

# 6 Views of third parties

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## Introduction

6.1. We invited views on the merger from the Ministry of Agriculture, Fisheries and Food (MAFF); producers and users of couverture; professional, trade and consumer associations; trade unions; and other interested parties. This chapter summarizes the evidence we received.

## **Government departments**

### ***Ministry of Agriculture, Fisheries and Food***

6.2. MAFF emphasized that a crucial point to be determined by the MMC in assessing the merger was the definition of the relevant market for couverture. MAFF's preliminary view was that product supplied and used solely by the same producer should be excluded from the market. On that basis, the merged company would have a combined share of 75 per cent of the UK market and 49 per cent of the European market, with the largest competitors in each market having only 11 per cent and 7 per cent shares respectively. These relatively high market shares caused concern, given that barriers to entry existed as a result of surplus capacity in the industry and economies of scale in production. However, if the producers-users were judged to be in the same market, this would reduce concern considerably. This was why a judgment on the definition of the market was so crucial. If the open market was a separate market, the merged company would have substantial market power and the merger could well be against the public interest because it would permit the combined company to raise prices to unjustifiable levels. MAFF added that if the MMC found the merger to be against the public interest, safeguards were unrealistic.

## **Producer-users of couverture**

### ***Associated British Foods plc***

6.3. AB Foods, owner of Burton's Biscuits Limited, chose not to express views on the merger but pointed out that a new manufacturer, Classic, was entering the market and would be producing chocolate chips in significant quantities.

### ***Cadbury Ltd***

6.4. Cadbury Ltd said that as it did not purchase couverture chocolate in any substantial quantity it felt it was inappropriate to comment on the merger.

### ***Nestlé UK Ltd***

6.5. Nestlé UK submitted written information and attended a hearing.

6.6. Nestlé UK told us that its confectionery division was made up largely of the Rowntree business acquired in 1988 together with its pre-existing chocolate manufacturing activities in the UK. At present it had about a quarter share of the UK confectionery market, and a quarter of its UK output went for export. Nestlé UK explained that it manufactured couverture exclusively for its own use. It rarely purchased couverture from other suppliers but would do so in an emergency or to satisfy a short-term requirement. It occasionally imported small amounts of chocolate from Nestlé's operations outside the UK which also supplied chocolate and couverture to independent customers in a number of other European countries. Nestlé had grown by acquisition and in the process had acquired diverse confectionery companies; some of these happened to manufacture couverture and Nestlé had continued to supply to the open market after acquiring these companies.

6.7. Nestlé UK said that, as a supplier of branded goods in the UK, it preferred to manufacture its own chocolate in-house because this enabled it to control the complete manufacturing process and achieve product differentiation. It preferred not to make its proprietary knowledge available to other suppliers.

6.8. Nestlé UK told us that it had periodically considered entering the UK couverture market. It had decided not to at present as demand was already satisfied by current suppliers and was fairly static compared with other markets. Overcapacity in the market meant that margins were small and profitability low. Also, as Nestlé UK restricted its output to a few recipes and as its production operation was given over to the bulk handling of large volume production on highly automated plant, it was not geared up to making small volumes of product to a large number of different recipes. Nestlé UK added that to service the couverture

market effectively a supplier had to have a significant degree of flexibility, the ability to tailor recipes to suit individual customers and the willingness to manufacture in small amounts, all of which required a great degree of manual involvement.

6.9. Nevertheless, Nestlé UK said that it was prepared to consider supplying the open market in the future. Currently it had little spare capacity. Entry to the UK open market for couverture was not a high priority but Nestlé UK would consider any future opportunities which might enable it to develop its business.

6.10. Nestlé UK added that it saw the market for the supply of couverture as essentially UK-based. Transportation costs from the Continent, though not necessarily prohibitively high, were a significant add-on cost which might deter the import of large quantities of couverture. Nestlé UK, whilst remaining fairly neutral in its views, thought that if the merger went ahead it was more likely to create opportunities in the market. Its effect on competition would tend to raise chocolate prices a little. There would clearly be a tendency on the part of the combined group to try to increase prices with present margins being so low. However, any adverse effects would be counterbalanced by the presence of existing suppliers or potential new entrants to the market. Increased margins could make the UK market a more interesting proposition both to UK and continental suppliers, including other Nestlé subsidiaries. Suppliers might also benefit from existing Callebaut/Barry customers wanting to continue to dual source.

