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Competition and Mergers in Consumer Goods Industries: The Case of Pet Foods

by

Professor Paul Dobson *

ABSTRACT

Recent announcements on restructuring plans and merger proposals amongst fast-moving-consumer-goods (FMCG) producers have attracted widespread media attention and business analysis commentary. The scale of the changes, the number of jobs at stake, and the sums of money involved all provoke interest. In the case of mergers and acquisitions, interest is not limited to business commentators and the media; competition authorities are likely to be concerned about activity that serves to consolidate markets. Until now competition authorities have generally allowed mergers amongst FMCG producers to proceed with at worst limited divestitures of various types. However, with an apparent new phase in strategic acquisitions taking place in the sector there is business concern about how competition authorities will respond and whether a tougher stance against mergers will be taken in light of merger prohibitions in other sectors.

This paper considers the appropriate policy response to mergers in the FMCG sector. The perspective that the paper offers is for the need to consider the competitive effects of mergers in light of changes taking place in the product supply chain. In the case of FMCG markets, the substantial shift in the balance of power in favour of retailers has greatly affected the nature of producer competition. The on-going consolidation taking place in retail markets has served to increase the enormous buying power that the major retailers can now exercise, ensuring that even the largest suppliers are placed under intense competitive constraints. In this setting, mergers amongst producers may facilitate efficiency improvements but are unlikely to allow for the exercise of abusive market power by producers when retailers retain the whip hand and are able to drive prices down by playing off suppliers against each other.

As an illustration of these aspects, the pet food market provides an interesting case as it has witnessed numerous mergers over recent years yet remains intensely competitive. However, the recently announced merger proposal between Nestlé and Ralston Purina to form the world's largest pet food producer has raised concern that competition could be stifled if the merger is allowed to be completed. In considering this issue, the analysis here examines the nature of competition in view of the changing structure and dynamics of power relations in the pet food market.

Key Words: Competition, Mergers, Consumer Goods

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1. INTRODUCTION

FMCG (fast-moving-consumer-goods) producers are presently going through some major organisational changes. In some cases, firms are scaling down their operations to focus on particular markets with re-focusing entailing closures and divestitures. At the same time, firms are often seeking to consolidate positions of perceived core businesses with strategic acquisitions intended to increase their efficiency and market reach. Given the large size of many of these organisations it is not surprising that these moves have received the attention of business commentators and attracted wide media interest. Nor, indeed, have the moves escaped the watchful gaze of competition authorities intent on ensuring that competition remains effective in consumer goods industries. Competition authorities have regularly sought to investigate mergers and acquisitions of such firms but by and large have allowed mergers to proceed with at worst limited divestitures of various types. Given the usually diversified and international nature of these firms, the enforced divestitures have typically been in the form of brand/product sell-offs or plant/capacity sell-offs.¹ In this way, so the competition authorities reason, the cost-saving benefits from mergers can be allowed while ensuring that market dominance by particular parties can be avoided.

With an apparent new phase in strategic acquisitions taking place in the industry there is concern about how competition authorities will respond and whether a tougher stance against mergers will be taken. Certainly, there have been ominous signs of authorities taking a stronger prohibition line from other markets where mergers did not even raise concerns about single-firm dominance, but rather about joint dominance where the merger was alleged to raise the prospect of market co-ordination to suit the joint interests of the leading firms. Concerns about post-merger oligopolistic dominance were cited as the basis of the European Commission's decision to prohibit the merger of *Lonrho/Gencor*². In this case the merged enterprise with its leading rival, *Amplats*, would together have controlled some 90% of underground platinum reserves. More controversially, the EC's decision to block the proposed acquisition of *First Choice* by *Airtours* was in the context of a dynamic market (with a history of fluctuating business fortunes and changing market shares) where, post-merger, the top three firms would have controlled around 80% of the UK package holiday market. More recently, the UK authorities have prohibited the merger of *Interbrew* and *Bass* and instructed full-divestment following the recommendations of a Competition Commission inquiry³. The basis for this decision appears to have rested on concerns that post-merger the two leading firms would jointly dominate and restrict competition in the UK beer market, even though their joint market share would only be around 60%. Unlike the other two cases where

¹ Two notable cases here concern *Nestle/Perrier* (Case IV/M190 [1993]; OJ L356) and *Unilever/Bestfoods* (COMP/M.1990 - 28/09/2000). In both cases the merging parties were required to divest brands to rivals by the European Commission. The former case centred on the mineral water market in France. In the latter case, the instructed divestments covered a wide range of food products in different EU member states.

² Case IV/M619 [1997]; OJ L11

³ Competition Commission, *Interbrew SA and Bass PLC: A report on the acquisition by Interbrew SA of the brewing interests of Bass PLC*, Cm 5014, TSO, January 2001.

limited divestments were not practicable, the UK authorities did not take the option of allowing the Interbrew/Bass merger subject to certain brand or capacity divestments but instead insisted on complete disposal.⁴

Clearly, if this tough line were to be pursued more widely by competition authorities then there would be widespread business concern that any proposed merger amongst leading firms in oligopolistic industries would run the serious risk of being blocked, even when single-firm dominance would not be an issue. The consequence could then be that firms avoid taking this risk but as a result potential efficiency gains from mergers would be lost. In the context of FMCG markets, typically oligopolistic in nature due to the need for firms to be large to reap economies of scale and scope, this issue might be expected commonly to arise. The fluidity and changing nature of these markets is likely to encourage firms to re-structure regularly to search for greater efficiency and extend market reach through strategic acquisitions and mergers. Accordingly it might well be in the context of these markets that the direction of merger control policy is likely to take further shape. Current investigations of recently announced mergers in FMCG markets are likely to make it clearer which way competition authorities are leaning towards: a rigorous prohibitive approach in oligopolistic markets or a more encouraging one where mergers are allowed to proceed untouched or at most subject to appropriate limited divestments to allay competition concerns.

This paper considers the issues that drive FMCG producers to undertake restructuring and how mergers and acquisitions can be viewed as appropriate responses to changes in market conditions. It goes on to consider the competitive effects of such mergers and whether and under what conditions competition authorities should be concerned about such merger activity. The central insight offered is that to assess the competitive effects one needs to understand the motivation for such mergers in the context of the markets in which the firms operate and the nature and developments of the supply chain in which they operate. Essentially, the need is to view competition as existing in a vertical (i.e. between trading parties at different levels of the supply chain) as well as a horizontal sense (between rivals competing to serve similar needs). This paper considers these aspects in the general context of FMCG markets, where fundamental changes have occurred in the balance of power in the vertical chain following the substantial consolidation of retail markets now dominated by a very limited number of multiple retail chain-store groups wielding enormous buying power and driving through aggressive own label strategies.⁵ The paper goes on to give specific consideration to the pet food market where merger activity amongst producers has been particularly pronounced over recent years and where further

⁴ Subsequent to this decision a judicial review of the case in the English High Court has found that the Competition Commission acted unfairly in failing to give Interbrew sufficient opportunity to comment on potential remedies. This has opened the door for negotiation between Interbrew and the UK government on the extent of required divestments. It is not presently clear whether Interbrew will still have to dispose fully of Bass Brewers (see e.g. “Interbrew victory over forced Bass sale”, *Financial Times* 24/5/2001; and “Interbrew order upset merger review policy”, *Financial Times* 26/5/2001).

