

## CHAPTER 9

### Conclusions

#### The conditions

457. The reference was made to us under the Monopolies and Restrictive Practices (Inquiry and Control) Act 1948. Conditions to which the Act applies would prevail as respects flour, or bread, if, under section 3(1) of the Act, at least one-third of all the flour, or bread, which is supplied in the United Kingdom were supplied by or to any one person, or, under section 3(2), at least one-third were supplied by or to two or more persons, who, whether voluntarily or not and whether by agreement or arrangement or not, so conduct their respective affairs as to prevent or restrict competition in connection with the production or supply of flour, or bread (whether or not they themselves are affected by the competition and whether the competition is between persons interested as suppliers or producers or between persons interested as customers of suppliers or producers).

458. The largest suppliers of both flour and bread in the United Kingdom are Associated British Foods Limited, Ranks Hovis McDougall Limited and Spillers Limited; but none of these accounts for as much as one-third of the United Kingdom supply either of flour or of bread. Conditions to which the Act applies do not therefore prevail under section 3(1) as respects either flour or bread.

459. We considered whether any suppliers of flour or bread, and particularly the Big Three groups, which together account for about 80 per cent of the supply of flour and about 60 per cent of the supply of bread, were so conducting their respective affairs as to prevent or restrict competition, and therefore whether the conditions might prevail under section 3(2).

460. Before discussing this point we draw attention to the fact that during the whole period of our investigation, and indeed before that, the flour industry and, even more so, the bread industry have been subject to a substantial degree of statutory control and official pressure. We have given some account of this in Chapter 4 and we have mentioned some of its effects in other chapters. Any consideration of competitive conditions, as well as the existence and effect on the public interest of possibly anti-competitive conduct, must take account of these circumstances.

#### Flour

461. Each of the three major groups is a vertically integrated organisation whose activities include both milling and baking. Although relatively small quantities of speciality flour are obtained from other millers and none of the groups would necessarily in all circumstances exclude the possibility of buying other flour from other millers, nevertheless it is the practice of each of the major groups to require its flour-using subsidiaries to buy their requirements of flour from its own mills in so far as it is possible to do so.

462. The groups argued that vertical integration of milling and baking did not necessarily imply any restriction of competition in the supply of flour. We accept that the mere fact that the activities of the groups include both milling and baking does not necessarily imply restriction, but a consequence of the practice of the groups, as we have just described it in paragraph 461, is that a proportion of the market for flour, which is significant in respect of each of the three major groups individually and which in total amounts to about 51 per cent of the whole market, is closed to competition from other millers.

463. We conclude, therefore, that ABF, RHM and Spillers, by each requiring its flour-using subsidiaries to buy their requirements of flour from the group's own mills as far as it is possible to do so, are so conducting their respective affairs as to prevent or restrict competition and that conditions to which the Act applies prevail under section 3(2) as regards these three groups in the supply of flour.

464. As far as customers outside the groups are concerned, each of the groups has agreements with a number of independent bakers to whom they have made loans under which those bakers buy their requirements of flour from the group in question as long as the loans remain outstanding (see paragraph 420). The groups argued that these agreements did not involve any restriction of competition in the supply of flour, or that any such restriction was negligible and should not be taken into account for the purposes of section 3(2) of the 1948 Act (see paragraphs 421 and 422). In addition RHM and Spillers have agreements to supply all or part of the flour requirements of a number of bakery companies with which they are financially associated (see paragraphs 423 and 424), but the quantities of flour involved are not large. All these agreements involve restriction of competition since they prevent other millers from competing in the supply of flour to the bakeries concerned, but we consider that the extent of the restriction is negligible.

465. We also considered whether suppliers of flour so conducted their affairs as to prevent or restrict competition in other ways. In particular we considered the implications of the uniformity of list prices for flour (see paragraphs 469 to 476) and the possible effects of the operations of the MMA and the NABIM (see paragraphs 477 to 482).

466. We examine these matters in relation to the supply of bakers' flour, the largest of the three broad categories of flour which we have distinguished in paragraph 35, since (as we explain below) we are satisfied that competitive conditions exist in the supply of the other categories of flour.

