

ISSN NO. 0114 - 2720

COMMERCE COMMISSION

DECISION NO. 297

Determination pursuant to the Commerce Act 1986 (the Act) in the matter of an application for clearance of the proposed acquisition involving:

GOODMAN FIELDER LIMITED

and

DEFIANCE MILLS LIMITED

The Commission:	Dr Alan Bollard (Chairman of Division) Terry Stapleton Roger Taylor
Summary of Proposed Acquisition:	That Goodman Fielder Limited, or any subsidiary of that company, acquire all of the New Zealand assets of the baking and milling operations of Defiance Mills Limited.
Determination:	Pursuant to s 66(3)(a) of the Act, the Commission determines to give clearance for the proposed acquisition.
Date of Determination:	17 June 1997

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MEMORANDUM

To: The Chairman
Terry Stapleton
Roger Taylor

From: Andrew Brice
Chief Investigator

Date: 17 June 1997 (Working day 11)

Subject **Commerce Act 1986: Business Acquisition:
Goodman Fielder Limited/Defiance Mills Limited**

Working Day 11: 17 June 1997
Confidential material in this report is contained in square brackets

THE PROPOSAL

- 1 On 30 May 1997, the Commission registered a notice from Goodman Fielder Limited (Goodman Fielder), seeking clearance for the proposed acquisition of all the New Zealand assets of the baking and milling operations of Defiance Mills Limited (Defiance).
- 2 The notice (the proposal) is for the acquisition of the same assets as were the subject of a clearance notice from Goodman Fielder dated 11 March 1997. That notice resulted in Commission Decision No. 289 of 14 April 1997, which declined to give clearance to that notice.
- 3 The proposal includes an undertaking by Goodman Fielder to divest, within 3 months of the date upon which clearance is given, its existing flour mill at Christchurch to Allied Foods Company Limited (Allied) under the terms and conditions of an agreement with Allied dated 30 May 1997. That agreement includes [
]
- 4 Goodman Fielder's undertaking and agreement with Allied are attached as Appendix 1 and Appendix 2, respectively. In accordance with section 69(A)(3) of the Commerce Act 1986 (the Act), the undertaking is deemed to form part of any clearance given to the proposal.
- 5 In addition to the agreement and the undertaking, the proposal involves a toll milling agreement which requires Goodman Fielder to purchase [] tonnes of flour from Allied in the [] period beginning with the divestment of Goodman Fielder's Christchurch mill. A copy of the toll milling agreement is attached as Appendix 3.

PROCEDURES

- 6 Section 66(3) of the Act requires the Commission either to clear, or to decline to clear, a notice given under s 66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a time extension. The due date for a decision was 16 June 1997. By agreement between the Commission and the applicant, the date for the Commission's determination on the proposed acquisition was extended to 4pm on 17 June 1997.
- 7 This report concludes that Staff are satisfied that implementation of the proposal would not result, or would not be likely to result, in the combined entity acquiring or strengthening a dominant position in any relevant market. Accordingly, it is recommended that the Commission give clearance to the proposal.

INVESTIGATION

- 8 Staff discussed the proposal with a range of parties with interests in the wheat, flour, stock feed, bakery ingredients, and baked goods industries. These included farmers, flour millers, bread bakers, bakery ingredients suppliers, bakery product manufacturers and supermarkets. Additional information was sought, and obtained, from the parties to the proposed acquisition.

THE PARTICIPANTS

- 9 Goodman Fielder, a company listed on the Australian and New Zealand Stock Exchanges, is engaged in the manufacture of a diverse range of food products, predominantly in Australia, New Zealand, Europe and Asia.
- 10 The New Zealand business operations of Goodman Fielder relevant to the proposed acquisition are organised through the following companies:
- Champion Mills Limited (Champion), which carries on the milling of wheat and specialty grains from four plants, and the distribution of bakery mixes;
 - Quality Bakers New Zealand Limited (Quality Bakers), which produces bread and a range of other bakery products under various brands from 14 plants located in the North and South Islands; and
 - Bluebird Foods Limited, which produces and distributes snacks, cereals, pasta, cake mixes, soups, vinegar and retail packs of flour.
- 11 Defiance, a company listed on the Australian Stock Exchange, is engaged in the milling of wheat and specialty grains and the manufacture of bread and other bakery products in Australia and New Zealand. Through its wholly-owned subsidiary, Defiance Food Industries Limited, the company is involved in milling at three plants in New Zealand; the manufacture and distribution of bakery mixes; bread crumb and sandwich making; and the baking of bread and other bakery products at four plants.

