CHAPTER 7

Conclusions

A. The merger situation

7.1. As we have explained in the footnote to paragraph 1.1, the proposed acquisition of Huntley & Palmer Foods PLC by Rowntree Mackintosh PLC was abandoned and the reference relating to this proposal was subsequently laid aside.

7.2. Under the terms of the other reference and the provisions of section 69(1) and section 75(2) and (4) of the Fair Trading Act 1973 we are required to investigate and report whether arrangements are in progress or in contemplation for the acquisition of Huntley & Palmer Foods PLC (HPF) by Nabisco Brands Inc (NBI) which, if carried into effect, will result in the creation of a merger situation in which section 64(1)(*b*) will be satisfied.

7.3. Section 64(1)(*b*) is satisfied if the value of assets taken over exceeds £15 million. As we have shown in Table 3.1, the assets of HPF exceed £15 million, and section 64(1)(*b*) is therefore satisfied.

7.4. By virtue of section 64(8) a merger situation qualifying for investigation exists if two or more enterprises have ceased to be distinct enterprises in the circumstances described in section 64(1). Under section 75(2) we are required to proceed in relation to a prospective merger as we could proceed if it had taken place immediately before the reference.

7.5. On 18 March 1982 NBI announced that it was contemplating making an offer to acquire the whole of the share capital of HPF. On the same day this matter was referred to the Commission. Pending the outcome of our inquiry, no offer has yet been made; but it is clear that the acquisition of HPF is still in contemplation by NBI.

7.6. We conclude that a merger situation qualifying for investigation will be created if the arrangements in contemplation for the acquisition of Huntley & Palmer Foods PLC by Nabisco Brands Inc are carried into effect.

B. The public interest

Competition and market shares

(i) Biscuits

7.7. HPF already has a substantial share, about 20 per cent in value terms, of the United Kingdom biscuit market, while NBI's share at present is estimated at just under 5 per cent. The merger would therefore give the combined companies a share of about 24 per cent if the two shares are simply added together. It may be that in practice the figure would be marginally below this since the full range of each company would not necessarily continue to be marketed, but broadly the market share as a result of the merger could be considered as approaching one-quarter.

7.8. This would be the merged companies' share of the United Kingdom biscuit market as a whole. But we recognise that biscuits can be divided into a number of categories and that in their buying and stocking decisions retailers do in practice distinguish between them. We therefore considered whether it was relevant to take into account also the two companies' shares of certain segments of the market. HPF has a share of over half of the plain biscuit segment of the market, and the merged companies would have over 60 per cent of this segment. In the savoury biscuits segment NBI has a share of about a quarter, and the merged companies' share would be rather more than a third. The merged companies' share of these two sectors of the market taken together would be more than a half, but it should be borne in mind that plain biscuits and savoury biscuits together account for only about 11 per cent of the total United Kingdom biscuit market. Although the combined shares in these two segments would be large, the areas of overlap between the two companies and the extent to which they are at present in competition with each other in the biscuit market are small.

7.9. In any case the boundaries between different categories of biscuits are not clear-cut since they are to some extent substitutes for one another and are regarded as such by consumers. Perhaps of more importance is that commercially manufacturers and distributors tend to handle all biscuits together for purposes of volume discounts, promotions and advertising. For these reasons, in assessing the effects of the merger on competition and market shares, we take account of the biscuit market as a whole rather than of separate segments of it.

7.10. The merged companies' share of about one-quarter of this market needs to be considered in terms of the possible effects on competition, both adverse and beneficial, of the companies' increased market share as a result of the merger. HPF is already the second biggest biscuit manufacturer; but its market share is barely half that of the largest manufacturer, United Biscuits, which dominates the market and is the acknowledged price leader. The merger would reduce the number of biscuit manufacturers by one, but it would give the merged companies a market share which would be not significantly greater than HPF's present share and would still be well below that of United Biscuits.

7.11. The structure of the United Kingdom biscuit market would not therefore be materially altered by the merger, and we consider that there would be no adverse effect on competition in the supply of biscuits.

