

## CHAPTER 7

### Conclusions

#### I The monopoly situation

209. The terms of the reference require us to report whether a monopoly situation exists and, if so, by virtue of which provisions of sections 6–8 of the Fair Trading Act 1973 it is to be taken to exist and in favour of what person or persons it exists.

210. As is stated in paragraph 18, net sales of reference goods by the Pedigree Petfoods Division of Mars Limited constituted about 50 per cent and Spillers' sales about 30 per cent of total sales of reference goods in the United Kingdom from 1972 to 1974. Both companies accept that in 1975, when the reference was made, each of them separately supplied more than one-quarter of the reference goods supplied in the United Kingdom. We conclude, therefore, that monopoly situations exist by virtue of the provisions of section 6(1)(a) of the Act and that they exist in favour of Mars Limited, Food Manufacturing (GB Company) Limited and Mars Incorporated and of Spillers Foods Limited and Spillers Ltd.

#### II The public interest

211. First, we have considered the effect on the public interest of the monopoly situations existing in favour of Pedigree Petfoods and Spillers under three main headings:

- (a) the effectiveness of competition between reference goods and other forms of cat and dog foods (ie fresh food and scraps);
- (b) the effectiveness of competition between suppliers of reference goods;
- (c) the general level of profits and prices of Pedigree Petfoods and Spillers and their efficiency.

212. Secondly, we have considered the following policies and practices of Pedigree Petfoods and Spillers which might constitute steps taken for the purpose of exploiting or maintaining the monopoly situations:

- (a) the level of advertising by Pedigree Petfoods and Spillers;
- (b) the wide range of flavours and brands produced and sold by Pedigree Petfoods and Spillers;
- (c) the nature and level of discounts given by Pedigree Petfoods and Spillers to the distributors.

#### Competition from fresh food and scraps

213. The share of the market for cat and dog foods in terms of quantity accounted for by fresh food and scraps decreased markedly between 1960 and 1975 (paragraph 14). The total quantity of fresh food and scraps consumed remained static while consumption in quantity terms of prepared cat and dog foods increased by over 170 per cent. The reasons for the relative decline in consumption of fresh food and scraps are set out in paragraph 17. Pedigree Petfoods said that, although the consumption of fresh food and scraps and

milk by cats and dogs had remained almost static between 1960 and 1975, these sources of nutrition still accounted for over half of total food consumption by cats and dogs. The growth in the proportion of total feeding accounted for by prepared cat and dog foods was, according to Pedigree Petfoods, principally a result of the ability of the prepared pet foods manufacturers to hold down the increase in the prices of their products. Pedigree Petfoods' prices for its cat and dog foods approximately doubled between 1965 and 1975 whereas the prices of pets' fresh meat and fish respectively trebled and nearly quadrupled over this period (paragraph 52). Although in this period the price of fresh meat and fish has risen more than that of prepared pet foods, both Pedigree Petfoods and Spillers considered that competition between prepared and fresh cat and dog foods remained strong, and that the sales of prepared cat and dog food were highly sensitive to movements in the relative prices of prepared and fresh cat and dog foods.

214. We are satisfied that there is continuing competition between fresh and prepared foods for cats and dogs. The effect of this competition upon the price of prepared foods is difficult to isolate, for prepared foods enjoy other advantages. They can be bought in a wider range of shops, they are more easily stored, they need no cooking and they are less disagreeable to handle. Nevertheless, the very considerable use of fresh food, milk and scraps for feeding cats and dogs must impose some limit on the freedom of manufacturers of prepared foods to increase their prices without losing sales.

#### **Competition between suppliers of prepared cat and dog foods**

215. Pedigree Petfoods and Spillers supply about 50 per cent and 30 per cent respectively of total prepared cat and dog foods. The next three largest suppliers, Quaker, Carnation and Windsor Foods, together supply a further 13 per cent. The market shares of Pedigree Petfoods and Spillers vary between the different types of prepared cat and dog foods (see paragraph 19). In canned products, which account for about three-quarters of the market, Pedigree Petfoods has 61 per cent and Spillers 25 per cent; in dog biscuits and meal Spillers is the major supplier, while in semi-moist and complete dry foods the respective market leaders are Quaker and Carnation.