- 12 Around 10 March 1997 Bunge Foods Queensland Limited (Bunge) issued a takeover offer for all the shares in Defiance. Around 29 May 1997 Bunge had acquired a sufficient shareholding to take control of Defiance. The takeover does not affect the proposed acquisition.

INDUSTRY BACKGROUND

- 13 Decision No. 289 provided detailed background for the relevant industries. Several changes to the bread and flour industries have occurred since Decision No. 289. These changes, including those that result from the proposed acquisition, are discussed below.

Flour Industry Background

- 14 New Zealand mills produce around 260,000 tonnes of flour annually. Flour milling is carried out by three millers operating in both the North and South Islands:
- Champion;
 - Defiance; and
 - Allied, which is 100% owned by George Weston Foods Limited, a company listed on the Australian stock exchange.
- 15 In addition, there are five smaller, single, mill companies operating in the South Island: Canterbury Flour Mills Limited (Canterbury Flour), South Canterbury Milling Limited, Milligans Eclipse Flour Company Limited, Harraway & Sons Limited (Harraways), and South Flour Limited. These five millers, along with Champion, Defiance, and Allied are collectively referred to in this report as “the milers”.
- 16 As discussed in detail in Decision No. 289, the flour industry is characterised by substantial surplus capacity, with most mills operating well below maximum capacity. Production figures in Table 1 are sourced from flour milling companies. Total potential capacity is calculated on the basis of flour mills working three shifts per day, six days a week, for 50 weeks of the year. Capacity is a relatively elastic concept and depends on a range of factors, including the age of the plant. While all of the small South Island mills have considerable excess capacity, it is very unlikely that any of them will ever produce to their full potential capacity.
- 17 Goodman Fielder is likely to allocate the divested production from the Christchurch mill to its (or Defiance’s) remaining mills, maintaining its total production level. The allocation of production will reduce Goodman Fielder’s excess capacity by a commensurate amount. Allied’s production capacity will increase by the rated total capacity of the Christchurch mill. These adjustments are reflected in Table 1.

Table 1: Flour Industry Participants - Post Acquisition

Name	Ownership	Location	Total Production (tpa)	Total Potential Capacity (tpa)	Excess Capacity
Champion	Goodman Fielder	Auckland Palmerston North Timaru Ex Christchurch			
Defiance	Defiance	Mt Maunganui Christchurch Dunedin			
Allied	George Weston	Auckland Wellington Rangiora Christchurch			
Canterbury Flour	Rivermill Bakery Limited	Ashburton			
South Canterbury Mills	Private	Temuka			
Milligans	Private	Ngapara			
Harroways	Private	Dunedin			
South Flour	50/50 Southern Arable Farmers/ Private	Invercargill			
TOTAL			[]	[]	[]

- 18 Industrial bulk flour is supplied in road tankers, or on pods aboard rail cars, to large users of flour, including plant bakeries, some larger in-store supermarket bakeries, biscuit manufacturers, and some large food manufacturers. Industrial bagged flour is generally supplied through wholesalers (eg: Davis Trading Company Limited), or direct to end users, for the production of bakery and other food products. Flour in retail packs is supplied for household use, and is sold mainly through supermarkets and other retail grocery outlets.
- 19 Some flour is moved in bulk and bagged form from flour mills in the South Island to users in the North Island. It is not economic to transport flour from the North to the South Islands.