7.12. It was a major part of the case for the merger, as we have explained in paragraphs 5.9 and 5.18, that in the biscuit market the effects on the public interest would be positively beneficial since the greater strength of the merged companies to compete effectively with the dominant biscuit manufacturer, United Biscuits, would increase competition.

7.13. We accept that, if NBI's plans for biscuit manufacture following the merger, which were described to us in considerable detail, were brought to fruition, there would indeed be the likelihood of maintaining and even in the long-term enhancing competition in the biscuit market. However, the relevant question for us is whether this would be likely to occur in the absence of the merger; and the answer to this lies mainly in the view we take of HPF's prospects of providing effective competition to United Biscuits if the merger does not take place.

7.14. It is possible that, if for any reason HPF was not acquired by NBI, it might be acquired by some other company; but this possibility is too speculative for us to take into account, and in any event we cannot say what advantages or disadvantages there might be in any particular case if it were to be proposed.

7.15. There is no doubt that, mainly because of insufficient investment in up-to-date plant, machinery and technology in its biscuit factories, HPF is a relatively high-cost producer of biscuits and that because of its lack of adequate profits it is limited in the extent to which it is able to provide effective competition to United Biscuits. The company's plans for rationalisation and re-equipment of its biscuit factories would undoubtedly reduce its costs and might ultimately improve its profit margins and thus put it in a stronger position to compete in price, advertising and promotions. But implementation of these plans would be costly and HPF acknowledged that, particularly in view of the present financial state of the company, full and successful implementation would be slow and difficult for the company on its own.

7.16. It is not possible for us to say with any confidence how far its plans for rehabilitation would in practice be implemented and thus to what extent the company would succeed in becoming a fully effective competitor in the biscuit market. However, it is our view that if, through acquisition, HPF had access to NBI's financial, technical and managerial resources the emergence of the company as a stronger challenger to the dominance of United Biscuits would be achieved with much greater certainty, in shorter time, and more effectively than would be the case even if HPF were to achieve a recovery on its own.

7.17. We take the view therefore that the merger would result in the United Kingdom biscuit market becoming more competitive than it would be without the merger and that this is a significant benefit to the public interest.

(ii) Confectionery

7.18. HPF, through its Confectionery Division, has a small share of the United Kingdom chocolate confectionery market (less than 5 per cent including its intra-group sales). NBI, though it has extensive confectionery interests in the United States of America, in Canada and in Holland, produces no confectionery in the United Kingdom. NBI might at some time in the future wish to enter the confectionery market in this country, in which case if the merger had taken place any market share it would achieve would be added to that which HPF already has. But the possibility of NBI entering the confectionery market is speculative and does not appear to be one which would be dependent upon acquisition of HPF.

7.19. We consider that it is not possible to predict any significant effect of the merger on competition in the United Kingdom confectionery market.

(iii) Snack foods

7.20. The market for snack foods, which we have described in some detail in Chapter 4, is concerned with crisps, extruded snacks and nuts. For the purpose of assessing the effect of the merger on market shares and on competition we shall consider the market for these three types of food primarily as a single market, but also take some account of the position in the three segments separately.

7.21. The principal feature of the market structure at present is the existence of four producers accounting for nearly 90 per cent (by value) of the market. As with biscuits the largest share (about 30 per cent) appears to be that of United Biscuits, but in snack foods this company does not occupy a similar dominant position, HPF's share being about 26 per cent, NBI's about 17 per cent and Golden Wonder's about 16 per cent. Indeed, in crisps and extruded snacks together, which account for over 80 per cent of the market, United Biscuits' share is slightly lower than HPF's, and it is only in the much smaller nuts sector of the market that its share, of approximately a half, is dominant.

7.22. The effect on market shares of acquisition of HPF by NBI would be to give the merged companies, with about 43 per cent, substantially the largest share of the snack foods market as a whole, and a similar position in both crisps and extruded snacks considered separately. Only in nuts would United Biscuits still be the largest supplier.

