for this product. However, third party estimates of delivered price differentials of foam imported from Western Europe vary between 0 and 8 per cent. Price is the major factor in the allocation of contracts in this sector, so a small increase in UK prices is likely to bring European suppliers into the market. Hence whilst the scope of the market is probably UK-wide, European producers appear well placed to enter and increase supply in the UK in response to any price increases by the remaining UK producers.

## **HORIZONTAL ISSUES**

### **Market shares**

Within the UK, post merger, there will be a reduction in the number of firms operating foam contracts from three to two. Woodbridge's share of 32 per cent will increase by less than 14 per cent (this figure represents all five contracts serviced by Fehrer only three of which will transfer to Woodbridge), giving a maximum combined share of 46 per cent, compared to Johnson's estimated 48 per cent and imports of 4-6 per cent. However, the increment to Woodbridge's share of supply must be considered in the light of the counterfactual. Fehrer has decided not to re-build its UK plant and so will not be an active competitor for future contracts from within the UK regardless of the merger (though it may well tender from its production facilities elsewhere in northern Europe). Furthermore, the production capacity and number of contracts being transferred is relatively small: the Fehrer Group is retaining two contracts. Of the business passing to Woodbridge, one contract expires in 2004 and the replacement contract has been won by another supplier, so that Woodbridge will actually acquire only two contracts which run until 2005 and 2007 respectively. In terms of capacity, Woodbridge is acquiring only the production carousel which is equipped to service only one particular car contract.

Competition is likely to remain between the plants operating in the UK. And any increase in UK prices should increase supplies from within Europe. This is a high fixed cost industry, with excess capacity of around 15-20 per cent across Europe as a whole and between 20-25 per cent in the UK. Contracts are large relative to the size of each

foam manufacturer, and therefore each is an important source of contribution to overheads. This will promote low prices as long as there is no co-ordination. Co-ordination appears unlikely in the UK, as the two UK producers would rapidly be undercut by foreign producers if they tried to increase prices.

Shares of supply across Europe are far more diverse with over 10 manufacturers having shares above 5 per cent, with the leading supplier holding a share in the region of 20 per cent.

### **Barriers to entry and expansion**

The parties argue that given that the technology required to produce moulded polyurethane foam is old and readily available, entry is straightforward and not costly: Woodbridge estimated the cost of constructing a plant of minimum efficient scale at £1.5 million. This would have the capacity to fulfil about 10 per cent of UK volumes, in the context of a UK sector worth approximately £80 million per year. However, a third party estimated the cost of building the factory at £5 million with production facilities costing a further £8 million.

Overall, the stagnant nature of the UK car manufacturing sector would appear to suggest that the incentives are not currently present for further capital investment. However, there is potential for easy entry by imports by European manufacturers, many of whom also have excess capacity and would benefit from a greater contribution to overheads.

### **Buyer Power**

The global nature of the car industry with large knowledgeable OEMs and supplier firms leads to significant buyer power operating over the two remaining foam producers in the UK.

Each seat contract forms a large portion of any foam manufacturer's turnover in the UK. In addition there are very close relationships between seat manufacturers and foam manufacturers on a global basis: over half of Woodbridge's worldwide turnover is accounted for by sales to one customer. This relationship gives the customer both knowledge, as they are aware of any cost differences across different countries, and power when negotiating price and contract terms.

In addition to the power imposed by the seat manufacturer, a significant degree of buyer power in the market originates from the OEM, which will often become involved in the choice of foam supplier even when outsourcing the seat contract. These firms have global buying power and frequently enter into Long Term Agreements with their

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<sup>1</sup> Woodbridge estimates the lower bound, the upper bound is given as a ball-park figure by a third party.

suppliers which offer long-term relationships, in exchange for year-on-year cost reductions and product improvements. Whilst the value of such buyer power inevitably diminishes in a marketplace where there are a limited number of firms to choose from, as with the seat manufacturer, the OEM can credibly threaten to take away business in other countries if it feels it is not receiving a competitive deal in the UK. Furthermore, this type of supply agreement is accepted custom within the industry, with one third party arguing that if any supplier wished to increase price it would have to justify this: the power is largely in the hands of the OEM.

## **VERTICAL ISSUES**

No vertical issues arise.

## **THIRD PARTY VIEWS**

The OFT contacted various third parties involved in foam manufacture, car seat manufacture and car manufacturers and their views have been taken into account in the above assessment. Customers generally expressed some concern at the loss of a competitor but argued that the impact would be relatively small and the merger was actually only a formalisation of the current situation resulting from the curtailment of production.

## **ASSESSMENT**

The merger will formally reduce the number of UK producers of moulded foam for use in the automotive sector from three to two. However, in reality Fehrer will not be tendering for any more contracts from its UK production facility given its decision not to re-build its UK facility following the fire in July 2002. The merger does not therefore represent a significant change to the situation absent the merger. In addition, the capacity being transferred is specific to the service of one customer contract, again limiting the likely impact of the merger.

Delivered prices of UK foam manufacturers currently tend to be below those of foreign producers due to the relatively high transport costs, but differentials are small and there is already some import, and export, of foam into the UK. Barriers to entry for foreign producers are low and an increase in price by UK producers is likely to bring them into closer competition with foreign rivals.

The ability to raise price is also likely to be limited due to the buyer power of the seat manufacturers and the OEMs, and the knowledge they have of the foam sector overall. Any exploitation of the limited degree of local competition in the UK could lead to retaliation by the seat manufacturers in the much bigger markets elsewhere in the

world. Also, as consolidation continues amongst OEMs, the firms have increasing power to demand year-on-year price reductions.

On balance, it appears that sufficient constraints will remain on the parties post-merger to prevent a substantial lessening of competition in the supply of polyurethane foam for use in car seats in the UK.

The merger does not appear therefore to result in a substantial lessening of competition within a market or markets in the United Kingdom for goods or services.

## **DECISION**

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