- 20 Apart from flour milled locally, flour is also imported, primarily from Australia. Currently, around 5,500 tonnes are imported into New Zealand annually. These imports are confined to industrial bagged flour, predominantly for supply to the Auckland region. The principal importer has been J C Sherratt and Company Limited, while the major users of imported flour have tended to be smaller bakers, and those requiring specialty flour.
- 21 The flour industry in New Zealand is characterised by a high level of vertical integration between flour milling and bread baking. There are currently three major vertically integrated groups and one smaller vertically integrated group. Each supplies a significant proportion of its output to bakeries within its own group. Goodman Fielder, Defiance, and Allied are the major groups, with Canterbury Flour/Rivermill Bakery Limited being the smaller group.

Proposed Divestment - The Christchurch Mill

- 22 The mill to be sold by Goodman Fielder and purchased by Allied is located at 183 Blenheim Road, Christchurch. The mill's rated capacity is [] tonnes of wheat per 24 hours, resulting in a nominal output of [] tonnes of flour (50 weeks per year, six days a week, 24 hours a day operation), per annum. In 1996 Goodman Fielder produced [] tonnes of flour from this mill.
- 23 The mill was established in 1947 and remodeled in 1992. The mill site includes eight rollermills, six plan sifters, one purifier, grain and flour storage facilities, a wheat cleaning section, and both retail bag and industrial bag flour packing systems. Allied have confirmed to Staff that the mill is in good, operational condition.
- 24 The sale includes all elements of the mill as they stand today (including storage silos and industrial and retail bag packing systems). The sale does not include a micronising plant¹. Allied have advised Staff that []

Bread and Other Bakery Products Industry Background

- 25 There is a wide variety of bread and bread products produced in New Zealand. These include various types of packaged loaves produced by plant bakeries and some in-store bakeries, and specialty or novelty lines produced by in-store bakeries and hot bread shops.
- 26 Bread and related products are baked by Quality Bakers, Defiance and Allied, each with plants in both Islands. There are three independent regional plant bakers who bake under franchise to Quality Bakers, and two regional plant bakers (Rivermill Bakery Limited and Yarrows (The Baker) Limited). These five bakers operate exclusively in the North Island.
- 27 On 28 May 1997, a fire destroyed Allied's Auckland bakery. The bakery was fully insured. According to Allied, the bakery will be re-located and fitted with new equipment within

¹ The micronising plant has been retained by Goodman Fielder to prepare small quantities of specialist grain for export to its Australian parent.

nine months. Allied is meeting its baking requirements by increasing production at its Wellington bakery, utilising an old Auckland bakery, and obtaining toll baking from Goodman Fielder. []

- 28 Bread is also produced by in-store bakeries owned by the major supermarket chains, and by hot bread shops. The applicant states that 72% of all supermarkets have an in-store bakery (ie: 242 out of a total of 338 outlets). Further, the applicant estimates that there are around 411 hot bread shops nation-wide.
- 29 Supermarkets account for around 70% of retail bread sales. In addition, they have an important role as operators of in-store bakeries, and as producers and/or purchasers of housebrand bread. Housebrand bread is generally contract baked by the major plant bakers on behalf of supermarkets, but sold under the supermarket's own brand name. In some instances (eg: Countdown stores), it may be produced and packaged at the supermarket's own in-store bakery.
- 30 The balance of bread is sold through the route trade (eg: dairies and service stations), to institutional purchasers (eg: hospitals and prisons), and to the food service industry (eg: caterers).

THE MARKETS

- 31 The purpose of defining markets is to provide a framework within which the competition implications of a business acquisition can be analysed. The relevant markets are those in which competition may be affected by the acquisition being considered. Identification of the relevant markets enables the Commission to examine whether the acquisition would result, or would be likely to result, in the acquisition or strengthening of a dominant position in terms of s 47(1) of the Act.
- 32 In Decision No. 289, the Commission identified the following markets as being relevant to the proposal:
- the market for the production and acquisition of milling wheat in the North Island;
 - the market for the production and acquisition of milling wheat in the South Island;
 - the market for the production and acquisition of industrial bulk flour in the North Island;
 - the market for the production and acquisition of industrial bulk flour in the South Island;
 - the market for the production and acquisition of industrial bagged flour in the North Island;
 - the market for the production and acquisition of industrial bagged flour in the South Island;
 - the market for the production and sale of retail bagged flour in the North Island;
 - the market for the production and sale of retail bagged flour in the South Island;

- the market for the production and acquisition of premium pastry flour in the North Island;
 - the market for the production and acquisition of premium pastry flour in the South Island.
 - the market for the production and acquisition of bran and pollard in the North Island;
 - the market for the production and acquisition of bran and pollard in the South Island;
 - the market for the production and sale of packaged bread in the upper North Island;
 - the market for the production and sale of packaged bread in the lower North Island; and
 - the market for the production and sale of packaged bread in the South Island.
- 33 For the reasons given in Decision No. 289, Staff consider that these markets are relevant for the purpose of assessing the dominance implications of the current proposal.