### ***Premier Biscuits***

6.11. Premier, a profit centre within Premier Brands (UK) Limited, a wholly-owned subsidiary of Hilldown, submitted written information and attended a hearing. Premier explained that its main activity was making biscuits which it marketed under licence from Cadbury, of which it had been a subsidiary until 1986. It made couverture, also under licence from Cadbury, firstly for use in its own biscuit-making activities and secondly for supply to Manor Bakeries. Finally it made couverture outside the framework of its licensing agreement with Cadbury for supply to the open market. It bought in from Cadbury cocoa butter and cocoa liquor for use in products to be sold under Cadbury's name, and from UK and continental suppliers for its other needs. It also bought in certain types of couverture which were not manufactured in-house. It had been able to reduce prices charged to it by Callebaut by threatening to produce chocolate chips itself.

6.12. Premier said that it competed vigorously with both Callebaut and Barry for customers in the open market. Though the combined Barry Callebaut group would have a major share of the UK market, Premier stressed that the market was European-based and should not be considered as a separate UK market. In this context fears about possible price increases would be counterbalanced by price competition from existing suppliers and the likely entry of new suppliers, based both in the UK and on the Continent. Premier itself expected to benefit from customers who felt uneasy about purchasing from a single group and who wished to continue to dual source. Premier added that it had no concerns about the ability of continental suppliers to meet quality standards or to satisfy individual recipe requirements. It had imported cocoa products from the Continent over a number of years and had not experienced any problems or difficulties in meeting delivery times.

6.13. Premier said that the primary purpose of its couverture operations had to be the supply of Cadbury's chocolate, but it was also working hard to build up a relationship with contract customers competing in terms of service, quality and price. It had spare capacity and planned to increase output based on efficiency improvements.

### ***United Biscuits (UK) Limited***

6.14. United Biscuits (UK) Limited (UB) submitted written information and attended a hearing. Its cocoa and chocolate-related interests in the UK are operated under the name McVitie's UK and we use the term UB/McVitie's to refer to the company.

6.15. UB/McVitie's explained that its UK couverture production had recently been centralized at a new factory at its Manchester site which provided all its couverture requirements, mainly for use in its own McVitie's brand biscuits. At present nearly all of its production was used internally. UB/McVitie's,

however, was seriously considering using excess capacity at its plant to supply the open market. Its preliminary observations were that customers, particularly those who did not want to be wholly dependent on one supplier, could readily be found. UB/McVitie's explained that its plant was fully able to meet any quality standards or match any recipe requirements. Currently it produced couverture only in liquid form but it was developing its capability to produce it in solid form.

6.16. UB/McVitie's thought that customers' main fear about the merger was that the combined group's increased market share might encourage it to raise its prices. If this was its intention, UB/McVitie's doubted that it would succeed. A number of producer-users in the UK and the rest of Europe could easily enter the open market and provide additional competition. Continent-based suppliers were unlikely to be deterred from entering the UK market if clear opportunities to expand their businesses arose. UB/McVitie's regularly bought cocoa-based ingredients from the Continent and had not found that this had caused any major operational problems.

### ***A producer-user of couverture***

6.17. A producer-user of couverture said that as it was self-sufficient in the production of couverture it had only an indirect interest in the merger. It could potentially source couverture from the Continent as it was a high value item and could economically be transported into the UK. However, it appreciated that for customers who were not self-sufficient in couverture, and needed to purchase their requirements in the open market, the merger could raise serious concerns because of the concentration in the number of independent UK couverture suppliers.

6.18. This producer-user added that it would be concerned if, in the future, Callebaut took steps to increase its influence (whether by acquisition or other means) in the cocoa butter market. In practice, the majority of chocolate producers chose not to produce cocoa butter and the EU was already limited by customs tariffs on the importation of cocoa butter from a number of producer countries.

### ***Another producer-user of couverture***

6.19. Another producer-user of couverture thought that the merger might have an effect on smaller manufacturers who depended upon bought-in couverture. This could, however, create a market opportunity to supply couverture to independent customers in the open market, subject to capacity constraints and price competitiveness.