467. Household flour is supplied almost entirely to the grocery trade, which is dominated by large buyers such as supermarket chains and buying groups who are able to exert considerable pressure on prices. The groups' branded household flours are sold alongside retailers' own brand household flours produced by millers who are not subject to the same costs as those incurred by millers marketing, selling and distributing branded flours. Own brand household flour is increasing its share of the market. In our view there is no lack of price competition in the supply of household flour.

468. 'Other flour' is mainly soft flour, for example biscuit flour and cake flour. For many types the groups do not publish list prices. The competition from independent millers in this sector of the free market is relatively strong,

and the price of biscuit flour in particular, which represents a substantial proportion of 'other flour', is subject to pressure from large buyers and we were told that its profitability was low. We think therefore that there is effective competition in the supply of 'other flour'.

469. For bakers' flour there has been a substantial degree of uniformity of list prices (albeit less so since 1973) but the list prices themselves are not published by the three major groups and are used by them merely as a starting point for determining actual prices to individual outside customers. It was argued by the groups that, since the actual prices charged are determined by negotiation with individual customers in the light of competitive circumstances, and in view of the function of list prices in this particular industry, the fact that list prices were uniform did not imply any prevention or restriction of competition.

470. However, disregarding allowances for quantity and bulk delivery and discounts for settlements, which are almost uniform between the three groups (see paragraph 265), the negotiated prices actually paid in no case appear to be much below list prices in percentage terms. Moreover, the number of customers who at any particular time are paying negotiated prices below list prices is relatively small, though since they are the larger customers the amount of flour being bought at such prices is proportionately higher. The major groups are undoubtedly supplying bakers' flour in competition with independent millers, and many customers obtain flour from both group and independent millers concurrently. However, the competition of independent millers tends to be somewhat local in its effect and this no doubt contributes to the facts that the majority of customers in the free market are not able to negotiate prices from the major groups below list prices and that for those who can do so the scope is limited.

471. As far as bakers' flour is concerned we do not accept that in considering uniform prices we should regard list prices as irrelevant and look only at the prices actually paid. In the majority of cases list prices (less the standard allowances and discounts mentioned above) are the prices actually paid and their uniformity is relevant to the question whether there is a restriction of competition.

472. The groups argued that in any case uniformity of prices did not amount to a restriction of competition. There were reasons, they said, why flour prices were bound to be uniform or nearly so, and in so far as they were uniform this was the result of competition and was not evidence of any restriction of competition (see paragraphs 404 to 408).

473. It was also argued that, although there have been discussions between RHM and Spillers concerning the amount and timing of flour price changes, these discussions have had no material effect on flour prices (see paragraph 409). We accept that this is so. In any case these discussions have taken place mainly under official sponsorship in the context of the statutory control and official pressure to which we have referred in paragraph 460.

474. In assessing whether the substantial degree of uniformity which exists in the flour prices of the three major suppliers implies a restriction of competition, it is relevant to have regard to the level of those prices as well as

to their uniformity. In this connection we examine whether the level of prices is such as to yield excessive profits.

475. The groups' profit on milling are set out in table 7.5. It is clear from table 7.9 that, particularly in recent years, there has been a marked disparity between the profitability of their milling and that of their reference bread baking, whilst a similar disparity between their milling and their baking activities generally is evident from table 7.11.

476. The relatively high rates of return on a historic cost basis on capital employed in milling suggest, and are consistent with, absence of price competition, or at any rate muted price competition, in the supply of flour. However, as we explain below, in paragraph 496, we do not think that the level of milling profits can reasonably be considered in isolation because these profits, and the flour prices which they reflect, are to a considerable extent the result of the distorting effects of statutory controls. We consider therefore that, while a high level of prices (as reflected in high profits) might generally indicate that uniform prices imply a restriction of competition, in this case the level of prices and profits is attributable to other factors and we do not think that the substantial uniformity of their prices for bakers' flour implies that the groups are so conducting their affairs as to restrict competition in the supply of flour.

