

Wienerberger/Baggeridge Brick merger inquiry

Summary of Provisional Findings

1. On 11 December 2006, the Office of Fair Trading (OFT), in exercise of its duty under section 33(1) of the Enterprise Act 2002 (the Act), referred to the Competition Commission (CC) for investigation and report the anticipated acquisition by Wienerberger Finance Service BV (Wienerberger Finance), a wholly-owned subsidiary of Wienerberger AG, of Baggeridge Brick Plc (Baggeridge). We are required to report by 28 May 2007.
2. Wienerberger Ltd (Wienerberger) is the third-largest manufacturer of bricks in Great Britain. It now operates nine plants in separate locations, and in 2006 had a market share of 15 to 20 per cent of non-fletton bricks in Great Britain. In the year ended 31 December 2006, Wienerberger made an operating profit of £11 million on turnover of £87 million. Baggeridge is the fourth-largest brick manufacturer in Great Britain. It operates seven brick plants from five locations, and in 2006 had a market share of 10 to 15 per cent. In the year ended 30 September 2006, Baggeridge made an operating profit of £4 million on turnover of £55 million.
3. In addition to Wienerberger and Baggeridge (the parties), there are two other large manufacturers of clay bricks in Great Britain (collectively, the four firms). Hanson Building Products Ltd (Hanson) operates 20 plants in England and Wales, focused in the South-East, Midlands, North and North-West. In 2006, Hanson had a market share of 20 to 25 per cent. Ibstock Brick Ltd (Ibstock) has 23 plants in Great Britain, and in 2006 had a market share of 30 to 35 per cent.

4. On 17 August 2006, Wienerberger Finance announced that it had agreed to purchase for cash the entire issued and to be issued share capital of Baggeridge through a court sanctioned scheme of arrangement. The proposed acquisition is a relevant merger situation over which we have jurisdiction.
5. Bricks are used primarily as a cladding material for the external faces of buildings. Demand for bricks has been on a declining trend for many years. There has been a steeper decline in the last few years and there is currently a higher than normal level of stocks held by the manufacturers. We were also told that the four firms all had significant excess capacity.
6. We concluded that the relevant product market affected by the merger included all clay facing and engineering bricks. We concluded that the relevant product market does not include (a) fletton bricks; (b) concrete bricks or (c) alternative cladding materials such as timber and render, because we did not consider any of those products to be demand-side or supply-side substitutes for non-fletton clay bricks. We concluded that the relevant geographic market was Great Britain.
7. Bricks are supplied by manufacturers primarily to three categories of customers: larger housing developers, builders' merchants and brick factors. Larger customers in all three categories tend to multi-source bricks, buying from some or all of the four firms in varying proportions during the course of a year.
8. There are a large number of brick products, with a wide range of prices and production costs. Although all of the four firms have, or are in the process of,

introducing published price lists, bricks are rarely sold at listed price but at a price determined by negotiation. The prices paid for bricks vary, depending in particular on the level of discount and rebate that may have been negotiated between supplier and individual customers, and on the delivery distance (bricks are heavy and transport costs are a significant factor).

9. In considering the effects of the merger, we focused first on whether the merger would have any adverse unilateral effects on competition. The evidence suggested that at least Hanson and Ibstock produce and supply bricks which are close substitutes for the vast majority of bricks that would be produced by the merged entity. Customers are already multi-sourcing between the four firms, and face no major switching costs; some customers are sophisticated large-scale buyers while others are in buying groups. Furthermore, Ibstock and Hanson have a wide geographic network and appear able to provide a competitive offer throughout Great Britain. Accordingly, the existence of alternative suppliers with national distribution capabilities, the relative ease with which customers may switch between suppliers, and the existence both of substantial excess stocks and spare capacity make it unlikely that unilateral action by the merged Parties would be profitable. We concluded that we did not expect the merger to give rise to substantial lessening of competition (SLC) through unilateral effects.
10. We then considered whether there would be any coordinated effects arising from the merger. In order to determine this, we looked first at whether coordinated effects existed before the merger and then whether the merger would increase the likelihood of coordinated effects so as to give rise to an SLC.

11. We looked first at whether there was evidence of coordination on prices or capacity over the last five years. We considered evidence relating to prices, costs, market shares, capacity and profits. The evidence indicated that there had not been coordination between the four firms during the last five years.
12. We then looked at whether the merger would increase the likelihood of coordinated effects so as to give rise to an SLC. Our guidelines set out three conditions which are necessary for coordination to occur and be sustainable over time.¹ These are: first, the market must be sufficiently coordinated for firms to be aware of the behaviour of their competitors, and for any significant deviation from the prevailing behaviour by a firm to be observed by other firms in the market; second, it must be clear that it will be costly for firms to deviate from the prevailing behaviour, so costly that it will be in a firm's interests to go along with the prevailing behaviour rather than seek to deviate from it; and third, there must be weak competitive constraints in the market.
13. In considering condition one, we analysed the effect of the merger on three issues. First, whether there would be focal points for price or capacity coordination. Second, whether there would be incentives to coordinate on price or capacity. Third, whether deviation from coordinated behaviour would be detectable.
14. We found that it would not be easy to identify focal points for coordination. The complexity of the mechanisms by which prices are set and sales made militates strongly against the identification of competitors' pricing structures. Changes in capacity, notably incremental changes, are difficult to observe, particularly at the plant level. We also found that there would not be

¹CC2 Merger References: Competition Commission Guidelines, June 2003, paragraphs 3.37 to 3.40.

incentives to coordinate. We based this finding on the absence of sufficient symmetry between the firms in the market after the merger, and in particular the absence of symmetry in operating costs, gross margin percentages, and absolute gross margins. Consequently, we did not think that there would be coordinated behaviour from which firms would then have to try to observe deviation. We could have concluded that condition one was not met either on grounds of lack of ability or lack of incentive. However, we also found that had there been coordinated behaviour the complex price setting mechanisms, and the complex way in which sales are made, together with market instability, would have made deviation difficult to detect. We therefore found that condition one was not met.

15. For completeness, we considered whether conditions two of three might also be met should the merger proceed. We found that condition two would not be met. Given that we could identify no incentive to coordinate, incentives to deviate would likewise be significant. The difficulty of detecting deviation from coordinated behaviour would mean that firms would not know when punishment was required and that the threat of punishment would not act as a deterrent to deviation. In considering condition three, we found that while barriers to entry are high, imports are limited, and there is no significant excess capacity in the hands of smaller producers, we consider that there are strategies that brick purchasers might employ to undermine coordinated behaviour. However, we did not have sufficient evidence to conclude on the likelihood of such strategies proving successful. We therefore did not reach a conclusion on condition three.

16. Our conclusions on the three conditions are reinforced by Wienerberger's strategic plans for the UK. This strategic direction does not lend itself to tacitly coordinated behaviour on either prices or capacity.

17. We therefore provisionally concluded that we did not expect the merger to give rise to an SLC.