7.23. It was argued by NBI that in the crisps segment of the market the merger would not change the competitive situation because Walkers' market did not overlap to any great extent with Smiths' or Tudor's, Walkers' sales being largely regional (mainly in the Midlands, East Anglia and Yorkshire) and mainly to wholesalers, Smiths' on the other hand being mainly direct to retailers and caterers and Tudor's being in the North of England and in Scotland. In addition Smiths' sales include a substantial proportion of retailers' private label crisps, while Walkers' do not. However, we do not think that these arguments carry much weight, because Walkers' sales area is already large and we have no doubt that NBI would wish to see it expand further, and because we do not think that sales through wholesalers can be regarded as immune to competition from sales to retailers, either branded or private label.

7.24. In assessing the effects on competition of these changes in market shares, we believe that the significant feature would be not merely the merged companies' increased share and the fact that they would displace United Biscuits as the largest supplier, but the fact that instead of four suppliers each with broadly comparable shares there would be two suppliers accounting for nearly three-quarters of the market between them. The next largest supplier would be Golden Wonder, whose share of the snack foods market as a whole is about 16 per cent and whose share of the crisps segment has been declining markedly.

7.25. In the snack foods market as it is at present, with four major suppliers, there is in our view effective competition. But the question arises how far in a market dominated by only two suppliers, effective competition would continue. In general and in the absence of other factors, the expectation would be that the smaller the number of major suppliers, the more readily would they be able to reach a position in which they did not effectively compete with each other in price. More specifically, when a very large share of the market was in the hands of only two suppliers, it would be possible that, without any active collusion, each individually would take the view that any attempt by either to gain a price advantage would quickly be matched by his competitor and that therefore price competition would be disadvantageous since it would simply lead to a lower level of prices for both suppliers. Though they were highly efficient producers, it would be unlikely in this situation of restricted price competition that the benefits of low-cost production would be fully passed on to consumers; prices could be expected to be higher than they would otherwise be, and it could also be expected that there would be greater emphasis on non-price competition including increased expenditure on advertising.

7.26. The relatively high level of prices that we are postulating might generally be expected to help smaller suppliers and encourage new entrants. However, this effect might be outweighed by the inability of small suppliers and potential new entrants to match the increased level of advertising and by their expectation that the response on the part of the major suppliers to such competition as they could offer would be greater than they could withstand. If this were the case there would be a tendency for the combined shares of the two major suppliers to become still greater.

7.27. However, it is necessary to consider alternative consequences which might in general arise from a situation in which two major manufacturers together account for some three-quarters of the market, and also to take account of the particular characteristics of the market with which we are concerned.

7.28. While a possible outcome would be, as we have suggested in paragraph 7.25, a situation of limited price competition and consequently of relatively high prices, we accept that there is no certainty of this and it would be equally possible that even in the conditions of increased concentration which the merger would create the major suppliers would see it as in their commercial interests to protect or expand their market shares by competing vigorously in price with one another and with other suppliers, and that the existing competitive situation would thus not be materially changed.

7.29. However, apart from this alternative possibility, the likelihood of a situation of limited price competition developing, or the extent to which it might develop, would depend largely on the buying power of the companies' customers, and it is generally recognised that in the food industry the buying power of the large retailers and wholesalers is such that pressure on manufacturers' prices is intense and, in the view of some manufacturers, so great that necessary re-investment in the food manufacturing industry is being prevented by inadequate profitability.

7.30. The power of large buyers may have less effect in the snack food market than in the biscuit market because a lower proportion of snack food sales is to such customers. Nevertheless a substantial proportion of snack foods is sold to large retailers and wholesalers, and we believe that this, together with large retailers' ability to switch to own label snacks supplied by smaller manufacturers, results in a considerable constraint on suppliers' prices. We believe that some constraint on snack food prices also arises from the fact that snack foods are in competition with other foods.

7.31. As regards the possibility of competition to the major suppliers from other manufacturers and new entrants, we note that in the crisps segment of the market both market shares and the number of suppliers appear to have fluctuated substantially in the past. We believe that there are at present at least a dozen manufacturers of crisps, including a number of relatively small regional crisps manufacturers who are operating successfully. At least four manufacturers appear to have entered the market within the last decade. Entry to this segment of the market does not appear to be difficult, and the cost of doing so does not appear to be a deterrent (see paragraph 4.58). In this connection we note that NBI told us that it was prepared to undertake that:

> 'if, following the acquisition of Huntley & Palmer, it should be decided to close any combined factory or factories, NBI would use its best efforts to sell such factories as operating manufacturing facilities, to qualified third parties together with those persons employed at such factories.'