## **Open-market suppliers of couverture**

### ***Classic Couverture Ltd***

6.20. Classic submitted written information and attended a hearing.

6.21. Classic told us that it had entered the couverture market in September 1989 and had invoiced its first customer in January 1990. It was now one of the largest independent suppliers in the UK market. It was planning to expand into a new factory in the autumn of 1997 [ *Details omitted. See note on page iv.*

]. It preferred to buy cocoa mass and cocoa butter from [ *Details omitted. See note on page iv.* ], rather than process cocoa beans itself.

6.22. Classic said that it competed directly with Callebaut and Barry in the UK market and it had succeeded in winning customers from both companies. Classic emphasized that it was fully capable of meeting the same quality standards, including the same food safety standards, as Callebaut or Barry and had no difficulty in matching a competitor's product. Although economies of scale were achievable in couverture production, Classic had found that a smaller firm seeking to supply a range of customers with a wide variety of products could do so profitably by operating a mixture of new and second-hand machinery at a relatively low utilization rate. A number of other independent suppliers, with similar capacity, supplied the open market. Some had connections with other European countries. Other integrated producers (such as

UB/McVitie's and Nestlé UK), while not competing in the open market at present, were free to do so if they wished. Both had spare capacity and could probably win a significant share of the market. European suppliers were also free to enter the UK market. Though this involved additional transport costs this did not place them at a significant disadvantage. Similarly, UK suppliers could supply other European countries if the margins involved made it worthwhile. Classic considered, therefore, that in most respects the UK market should be considered as part of a European-wide market and should not be narrowly defined as solely a UK market.

6.23. Classic thought that UK market shares were likely to change as a result of the merger. A number of Callebaut and Barry customers would want to continue to dual source and this could benefit other suppliers. The merged company would have a dominant position in the market but price transparency in the industry would prevent it from taking advantage of its position by raising its prices. Price rises would be countered by the likely entry of integrated UK producers or other European suppliers into the open market. [  
*Details omitted. See note on page iv.*

]

## **Users of couverture**

### ***Bendicks (Mayfair) Limited***

6.24. Bendicks submitted written information and attended a hearing.

6.25. Bendicks said that it was a wholly-owned but autonomously managed subsidiary of a German confectionery group, Storck. It benefited from considerable investment by Storck in its business. It manufactured for the UK and export markets a range of boxed chocolate mints and English-style chocolate assortments under the Bendicks of Mayfair brand name. It also manufactured most of the boxed chocolate mints sold by Marks and Spencer plc (Marks and Spencer) under the St Michael brand name. The sales turnover resulting from its Winchester manufacturing operations had amounted to approximately £14 million in 1995. It also imported some of its parent company's brands, such as Werthers Original toffees.

6.26. Bendicks bought the bulk of its couverture from Callebaut and it also bought from Barry UK white chocolate imported from elsewhere in the Barry group. This chocolate was then used in various production processes to arrive at the finished product.

6.27. Bendicks told us that Callebaut and Barry were the two largest couverture manufacturers in the UK. [  
*Details omitted. See note on page iv.*

] It believed that other chocolate manufacturers shared this view and consequently these smaller couverture manufacturers found it hard to compete against Callebaut and Barry. Some of the small independent manufacturers produced coarse chocolate for biscuits rather than fine chocolate for confectionery.

6.28. Couverture was used in the UK by confectionery makers and by ice-cream and biscuit manufacturers. The largest of these had their own UK plants for the manufacture of couverture. In Bendicks' view, however, these vertically integrated manufacturers were not part of the market in which Callebaut and Barry competed. This was because such manufacturers either did not make open-market sales or made only a small number of such sales and certainly did not rely on these sales to maintain production volumes.

6.29. Most continental chocolate was made to a different recipe from that which resulted in the preferred traditional English chocolate taste. The distinctive and preferred English taste resulted from different cocoa beans being used and different manufacturing processes. Most English chocolate was made from Ghana beans, while most continental chocolate was made from Ivory Coast beans. Bendicks believed it would take years for a continental manufacturer to develop chocolate that could match its specifications. It had been working with Barry for some five years in order to achieve a flavour match of the chocolate currently supplied by Callebaut (Barry's proposal was to produce cocoa liquor from Ivory Coast beans in France and blend it at the Chester plant). If the merger between Barry and Callebaut were to go ahead in France, then Barry and Callebaut would no longer be competing with each other and Bendicks would not

wish to continue with its efforts to get Barry to produce a cocoa liquor which had the same flavour as Callebaut's.