⁵ This shift in power towards retailers has been coupled with the decline of the traditional intermediary wholesaling sector. Retailers themselves have largely taken over this role leaving traditional wholesalers to serve the small, independent retail sector.

activity is in the process of taking place. The conclusion reached is that in light of the present market dynamics and the presence of concentrated buying power this merger activity is likely to be pro-competitive and supportive of innovative activity while helping to ensure that consumers continue to have a wide choice of products. Specifically, the announced merger proposal between Nestlé and Ralston Purina is likely to lead to increased productive efficiency and heightened competitive activity as suppliers compete intensively for a share of the increasingly global market.

2. MERGERS AS RESPONSES TO CHANGING MARKET CONDITIONS

Changing market environments force firms to re-think their organisational design and their basis for competing in a market. In this regard, mergers and acquisitions can be viewed as responses to changing market circumstances: not just a means for growth but rather a route to a more efficient organisational structure, better able to compete in the market. Mergers allow firms to reorganise their portfolio of activities and product offerings to better suit changing market conditions. The driver of such organisational change could be identified with a key change in the broad business environment, say down to technological developments leading to changes in processes or products or other external factors, such as shifts in consumer behaviour. More often than not, though, it is the process of competition itself that dictates the need for change.

For firms, competition is more than the mere jockeying for market position between rivals producing similar products, but rather competition for profits generated by the whole supply chain, i.e. taking account of the positions of suppliers and buyers as well as competing producers (Porter, 1980). Shifting positions of market power may then give rise for the need to undertake restructuring through a merger to compete more effectively. This change might be at the horizontal level where, say, an increasingly dominant position of a firm encourages rivals to contemplate merger as a response to the threat posed. Equally, it could be due to shifts in power within the supply chain, i.e. in a vertical sense. This latter view was advanced by J.K. Galbraith (1952) and associated with the notion of mergers as a countervailing force or response to the emergence of market power at another level.

For Galbraith, the merger response was intended to improve a weak bargaining position, where merger allowed for the development of bargaining power so as to neutralise the market power of suppliers and/or buyers. The private benefits to the merger in these circumstances would arise from improved bargaining power by the pooling of financial resources (to build deep pockets) and the restriction of opportunities for trading partners to play off rival firms against each other. More contentiously, Galbraith claimed that there would be public benefits as well since the development of bargaining power would prevent suppliers from exercising *monopoly power* (restricting supplies to drive price up) and equivalently prevent buyers from exercising *monopsony power* (restricting purchases to drive price down) (Dobson *et al.*, 1998). Benign economic welfare effects would result for certain only as long as a merger led to the establishment of *countervailing power* and not a source of *original power*, for instance where buyers developed countervailing power against powerful suppliers but in doing so created selling power of their own (Dobson and Waterson, 1997). In practice, where the development of buying power goes hand-in-hand with the development of selling power, and vice versa, e.g. where increased market share extends both forms of power, the economic welfare benefits of a merger in Galbraith's terms will not be certain.

But there is another fundamental aspect to changing positions in the supply chain that is more widely overlooked. The growing market power of trading partners does not only offer incentives to look to mergers as a means to gain matching bargaining

power, but the very process of the changes taking place at one level may affect the nature and intensity of competition at a different level. Thus a process of consolidation having occurred at one level, say amongst an industry's buyers, may then spur on consolidation at an adjacent level, e.g. amongst producers supplying these buyers. For instance, as one level of the chain consolidates, competition at that level may shift with firms seeking to differentiate their position encouraging their trading partners to provide a means to reinforce that differentiation, in the process altering the basis of their own competition. This might arise, for example, through encouragement for suppliers to provide exclusive products and/or buyers to provide dedicated selling services.

More generally, as one level consolidates and seeks to exploit its market power against weaker trading partners, there will be increased emphasis on the trading partners providing added value and increased efficiency in the system which can then be appropriated by the powerful players. Notably, powerful firms will have a vested interest in ensuring that their trading partners increase their efficiency (but not their bargaining position). Thus a powerful buyer might insist that its suppliers invest in the latest technology to improve their own efficiency to serve better the buyer, say, with lower cost supplies or higher quality supplies. In this way the buyer can extend its own market power as a producer or re-seller by improving its competitive advantage over other buyers. With a number of powerful buyers vying for competitive advantage over each other, and with high stakes to play for, intense pressure may be put on suppliers to adapt and serve their specific needs. As a consequence, supplier competition itself will change raising the prospect that organisations will need to change themselves to suit better the new competitive environment. In such circumstances mergers may offer suppliers cost savings to allow them to better withstand the intense pressure they are under from buyers to produce goods at lower prices.

Thus a shift in the balance of power in the supply chain favouring one level can not only spur firms on at the adjacent level to undertake restructuring activity to search for efficiency improvements and countervailing bargaining power but may be critical as a means of adjusting to the new shape of competition. With a shift of power in the chain, the level with power in being able to dictate terms on trading parties can substantially alter the rules of competition between these parties. Restructuring and portfolio adjustment may then be a necessary process which firms are required to take in order to remain economically viable and best adapt to changing market circumstances. This can apply to large firms and small firms alike.

3. CHANGING MARKET CONDITIONS IN THE SUPPLY OF GROCERY AND DAILY GOODS

The competitive processes and drivers of change outlined above are perhaps no better illustrated than through the recent developments that have occurred in the consumer goods industry, and more particularly the supply of packaged and processed food and other products collectively referred to as fast-moving-consumer-goods. Here powerful retail chains have emerged to dominate food and daily goods markets at the national level and increasingly at the international level. From a situation where retail markets used to be highly fragmented, consisting predominantly of traditional independent retailers, they have become highly consolidated, driven by a process of organic growth and mergers by leading retailers. The result has been the marginalisation of small independent retailers, restricted to acting as convenience stores (for so-called top-up shopping), and market domination by a limited number of large-format, multiple-store retailers that attract the bulk of consumer spending.

The consolidation process has occurred across all developed nations to a greater or lesser extent. As Table 1 shows, there is variation in the levels of retail concentration across EU member states, but the general trend is one of apparent relentless increase over time. As illustrated by the Table there have been notable increases in the market share controlled by the five leading retailers in particular countries, and overall the (weighted) average level of concentration across the 15 member states increased by 20% over the six year period shown.