216. In view of the evidence that owners generally are not strongly committed to a particular type of prepared cat or dog food (paragraph 20), we considered all types as competing within a single market. Although about 80 per cent of the market for prepared cat and dog foods is held by Pedigree Petfoods and Spillers, most of the distributors who have presented evidence have expressed the view that the market is highly competitive. This competition takes a number of forms. Competition is very active in the development of new forms of prepared cat and dog foods (such as semi-moist and complete dry cat and dog foods), in improvements in formulation and palatability of existing types of product, in the offering of new flavours of existing types of product and in advertising and marketing.

217. Is there also price competition between Pedigree Petfoods and Spillers? We have examined the movements of the prices of the products of the two companies, and particularly the prices of the products included in Appendix 7 (see paragraph 159). Pedigree Petfoods challenged the validity of the comparisons made in this Appendix. It is true that the paired products are based upon different formulations and so are not identical. Each pair, however, consists of one

product of each company, both canned, both intended for the same animal and both, at the beginning of the period taken, offered at the same (or almost the same) price. We therefore consider that these comparisons are to a sufficient degree between like and like, and the relative movement of the prices of these particular products might justify certain general inferences.

218. The figures in Appendix 7 show that over a certain period increases of price were usually initiated by Pedigree Petfoods, with Spillers following fairly closely with increases of the same amount. This period extended generally from 1970 to the first half of 1975, though it started later for some of the products and for others went on a little longer.

219. Several distributors and smaller suppliers told us that they regarded Pedigree Petfoods as a price leader. Pedigree Petfoods recognised (paragraph 168) that, as the leading supplier of pet foods, it has an important influence on prices, and Spillers accepted that its prices are influenced by the prices charged by Pedigree Petfoods although it did not accept that it necessarily follows all Pedigree Petfoods' price changes. Pedigree Petfoods pointed out that its prices must necessarily be affected by prices of competitive products, and maintained that, since it is anxious to expand the market for prepared pet foods, it has exercised a restraining influence on prices.

220. The weighted average price of Pedigree Petfoods' products fell in real terms between 1965 and 1975 (see paragraph 52).

221. In considering the movements of the prices of these products it is necessary to bear in mind the following factors. The products of Pedigree Petfoods and Spillers are in broad terms similar, and important price increases (eg those of ingredients, containers and fuel) are likely to have similar effects upon them both. Since Spillers has a smaller market share, it is naturally reluctant to increase its prices before Pedigree Petfoods, and it is difficult for Spillers to undercut Pedigree Petfoods' prices in view of its present comparatively low return on capital (see paragraph 235). Pedigree Petfoods, like other producers, faces the competition of fresh foods and scraps, and has been anxious to maintain its prices at a level to encourage the sales of prepared pet foods.

222. Weighing up all these considerations, we do not consider that the price movements between 1970 and 1975 justify any inference of uncompetitive behaviour on the part of Pedigree Petfoods or Spillers. Both companies appear to have fixed their prices for the purpose of maintaining, and if possible improving, their position both as against each other and as against suppliers of fresh food. There is no evidence that Pedigree Petfoods has used its influence on its competitors' prices to maintain its pet foods prices above the level that would prevail in the absence of any price leadership. In fact, Spillers said that, in order to achieve a better return on capital, it would raise its prices more if it were not restrained by the level of Pedigree Petfoods' prices.

223. An assessment of the competitive position in the market for reference goods must also take account of any advantages enjoyed by Pedigree Petfoods and Spillers over existing smaller competitors and new entrants. We examine these questions in the following paragraphs.

224. Entry into the industry does not require exceptional capital resources as the minimum size of plant necessary to operate on the same level of efficiency as existing producers is comparatively small. It was suggested to us that such a

plant could be set up at a cost between £100,000 and £300,000 according to the type of product and whether the land and buildings were leased or bought. Hence, even if working capital is included, the costs of entry for new producers are not very high. In general, expansion of capacity in pet food production involves replication of production lines and so offers only limited opportunities for economies. In distribution, on the other hand, cost economies arising from a greater volume of sales are more important, particularly where the greater volume of sales allows larger average delivery quantities.