6.30. [ *Details omitted. See note on page iv.* ]

[ *Details omitted. See note on page iv.*

]

6.31. Callebaut had entered the UK market by purchasing the UK manufacturer S & A Lesme. However, there were no worthwhile UK acquisition targets left for a continental manufacturer which wished to purchase a share of sales in the UK. Bendicks was therefore of the opinion that the relevant geographic area over which the effects of the merger should be assessed was the UK and not Europe as a whole.

6.32. [ *Details omitted. See note on page iv.* ]

(a) [ *Details omitted. See note on page iv.*

]

(b) [

*Details omitted. See note on page iv.*

]

(c) [ *Details omitted. See note on page iv.*

]

(d) [ *Details omitted. See note on page iv.*

] Bendicks said that it had not sought to be supplied by UB/McVitie's in the past because Terry's, a competitor of Bendicks in the supply of chocolate confectionery, had been part of the same group as UB/McVitie's.

6.33. [

*Details omitted. See note on page iv.*

]

6.34. First, the merged company would not be competing with a company of similar size. At present Callebaut and Barry acted as a check on each other's ability to increase prices. The smaller independent UK suppliers were unlikely ever to constitute serious competition to the merged company, given its market share. [

*Details omitted. See note on page iv.*

]

6.35. Secondly, in common with many other purchasers of couverture, Bendicks did not have the buying power to resist increases in price by the merged company. One of the divisions of its parent company in Germany did currently buy some of its couverture from Callebaut on the Continent, and this could give the group commercial leverage in its price negotiations with the merged company. However, as Bendicks' parent company made most of its own couverture, it was quite possible that in due course it would not need to buy from Callebaut on the Continent, whereupon Bendicks would be in the weak negotiating position of a relatively small UK user buying from a monopoly UK supplier.

6.36. Some of the larger purchasers of couverture might be able to use their considerable buying power to keep the prices they were charged by the merged company at a reasonable level. However, pricing arrangements between supplier and purchaser were always strictly confidential and smaller users would not therefore be aware of, and would not be able to object to, larger users receiving more favourable pricing from the merged company. For these reasons, the merger would have an adverse effect on competition in the UK industrial chocolate market. Bendicks suggested that it might be appropriate to impose price controls on the tolling charge of the merged company, that is the price paid to Barry Callebaut for transforming the raw materials into couverture plus their profit margin.

6.37. Nevertheless, Bendicks added, there could be benefits in the merger if efficiencies were passed on to the customers. As mentioned in paragraph 6.32, Bendicks preferred its beans to be roasted in the UK. If the merger meant that the roasting of beans at Banbury became more viable, and that Callebaut was less likely to try to match Banbury-type chocolate with liquor brought over from Belgium, then Bendicks would see advantages in the merger.

### ***Birds Eye Wall's Ltd***

6.38. Birds Eye Wall's, part of Unilever, said that the merger was unlikely to affect its sourcing strategy. Callebaut in the UK was its main supplier and was likely to remain so. For the scale of its business there was no commercially attractive UK alternative. Alternative supply from the Continent, for example Belgium, was a possibility but would involve significant additional transport costs.

### ***De Roma Ice Cream Ltd***

6.39. De Roma Ice Cream Ltd was unconcerned about the merger. Competition was likely to remain in the market and the presence of a number of suitable alternative UK suppliers would ensure that its ability to dual source was unaffected.

### ***Duncans of Scotland Ltd***

6.40. Duncans of Scotland Ltd (Duncans) firmly believed that a merger which would give Barry Callebaut an approximate 75 per cent share of the UK couverture market would be against the public interest. Currently there were no suitable alternative suppliers to Callebaut and Barry in terms of their range of products, technical expertise and quality of product. Though other suppliers might be prepared to enter the market they were unable to manufacture products of the same quality. The additional costs of importing bulk couverture from continental Europe to Scotland would be prohibitively expensive and would eventually lead to significant loss of business and employment.