Table 1 - Five-Firm Concentration (%) in Grocery and Daily Goods Retailing for EU Member States (1993-1999)			
	1993	1996	1999
Austria	54.2	58.6	60.2
Belgium+Luxembourg	60.2	61.6	62.5
Denmark	54.2	59.5	56.4
Finland	93.5	89.1	68.7
France	47.5	50.6	56.3
Germany	45.1	45.4	44.1
Greece	10.9	28.0	31.1
Ireland	62.6	64.2	58.3
Italy	10.9	11.8	17.6
Netherlands	52.5	50.4	56.2
Portugal	36.5	55.7	63.2
Spain	21.6	32.1	40.3
Sweden	79.3	77.9	76.7
UK	50.2	56.2	63.0
EU 15 (weighted av)	40.7	43.7	48.9

Source: Estimates based on data from CIR's European Retail Handbook

However, it is not only at the national level that significant increases in concentration have occurred.⁶ Increasingly, the major retailers have sought to expand internationally. Wal-Mart, the world's second largest company with \$193bn global turnover and 1,244,000 employees, has become a major player in Europe through key acquisitions in the UK and Germany. At the same time, Carrefour's recent merger with Promodes has created Europe's largest and the world's second largest retailer, consolidating its dominant position in France and Spain and increasing its position considerably in other countries. Other major retailers, notably from Germany (Rewe, Metro, Aldi and Edeka), France (Intermarche, Auchan and Leclerc) and the UK (Tesco), have meanwhile strengthened their domestic and international positions.

Indeed, the concerted international as well as domestic expansion by the very leading food retailers has meant that they are increasingly taking a larger share of overall sales away from other retailers. The result has been a sharp increase in aggregate concentration across the EU. The top ten retailers in the EU now account for over 30% of sales of all food and daily goods. As shown in Table 2, this level has increased by some 25% in just six years. Moreover, it is clear that the top ten, or at most the top twenty, retailers are pulling away in growth terms from the rest. For instance, while the share accounted for by the leading 50 retailers was 49% in 1999, the level had only increased by 7.7% over the previous six years. As evidenced by the breakdown of rankings into decile groups, it is apparent that only the top two groups (1-10 and 11-20) increased their share, while those ranked lower accounted for reduced shares over time.

Table 2 - Aggregate Concentration in Grocery and Daily Goods Retailing for the European Union (1993-1999)				
Share of firms Ranked:	1993	1996	1999	1993-1999 % change
1-10	24.5	27.4	30.6	+24.9%
11-20	11.3	12.6	12.4	+9.7%
21-30	5.0	4.9	3.7	-26.0%
31-40	2.9	3.0	1.8	-37.9%
41-50	1.8	1.4	0.5	-72.2%
Top 50	45.5	49.3	49.0	+7.7%
Top 30	40.8	44.9	46.7	+14.5%
Top 20	35.8	40.0	43.0	+20.1%
Top 10	24.5	27.4	30.6	+24.9%

Source: Estimates based on data from CIR's European Retail Handbook

⁶ It should be noted that the market base in Table 1 is the retail sales of all food and all daily items. Accordingly, these figures understate the level of concentration specific to items sold as prepared grocery or daily goods and predominantly identified with grocery stores. Other sources show higher levels of concentration. For instance, AC Nielsen figures show that for 1999 the market shares of the five majors in grocery were in Austria 93%, Belgium 72%, Denmark 84%, Finland 83%, France 83%, Germany 76%, Greece 45%, Italy 31%, Netherlands 95%, Portugal 54%, Spain 51%, Sweden 95%, and UK 71%. Also, figures vary by store size classes. In the UK, for example, the Competition Commission (2000) found that the top five retailers accounted for 69.2% of sales of grocery and daily products but that the top five grocers accounted for 75.6% of stores over 600 sq.m. and 89.3% of stores over 1,400 sq.m. - see Bell (2000) for further discussion.

The evidence from Tables 1 and 2 clearly points to a considerably more consolidated retail sector both at the national level as well as at the Community level. The leading retailers have strengthened their domestic positions and have expanded internationally to the point where a handful of leading players account for a large proportion of retail sales of FMCG products across Europe. It is on these retailers, with their enormous buying power, that the livelihood of most FMCG suppliers depends. With their control of retail markets, the powerful store groups are able to wield their bargaining power to extract beneficial trading terms from suppliers pressurised into making concessions in order to gain access to their customers. The superior trading terms obtained by the leading retailers further reinforces their competitive advantage over smaller rivals, which in turn leads to further consolidation at the retail level. The process is one of a virtuous circle for the very largest retailers where size and market share beget bargaining concessions from suppliers which reinforces cost advantages over smaller rivals enabling the large retailers to selectively reduce their retail prices which in turn increases the large retailers' sales and market share, and so on.

Yet, it is not only the buying power of the major retailers, exercised through their sheer size and control as gatekeepers to consumers, which has shaped the way that suppliers must respond in order to secure sales. As grocery retail markets have consolidated, the leading players have increasingly sought to differentiate themselves one from another by developing their particular appeal to consumers with the intention of increasing the number and loyalty of their customers. As a consequence there has been a considerable emphasis on retail branding and self-promotion (typically along the lines of self-styled "consumers' champion") with a substantial move towards the provision of own-label goods promoting the name of the retailer at the expense of branded goods carrying the name of the producer. Initially conceived as low quality discounted items, own-label products have now been typically repositioned to compete more directly with the leading brands. The limited availability of in-store shelf-space has meant that secondary and tertiary brands have in many instances been de-listed by retailers to make way for the increased presence of own-label goods (Bell *et al.*, 1997). The result has been a fundamental shift in the nature of supplier competition, with an effective market polarisation between firms choosing either to focus on leading brands or produce own-label goods under the direction of the major retail chains, but with fierce competition in either line.

In the case of own-label goods, producers are often put into a bidding situation, where the only guarantee of winning a contract to supply a retailer is by offering the lowest price possible. Hence price-focused, cut-throat competition typically prevails, driving on own-label suppliers to search for efficiencies and cost savings in order to stay in business.