7.32. In the extruded snacks segment of the market new entrants are likely to be encouraged to accept the relatively high risk involved in the expectation of high rewards from the development of a successful product. Moreover, the extent to which even major suppliers can acquire or retain market power is limited by the facts that the products themselves depend for their success, which is unpredictable, on new ideas in order to differentiate them, and that typically even the successful products have a short life-cycle.

7.33. In the nuts segment of the market United Biscuits, with its KP brand, has by far the largest share at present and would continue to be the dominant supplier even after the merger. The merger can therefore be seen as producing a more effective competitor to the dominant supplier in this segment.

7.34. In our judgment, because of the factors we have referred to in paragraphs 7.29 to 7.33, the particular nature of the snack foods market is such that we do not believe that there would be seriously damaging effects on the public interest as a result of market power in the hands of the two major suppliers. Even if there were to be some adverse effects on competition in the snack foods market, we believe that they would not be serious enough to outweigh the advantages of the merger which would accrue in the biscuits market.

7.35. Nevertheless, we considered whether the risk of adverse effects on competition might be removed in some way short of the merger being prevented. If the merger were to exclude all or part of HPF's snack food interests or if these interests were to be disposed of by NBI following the merger, it appeared that this might eliminate the possibility of adverse effects on competition (since it would be only in the snack foods market that there would be any risk of any such effects) and might at the same time not prevent the likely beneficial effects in the biscuit market. We put this possibility to both NBI and HPF but after considering their representations on it we are satisfied that this would not be an appropriate course.

7.36. We have set out in Chapter 5 the reasons why NBI considers that the advantages of the merger, as it sees them, would be fully realised only if it acquired HPF as a whole. We think that if part or all of HPF's snack foods activity were excluded from the merger it would be doubtful whether NBI would wish to proceed with the acquisition. In that event HPF's situation could be made even more difficult than it is now by a possibly prolonged period of uncertainty about its future, while the advantages which we believe would result from the merger to the competitive situation in the biscuit market would not materialise.

Conclusion on the effects of the merger on competition

7.37. To summarise what we have said in the foregoing paragraphs concerning the effects of the merger on competition, it is our view that the merger would yield significant benefits to competition in the biscuit market and that, while we recognise the threat to the public interest that may generally be expected from the type of market structure that the merger would produce in the snack food market, we do not foresee that in this particular case the increased concentration would on balance be likely to result in any serious detriment.

7.38. In saying this we do not wish to imply that there is no degree of concentration in the snack foods market which we would regard as against the public interest. Any contemplated acquisitions by the major suppliers which would further increase the degree of concentration would merit careful scrutiny and would be unlikely to yield the advantage to the public interest which in our view is an important advantage of the merger we are investigating. In this connection we note that NBI told us that it was prepared to undertake that 'for a period of 10 years following the completion of the acquisition of Huntley & Palmer, it will not seek to acquire in the United Kingdom any other crisps business'.

Effects of the merger on employment

7.39. The likely effects of the merger on employment both in NBI and in HPF are difficult to predict, but considerable numbers of employees could be affected and we appreciate that the trade unions and the employees whom they represent are concerned at the possibility of a substantial reduction in the numbers employed.

7.40. There is no doubt that if the merger takes place the total number of employees in the merged organisation will be substantially reduced over a period of perhaps five years. Equally there is no doubt that HPF's plans for rationalisation and modernisation principally in its biscuits and snack foods divisions will also involve substantial reductions in the number of employees if the merger does not take place. It is not possible to say precisely what numbers would be involved in either case, but we have compared the estimates given to us by NBI on the assumption that the merger takes place with those given to us by HPF on the assumption that it does not. HPF's existing estimate for a limited period ahead was related to the amount of reorganisation and re-equipment which the company believed it would have the financial resources to carry out. NBI took the view, however, that HPF's plans were inadequate for the medium- and longer-term and that more radical changes would be necessary both in the factories and in distribution if HPF were to become an efficient supplier able to compete effectively in the biscuits and snack foods markets. HPF agreed with this view and its perception of what was needed if it had the financial resources to achieve it and of the consequent reduction in the number of employees was not significantly different from NBI's over the same period of time as that envisaged in NBI's plans.

