

Barriers to entry and expansion

Barriers to entry by British producers

1. At the domestic production level, there are absolute regulatory barriers to entry that prevent new producers from setting up in Britain. British Sugar is the sole holder of the UK quota for the production of sugar from beet, whilst Tate & Lyle benefits from the ACP Protocol, which allows the company the sole right to import sugar cane from ACP countries in order to produce sugar in the UK. Under the sugar regime, new entrants cannot be awarded any part of the UK's quota for sugar production, and therefore it is not economically viable for a new producer to be established in the UK.

Barriers to entry and expansion by British resellers

2. In contrast, at the resale level of the market (ie covering the activities undertaken by merchants, wholesalers and small resellers), the barriers to entry would appear to be somewhat lower.¹
 - (a) There are no legal or regulatory barriers preventing new domestic resellers from entering the market. Neither are there any patents or other intellectual property rights relating to the sale or movement of sugar that would prevent market entry at this level.
 - (b) Resellers in the sugar market are essentially traders and logistics operators. NBF claims that, provided that a company can ensure the delivery of a product efficiently and on time, there is no reason why a company could not enter on a small scale. All that NBF believes would be needed to get started would be a phone, a desk, some knowledge of the customer base and access to sugar.

¹It is worth noting that resellers tend to be far smaller companies than sugar producers, and hence the lower barriers to entry in the reseller sector apply predominantly to small potential entrants rather than potential entrants looking to commence trading on a large scale.

Henley Bridge Ingredients Ltd is one example of market entry on a small scale in this way.

- (c) In particular, general wholesalers of other food and ingredients products would be expected to encounter low barriers to extending their operations to include the resale of sugar products. Examples of companies that have pursued such a strategy include BAKO and BFP Wholesale.
 - (d) Given the low set-up costs involved, it does not appear that there is a minimum efficient scale that is necessary in order to enter the market profitably.
3. Despite the factors raised above, however, there are a number of barriers to entry that may deter new resellers from entering the British sugar market.
 4. **Presence of incumbent operators:** The presence, size and protected position of British Sugar and Tate & Lyle in the market may deter entry from operators who fear that they would be unable to compete with these large incumbents. Similarly, the presence and relative size of NBF and JBS in the market may deter entry from new resellers. NBF and JBS told the CC that they believe that, to the extent that British Sugar and Tate & Lyle were to increase supplies to other resellers, the increased volumes would be likely to come from NBF and JBS volumes rather than the refiners' own volumes. As such, it appears reasonable for any potential entrant to believe that NBF and JBS (as well as British Sugar and Tate & Lyle) would vigorously defend their market position in the face of new competitors.
 5. **Negotiating with British Sugar and/or Tate & Lyle:** An important avenue for entry and expansion is to negotiate supply contracts with British Sugar and/or Tate & Lyle. As an alternative, supplies could be purchased from larger resellers such as NBF and JBS (or from overseas sources) but if a new entrant was to grow to any significant size, direct supplies from the producers would be important. This need to

secure sugar supplies could deter entry and limit expansion by new resellers whose relative negotiating power would be minimal when compared with the producers.

6. **Need for reputation with industrial customers:** In order to attract customers, it is necessary to build up a reputation as a capable and trustworthy supplier. This is particularly important in the industrial sugar market, where timely deliveries of sugar supplies are vital to production processes, and the ability of companies to guarantee supplies to their customers is of paramount importance.
7. **Need for financial support:** In order to obtain supplies of sugar, it is necessary to avoid being seen as a credit risk. In addition, in order to sell sugar to industrial users, it is important to be able to provide a credit facility. Therefore, appropriate financial backing is required, and the need to obtain such backing could act as a barrier to entry and expansion in the market (as indeed it would in other markets).
8. **Existence of annual supply contracts:** The fact that the majority of industrial customers enter into annual supply contracts with one or more sugar suppliers may limit the ability of new entrants to attract new customers away from the incumbents. Since most contracts appear to be negotiated in November/December each year, it is predominantly during this period when entry is realistically viable.
9. **Customer Inertia:** The industrial sugar market appears to be characterized by a significant degree of inertia, with suppliers predominantly supplying a given customer base and only adding or losing a very small number of customers in any given year. This impression is reinforced by NBF's assertion that its strategy approaching each annual contract season is:

[X]²

It is also consistent with the results of the customer survey conducted on behalf of the CC by NOP, as well as [X] assertion that customers are reluctant to switch suppliers because sugar is a fundamental ingredient. This aspect of customer behaviour could act as a significant barrier to entry and expansion in the industrial sugar market.