For the leading brand producers, the competitive pressures can be equally strong. For not only do the brand producers have to fight to build and maintain leading brand recognition, with the necessary brand investment and promotion that this requires, but they face powerful retailers willing and able to substitute their products for those of rival brands or retailers' own-label goods. Thus while investing heavily in brand

promotion they are also under pressure to cut costs to remain competitive in pricing terms. The drive for efficiency gains and cutting costs is further intensified by the now prevalent practice of retailers demanding substantial up-front fees for access to shelf-space and key in-store positions (e.g. end of aisle or so-called “gondola” positions) (Dobson Consulting, 1999; Competition Commission, 2000; Davis, 2001). These practices arise from the disparity in relative bargaining power, which is all too apparent when consideration is taken of the extent of relative dependency between the trading parties. The retail sales of a given large retailer dwarf those of most FMCG suppliers and purchases from the largest supplier will generally account for no more than 1 or possibly 2% of the retailer’s total purchases (Competition Commission, 2000). Moreover, it is more straightforward for a retailer to fill shelf space with another supplier than it is for a supplier to gain extra sales at another retailer.⁷

The internationalisation of grocery retailing has also brought suppliers new challenges. International retailers will themselves look for procurement economies through centralising their buying practices as much as possible. This means that suppliers in different countries may end up competing against one another for contracts that cover several countries. While some global brands exist, most brands are only recognisable at the national level. The desire of retailers to award international contracts will spur brand producers to build or acquire leading brand positions in each of the countries to be served to enhance their chances of winning such international contracts. Similarly, own-label producers will be induced to expand abroad in order to secure international contracts. Accordingly, the internationalisation of retailing and the resulting changes to the way that the retailers purchase goods will act as a driver for the internationalisation of producers seeking efficiencies and widespread presence in order to secure contracts. Given the time required to build new positions organically, producers may instead be expected to extend and adjust their international reach through strategic acquisitions. It is precisely this aspect which lies behind much of the international acquisition and sell-off activities of leading branded FMCG producers where adjustment to product portfolios is taking place.

Moreover, the drive for producers to be competitive on an international basis is not only a result of the very largest retailers taking up increasingly strong international positions but from the broad set of large retailers generally participating in international buying alliances. This practice is now common in the EU where buying alliances have formed representing retailers from different member states (normally with one member per country), increasing retailers’ scope for extracting discounts by collaborating on purchasing using joint order size as a bargaining lever (Dobson Consulting, 1999).

⁷ The power from the gatekeeper position held by a major retailer arises not simply from the limited number of opportunities for a producer to reach consumers (i.e. through alternative store groups) but also that from the consumers’ perspective brand switching is easier than store switching. In these circumstances, the “captive” consumer will typically buy another product even if his/her favourite product is unavailable (due to it being delisted by the retailer).

Thus for a variety of interrelated reasons the substantial consolidation and internationalisation of grocery retailing in altering the nature of retailing competition has also altered the nature and intensity of supplier competition. FMCG suppliers have been forced to search for available economies in order to remain competitive. While cost-savings have been made through increasing the efficiency of existing capacity and brands supplied, for many producers the only way to increase efficiency further is via mergers and acquisitions and other re-structuring activity to reap economies of scale and product/category specialisation. In this sense, the recent activity of FMCG producers in adapting and enhancing their product portfolios through M&A activity can be seen as a natural and efficient response to the changing retail environment which they now face.

4. THE ECONOMIC IMPACT OF MERGERS BETWEEN FMCG PRODUCERS

While there are clear efficiency advantages to the restructuring activity of producers outlined above, there have nevertheless been concerns expressed that the scale and extent of market share controlled by prospective merged enterprises in key FMCG markets will restrict competition to the public detriment. It is now not untypical in FMCG markets (as narrowly defined on a product or category basis) for one or more producers to have market shares near to or even exceeding the 40% level at which competition authorities have traditionally been concerned about problems of *single-firm dominance* arising. Further mergers in the sector are likely to increase the number of product markets where potential issues of dominance arise. However, as with all merger cases, assessment needs to take into account the actual nature of competition in the market, not simply rely on market shares thresholds being exceeded. This can work both ways. It is conceivable that even with mergers where 40% market shares are not achieved problems of *joint dominance* and intentional avoidance of competition amongst key players may still arise. Equally, where a merger allows a firm to advance beyond 40% market share it is conceivable that competition may not be adversely affected and may be even enhanced. Whether competition is likely to be restricted or enhanced by the merger will depend on the economic conditions in the market and the precise nature of post-merger competition.

Problems of single-firm dominance arise in situations where the merged enterprise has the unilateral power to raise prices without being substantially constrained by competition. Very large market share might be a pre-requisite for single-firm dominance but is not sufficient in its own right if market conditions allow for competitors to respond by taking sales away from the firm if it raises prices. The additional conditions that can support single-firm dominance are where the market is characterised by differentiated rival product offerings and a focus on non-price rivalry (allowing for relatively inelastic individual demand), capacity constraints (preventing competitors supplying increased volumes), and high entry barriers (preventing new competitors coming into the market). In these circumstances, neither potential nor actual competitors are likely to pose sufficient concern to a dominant merged enterprise from exercising its market power.⁸

In regard to joint dominance, the concern is that the merger will encourage the key firms in the market to co-ordinate their behaviour by consciously adopting parallel pricing and thereby reduce price competition. For this to be credible, the firms in the post-merger environment will need to be in a position to reach tacit agreement on collusive price levels (essentially by identifying suitable focal prices), be able to monitor the agreement and maintain it by having the credible ability to punish any

⁸ For example, in consideration of the *Kimberly-Clark/Scott Paper* (Case IV/M63 [1996] O.J. L183/1), the European Commission concluded that the concentration would lead to a dominant position of the merged entity on the UK and Irish markets for household tissue products. This finding was based on the parties' high market shares, e.g. for the UK exceeding 75% share of branded toilet tissue and branded hankies/facials and 50% of branded kitchen towels, as well as the competitive strength of the parties brands, *Kleenex* and *Andrex*, which were the leading two brands in the UK and Ireland.

firm deviating from the tacit agreement. Based on case histories and economic theory, it is accepted that there are a number of market conditions that when simultaneously arising strengthen the possibility or at least feasibility that such behaviour might occur. The conditions which are often cited as being supportive are that the market is characterised as a tight oligopoly (with very few key players) supplying relatively homogenous products combined with limited scope for innovation and similarity of product ranges, broadly symmetrical market shares and cost structures, stable and inelastic market demand, high entry barriers and an ossified market structure (where positions change very little over time), fragmented buyer power, and transparent market conduct.^{9 10}

In practical terms for joint dominance to be effective, the parties concerned need to be able to focus on a price (or set of prices covering different customer classes) which they independently understand to be appropriate, which they would then gravitate towards and that once they reach that point and set common prices they do not deviate from this position. Critically, prices need to be transparent enabling the parties to see what is going on in the market and particularly how rivals price, and that a market-wide price (or equivalent parity of prices which reflect accepted quality differences in the products) can emerge. Evidence of widespread price dispersion and ignorance over prices in the market fundamentally undermine the tacit collusion story. Rival firms need a price to focus on and co-ordinate around. In many markets this is simply not possible when negotiations with customers are private and terms not publicly disclosed.

In contrast to arguments concerning single-firm or joint dominance, it is feasible that a merger that significantly increases market concentration may not be damaging to competition. In theory, a market can be fully competitive even with just two firms operating.¹¹ This can be the case where the firms produce near identical products, have similar cost structures, are not capacity constrained and where the focus of competition is on continuous head-to-head price competition. In such circumstances each firm will be forced to price competitively for fear of losing substantial market share.¹²

⁹ See for instance the arguments put forward by the Competition Commission (2001) in the *Interbrew/Bass* merger regarding post-merger joint dominance in the UK beer market.