477. RHM and Spillers are members of the Millers' Mutual Association and although ABF itself is not a member it has allowed its wholly-owned subsidiary, Cranfield Brothers Limited, to remain in membership since its acquisition by the group in 1972. Any restriction of competition involved in membership of the Millers' Mutual Association would, of course, be a matter concerning all the milling companies in membership and not merely the three major groups.

478. One of the principal objectives of the Millers' Mutual Association has been the rationalisation of the milling industry by means of levies on members for the purpose of purchasing from millers wishing to leave the industry the goodwill, plant and machinery of their milling businesses so that the mills may be closed and their plant and machinery broken up (see paragraphs 71 and 313). It appeared that the members of the Association, in acting collectively to remove milling businesses from the industry, might be so conducting their affairs as to restrict competition.

479. The Association played a significant part in the process of concentration and rationalisation of the milling capacity between the wars and in the early years after the second world war. More recently, with the substantial fall in the number of independent millers, the scale of the Association's activities has been much reduced (see Appendix 2), and the levies, the last of which was made in 1973, have been used to make payments only to milling concerns which would in any case have gone out of business. The Association does not approach any miller with the suggestion that he should dispose of his assets to the MMA. In view of the very small share of the market supplied by those independent millers who have been bought out by the MMA in recent years, we consider that the activities of the MMA do not today involve any significant restriction of competition and do not to any significant extent have the effect of holding up flour prices.

480. The Association circulates to its members detailed information on flour deliveries and mill running hours (see paragraph 314 and Appendix 3), but we are satisfied that this does not have any restrictive effect on competition in the supply of flour.

481. Certain Rules of the Millers' Mutual Association's constitution appeared to us to be possibly restrictive of competition in that they apparently involved some discrimination against millers who are not members (see Appendix 4 and paragraph 315). However, we accept that the Rules in question are not in practice implemented and have not been implemented for some years.

482. We also noted that certain information on milling costs is circulated by NABIM (see paragraph 318 and Appendices 7 and 8), but we do not think that this is likely to have any restrictive effect on competition.

### **Bread**

483. As with flour, we considered whether the uniformity or near uniformity of list prices for bread amounted to, or was evidence of, a restriction of price competition. Retail list prices for bread are published by each of the three major groups. These prices have been uniform or practically uniform for many years (see paragraph 308), but there has also been keen competition in discounts. These discounts have not been in accordance with any fixed scales based on the value or volume of business: they have been determined individually by the competitive situation and the bargaining strength of the customer concerned. For a decade before January 1975 discounts had been rising. During this period a number of agreements were made by the three major groups or their subsidiaries for the purpose of limiting discounts and other incentives. The dates of the majority of these agreements are said to be uncertain, but most of the remainder came into existence between 1970 and 1974; some were earlier, exceptionally as early as 'about 1961'. We regret to find that particulars of these agreements had not been furnished to the Director General of Fair Trading (formerly to the Registrar of Restrictive Trading Agreements). Particulars of them were ultimately furnished in July 1975 and the agreements, which had by then been abandoned, were subsequently registered. We are prevented by section 29(1) of the Restrictive Trade Practices Act 1956 and paragraph 7 of Schedule 11 to the Fair Trading Act 1973 from finding that conditions to which the 1948 Act applies prevail by reason of these agreements.

484. In spite of the agreements referred to above discounts escalated particularly in the latter half of 1974, and by the end of 1974 discounts of up to 35 per cent off retail list price were being given to some customers (see paragraphs 299 to 303). In January 1975 the extent of competition in discounts was substantially reduced by a provision of the Bread Subsidy Scheme 1975 (made under the Prices Act 1974) which generally limited discounts to retailers to not more than  $22\frac{1}{2}$  per cent (see paragraph 298). Notwithstanding the registered agreements (which we are unable to consider), there has been keen competition in discounts and other inducements, and thus in the net prices charged, when and to the extent that statutory provisions have not prevented this. Because of this we do not consider that the uniformity of the three major groups' list prices for bread is evidence of, or amounts to, their so conducting their affairs as to prevent or restrict competition.