ASSESSMENT OF DOMINANCE

- 34 Section 66(3) of the Act, when read in conjunction with s 47(1) of the Act, requires the Commission to decline to give clearance to a proposed acquisition if it is not satisfied that the proposed acquisition would not result, or would not be likely to result, in a person acquiring or strengthening a dominant position in a market.
- 35 Subsequent to Decision No. 289, the following changes have arisen in the relevant markets and have been considered:
- the sale and purchase agreement between Goodman Fielder and Allied for the Christchurch flour mill;
 - the flour toll milling agreement between Goodman Fielder and Allied;
 - the loss by fire of Allied's Auckland bakery; and
 - potential changes in South Island housebrand bread baking contracts.
- 36 A dominance assessment for each of the relevant markets follows.

Milling Wheat Markets

- 37 Markets were identified in Decision No. 289 for the production and acquisition of milling wheat in the North Island, and the production and acquisition of milling wheat in the South Island.
- 38 United Wheat Growers raised concerns over growers' ability to readily switch production of crops away from wheat in the short-term, and regarding the combined entity's potentially increased ability to set wheat prices. Staff concluded in Decision No. 289 that it is in the best commercial interests of the combined entity to encourage, rather than to discourage,

the production of milling wheat, especially in the South Island where South Island wheat is cheaper than the landed cost of foreign wheat.

- 39 In Decision No. 289, Staff concluded that no dominance concerns would arise in the milling wheat markets post-acquisition due to the constraints on the combined entity. As a result of the purchase of the Christchurch mill, Staff believe Allied is likely to become a larger purchaser of wheat. Staff confirm the conclusions in Decision No. 289.

Industrial Bulk Flour Markets

- 40 Markets were identified in Decision No. 289 for the production and acquisition of industrial bulk flour in the North Island, and the production and acquisition of industrial bulk flour in the South Island.
- 41 Industrial bulk flour is produced by flour millers predominantly for use by plant bakeries, but it is also used by other parties including some supermarket bakeries, pie and bun manufacturers, and pre-mix manufacturers. The four largest flour millers use a significant portion of their output for tied baking purposes and the remainder for free sales. The other flour millers do not have their own plant bakeries and sell all of their flour output to non-tied parties.
- 42 Given the difficulties inherent in forecasting post-acquisition market shares in both the North and the South Island markets, Staff considered the impact of the divestment on total milling capacity. Capacity is of most relevance when considering the industrial bulk flour market given the significantly larger tonnages of flour transacted. However, the impact of excess or constrained capacity applies in varying degrees across all the relevant flour markets. Table 3 compares pre-acquisition milling capacities² with post-acquisition milling capacities.

Table 2: South Island Milling Capacity

Company	Tonnage of Milling Capacity and % of Total			
	Pre-Acquisition		Post-Acquisition	
Goodman Fielder Defiance				
Combined Entity Allied Canterbury Flour Other				
Total	157,890	100%	157,890	100%

² Decision No. 289, Table 1

Source: Applicant and collated information. Tonnages are estimates only

- 43 The figures in Table 3 show a significant shift in South Island flour milling capacity. Post-acquisition, Allied's capacity will increase from [] of the total market, to [] of the total market. The combined entity's capacity will decrease from [] of the total market to [] of the total market. Pre-acquisition, Allied had less than [] spare capacity, or [] of the total market. Post-acquisition, Allied's spare capacity increases to [] of the total market. While Allied could choose not to utilise this spare capacity, it is reasonable to assume that some portion of the spare capacity will be used. For instance, it is likely that Allied will supply increased quantities of bulk flour to its own South Island bakeries (to meet potentially increased baking requirements), which would result in a shift in South Island industrial bulk flour market share from the combined entity to Allied.
- 44 The combined entity's 1996 level of South Island production was [] tonnes. It is clear from Table 2 that, post-acquisition, the combined entity will retain sufficient South Island capacity to meet its current levels of production. The divestment does not result in the combined entity being supply-constrained.
- 45 However, the divestment does result in Allied obtaining significant additional capacity. []