6.41. Duncans added that though its policy was to employ the services of a number of different suppliers for the supply of different products, the virtual impossibility of replicating one manufacturer's recipes with other suppliers meant that it was not possible to have more than one supplier of any single recipe or product.

### ***Gilchris Confectionery Limited***

6.42. Gilchris Confectionery Limited (Gilchris) submitted written information and attended a hearing.

6.43. Gilchris said that it was a subsidiary of Kinnerton Confectionery (Company) Limited and supplied chocolate confectionery products to the major high street retailers. It used only high-quality couverture (that is, couverture as defined in the EC Directive), not couverture made with non-cocoa fats in substitution for cocoa-butter.

6.44. Gilchris said that its research of the market, both in the UK and elsewhere in Europe, showed that the effective removal of any competition would have an adverse effect on prices.

6.45. The customers of both Callebaut and Barry consumed couverture or chocolate-type compound in the ice-cream, biscuit, chocolate confectionery and bakery industries. The customer base could be divided into three:

- (a) *Large companies.* These included Northern Foods and Thorntons, which did not have their own chocolate manufacturing facility.
- (b) *Medium-sized companies.* There were a large number of private companies, such as Gilchris, which had created their own unique recipes. If the merger went ahead it was likely that Barry Callebaut would wish to rationalize costs and, because it faced no competition, would not offer the flexibility that had been in evidence before the merger.
- (c) *Small independent companies.* There were thousands of small family bakers and chocolate businesses which made hand-made products and relied totally on their raw material suppliers. If the merger were allowed to go ahead these companies would be left with only one player in the market. Prices were bound to rise in a monopolistic situation.

6.46. Gilchris submitted that the market share considered should be that of the open market. When Lesme took over Stewart & Arnold and subsequently merged with Callebaut the argument was put forward by these companies that the couverture market in the UK should be calculated to include output from such companies as Mars, Cadbury and Nestlé. However, these companies manufactured couverture purely for their own consumption and should not therefore be taken into account when calculating the overall size of the market. Gilchris understood that these companies, from time to time, were themselves short of capacity and often used SALC or Barry UK as a back-up supplier. If the merger were allowed to stand, Barry Callebaut would dominate the UK open market with a share of over 80 per cent.

6.47. The merger was not in the interests of customers, who added value to the liquid chocolate at all levels. The industry as a whole would lose creativity, for which European chocolate products were admired and consumed throughout the world, and would become less competitive.

6.48. Gilchris had asked Barry to guarantee existing prices after the merger. Barry had given verbal assurances but, when pressed to confirm this guarantee in writing, had declined to give such an assurance. It had argued that such a document would have no legal standing. If this assertion was correct, Barry's reluctance to provide the undertaking was bound to lead to the conclusion that prices would be increased if the merger were allowed to stand.

6.49. For the owner of the Swiss holding company that controlled Callebaut and all its international operations, the merger was an obvious business move to build a dominant position to maximize profitability. In view of the high price being paid to purchase Barry, the Callebaut group had obviously calculated that it could achieve an increased return on investment through cost control, economies of scale and, without doubt, higher pricing to its customers due to the lack of serious competition. It would no doubt rationalize

production in Belgium and the UK and centralize all possible activities, leading to the loss of jobs in these various markets.

6.50. Gilchris said that it was constantly examining the UK market for other producers of couverture. During the last year it had visited two companies but it did not believe they could guarantee products of consistent quality nor did they have sufficient capacity to be able to guarantee continuity of supply. In one instance, it had taken over a year for the producer to develop the correct recipe. Furthermore, Gilchris had doubts over the manufacturing and testing processes of the smaller independent manufacturers, unlike Callebaut and Barry whose laboratory facilities and microbiological testing could be relied on.

6.51. Gilchris did not see producers from countries outside the UK as a viable source of supply. Its storage capacity for the various types of milk chocolate couverture was limited and couverture could not be stored for longer than a week. Any interruption to the supply chain would bring production in its factory to a halt. During the past year Gilchris had suffered from the closure of the Channel Tunnel and delayed sailings through storms. The French lorry drivers' strike had blocked supplies of white chocolate which were being imported from Barry in France and Gilchris had been forced to purchase from SALC at a much higher price.