10. **Volumes demanded:** For large customers, the volume of sugar demanded may be in excess of the volume of sugar that small resellers are able to source, either from domestic sugar producers, other resellers, or foreign sugar suppliers. The size of individual contracts may therefore act as a barrier to entry, since small new entrants will not be able to bid for contracts with the largest customers, due to an inability to acquire the volume of sugar required to supply such contracts.
11. **Bundling of transport:** Some customers have suggested to the CC that they are unable to obtain an ex-works price from British Sugar and Tate & Lyle for the supply of sugar. If this is the case, the bundling of transport services with sugar supplies could act as a barrier to entry preventing resellers from entering the market and conducting their own sugar transportation. However, British Sugar stated that it is happy to provide an ex-works price to any customer who requests it (although it advised the CC that only NBF, JBS and Britannia Superfine are currently supplied on an ex-works basis).
12. These factors may have contributed to the fact that entry at the level of reseller has been fairly limited in recent years, despite the lack of legal or regulatory barriers or significant set-up costs. Whilst some entry has been observed, it has tended to be on a fairly limited scale, with no new entrant of the past 20 years coming close to

²Source: NBF.

rivalling NBF or JBS in terms of market share. Many of these entry barriers may also act as barriers constraining the ability of sugar resellers to expand within the market, even if they are successful at entering the market on a small scale.

Barriers to entry and expansion by European producers

13. NBF believes that 'the most likely candidates for entry at a larger scale are existing EU refiners'.³ They believe that the European producers would be able to enter the market very easily, since (a) there are no technical barriers preventing market entry, and (b) the cost of transport would not be prohibitive to most British locations, as 'transport costs are generally lower for suppliers based on the continent'.⁴

14. **British Sugar's pricing strategy:** In setting its prices, British Sugar's main objective is to sell its entire quota of sugar into the UK market. It achieves this by pricing in such a way as to leave no sustainable financial incentive for EU sugar producers to import material volumes of sugar into the UK. This strategy acts as a barrier to entry for European sugar producers.⁵

15. **Transport costs:** There are costs associated with transporting sugar to the UK from the Continent that may act as a barrier to entry and expansion for EU sugar producers (to the extent that they are greater than the transport costs associated with transporting sugar from British Sugar and Tate & Lyle's factories to customers in the UK). British Sugar estimates that transport costs per tonne for imported sugar are as follows:

³Source: NBF.

⁴Source: NBF.

⁵It should be noted that any pricing strategy pursued by British Sugar must comply with the undertakings given by the company to the European Commission in 1986.

We would estimate that the cost of transporting sugar from the Continent to Britain is approximately €38 to €65 made up of the following elements:

- (a) Approximately €7 to €20 for haulage from the Continental factory to the Continental port;
- (b) Approximately €20 for channel crossing via the tunnel or shipping; and
- (c) Approximately €11 to €25 for haulage from the British port to the customer.

These elements will vary depending on the volumes and location of factories relative to ports.

Converting these figures using the prevailing exchange rate at the time the statement was made, we obtain the following:

TABLE 6 **British Sugar estimates of transport costs from the continent converted into £-equivalent**

<i>Transport segment</i>	<i>Cost (£)</i>
Continental factory to port	£5 to £14
Channel crossing	£14
British port to customer	£8 to £17
Total	£26 to £45

Source: British Sugar.

Evidence on transport costs was also provided by Kent Foods, both in their hearing with the CC and through the provision of shipping invoices for sugar imported from Belgium. This evidence suggested that the cost of shipping white granulated sugar from the continental sugar factory to the customer's warehouse was between £[~~] and £[~~] per tonne.⁶~~~~

⁶Some figures for transport costs have been excised from the paper, due to issues of confidentiality. However, as a guideline, the overall average of the various estimates of transport costs for shipping white granulated sugar from a continental sugar factory to the customer's location in Britain is estimated at £34 per tonne.

16. **Existence of annual supply contracts and timing of negotiation rounds:** The fact that the majority of industrial customers enter into annual supply contracts with one or more sugar suppliers may limit the ability of European importers to attract customers away from the incumbents. This problem is exacerbated by the fact that most British sugar contracts are negotiated in November/December each year, which is somewhat later than the annual negotiation rounds on the continent. The discrepancy in timing between the annual agreement rounds in Britain and the rest of the EU may result in any potential European importers being unwilling to keep some of their production capacity uncommitted until the time of the British negotiation rounds. This problem was raised by Nestlé UK Ltd (Nestlé) in their hearing with the CC, when they stated:

It had proven in the past difficult to source considerable volumes of continental sugar into the UK due to the way the markets worked. It was the accepted practice that the Continental refiners would conclude their negotiations in September to November whereas the UK refiners would issue their price rise letters in late November/December after the Continentals had allocated all their volumes and therefore Sugar from the Continent was not, when requested, available during their normal round of sugar negotiations.⁷

Nevertheless, the impact of this timing differential might be more limited in those EU member states (such as France) that have production quotas far in excess of domestic demand, and which are therefore likely to have a surplus of sugar available that could potentially be sold into the UK, even after domestic agreements have been reached.⁸

⁷Source: Hearing with Nestlé.

⁸This source of surplus sugar may become freer still as the pressures on the European restitution system increase. The accession of new Member States to the EU increases the volume of sugar competing for a set amount of export rebates, potentially increasing the volume of A and B quota sugar being sold within the EU, and hence available to be sold to industrial customers in the UK.