485. We have not overlooked the fact that the Federation of Bakers, of which all the three major groups are members, suggested to its members in mid-1975 that they should not seek to match the lower prices of one particular baker who was not a member of the Federation. The circumstances in which this happened are described in paragraph 330, and we are satisfied these were abnormal circumstances created by the fact that for special reasons the baker concerned had been permitted by the DPCP to reduce his price for standard bread loaves to less than that which other suppliers could charge. We are satisfied also that the Federation of Bakers does not normally concern itself with its members' trading practices or seek to influence their pricing behaviour.

486. As with flour we considered whether the existence of certain agreements under which each of the three major groups has tied outlets for bread involved any material restriction of competition. The extent of these agreements and the groups' arguments concerning them are set out in paragraphs 436 to 442. We accept that no significant restriction of competition is involved.

### **Conclusion on the 'conditions'**

487. Our conclusions concerning the conditions under the Act are:

- (a) conditions to which the Act applies prevail under section 3(2) in respect of flour because Associated British Foods Limited, Ranks Hovis McDougall Limited and Spillers Limited so conduct their affairs as to restrict competition in the way described in paragraph 463;
- (b) conditions to which the Act applies do not prevail in respect of bread.

### **The public interest**

488. In Chapter 2 we have described the way in which the flour and bread industries in the United Kingdom came to be dominated by the three major vertically integrated milling and baking groups—ABF, RHM and Spillers. Briefly, the acquisition of bakeries by Allied Bakeries Limited (which subsequently became ABF), together with the decontrol of the flour industry in the mid-1950s and the possibility of once again importing Canadian flour as Allied Bakeries had done before the war, led RHM and Spillers, then the two largest milling concerns, to take steps to protect their flour businesses. Accordingly, they began about this time to acquire bakery businesses on a large scale in order to ensure that they had outlets for their flour.

489. In 1961 ABF, being unwilling to risk having to rely on its principal competitors in baking (RHM and Spillers) for supplies of flour in the event that Canadian flours were no longer economical to import, itself decided to enter the milling industry. We have briefly described in paragraphs 123 to 125 the programme of acquisitions, modernisation, rationalisation and building of new mills on which the group then embarked.

490. Whereas RHM and Spillers integrated forward from milling into baking in order to ensure outlets for their flour, ABF integrated backward into milling in order to ensure supplies of flour as advantageously as possible for its flour-using subsidiaries. An indication of the ways in which productivity has been

increased and economies have been achieved by ABF as a result of modernisation and rationalisation of its milling capacity is given in paragraphs 131 and 132. Indications of similar achievements in productivity by RHM and Spillers are given in paragraphs 163 and 189 respectively.

491. As we have noted in paragraph 419 all three groups emphasised that the benefits of integration of milling and baking lie not only in economies of scale, which enable flour production to be concentrated in large modern mills, but also in the scope for specialisation, liaison between mills and bakeries in production, planning and technical matters and in the facilitation of research leading to increased extraction rates and the use of cheaper grists.

492. We accept that significant cost savings arise from the integration of large-scale milling and baking organisations, and that the achievement of these savings depends on the baking side obtaining all, or virtually all, of its flour from the mills owned by the group<sup>1</sup>. However, the fact that the groups are integrated and have large market shares in both milling and baking could enable them to choose whether or not they pass on the cost savings. It could also enable them to discriminate in price between their own baking subsidiaries and external customers; and it could make possible cross-subsidisation between their milling and baking activities, which could damage either independent millers or independent bakers. Since these are matters which could affect the public interest we think it is relevant to consider the profits being made on flour, the relationship between transfer and external prices, and the possible effects of cross-subsidisation between milling and baking. In considering these points we are concerned particularly with bakers' flour since, as we have explained in paragraphs 467 and 468, we believe that there is adequate competition in the supply of household flour and 'other flour'.