6.52. Gilchris' experience showed that it took up to a year to find alternative sources of supply. It was very difficult for another chocolate producer with different manufacturing processes to replicate Gilchris' recipes. Its major supplier before the merger had been Barry UK, which had been very competitive. SALC was significantly more expensive than Barry UK for the same grades of chocolate. Gilchris' margins were small and raw material cost increases were impossible to pass on. Further increases as a result of the merger could therefore affect Gilchris' viability.

6.53. The cost of entry into the manufacture of couverture was extremely high and Gilchris would be surprised to see any new entrants into this market. To make couverture competitively needed a very high level of investment, not only in the plant and machinery but in the laboratories and in the buying. Entry into the market was likely to be possible only for a company that had existing facilities available.

6.54. Gilchris said that a solution would be for the merged entity to be asked to dispose of one of its two UK factories to another party so that the monopoly situation was reduced.

### ***The Glisten Co Ltd***

6.55. The Glisten Co Ltd (Glisten) pointed out that in the UK only a few companies, including Callebaut and Barry, manufactured couverture exclusively for third party use. Callebaut's and Barry's technical expertise was superior to that of other companies. Healthy competition had existed since Barry entered the UK market. Glisten was concerned that if the merger proceeded the new company would have a dominant position in the market which could enable it to dictate prices and supply.

### ***Manor Bakeries Ltd***

6.56. Manor Bakeries, a company within the Ranks Hovis MacDougall group (in turn owned by Tomkins), submitted that the merger would create a company which would dominate the supply of couverture in the UK open market. A major element of competition would be eliminated from the sourcing process and the new enlarged company might abuse its new-found status by manipulating supplies or imposing commercially unwarranted pricing levels. Smaller manufacturers might find themselves the victims of price manipulation and would have only limited financial resources with which to withstand or counter such tactics.

6.57. Manor Bakeries added that though the merger would create a dominant supplier in the UK open market, it believed that a wider, less parochial, view needed to be taken since both companies operated in the rest of Europe and beyond. As part of the growing trade between EU countries, many UK businesses regularly obtained their product requirements for a variety of continental suppliers. Manor Bakeries was no exception to this trend and would not hesitate to purchase raw materials from outside the UK if necessary. In these circumstances, it considered that the merger was not against the public interest and it could see no valid

reason why it should not proceed. It concluded that if competition concerns still existed they should be examined as part of a wider, more complex, pan-European scenario.

### ***Northern Foods plc***

6.58. Northern Foods said that it was the ultimate parent company of Fox's Biscuits, The Park Cake Bakeries and Elkes Biscuits. Fox's Biscuits used plain, milk and white chocolate couverture for enrobing and moulding biscuits under the Fox's Biscuits brand and private-label brands. Elkes Biscuits used milk and plain chocolate couverture for coating biscuits. The Park Cake Bakeries used couverture for covering cakes and for incorporation into butter creams and ganache (a blend of chocolate, cream and sugar).

6.59. Northern Foods said that Fox's Biscuits and The Park Cake Bakeries both had policies of dual sourcing. Northern Foods pointed out that there were only a small number of independent couverture producers in the UK. At present none had the capacity or technology to produce high-quality couverture, nor to provide technical support. Northern Foods said that it valued the technical support Callebaut and Barry provided to their customers in terms of product development and advice, for example on how their couverture products interfaced with equipment, and on their structure and performance. Small independent producers of couverture had neither the technical knowledge nor the resources to provide such support. Smaller couverture manufacturers tended to use McIntyre equipment which ground chocolate less finely and produced a less smooth product than Buhler equipment. This did not meet Northern Foods' quality requirements.

6.60. Matching of flavours, which was extremely difficult, represented another major obstacle to switching suppliers. In Northern Foods' experience, it could take anywhere between 6 and 18 months of trials for a couverture producer to match the flavour produced by other producers. For these reasons, Northern Foods considered that no other UK producers of couverture offered a viable alternative to Callebaut and Barry.