17. **Ability to guarantee a constant timely supply:** As discussed above, customers may be unwilling to rely on suppliers when they have no guarantee as to their ability to ensure regular and adequate supplies. Whilst the problem for new entrant resellers may be one of reputation, this is likely to be less of a problem for well-established European sugar producers. However, importers potentially face greater difficulties in ensuring constant timely supply, given that they will have to transport their products (a) over longer distances and (b) across the natural barrier of the Channel. Whilst there is no evidence to suggest that these barriers are sufficient to prevent an effective distribution system from being established, they may make British industrial customers reluctant to rely on European imports as their main source of sugar. The problem is less one of actual logistic difficulties, and rather one of gaining the confidence of customers in imported sugar as a reliable source of supply. As evidence of this reluctance, consider the following statement made by [REDACTED] in their hearing with the CC:

There just has to be a physical limit on the amount of sugar that, as a company, we can risk being on the other side of a piece of water. [REDACTED] tonnes of sugar, divide that by 25, it is a phenomenal number of movements that you need. To think of all those movements having to come from mainland Europe and crossing the channel in some way, I think, logistically, just gives us some difficulties... We probably want to dual source a factory with a continental and a UK base so that we could at least get some continuity. I must say we have not had any difficulties with a continental one so far, but it is a fear and it is a particular fear for factory managers.⁹

One way for importers to overcome customers' reluctance to rely on EU imports, and to be able to guarantee industrial customers a large, frequent and timely supply of

⁹Source: Hearing with [REDACTED].

sugar may be for importers to build up stocks of imported sugar in Great Britain. There would be an additional cost generated by this requirement that could act as a barrier to entry by European sugar producers.¹⁰

18. **EU quota system:** In practice, the EU Sugar Regime quota system tends to have the effect of sustaining separate self-sufficient domestic markets. This conclusion has been recognized by the European Court of Justice, which has referred to the sugar regime as a system that is 'designed to consolidate a partitioning of national markets by means of national quotas'¹¹ The ECJ also states:

It is beyond doubt that, as the aforementioned system of national quotas stopped production moving gradually to areas particularly suitable for the cultivation of sugar beet and, in addition prevented any large increase in production, it cut down the quantities which producers can sell in the common market.¹²

This restriction together with the relatively high transport costs, is likely to have a not inconsiderable effect on one of the essential elements in competition, namely the supply, and consequently on the volume and pattern of trade between Member States.¹³

Hence, the quota system itself acts as a barrier to entry for European sugar producers who wish to import sugar to the British market.

19. **Retaliation by British producers:** The British market situation is such that domestic production of sugar under the UK sugar quota (discussed above) and the ACP Protocol is roughly equivalent to domestic demand for sugar. In addition, both domestic supply and domestic demand are relatively fixed within this market. Hence,

¹⁰This barrier was discussed by the European Commission in Decision 1999/210/EC, para 63.

¹¹Judgment of 16 December 1975 in Joined Cases 40 to 48, 50, 54 to 56, 111, 113 and 114/73, *Suiker Unie and others v. Commission*, [1975] ECR 1663, 1914, paragraph 24.

¹²*Suiker Unie* judgement, para 16.

¹³*Suiker Unie* judgement, para 17.

any sugar imports brought into the country would have the effect of 'squeezing out' some domestically-produced sugar, thereby reducing the British producers' profits. Hence, it is reasonable for potential importers to expect the incumbent British producers to vigorously defend the domestic market from entry by European importers. (It is also interesting to note that the very act of importing sugar to Britain would free up domestic sugar, produced by British Sugar and Tate & Lyle, for use as a retaliatory tool as a low-price export to the importer's own domestic market.)

20. **History of British sugar companies with respect to competition law:** The threat of retaliation discussed above may be reinforced by the fact that British Sugar, Tate & Lyle, NBF and JBS have in the past been fined by the European Commission for breaching European competition law. This may deter potential European competitors from attempting to enter the British sugar market. Past findings that the four companies coordinated their behaviour in order to restrict competition could have generated a reputation that may deter European companies from taking them on by importing into the British market.

21. **Differences between sugar from different countries:** Differences in sugar characteristics can have a significant impact on the quality of products manufactured by industrial users of sugar. Hence, if sugar from different sources exhibits slightly different properties, imported sugar may be considered unsuitable as a substitute for domestically-produced sugar. Real or perceived differences in the characteristics of sugar from different sources may make industrial customers reluctant to switch to a new supplier, particularly if they have a current domestic supplier to whose sugar their production processes have been aligned. Having said this, the potential for significant differences in product characteristics to arise in practice is limited by the operation of standard product specification/quality tests in Europe.

22. The entry barriers discussed above may have helped to constrain the number of European sugar producers who have attempted to enter the British market. Whilst some producers have begun to import sugar to Britain, entry has tended to be relatively limited. This could be partly due to the fact that many of these barriers have the potential to constrain the large-scale expansion of imports into the British market, even if European suppliers have been successful in importing sugar in relatively limited quantities.