### Profits

493. The groups' returns on capital employed in flour milling on an historic cost basis, as set out in table 7.5, show a clear pattern in the last few years of substantial and mainly increasing profits. Particularly high rates of return are shown for ABF in the two latest years for which we have figures (53 per cent in 1974 and 56 per cent in 1975), but it needs to be borne in mind that, as we have explained in paragraph 388, ABF's figures of return on capital employed are in one respect not comparable with those of the other two groups in that part of its stocks of wheat are bought and held by its subsidiary Mardorf, Peach to whom it pays commission on purchases. It is not possible to obtain a consolidated result for ABF's milling activity as a whole including Mardorf, Peach's wheat procurement activities. When adjustment is made for the effects of inflation ABF's return in the two latest years is reduced from 53 per cent to 23 per cent and from 56 per cent to 19 per cent respectively; and the effect of adjusting for Mardorf, Peach's activities would probably be to reduce these inflation-adjusted returns.

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<sup>1</sup> In the case of ABF this applies also to the Chancelot mill, which is part-owned by the Scottish Co-operative Wholesale Society (see paragraph 124). This mill supplies flour for use by ABF and the Society, both of which have agreed to maximise their offtake from the mill.

494. We have referred already to the wide apparent disparity between the profitability of milling and that of bread baking. We recognise that because of the problem of apportionment of costs between bread baking and other bakery activities, to which we have referred in paragraphs 383 and 384, the figures of return on capital employed for bread given in table 7.7 must be treated with caution. Nevertheless we think it is clear that for the period for which we have figures returns on bread baking on an historic cost basis have been largely inadequate and, more recently they have been negative. The returns on baking operations as a whole on an historic cost basis have also been generally low since 1974 (see table 7.11).

495. The disparity between milling and baking profits, which goes back for some years, is to some extent due to the power of the Big Three groups and to the fact that, as regards bakers' flour, milling is a less competitive industry than baking. On its present scale the disparity is to a considerable extent the result of distorting effects of statutory controls. These controls appear to have depressed bread prices much more severely than flour prices, and the groups have had to accept very low profits, or losses, on their baking operations in recent years. In their view they have been justified in compensating themselves by making what profits they could on milling. Moreover, as has been noted in paragraph 260, since under the Price Code increases in flour prices have been allowable cost increases for bakers, it has been in the interests of the integrated milling and baking groups to keep the price of bakers' flour as high as possible by taking full advantage of every allowable increase. If they had not done so, not only would there have been less compensation for the low profitability of baking, but the profitability of baking would itself have been still further depressed. Independent bakers would have been adversely affected in the same way.

496. In our view the fact that the three groups are operated as integrated milling and baking organisations, combined with the fact that the disparity of profitability is largely due to the factors we have just mentioned, justifies the claim put forward by the groups that any consideration of whether profits are excessive must have regard to the combined profits of the milling and baking activities of the integrated groups and not to the profits of their milling in isolation.

497. The groups' returns on capital employed on an historic cost basis for flour milling and reference bread baking together in the five years to 1975 have been as follows:

*Return on capital employed (historic cost basis)—  
Flour milling and reference bread baking (combined)*

	<i>ABF</i>	<i>RHM</i>	<i>per cent Spillers</i>
1971	19.5	16.7	N/A
1972	17.6	15.5	4.0
1973	5.9	15.8	0.9
1974	11.2	11.5	6.4
1975	19.9	17.2	18.2

As we have said in paragraph 494, the difficulty in apportioning costs between reference bread baking and other bakery activities makes it necessary to treat

figures of return on capital employed for bread baking alone with caution. It follows that the above figures in respect of milling and bread baking combined must also be treated with caution. As we have explained in paragraph 400, we obtained the rates of return on capital employed in the whole milling division and the whole baking division, both separately and combined, for each of the groups. The combined rates on an historic cost basis (as set out in table 7.11) are as follows:

*Return on capital employed (historic cost basis)—  
Total milling division and total baking division (combined)*

	<i>ABF</i>	<i>RHM</i>	<i>per cent Spillers</i>
1971	23.3	17.7	N/A
1972	24.8	18.3	5.4
1973	14.8	19.8	1.8
1974	14.8	12.8	3.1
1975	23.2	16.4	14.4

These figures are in most cases slightly higher than those for milling and bread baking, but in our view none of the rates of return in either of the two tables can be regarded as excessive.