¹⁰ The other supportive condition sometimes cited is the availability of excess capacity for each of the tacitly colluding parties as this may allow the firms to lower prices and increase output as a means of punishing a rival who initiated a price cut to sell more (i.e. as a punishment mechanism). However, it is clear that parties having excess capacity may be encouraged anyway to seek to fill that capacity thereby generally undermining the stability of any agreement (e.g. the EC decision in *Pilkington-Techint/SIV* - Case IV/M358 [1994] O.J. L158/24). Indeed, reaching and sustaining an agreement is more likely to depend on none of the rivals having significant excess capacity as then no firm would have an incentive to cut prices (since they would be unable to cater for the ensuing increased demand).

¹¹ In theory, even if only a single firm exists the market could display an outcome equivalent to perfect competition as long as entry and exit are free to the extent that the monopolist could be replaced if it priced higher than its unit cost level. In such a “perfectly contestable”, a monopolist would be constrained by the threat of hit-and-run entry to price at the competitive level (Baumol *et al.*, 1982).

¹² This market is known as a “Bertrand” oligopoly where price competition between identical firms results in them pricing at the fully competitive level (i.e. setting price at the level of marginal cost). At

Recognising this pro-competitive potential, competition authorities may look favourably on mergers that even out discrepancies in the market shares of the leading players to establish a more level playing field, even though market consolidation has occurred. For example, a combination of two non-leading firms may yield a merged enterprise that can more effectively challenge the leading firm's position thereby stimulating competition. In addition, competition authorities are likely to be less concerned about a merger when the industry faces strong buyer power. Here, sophisticated buyers may still be able to dictate terms by inducing suppliers to compete against one another on price (e.g. as a bidding contest). Thus the presence of powerful buyers may be the instrument which ensures that even tight supplier oligopolies compete rigorously on price. This is made easier if there is a credible threat of new entry if incumbent firms were to make excessive ("supra-normal") profits.

These arguments apply even in circumstances where merger takes market shares into levels associated with single-firm dominance. The structural indicator of market shares may then not be a reliable market performance indicator since ultimately it is the conduct of the firms which dictates market outcomes. As just illustrated even highly concentrated markets may operate highly competitively, where firms have no protected position due to an absence of barriers to mobility or entry and where rivals can readily expand supply if they undercut existing prices and buyers choose to switch suppliers accordingly.

Moreover, it is not just immediate post-merger competition to consider, but also the long-term implications. In highly dynamic markets, where innovative activity is taking place, greater market concentration may enhance the pace of change where R&D resources may be pooled. It is also in such markets where relative positions are likely to be more fluid as market shares may change not just through price competition but through competition to offer superior and/or differentiated goods or services which better serve the needs of customers. Here the market may develop rapidly through a process of innovation by one firm followed by rapid imitation by others and then innovation again, perhaps by another firm, followed by imitation, and so on with each round adding economic value of public benefit. In these dynamic market circumstances competition authorities might be expected to be more reluctant to block a merger through concern of impeding the innovative process.

Indeed, the emphasis on innovation and experimentation with new products and new variations is typical of many FMCG markets. Each firm strives to steal a march on its rivals with new product introductions often only to see its rivals subsequently emerge with new products to which it in turn must respond with further innovation. Thus one firm's innovation drives on others to innovate in order to remain competitive in the market and not lose substantial market share. Such characteristics need to be seen not only as pro-competitive but the ultimate drivers of increased economic welfare. Merger control in such circumstances can be detrimental not only to the immediate

this price level neither firm will have an individual incentive to raise its price as this would leave its rival offering a lower price allowing it to capture all sales.

efficiency of firms, where mergers allow for productive efficiency gains, but the long-term interests of the market where market development is hampered by firms being unable to resource effectively R&D and other product investment effort.

In summary, even though consolidation levels in FMCG markets may appear to be high compared with other markets there are good economic reasons for this. First, economies of scale and scope are typically available, where efficiency advantages come from operating with a large size and providing a wide range of related products. Second, because of the required emphasis on new product development, efforts to innovate involves risk taking and support from significant resources that may be best suited to large, diversified firms. Third, the shift in the balance of power towards retailers has typically polarised supplier competition and forced those firms specialising in branded goods provision (rather than own-label goods) to consolidate in order to preserve brands and thereby consumer choice. But, behind all of these aspects lies buyer power as the ultimate driver of current market changes and explanation for why supplier mergers are unlikely to serve against competition. Suppliers with even relatively high market shares can still be dictated to by retailers even if those retailers individually have lower market shares of their respective retail market than the suppliers do of their market.¹³ The reason for this is down to relative dependency measured in terms of relative switching costs. If a retailer delists a brand, it is far easier for the retailer to find an alternative source to fill its shelves than it is for the brand producer to find a new equivalent outlet. The greater flexibility of the retailer is what affords it buyer power over the producer who has no or only limited outside options. It is this power in turn that enables retailers to largely dictate terms and engineer intense price competition in even highly concentrated FMCG markets.

¹³ As acknowledged by the UK's Competition Commission, the general atmosphere has been of a "climate of apprehension" amongst suppliers where there has been a reluctance by firms in the sector to speak out against retailer power for fear of reprisal and subsequent delisting by the major retailers.

5. COMPETITION AND MERGERS AMONGST PRODUCERS OF PET FOODS

The prepared pet food market has undergone substantial changes over recent years. Dominated by the provision of food for cats and dogs (jointly accounting for some 95% of pet food sales), the variety of products has increased considerably with the development of “dry” and “semi-moist” products in competition to the traditional tinned “wet” food products. At the same time as these new forms of prepared pet food have been developed, wider product ranges across each form have been introduced to cater more precisely for individual pet needs. As a result there is now more variety in terms of the products’ constituents (e.g. different meats, different cereals, etc.), the size of packs and tins (to cater for different animal sizes), and different packaging (e.g. resealable packs). These developments have maintained market growth. The total pet food market in Europe is presently worth some EURO 8.5bn, with a produced volume of 5 million tonnes.¹⁴

The greatly expanded market and buoyant conditions in turn has led to the emergence of new specialists, for example focusing on organic pet foods, nutraceutical pet foods and other new niches. Moreover, as with other FMCG markets, own-label products have appeared to compete with the established brands and their extensive ranges. It is estimated that own-label sales now account for 15% of total pet food sales in the European Economic Area (EEA).