6.61. Northern Foods added that within the UK there were a number of manufacturers which produced couverture primarily for their own use. These included Cadbury, Mars, Nestlé, Premier and UB/McVitie's. Such manufacturers competed with Fox's Biscuits and Elkes Biscuits to supply biscuits. If Fox's Biscuits and Elkes Biscuits were to source couverture from these suppliers, they would have to divulge confidential information to their competitors. Accordingly, Fox's Biscuits and Elkes Biscuits, which were together responsible for over 92 per cent of Northern Foods' couverture requirements, did not regard in-house manufacturers of couverture as viable alternative suppliers to Callebaut and Barry. Accordingly, the presence of manufacturers of confectionery or cakes and biscuits which produced couverture in-house was unlikely to act as a strong competitive constraint upon the merged entity.

6.62. Northern Foods accepted that there might be producers outside the UK which could meet its requirements in terms of product quality, volumes and safeguards against contamination. However, sourcing couverture from outside the UK would involve a significant reduction in the flexibility with which it was able to source couverture at present. This was particularly likely to be a problem when couverture was sourced in bulk liquid form and could not easily be stored. In 1995/96 bulk liquid couverture had represented 94 per cent of its total requirements, and in its experience the volumes of bulk liquid couverture that could be stored at manufacturing sites were limited by tank storage capacity. Northern Foods estimated that it would take on average two days to transport bulk liquid couverture from overseas suppliers. Given that its businesses took daily deliveries, it considered that if it had to source couverture from abroad, it would lose the high degree of flexibility that was vital to its businesses. It also considered that the combination of transportation costs, foreign currency exposure and the risks of adverse currency movements would significantly increase the cost of purchasing couverture from overseas suppliers.

6.63. Northern Foods said it was concerned that if the merger was to proceed, the majority of the UK open market for couverture would be concentrated in the hands of just one supplier. It did not regard other coatings as viable alternatives to couverture. Legal requirements dictated that chocolate, and therefore couverture, must contain cocoa fat. Compound coating, however, contained other vegetable fats.

6.64. Another major concern was that, as chocolate was susceptible to salmonella, safeguards had to be built into the production process in order to avoid microbiological contamination. Northern Foods said that it relied heavily on a system called 'Hazard Analysis of Critical Control Points' which involved the thorough

examination of the production processes of couverture producers. Undertaking such a study would represent another obstacle to switching suppliers.

6.65. The costs of switching supplier were extremely difficult to estimate but Northern Foods believed that switching might cost around £10,000 per recipe. However, this figure would depend upon a number of variables including, *inter alia*, the time taken to match recipes and the examination of suppliers' production processes.

6.66. Northern Foods understood that there were no manufacturers of non-couverture products (such as compound coatings) in the UK that could easily switch to the production of high-quality couverture should profitable opportunities arise. This was because such manufacturers would incur significant capital costs associated with the purchase of specialized equipment. Therefore it did not consider that the merged entity would face competition from manufacturers of non-couverture products.

6.67. In the absence of strong competition in the open-market supply of couverture, and the lack of an alternative ingredient to couverture, Northern Foods expected that the margins earned by the merged entity would increase over time. Northern Foods would be forced to continue to compete with manufacturers such as Cadbury, Mars and UB/McVitie's which would enjoy an artificial cost advantage by producing couverture in-house. This was likely to distort competition in the supply of biscuits and cakes.

6.68. Accordingly, if the merger were to proceed, Northern Foods would be forced to investigate the possibility of either fostering one of the smaller UK suppliers of couverture or setting up its own in-house production facility. Without a full investment appraisal, it was extremely difficult to estimate the cost of bringing a small couverture manufacturer into line with Northern Foods' requirements.

6.69. However, Northern Foods considered that the cost of building a 20,000 tonne capacity couverture production plant might be in the region of £10 million and concluded that the greatest obstacle to such a project would be the time required to match recipes, which could be as long as 18 months.

### ***Northumbrian Fine Foods PLC***

6.70. Northumbrian Fine Foods PLC opposed the merger. It thought the merger would drastically reduce competition in a market where there were few alternative suppliers. It considered that supply from outside the UK was not a viable alternative.

### ***OP Chocolate Limited***

6.71. OP Chocolate said that the merger would adversely affect its business and the UK biscuit and confectionery markets as a whole. Competition existed at present between the parties, with both offering a wide range of couverture grades and excellent technical services. If the merger was successful, there would be no other major manufacturer of liquid couverture in the UK. This could allow the combined company to manipulate prices and/or rationalize couverture grades and services. OP Chocolate stressed that couverture was its highest-valued ingredient; any upward movement in price would add a significant cost to its business.