498. In any case, given the rate of inflation in recent years, we do not think that profits can satisfactorily be considered solely on an historic cost basis. On an inflation-adjusted basis, the returns on capital employed are substantially reduced. For the two years for which we have information the returns are as follows:

*Return on capital employed (inflation-adjusted basis)—  
Flour milling and reference bread baking (combined)*

	<i>ABF</i>	<i>RHM</i>	<i>per cent Spillers</i>
1974	loss	loss	loss
1975	1.6	7.7	6.8
<i>Total milling division and total baking division (combined)</i>			
1974	1.6	loss	loss
1975	3.0	6.4	4.1

499. The rates of return on an historic basis have not, as we have said, been excessive; and it is evident that, taking account of inflation, they have been low or even negative.

500. The modest level of profitability, whether of flour milling together with bread baking or of the total milling divisions together with the total bakery divisions, is not surprising since the price of bread is severely limited by statutory controls, and even in the absence of such controls the net price would be effectively restrained by the substantial degree of competition which prevails in the supply of bread and by the existence of large and powerful buyers. The power of large buyers is not confined to supermarkets and large chains of retailers but is also increasingly exercised by small retailers through buying groups. All of these buyers are normally in a position to exert pressure for discounts on the bakers and therefore to retail competitively to the public. The retail price of standard bread also influences the price of non-standard bread; master bakers who bake and retail their own bread are able to charge

higher prices for non-standard bread, but only to the extent that the public is willing to pay the differential. In our view therefore, although apparently high profits have been made on milling, the public is not in general being exploited by high prices for bakers' flour.

### **Transfer prices**

501. The groups claimed that internal transfer prices for flour were on an arm's length basis and therefore comparable to those charged to external customers. Precise comparisons between transfer prices and external prices are difficult to make but such evidence as was available indicates that there is no significant difference (see paragraphs 259 and 390) and we are satisfied that there is no question of independent bakers being put at a competitive disadvantage by the groups discriminating in price in favour of their own baking subsidiaries and against independent bakers.

### **Cross-subsidisation**

502. Although for the reasons we have explained we do not think that the level of milling profits can be considered in isolation and we do not therefore find them to be excessive, we need to consider the effects of the wide disparity in profitability between the milling and baking activities of the three major groups on independent bakers.

503. It has been suggested that it is the policy of the groups to accept low profits on bread so as to make it difficult for independent bakers to compete. It is clear that limited competition in the supply of flour and the dominant position of the three major integrated groups may enable them to compensate themselves for the low profitability of bread by relatively high profits on flour. We are satisfied, however, that the groups are not deliberately depressing the profitability of baking and manipulating the price of flour. They do not willingly accept the low profitability of baking and would indeed prefer to see the disparity reduced and their baking activities making profits which they would regard as adequate.

504. For some years the total number of independent bakers has been declining, as some go out of business and others are taken over; and this has no doubt been due in part to the relative unprofitability of the baking industry. It is difficult to generalise about the profitability of independent bakers because of the wide variety in the types of business. Such evidence as we have suggests that neither plant bakers nor master bakers are on the whole making large profits but that it has been possible, particularly for those master bakers who have a good business in flour confectionery or in special types of bread (for which there is a limited demand but which are not subject to price control), to make satisfactory profits. However, in so far as the bread baking industry is unprofitable this is not attributable to anything done by the three major groups as a result of 'conditions' which we have found to prevail in respect of flour (see paragraph 463). The unprofitability is due largely to the effects of statutory price control and other forms of official intervention. If modification of these

controls leads to the Big Three groups making better profits on baking, but the profitability of their milling activities remains at a high level, the situation may need to be re-examined.

#### Conclusion

505. We conclude that neither the conditions which we have found to prevail as respect the supply of flour as described in paragraph 463 nor any things done as a result of, or for the purpose of preserving, the conditions operates or may be expected to operate against the public interest.

J G LE QUESNE (*Chairman*)

G F ASHFORD

T BARNA

R G OPIE

J S SADLER

Y LOVAT WILLIAMS (*Secretary*)

1 April 1977