225. The number of different products that a retailer can sell is limited by the amount of shelf space at his disposal, and there are certain extra costs in having additional suppliers. As a result, several retailers and smaller suppliers have told us that there is a reluctance to accept new reference products unless they possess some clear advantages over the products of established suppliers or are well supported by advertising.

226. We consider that the difficulties of smaller suppliers seeking to increase their sales, or of entrants to the market, are increased by the cost of national advertising which bears more heavily on them than on a supplier with a large share of the market.

227. Smaller suppliers and new entrants do, therefore, face disadvantages. These disadvantages arise from common features of the grocery trade, but in the market for prepared pet foods they are not insurmountable. Established food manufacturers can form subsidiaries to enter this market. Their resources are adequate for the advertising and promotion necessary to introduce their subsidiaries' pet food products, and for bearing initial losses. They can distribute the pet foods together with their other products. Quaker and Carnation are two companies of this kind which have entered the market for prepared pet foods in recent years.

228. Smaller concerns can maintain themselves in the market, or achieve entry into it, in two ways. First, they can limit their sales to a particular locality. This minimises costs of distribution, and enables the manufacturers to acquire a local reputation without great expenditure on advertising. Within their chosen localities such manufacturers do succeed in maintaining a share of the market in competition with the large suppliers. Secondly, the small manufacturer can supply his products to multiple retailers for sale under the retailers' 'own brand' labels.

229. It is, therefore, possible to this extent for new suppliers to enter the market for reference goods, and for small suppliers to maintain themselves in that market, in spite of the advantages which Pedigree Petfoods and Spillers enjoy.

### **Prices, profits and efficiency**

230. We have received no general complaints that Pedigree Petfoods' and Spillers' prices are unduly high. Pedigree Petfoods provided evidence showing that the prices of its products to the pet owner had been reduced in real terms and in comparison with the price of fresh food (paragraph 52). This it attributed to its efficiency in production and to its success in substituting low cost for high cost ingredients without loss of palatability or nutritive value of the product.

231. Pedigree Petfoods had an average return on capital employed of 44.0 per cent on historic costs and 20.4 per cent on current costs over the period 1972-76.

Its profits on sales during this period averaged 7.1 per cent on historic costs and 4.3 per cent on current costs. In Appendix 5 we compare Pedigree Petfoods' figures for percentage return on capital and on sales and the ratio of sales to capital employed during the period 1971-74 with corresponding figures for United Kingdom manufacturing industry and for the food industry divided into quartiles. This Appendix is based on historic costs and on pre-tax figures.

232. The following table, which is based on Appendix 5, summarises the results of Pedigree Petfoods, compared with the average results of all manufacturing industry and of the food industry in the United Kingdom, during the period 1971-74. Figures for 1975 have been added for purposes of comparison. Pedigree Petfoods derives great advantage from its use of capital and financial control of a kind exceptional among large companies in this country (see paragraph 183(c)). Pedigree Petfoods, at our request, calculated how its return on capital employed would be reduced if the figure of capital employed were adjusted to allow for these practices. We made corresponding calculations to show how the return on sales would then be increased. Both the unadjusted and the adjusted figures for return on capital employed and for return on sales are given in Appendix 5 and in the following table. However, the adjustments presuppose so great a change of Pedigree Petfoods' methods of doing business that they must be treated with reserve. We prefer to concentrate on the unadjusted figures.

		<i>Return on capital employed (per cent)</i>	<i>Return on sales (per cent)</i>	<i>Sales/capital employed ratio</i>
1971	All manufacturing industry	12.5	6.4	1.6
	Pedigree Petfoods—unadjusted	44.5	7.4	6.0
	Food industry	12.4	5.0	2.1
1972	All manufacturing industry	15.0	8.1	1.5
	Pedigree Petfoods—unadjusted	74.2	8.7	8.6
	adjusted	34.0	11.1	3.1
	Food industry	16.3	5.7	2.0
1973	All manufacturing industry	17.4	8.5	1.7
	Pedigree Petfoods—unadjusted	48.3	6.7	7.2
	adjusted	25.6	9.0	2.8
	Food industry	16.8	5.4	2.5
1974	All manufacturing industry	17.0	7.3	2.0
	Pedigree Petfoods—unadjusted	29.3	5.6	5.3
	adjusted	19.1	7.7	2.5
	Food industry	17.1	5.2	3.0
Average 1971 to 1974				
	All manufacturing industry	15.5	7.6	1.7
	Pedigree Petfoods—unadjusted	49.1	7.1	6.8
	Food industry	15.7	5.3	2.4
Average 1972 to 1974				
	All manufacturing industry	16.5	8.0	1.7
	Pedigree Petfoods—unadjusted	50.6	7.0	7.0
	adjusted	26.2	9.3	2.8
	Food industry	16.7	5.4	2.5
1975	All manufacturing industry	15.2	6.9	2.2
	Pedigree Petfoods—unadjusted	35.1	7.5	4.7
	adjusted	22.9	9.3	2.5
	Food industry	18.6	5.1	3.7