In terms of production there are fundamental differences in the production methods used to produce wet, dry and semi-moist products. Each form requires dedicated production scheduling and different processes. Whereas it is conceivable for a plant to produce similar forms of cat and dog food (e.g. wet or dry) on the same production lines at different times, production of different forms is usually carried out separately at the same plant or even in separate plants. In terms of consumer demand, pet owners clearly distinguish between cat and dog food. They also distinguish between wet and dry pet foods, tending to see them as weak substitutes (where pet owners will often favour the use of one form over another – though either could satisfy nutritional requirements) or even as complements (where owners seek to mix wet and dry products). Accordingly, it is conceivable, though not necessarily the case, that each form for each pet constitutes a separate economic market.¹⁵ Indeed the arguments on product market definition are discussed in two recent EC decisions on proposed mergers of pet food manufacturers. In both *Dalgety/Quaker Oats*¹⁶ and

¹⁴ Figures from FEDIAF (at <http://www.fediaf.org>).

¹⁵ In principle, the relevant economic markets can be determined by standard application of the SSNIP test (a.k.a. the “hypothetical monopolist” test). For example, it would appear reasonable that a 5% price rise in, say, wet dog food would not result in a shift in sales to any form of cat food but might increase the demand for dry dog food. However, the effect on dry dog food might be limited if it is seen by owners as either a complement or distant substitute for wet pet food. While there might conceivably be four independent economic markets the presence of semi-moist products makes product market definition more difficult here since demand for these products is likely to be more sensitive to price changes in the other products and vice versa.

¹⁶ Case IV/M554 – *Dalgety plc/Quaker Oats Company*, 13/03/1995.

*Nestlé/Dalgety*¹⁷, the Commission noted the differences in production techniques and consumer demand while recognising the demand substitutability between the forms. In accepting that cat food and dog food were separate markets, no firm conclusion was reached but on whether wet and dry foods were economically distinct markets.

In terms of geographic scope of the market the European Commission concluded in the same two merger cases that the EEA represented effectively a single market. This was attributed to the considerable trade flows between EEA countries and the observation that several retailers source pet food on a European scale. In addition, it was noted that the same brands were essentially present for all EEA countries. Given the increasingly global operation of many pet food producers, and the not insignificant trade flows across continents, there are arguments for taking an even wider definition perhaps viewing the market as a global one. However, the continued presence of key nationally and locally operating producers indicates that the appropriate definition is narrower than a global market.

The structure of the industry has changed over recent years with the strong organic growth of specialist dry pet food manufacturers and general global consolidation through a wave of mergers and acquisitions which have taken place over the last five or so years. Former near-monopoly or fragmented structures operating on national lines have given way to a more international oligopoly structure where half a dozen major international players compete with national-based firms in highly commercialised markets.¹⁸

Merger activity has had a noticeable effect in driving forward and re-shaping the industry. In the European context, Dalgety acquired the European pet food division of the US company Quaker Oats in 1995 to merge it with its Spillers division. This merged division was subsequently divested to Nestlé in 1998 which also acquired Mac'ani in August 2000 following on from previously acquiring Jupiter Petfoods in 1998 and Alpo Petfoods in 1994. These acquisitions by Nestlé had the effect of propelling it to the number two spot in Europe, behind the long-time market leader Mars. In addition, there were changes amongst other players in the market. In April 1998, Top Number, a dry food specialist, was acquired by Dutch firm Provimi, one of Europe's leading manufacturers of animal nutrition and health products. More significantly, in July 2000, the leading dry pet food supplier in France, Royal Canin purchased James Wellbeloved, to extend its base and compete more effectively against the other key dry pet food specialist, Ralston Purina (which had acquired Edward Baker Petfoods in 1997). In August 1999, the giant multinational household products manufacturer, Procter & Gamble (P&G), entered the frame by acquiring Iams for \$2.3bn, giving it a modest position on which to build in Europe. Meanwhile, Doanes, the leading global manufacturer of own label pet foods has since 1996 acquired Effeffe (Italy), Ipes Iberica (Spain), and Arovit (Denmark).

¹⁷ Case IV/M1127- *Nestlé/Dalgety*, 02/04/1998.

¹⁸ The UK presents an interesting case where the near monopoly position held by Mars in the past (as for instance observed by the Monopolies and Mergers Commission (1977)) has evolved into a broader oligopolistic structure which presently characterises the market.

All of this activity had by the end of 2000 left the market in the EEA ostensibly dominated by two main players, Mars and Nestlé, operating with successful brands in each of the categories, along with Royal Canin and Ralston Purina holding good positions in the dry pet food segments. In addition, there was presence by P&G (Iams), own-label producers including Doanes and Continentale Nutrition (from France), as well as national specialists, e.g. the UK's Butcher Pet Care (owned by the Baker Group), and the limited but potentially growing presence by global operators Heinz and Hills Pet Nutrition (owned by Colgate-Palmolive).¹⁹

Estimated market shares across the EEA for 2000 are shown in Table 3.²⁰ At that time, Mars possessed market-leading positions in both the cat and dog food markets, but its share of the wet pet food markets had declined from previously higher levels in the mid-1990's when it controlled in excess of half of all dog and cat food sales.²¹ Nestlé had consolidated its position as the number two overall and was challenging hard to become the number one cat food producer. Own-label sales ranked collectively at number three in the market; their strong position highlighting the serious competitive threat posed to brand manufacturers. In addition, Royal Canin and Purina held strong positions in the dry dog food segment while minor brands accounted for the remainder of the market, being particularly significant in the dog food market.

Table 3 – Market Shares in the Pet Food Sales across EEA, 2000						
	Cat Food			Dog Food		
	Wet %	Dry %	Total %	Wet %	Dry %	Total %
Mars	43	38	41	45	22	34
Nestlé	31	39	34	15	15	15
Royal Canin	0	2	<1	0	18	8
Purina	0	2	<1	0	10	5
Own label	17	10	15	22	11	17
Others	9	9	9	18	24	21

Source: Author's estimates based on industry sources

In the wider context of comparisons with other consumer goods markets, the figures in Table 3 indicate that the pet food market is relatively concentrated with the leading two players jointly accounting for 75% of cat food sales and 49% of dog food sales. However, even with all the merger and acquisitions activity over recent years, the process of consolidation through such activity does not appear to have ended. In

¹⁹ Indeed, the looming presence of Heinz and Colgate-Palmolive shows that entry is possible and expansion quite feasible in this market if firms have products to suit consumer needs and adequate resources.

²⁰ The ratio of wet to dry cat food sales is 80:20 and for dog foods sales the ratio is 55:45.

²¹ For example, the European Commission recorded Mars's share of cat food to be 50-60% and dog food 50-60% of European sales.

January 2001, Nestlé announced its intention to acquire Ralston Purina and merge its pet food businesses. This merger proposal, still under the scrutiny of the competition authorities, if allowed to proceed would further enhance Nestlé's position, particularly in the dog food market where it would become the market leader in dry dog foods. The issue to consider then is whether such a merger would be pro- or anti-competitive in the present circumstances and whether this would be in the public interest.