### ***Thorntons PLC***

6.72. Thorntons submitted written information and attended a hearing.

6.73. Thorntons explained that, as a manufacturer and retailer of high-quality chocolate products, it had purchased bulk chocolate to its own requirements from both Callebaut and Barry over a number of years. It had welcomed Barry's decision to build a plant at Chester. Barry's aggressive marketing policy had prevented Callebaut from allowing its prices to drift upwards. Thorntons said that it had purposely maintained two suppliers to ensure competitive pricing, quality and service. Unlike other large UK confectioners, it had neither the facilities nor the resources to manufacture its own couverture, nor would it be cost-effective for it to do so. The size of Barry Callebaut's combined market share would, therefore, be extremely damaging to its business and competitive position, and that of other independent UK chocolate

manufacturers, and would adversely affect its buying power and pricing structure. If Barry Callebaut did decide to increase its prices, smaller suppliers would most likely follow suit.

6.74. Thorntons thought that Callebaut clearly intended to dominate the UK couverture market. The number of sizeable independent couverture manufacturers in the UK and the rest of the EU had declined considerably in recent years, with supplies increasingly concentrated in a few suppliers. Though there were a number of independent UK suppliers, very few had the capacity or capability to produce the range or volume of chocolate Thorntons required, to reproduce its recipes or to satisfy its quality standards. Alternative suppliers would take at least 12 months to satisfy Thorntons' requirements, if they could do so at all. Also, as yet none of the smaller independent suppliers produced white chocolate, which made up approximately 30 per cent of Thorntons' requirements.

6.75. Thorntons did not believe that the entry of fully integrated producer-users such as Nestlé or Mars to the market, even were this to happen, would allay its fears. Though producer-users might be prepared to sell excess capacity on the open market when it suited them, they would, understandably, put their own needs first and could not be fully relied upon as regular suppliers. Thorntons believed, however, that it could be supplied by certain companies which had spare capacity and the ability to offer quality products. It regarded Premier as a suitable supplier and was encouraged by the possibility that UB/McVitie's might begin to supply the open market on a regular basis. It added that the price would have to be right.

6.76. Thorntons added that sourcing outside the UK was not a viable alternative although, over recent months, there had been encouraging signs that the prices quoted for white chocolate from other European sources were coming much nearer to UK prices. Thorntons was, however, concerned that levels of service from other European suppliers would be less reliable than from UK suppliers.

### ***A confectionery manufacturer***

6.77. A confectionery manufacturer told us that competition between confectionery manufacturers in the UK was intense. A merger of the two major independent UK couverture manufacturers would have an immediate effect on competition and on choice of supplier. Though there were a number of other independent suppliers in the UK market none offered the financial security, technical support and consistency provided by Callebaut and Barry. The merger was, however, unlikely to affect the quality of the product and might even enhance it.

6.78. The confectionery manufacturer thought that, although the merger was not specifically against the public interest, Barry Callebaut was bound to reduce staff through rationalization. The manufacturer's own concerns were that the merged company could impose stricter trading terms and higher prices. Also, if the merger failed to go ahead in the UK yet was allowed in most other countries where the two companies operated, this might leave SALC and Barry UK vulnerable to a take-over, which would not be in the manufacturer's interests. If the merger did go ahead, the manufacturer recommended that safeguards should be put in place to ensure that the combined company did not abuse its monopolistic position, particularly with regard to pricing. Sourcing from European suppliers was not a problem as long as exchange rates were in a UK manufacturer's favour.

## **Retailers**

### ***Marks and Spencer plc***

6.79. Marks and Spencer told us that it had been a customer of both Callebaut and Barry for many years and had jointly developed with them many new chocolate products. It had always found both companies innovative and flexible and hoped that this approach would be unaffected by the merger. It noted that several of its current suppliers of chocolate confectionery had raised objections about the commercial implications of the merger. As a consequence, it was concerned that this might directly affect the cost of its finished goods. Any cost increases would in turn have to be passed on to consumers.

G D W ODGERS (*Chairman*)

P G CORBETT

M R PROSSER

P A BOYS (*Secretary*)

17 April 1997