233. Pedigree Petfoods' return on capital employed compares very favourably with the overall averages for manufacturing industry and for the food industry, and even with the averages for the top quartiles of those two sectors. Pedigree Petfoods' return on sales, on the other hand, is below the average for manufacturing industry and not greatly in excess of the average for the food industry. The explanation of this contrast is Pedigree Petfoods' very high ratio of sales to capital employed; and this, we believe, is due to its high level of efficiency in the respects set out in paragraphs 183-186.

234. We conclude that Pedigree Petfoods' high return on capital employed is the result of its high level of efficiency. Bearing in mind that the prices of Pedigree Petfoods' products have been reduced in real terms (paragraph 230) and that Pedigree Petfoods is exposed to competition from fresh foods and from both new suppliers of pet foods and other existing suppliers, we do not consider that Pedigree Petfoods' high profits result from monopolistic exploitation of the market. Consequently, we see nothing in Pedigree Petfoods' rate of return on capital employed which is adverse to the public interest.

235. Spillers' average return on capital employed for the four years ended 31 January 1976 was 19.2 per cent and its average return on sales was 6.4 per cent on an historic cost basis. Current cost figures are available only for the single year ended 31 January 1976 when Spillers' return on capital employed was 2.7 per cent and its return on sales 1.2 per cent compared with 18.3 per cent and 5.2 per cent respectively on historic cost. In Appendix 5, Spillers' return on capital employed and on sales and the ratio of sales to capital employed on historic cost during the period 1971-74 are compared with corresponding figures for the United Kingdom food industry and United Kingdom manufacturing industry as a whole and as divided into quartiles. Spillers' rate of return on capital employed and profit on sales are moderate, and we see nothing in them adverse to the public interest.

236. We now consider whether the particular policies and practices set out in paragraph 212 are likely to affect the public interest.

(a) *Advertising*

237. The tables below show respectively the percentages of the net value of Pedigree Petfoods' and Spillers' sales of reference goods represented by advertising (which is almost entirely on television) and the percentages spent on promotions:

**Advertising as a percentage of sales value**

	<i>Pedigree Petfoods</i> (1)	<i>Spillers</i> (2)
1971	5.5	3.3
1972	5.0	4.6
1973	3.5	3.1
1974	2.4	2.6
1975	2.9	2.2
1976	3.0	N/A

*Notes:* (1) For Pedigree Petfoods the figures relate to the 12 months ended 31 July 1971 and thereafter to calendar years.

(2) For Spillers the figures relate to the 12 months ended 31 January of the following year.

Appendix 8 compares figures of advertising expenditure on certain branded consumer goods including prepared cat and dog foods.

**Promotion as a percentage of sales value**

	<i>Pedigree Petfoods (1)</i>	<i>Spillers (2)</i>
1971	3.9	5.0
1972	4.0	5.6
1973	2.2	4.6
1974	1.9	3.5
1975	3.6	4.2
1976	3.5	N/A

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*Notes:* (1) For Pedigree Petfoods the figures relate to the 12 months ended 31 July 1971 and thereafter to calendar years.

(2) For Spillers the figures relate to the 12 months ended 31 January of the following year.

Pedigree Petfoods' sales promotions consist largely of temporary price reductions for particular products or retailers and, to a less extent, of free samples, gift coupons etc (paragraphs 65 and 67). The forms of promotion used by Spillers are 'money off' packs and special trade bonuses to retailers to assist them in the launching of new products and to enable them to feature particular brands at specially reduced prices (paragraph 108).