North Island Industrial Bulk Flour Market

- 46 In Decision No. 289, Staff did not believe that any dominance concerns would arise in the North Island industrial bulk flour market post-acquisition due to the constraints on the combined entity. Staff confirm the conclusions of Decision No. 289.

South Island Industrial Bulk Flour Market

- 47 In Decision No. 289, Staff concluded that in view of the height of barriers to entry, the lack of either existing or potential competition, the non-viability of bulk foreign or North Island imports, and the lack of suppliers or acquirers who would act as a constraint on the combined entity, the proposed acquisition would result, or would be likely to result, in the combined entity acquiring a dominant position in the market for the production and acquisition of industrial bulk flour in the South Island.

Market Shares

- 48 In Decision No. 289 market share figures were calculated on the basis of sales of industrial bulk flour.³ Staff have confirmed that market shares based on sales by the millers over the last five months have not changed significantly from the market shares in Decision No. 289. These gave the combined entity [] of the industrial bulk flour market, with Allied the only other competitor with [] market share. The South Island market shares are reproduced in Table 3.

³ Decision No. 289, Table 5

Table 3: South Island Industrial Bulk Flour Market for Year Ended 31 December 1996

Company	Bulk Flour Produced and Sold	
	Tonnage	%
Goodman Fielder Defiance		
Combined Entity Allied Canterbury Flour		
Total	45,651	100%

Source: Applicant and collated information. Tonnages are estimates only

49 The purchase of the Christchurch mill by Allied does not include the transfer of any customer contracts, so there will be no immediate change in market share. While it is not possible to predict future market share shifts with any degree of certainty, Staff believe that the divestment is likely to lead to a gradual shift in market share from the combined entity to Allied. Staff believe the combined entity's market share will lie between its current [] and the lower capacity bound of [].

50 The toll milling agreement requires Goodman Fielder to purchase [] tonnes of flour from Allied in the []. It is expected that this flour will be supplied in bulk, initially increasing Allied's market share of the South Island industrial bulk flour market from [] to around [], and decreasing the combined entity's from [] to around []. Staff do not consider it likely that this agreement will be renewed, therefore applying minimal weight to this factor, but do regard it as indicative of the effect Allied is likely to have in this market.

Constraint from Existing Competitors

51 Canterbury Flour, the South Island's third largest miller, has a very limited ability to expand production and provide additional amounts of industrial bulk flour. No other South Island miller is believed to be a serious competitor in this market. Further discussion of their capability is contained in Decision No. 289.

52 Staff expressed concerns in Decision No. 289 over Allied's production capabilities, and discounted its ability to provide sufficient constraint. Decision No. 289 indicated Allied had minimal spare South Island capacity and was supplying the majority of its production to its own group bakeries.

53 The purchase of the Christchurch mill, renewed commitment from its parent's management, and a strong financial position suggest a significant change in Allied's attitude and capability to compete in the South Island market.

54 Allied has indicated to Staff that it []

55 As noted, any additional bulk flour required at Allied's South Island bakeries is likely to be supplied from its own mills. This in turn, is likely to result in some market growth, with increased market share for Allied.

56 Staff believe that, as a result of its increased capacity and commitment to compete for sales, the actual and potential competition posed by Allied, post-divestment, will provide constraint on the combined entity in the market for the production and acquisition of industrial bulk flour in the South Island.

Constraints from Industrial Bulk Flour Imports

57 Decision No. 289 considered two alternative scenarios:

- foreign (Australian) bulk flour imports into the South Island; and
- North Island bulk flour imports into the South Island.