As noted by the EC in its two previous merger decisions regarding *Dalgety/Quaker Oats* and *Nestlé/Dalgety*, prices had been falling in relative terms and competition in the market appeared healthy. The Commission had given specific regard in the latter 1998 case to whether the merger could lead to duopolistic dominance in the more concentrated cat food market. A number of features in the market suggested that this was in fact unlikely. First, the products are differentiated through branding, types of products, package sizes and categories of cat food. Second, it was noted how dynamic the market was in terms of the faster growth in sales of dry cat foods compared to sales of wet cat foods.²² Third, the market was characterised by a certain degree of innovation in product development and packaging. Fourth, there was a high degree of market transparency allowing for customers and competitors to be knowledgeable about prices and sales levels in the market. In addition it was noted that own label under powerful retailers' guidance could be expected to develop and put a general pressure on prices. Furthermore, it was argued that the asymmetric positions of the two companies, in terms of Mars's strong position in wet cat foods and Nestle being strong in dry cat foods would mean that each of them would have strong incentives to compete in the growing market. Finally, significant potential entrants were noted, principally from firms operating in the dry dog food market (Royal Canin and Purina) and global operators (Heinz).

Since that EC decision in 1998, dry pet foods have increased their share of sales and semi-moist products are beginning to add to sales. The market remains dynamic and appears competitive with relative prices continuing to decline (e.g. Mintel 2000). There are no indications that problems of joint dominance problems have emerged in the market. In terms of the proposal to merge the pet food businesses of Nestlé and Ralston Purina, as indicated by Table 3, this would not affect the cat food market positions directly given Purina's focus on dog food. However, it would increase the potential for Nestlé to compete more aggressively in the dry cat food market with the added plant capacity that it might be able to call on from Purina, and hence could be a pro-competitive element in the cat food market. In terms of the dog market, the acquisition of Purina would consolidate Nestlé's number two position and with its primary focus on dry dog foods, as leader of that segment, it could be expected to gain further market share to challenge Mars's overall leading position. Thus in both the cat food and dog food markets, the merger is likely to stimulate competition.

This pro-competitive view and continued absence of joint dominance concerns is reinforced by the continued strength of own label sales supported by powerful

²² Dynamics are also an issue in relation to developments in the retail market with the growing domination of grocery multiples along with the emergence of specialist pet food superstores as "category killers" dominating the independent specialist pet food retail sector.

retailers which can act as a ready curb on any attempts by brand producers to raise prices anti-competitively. Retail sales of pet foods continue to consolidate in the hands of a limited number of retailers. As illustration of this, Table 4 shows the share of UK sales accounted by grocery retailing and pet superstores increasing over time at the expense of sales through small pet shops and other small stores. Moreover, when the outlet type figures are broken down by retailer share, it is evident that concentration of sales lies in the hands of a few key retailers. For the UK, the majority of sales are handled by the four largest grocery chains (Tesco, Sainsbury, Asda and Safeway) and the largest pet superstore (the merged Pet City/PetsMart/Pets at Home), each pursuing aggressive own label strategies to increase market share. A similar situation exists in most other EEA countries. Thus there would appear to be intense pressure from retailers on brand producers to ensure that prices are held down. Furthermore, the increased quality and acceptance by consumers of own label products has increased the credibility that retailers could use the threat of delisting to extract further concessions.²³ In addition, the operation of international buying alliances, in which many of the major grocery retailers in Europe participate, can allow for greater information exchange on transaction prices and offer scope for collective buying thereby ensuring that producers have no scope to exploit particular national markets.

Table 4 - UK Sales of Cat and Dog Food by type of outlet (%), 1995-2000								
	Cat Food				Dog Food			
	1995	1997	1999	2000	1995	1997	1999	2000
Grocery multiples	77	79	79	80	56	60	60	62
Independent grocers	9	7	7	6	10	8	8	7
Co-ops	6	6	6	5	7	5	5	5
Independent pet shops	6	5	4	4	19	17	16	15
Pet superstores	1	2	3	4	3	4	5	5
Other ²⁴	1	1	1	1	5	6	6	6

Source: derived from Mintel (2001)

These elements associated with effective retailer buying power, along with the known hostility of the two main producers towards each other in other markets they operate in (most notably impulse ice cream) lend themselves to ensuring continued intense competition in this sector and the absence of any joint dominance concerns. Indeed,

²³ A typical delisting strategy would be for a retailer to target a particular brand manufacturer and threaten to delist all of its range possibly with the exception of its core products unless it provides the retailer with increased margin or increased shelf-space fees. Failure to comply results in the retailer taking the shelf space away from the manufacturer and offering it to other brand producers or as means of increasing own-label presence. Even the very largest pet food producers, including Mars, are not immune from such treatment and the strategy has proved effective following on from temporary delistings in numerous instances.

²⁴ This includes petrol station forecourt shops, market stalls, DIY stores, garden centres, agricultural country stores, mail order and the Internet

the merger between Nestlé and Purina is only likely to fuel this competition and drive the need for greater efficiency amongst its rivals. Mars, not least with its recently declining market share, will be under pressure to make cost-efficiency and product range improvements to maintain its competitive position. It is not inconceivable that the main parties may require further acquisitions to facilitate such improvements. In particular Mars will need to strengthen its position in dry dog foods if it is to act as a major competitive force in this segment of the overall market and maintain the competitive pressure on a combined Nestlé/Purina operation.

As the two big players, Mars and Nestlé, fight for the mainstream branded pet foods market, continued new opportunities are likely to emerge for the specialist players and for the other global players, P&G, Heinz and Colgate-Palmolive (all with strong brand ranges in North America), as well as possibilities for further in-roads by own-label producers. In addition, with the greatly expanded market for dry pet foods, there is scope for animal feed producers to make successful entry if existing firms fail to satisfy the needs of retail customers on price. Entry barriers for such producers are low given the generally open access to required production and packaging technology (such that even small niche operators have been able to enter and prosper). Moreover, the heavy promotion investment required for brand building, which might otherwise be perceived as a significant entry barrier, can be overcome by choosing to specialise in own-label production or retailer-sponsored supply (e.g. as an exclusive brand or to serve a particular retailer's need on nutritional or organic food grounds).

Thus, even though the pet food market in Europe may give the appearance of high concentration levels following a wave of consolidation and with further mergers on the horizon, there are strong reasons for believing that the market will remain competitive. Problems associated with joint or single-firm dominance are unlikely to arise while the two leading players have such strong incentives to be combative and fight for market share. Moreover, unless retailers appropriate the benefits of this intense producer competition by not passing on lower prices, the consumer is likely to be the ultimate winner from this consolidation process. Prices are likely to continue following a downward trend, spurred on by producer efficiency gains, and consumer choice is likely to be enhanced with existing brands being preserved in the consolidation process and new products being continually added by the current mainstream and specialist players.