238. The figures in Appendix 8 suggest that the advertising expenditure of Pedigree Petfoods and Spillers is by no means unusually high. Such advertising must nevertheless represent some obstacle to suppliers wishing to enter the market or to enlarge their share of it, but suppliers other than Pedigree Petfoods and Spillers have in fact increased their aggregate share from 17.1 per cent in 1972 to 21.5 per cent in 1974 (paragraph 18).

239. Pedigree Petfoods' and Spillers' advertising is concentrated largely on their higher priced brands (paragraphs 66 and 110). The cheaper brands supplied by Pedigree Petfoods and Spillers are for the most part not advertised; nor are the products supplied by many of the smaller producers and those supplied under retailers' own brands. The purchaser can choose between advertised and unadvertised brands of cat and dog foods.

240. The present scale of advertising by Pedigree Petfoods and Spillers does not appear to us unreasonable, and we consider that it does not operate and may not be expected to operate against the public interest.

*(b) Range of flavours and brands*

241. The frequent introduction of different flavours within each brand and of new brands could operate against the interest of consumers if the demand were artificially created by advertising and if the range of flavours and brands significantly raised costs of manufacture and distribution. Pedigree Petfoods, however, stated that costs of changing machinery from the production of one flavour or brand to another were not significant (paragraph 181). Some retailers complained that the number of flavours and brands complicated their task, but they did not produce any figures sufficient to show that the costs of distribution

were significantly raised thereby. Spillers, while admitting that there was some increase in production costs, argued that a variety of products was likely to increase total sales and so to reduce unit costs (paragraph 208). Pedigree Petfoods and Spillers both argued that the variety of flavours and brands offered is in response to consumer demand (paragraphs 180 and 207), and we see no grounds for not accepting this contention. We conclude, therefore, that the range of flavours and brands offered does not operate and may not be expected to operate against the public interest.

*(c) Discounts*

242. Pedigree Petfoods gives discount according to the number of cases of its products (whether reference or non-reference products) included in an order. On orders of less than 40 cases no discount is allowed, while the maximum discount of 6.8 per cent is allowed on orders of 600 cases or more (paragraph 54). Spillers also gives discount according to the number of cases of its products (whether reference or non-reference products) included in an order. On orders of less than 26 cases no discount is allowed. The maximum discount, which on pet foods varies from 11.2 per cent to 13.5 per cent according to product, is allowed on orders of 500 cases or more (paragraph 98). Pedigree Petfoods' discounts appear to us to be as closely related as is practicable to savings in delivery costs; Spillers' discounts may somewhat exceed these savings.

243. In addition, Spillers allows large customers over-riding discounts based on their total turnover of all products of the Spillers Foods Group sold by Spillers Foods and Spratts respectively. These discounts are open to the objection that they are not directly related to savings in distribution costs and that they give Spillers an advantage over suppliers whose production is confined to prepared cat and dog foods. Spillers replied that large customers now expected them and that Spillers would suffer a loss of sales if it abandoned them (paragraph 199). The over-riding discounts granted by Spillers must secure to Spillers a larger market share than it would otherwise possess. However, we recognise that the granting of such discounts by Spillers is partly a reflection of the bargaining power of major customers, and we note that these discounts, which average 0.7 per cent of Spillers' gross sales, have not been sufficiently advantageous to Spillers to prevent the loss of market share to other suppliers of prepared pet foods. In the circumstances, we consider that these over-riding discounts do not operate and may not be expected to operate against the public interest.

### **III Conclusions**

244. We conclude that:

- (a) monopoly situations exist in the supply in the United Kingdom of prepared cat and dog foods as defined in the reference by virtue of section 6(1)(a) of the Fair Trading Act 1973 because Mars Limited and Spillers Foods Limited each supplies at least one-quarter of the reference goods supplied in the United Kingdom;
- (b) the monopoly situations exist in favour of Mars Limited, Food Manufacturing (GB Company) Limited and Mars Incorporated and of Spillers Foods Limited and Spillers Limited;

(c) none of the facts found by us in pursuance of our investigations operate or may be expected to operate against the public interest.

J G LE QUESNE (*Chairman*)

ROGER FALK

T P LYONS

C T H PLANT

H STREET

Y LOVAT WILLIAMS (*Secretary*)

29 March 1977