58 With respect to these scenarios, Decision No. 289 concluded that:

- foreign bulk imports, though technically viable, were not considered to be likely, extensive, timely, or sustainable, and therefore were not likely to act as a constraint on the combined entity in the South Island industrial bulk flour market.
- North Island bulk imports into the South Island were not occurring, did not appear economical, and were not likely to constrain the combined entity.

59 Staff believe that the conclusions of Decision No. 289 apply with equal force to the current proposal.

Constraint from Potential Competitors

60 Decision No. 289 concluded that new entry to the South Island industrial bulk flour market by way of a new flour milling facility was very unlikely, primarily due to the sunk costs, the combined entity's size and reputation, and the excess capacity in the industry. Staff confirm the conclusions of Decision No. 289.

Constraint by Suppliers

61 Milling wheat used in the production of bulk flour is readily available in New Zealand and from overseas with all flour millers paying similar prices. Staff do not believe that suppliers of wheat will constrain the combined entity.

Constraint by Acquirers

62 As much of the bulk flour supplied in each market would be sold to the combined entity's own plant bakeries, constraint by these acquirers is not likely. []

Conclusion on the South Island Industrial Bulk Flour Market

63 Based on the actual and potential competition posed by Allied, post-divestment, to constrain the combined entity, Staff conclude that the proposed acquisition would not result, and would not be likely to result, in the combined entity acquiring or strengthening a dominant position in the market for the production and acquisition of industrial bulk flour in the South Island.

Industrial Bagged Flour Markets

- 64 Markets were identified in Decision No. 289 for the production and acquisition of industrial bagged flour in the North Island, and the production and acquisition of industrial bagged flour in the South Island.

North Island Industrial Bagged Flour Market

- 65 In Decision No. 289, Staff did not believe that any dominance concerns would arise in the North Island industrial bagged flour market post-acquisition due to the constraints on the combined entity. Staff confirm the conclusions of Decision No. 289.

South Island Industrial Bagged Flour Market

- 66 In Decision No. 289, Staff considered that in view of the height of barriers to entry, neither existing nor potential competitors would constrain the combined entity. As neither suppliers nor acquirers would act as a constraint, Staff concluded that the acquisition would result, or would be likely to result, in the combined entity acquiring a dominant position in the market for the production and acquisition of industrial bagged flour in the South Island.

Market Shares

- 67 For Decision No. 289, flour sales figures were obtained from the flour millers for the 1996 calendar year. Based upon those figures, the industrial bagged flour market shares shown in Table 4⁴ were compiled. As recent inquiries of the millers have confirmed that there have been no substantial changes to their sales in the first five months of this year compared with the corresponding period last year, Staff believe that the market share figures set out in Table 4 continue to give an accurate view of market shares in the South Island industrial bagged flour market.

**Table 4: South Island Industrial Bagged Flour Market
for Year Ended 31 December 1996**

Company	Bagged Flour Produced and Sold	
	Tonnage	%
Goodman Fielder Defiance		
Combined Entity Allied Canterbury Flour S Canterbury Mills South Flour Milligans		
Total	20,810	100%

⁴ Decision No. 289, Table 6

Source: Applicant and collated information. Tonnages are estimates only

68 The combined entity would have a [] share in the South Island industrial bagged flour market. Allied would be the largest competitor with a [] share, followed closely by Canterbury Flour with [].

Constraint from Existing Competitors

69 In Decision No. 289, Staff concluded that individually, no existing competitor provided a constraint on the combined entity. At that time, Allied had an insignificant amount of spare capacity and no other South Island miller, including Canterbury Flour, was believed capable of supplying sufficient quantities of industrial bagged flour in combination with effective sales and technical support. However, Staff note that the combined market share of the smaller millers (excluding the combined entity and Allied), is [].

70 Post-acquisition, Allied would have significant spare capacity available to produce industrial bagged flour. The Christchurch mill purchase includes Goodman Fielder's current industrial bagging facilities. Allied have indicated they intend []. Staff believe that Allied's current market share of [], achieved when flour supply was limited, is therefore likely to increase over time.