7.41. This merger is not a case of a company acquiring another in order to close it down. We are satisfied that NBI's intentions are the opposite of this and that its aim is to develop HPF and to turn it into a sounder business with better prospects for the future. Since NBI intends to spend as much as £95 million on HPF for this purpose, we think it reasonable to assume that its far-reaching plans and a reduction of approximately the magnitude estimated in the number of employees, which form part of those plans, are no more than would be necessary.

7.42. We take the view that although the merger would involve substantial job losses, the losses would probably not be greater than would be necessary if HPF is to become an adequately profitable company with a sound future. In the long run even a reduced level of employment must depend on the ability of the business to survive in the face of competition. We believe that the long-term prospects for employment are likely to be more favourable if the merger takes place than if it does not, not least because of the substantial capital investment which we believe NBI would make and which we think HPF would be unable to match.

7.43. We recognise that job losses of the magnitude that may be expected in HPF, whether the merger takes place or not, are a very serious matter for those concerned, particularly in the current conditions of already high unemployment. But given that losses are inevitable, it becomes important to consider how NBI would handle the matter if the merger takes place. The company foresees that the losses would be spread over at least five years and it intends that they should be achieved as far as possible by natural wastage. Nevertheless, there would undoubtedly be redundancies, and NBI gave us a considerable amount of information on how it handles situations of this kind. In particular it told us that its policy would be to give the unions details of its plans for closures as far in advance as possible so that wherever possible alternative arrangements could be made. NBI recognised that its plans, including those for closures, would not be easy to implement; but no criticism of NBI as an employer was made to us by any of the unions concerned, and we have no reason to suppose that in the implementation of its plans the company's attitude would be any less generous or sympathetic than HPF's would be in implementing similar plans if it continued to be independent.

7.44. Our view is that, although the outlook for employment in HPF is not good, this is due to circumstances already prevailing in the company and the outlook is not likely to become materially worse, and indeed may in the long run become better, if the merger takes place.

Effects of the merger on the United Kingdom balance of payments

7.45. NBI told us that if the merger took place it would intend to develop the export of HPF's branded biscuits and especially its chocolate biscuit countlines, and believed that there were export opportunities in the EEC because of its own existing presence there. It also considered there were export opportunities in South America, the Caribbean and the Middle East.

7.46. As regards snacks, NBI would continue to exploit opportunities to export processed nuts to countries unable to sustain a processing industry of their own. Other snacks are unsuitable for export because of their low value/high bulk ratio and their limited shelf life, but Nabisco would concentrate the development of extruded snack technology in the United Kingdom and royalties would accrue from licences to NBI companies in other countries.

7.47. In these ways there might as a result of the merger be some gain to the United Kingdom balance of payments; but we do not think, and the company did not claim, that any gain would be significant.

Conclusion

7.48. The principal areas of concern in which potential detriments to the public interest could arise as a result of the merger are the effects of increased concentration in the snack foods market and the effects on employment. Our conclusion on the former, which is summarised in paragraph 7.37, is that the increased concentration would not on balance result in any serious detriment; and our conclusion on the latter, which is summarised in paragraph 7.44, is that while the outlook for employment in HPF is not good, it is not likely to become materially worse, and may in the long run become better, if the merger takes place.

7.49. We conclude that the merger situation which will be created if the arrangements in contemplation for the acquisition of Huntley & Palmer Foods PLC by Nabisco Brands Inc are carried into effect may be expected not to operate against the public interest.

J D Eccles (*Chairman*)

R L Marshall

L Kelly

N E D Burton (*Secretary*)

8 September 1982

The following members of the group dissent from the conclusion for the reasons set out in the note of dissent included in this report.