6. CONCLUSION

Mergers, acquisitions and divestments are a key part of the process by which FMCG producers compete and alter their portfolio of activities to reflect changes in market conditions. The recent announcements on restructuring plans by the leading global players (like Unilever, P&G and Nestlé) and others reflect this process. The process is undertaken to increase efficiency and increase product range positions, all of which in light on continued pressure from substantial retail buying power may be expected generally to increase competition in markets.

However, this has not stopped commentators questioning the competitive implications of the mergers. Concerns expressed are about mergers leading to higher prices, reduced choice and reduced innovation in particular markets and a broader concern of dominance by multinational, multi-category FMCG companies. The reality, though, is that there is vigorous competition in most FMCG markets. For instance, the food giants include a dozen or more well-known companies such as KJS (part of Philip Morris), Unilever, PepsiCo, Danone, Mars, Kelloggs, Heinz, Procter & Gamble, Sara Lee, etc. Each of these firms may have particular product specialisms but, given their general resource strengths, all have the potential to enter or re-position themselves to fight in markets in which they currently do not operate in or only have a small stake in. In addition, these multinationals typically face strong competition from leading national players in each of the national and local market they serve, as well as facing the ever-increasing strength of the leading own-label producers, which are themselves become increasing international and who are supported and promoted by the leading retailers. The result is that these FMCG markets are characteristically dynamic, reflected by the extensiveness and diversity of product ranges offered to consumers and the rate of innovation on new product introductions and added features (e.g. superior forms of packaging increasing ease of use or shelf life).

The oligopolistic nature of many of the FMCG markets is in fact ideal for supporting wide consumer choice and new product introductions. In these situations, the firms are forced to compete for market share to gain scale economies and remain efficient. Offering the consumer something distinct or superior to existing products is the key to share growth, thereby ensuring product diversity and innovation. At the same time, retailer buying power can be expected to check any concern that enlarged or re-positioned producers will be able to force through price increases. As long as there remains at least two effective rivals, serving the same customer needs through similar product ranges, retailers will generally possess the means to play off one producer against another. Fortunately for retailers, they usually have the greater luxury of substantially more than two producers to play off against each other as well as the ability to cap any market power of the leading brand producers by using own label products to compete with branded items. Accordingly, in most circumstances the presence of sophisticated and powerful retailers will ensure that mergers of FMCG producers will not serve anti-competitive means.

This is not to say that all mergers in FMCG markets are likely to be without genuine competition concerns. Competition authorities need to assess mergers that

significantly concentrate markets and also keep a watchful eye on markets to ensure that there is no anti-competitive behaviour subsequent to mergers having proceeded. In some instances, enforced divestments of products and/or capacity might be required to ensure that a merger does not have a damaging effect on the market. This might, for instance, arise if in the absence of suitable divestments the merger would create a substantially dominant position that significantly restricted effective competition (say when a substantial asymmetry in market shares resulted from the merger). Equally, it is conceivable that a joint dominance problem could arise where two or perhaps three firms controlled the post-merger market and where they then could collectively implement ways of avoiding competition (e.g. through conscious parallel pricing or deliberate market segmentation).

Nevertheless, even in FMCG markets that give the appearance of being highly concentrated, mergers without any divestment requirements may not necessarily be anti-competitive. Indeed they can be pro-competitive where they allow for significant productive efficiency gains for the merging parties and where the competitive standing of the merged enterprise is improved to compete more effectively against the leading player or players.

In this regard, the pet food industry provides an interesting case as it is a relatively concentrated market in which there has been considerable M&A activity over recent years and which has been regularly scrutinised by competition authorities. During this time the pet food market has expanded considerably, innovative activity has been high, consumer choice appears very wide and prices have been on a downward trend throughout the period of consolidation. Nevertheless, the recent announcement of Nestlé's intention to acquire Ralston Purina caused an outcry, notably in the US, by a range of critics including retail organisations and farmers' associations.²⁵ Concerns were expressed that price competition would be inhibited, retailers would be unable to play off producers against each other, and that farmers would suffer from being paid lower prices for their crops and livestock as raw material for the pet food.

However, in the European context, it is clear that the merger will not allow Nestlé to dominate the market. With the merger, Nestlé will only become broadly of the same size as the current market leader, Mars.²⁶ Only in the dry dog food segment would Nestlé have a clear competitive advantage, but even here its 25% share cannot be regarded as offering a single-dominant position. Moreover, there appears to be little prospect of joint dominance issues arising given that the market conditions are so unsuitable for parallel pricing and other means of deliberate avoidance of competition. The key market features, namely differentiated products, asymmetric market

²⁵ For example see "Merger of Giant Pet-Food Makers Unites an Unusual Mix of Foes" by Greg Winter, *New York Times*, 14/4/2001.

²⁶ In the US there might be more genuine concerns about competition because the merger will allow Nestlé to become the market leader with about 40% of the market and be along way ahead of its nearest rival, Mars. Thus, in the US, the competition issue is likely to centre on whether Nestlé holds a single-firm dominant position – even though the market appears to be highly competitive with a number of multinational producers holding good market positions. In contrast in Europe, where the market shares are more even, the competition issue effectively rests on whether a problem of joint dominance is likely to arise with Nestlé and Mars deliberately avoiding competing against each other.

positions, the emphasis on innovative activity, variable segment growth rates, strong own label presence, and most importantly sophisticated and powerful retail customers, all work against the feasibility of joint dominance taking place. Given the cost-efficiency benefits that would result from the Nestlé/Purina merger, its overall effect is likely to be pro-competitive. Furthermore, it is reasonable to argue that given the nature of the market further mergers amongst producers would not necessarily be detrimental here either.

Over the last few years there has been an increasing tendency by competition authorities to take a tough stance against mergers in markets characterised by oligopolies, even where the market is clearly dynamic and a number of evenly sized competitors exist. In each case there may have been good, specific reasons for prohibiting the merger or enforcing certain product/capacity divestments through concerns about joint dominance problems arising. However, if competition analysis in such cases is not sensibly applied to examine the exact competitive conditions and understand the dynamics within the market there is a very real prospect that pro-efficiency and pro-competitive mergers will be blocked or heavily restricted if the presumption is guilty until proven innocent. This would send the wrong signal to business if it deterred parties from undertaking efficiency- and competition-enhancing mergers.

In the case of FMCG markets the key driver of mergers is to gain cost-efficiencies and enhance the competitive product offering. The intense competition which powerful retailers have placed the producers under not only drives this merger or restructuring requirement but also serves to ensure that subsequently producers cannot exploit their enhanced position. Moreover, retailers will continue to hold the whip hand because they ultimately have the greater flexibility in trading relationships (facing lower switching costs than producers) which they can be trusted to use to drive hard bargains and keep producers' prices down. In these particular circumstances, mergers amongst FMCG producers such as those presently occurring in the pet food market should be looked upon benignly and be seen as a necessary part of the overall competitive process.

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