K D George

P Goldman

Note of Dissent

by Professor K D George and Mr P Goldman

1. In the two principal areas of concern—the effects of the merger on competition and the effects on employment—our colleagues have concluded that the merger may not be expected to operate against the public interest.

2. We agree that whether or not the merger takes place the outlook for employment in HPF is not good, but we are less confident that the merger may have a net beneficial effect in the long run mainly because we take a less pessimistic view than our colleagues of the prospects for HPF on its own.

3. On the competition issue our colleagues have concluded that the merger would not be likely to result in any serious detriment in the snack foods market, and that it would yield substantial benefits to competition in the biscuit market.

4. We agree with our colleagues that the current situation in the snack foods market is very competitive. The four leading suppliers are reasonably well matched and each has a strong incentive to maintain its position in the market. The level of advertising expenditure has not been excessive and there has been much emphasis on promotional discounts which have benefited the consumer. There have also been a number of successful entries into the market.

5. The merger would radically alter the structure of this market by giving the two leading companies a combined market share of over 70 per cent. This dominance would give these two companies the power to raise prices above the level which would exist in a less concentrated market. We fear that as less emphasis would be placed on price competition there would be greatly increased expenditure on advertising. The dominance of the two leading companies and the high levels of advertising expenditure which they would be likely to engage in would make new entry much more difficult than it has been in the past, and might make it more difficult for some existing manufacturers to survive.

6. Our colleagues have argued that the risk of these adverse consequences occurring would be reduced to an acceptable level by such factors as the availability of substitutes, the buying power of multiples and other large buyers, the volatility of market shares, and ease of entry. We are not convinced that these forces would be sufficiently effective to offset the market power of the two dominant suppliers. The availability of substitutes limits the extent to which dominant companies can raise prices but they may nevertheless be able to raise them well above the competitive level especially where they engage in heavy advertising expenditure. Compared to the present position the countervailing power of large buyers will be reduced when the supply side is dominated by two companies. In so far therefore as countervailing power has benefited consumers in the form of lower prices this benefit is likely to become less secure if the merger proceeds. As to the volatility of market shares and ease of entry we do not believe that the past is necessarily a good guide to the future. Entry conditions in particular are, as mentioned earlier, likely to change considerably as a result of the merger.

7. In concluding that the merger would not be likely to result in any serious detriment in the snack foods market our colleagues have said that they do not wish to imply that there is no degree of concentration in this market which they would regard as against the public interest. We are of the view that the merger would result in a degree of concentration that would be against the public interest.

8. In the biscuit market competition in recent years has been vigorous and much of the benefit of this competition has been passed on to the consumer. The important question is whether in view of HPF's relatively weak position, this competitive situation can be maintained if the merger is not allowed to proceed.

9. In its evidence to the Commission HPF explained what it had to do to close the efficiency gap between itself and United Biscuits. It told us that the factors that would contribute most to closing this gap were the plant closures which it had planned and the rationalisation of production in the remaining plants. This programme of rationalisation and plant closures will be pursued whether the merger proceeds or not. The future of the company will also depend upon substantial new investment in production and distribution. This will take longer to achieve if HPF is on its own but HPF management did not suggest that it could not be done or that the very existence of the company would be in jeopardy if the merger were not allowed to proceed.

10. We agree with our colleagues that the re-emergence of HPF as a strong competitor to United Biscuits will be achieved with greater certainty and in a shorter time if HPF has access to Nabisco's resources than if it attempts to go it alone, although we are more sceptical about the benefits that a merger would bring to the consumer.

11. Nevertheless we recognise that in the biscuit market an argument in favour of the merger does exist, and as an alternative to opposing the merger we would favour a recommendation that the merger be allowed to proceed provided that all of HPF's snack interests were excluded or were disposed of by Nabisco following the merger. Although we can see why such a course of action would not be favoured by the companies we believe that this would be an appropriate way of safeguarding the public interest. If such a course of action were not practicable we would recommend that the merger be not allowed to proceed.

K D George

P Goldman

8 September 1982