71 In order to gauge the level of sales required to significantly change market shares, Staff assessed the tonnages required for Allied to reach a market share that would potentially constrain the combined entity in this market. The likelihood of Allied achieving this would then provide a guide as to its ability to provide market constraint. Allied would need to increase sales by about [] (from [] tonnes to around [] tonnes), to reach a [] share of the market. Given the large number of acquirers in the market, the frequency of acquirer contract renewals, the small size of average transactions (approximately 54 tonnes per annum), and a stated intention by Allied to increase its sales activity, Staff believe it is feasible that Allied could sell an additional [] tonnes of industrial bagged flour per year at the combined entity's expense. Allied has the capacity, the technical expertise, the marketing power, and the commitment to achieve this. Allied has recently employed two full-time sales representatives to promote and sell its industrial bagged flour.

72 Staff conclude that a more significant Allied presence in this market, combined with the market share currently held by the smaller millers, would potentially constrain the combined entity in the South Island industrial bagged flour market.

Constraint from Industrial Bagged Flour Imports

73 Decision No. 289 considered two alternative scenarios:

- foreign (Australian) industrial bagged flour imports into the South Island; and
- North Island industrial bagged flour imports into the South Island.

74 With respect to these scenarios, Decision No. 289 concluded that:

- prices of imported industrial bagged flour from Australian mills would not be competitive and therefore, foreign imports were unlikely to act as an effective constraint on the combined entity in the South Island industrial bagged flour market; and

- prices of industrial bagged flour from the North Island would not be competitive and therefore, North Island imports were unlikely to act as an effective constraint on the combined entity in the South Island industrial bagged flour market.

75 Staff believe that the conclusions of Decision No. 289 apply with equal force to the current proposal.

Constraint from Potential Competitors

76 The entry conditions to the industrial bagged flour market by way of manufacture are substantially similar to those in respect of the industrial bulk flour markets. Accordingly, the barriers to entry are considered by Staff to be high, forming a strong disincentive to such entry.

Constraint by Suppliers

77 Wheat used in the production of industrial bagged flour is readily available in New Zealand and from overseas with, all flour millers paying similar prices. Staff do not believe that suppliers of wheat will constrain the combined entity.

Constraint by Acquirers

78 Food manufacturers (eg: snack bars, pasta, petfood, fast food, institutions), and hot bread shops purchase 84% of industrial bagged flour sold in the South Island. These acquirers are numerous, geographically dispersed, and tend to purchase in small quantities. The remaining 16% of South Island industrial bagged flour is purchased by supermarkets. While no individual acquirer or group of acquirers is of sufficient size to constrain the combined entity, it is noted that the many acquirers have five supply alternatives in addition to the combined entity. Further, while supermarkets purchase relatively small quantities of industrial bagged flour, when considered with their other purchases from the combined entity (eg: retail bagged flour and packaged bread), they may provide some constraint on the combined entity.

Conclusion on the South Island Industrial Bagged Flour Market

79 Based on Allied's ability to compete, the active presence of smaller millers in the market, and some countervailing power of acquirers, Staff conclude that the proposed acquisition would not result, and would not be likely to result, in the combined entity acquiring or strengthening a dominant position in the market for the production and acquisition of industrial bagged flour in the South Island.

Retail Bagged Flour Markets

80 Markets were identified in Decision No. 289 for the production and sale of retail bagged flour in the North Island, and the production and sale of retail bagged flour in the South Island.

81 For Decision No. 289, flour sales figures were obtained from all flour millers and from the Foodstuffs Co-Operative (Wellington) Limited (Foodstuffs (Wellington)) supermarket chain for the 1996 calendar year. Those figures were used to compile the North and South Island retail bagged flour market shares shown in Table 7 of Decision No. 289. Staff have

analysed these markets in detail to establish a view of the current market share structure. The revised market shares are shown in Table 5.

82 The market share figures in Table 5 include the retail bagged flour sold by millers for use as housebrands by the supermarkets. While the applicant argues otherwise, Staff consider, for the reasons outlined in Decision No. 289, that the inclusion of the combined entity's housebrand business in the retail bagged flour market share figures is appropriate. Nevertheless, Staff have considered housebrands when assessing the countervailing power of the supermarkets.

**Table 5: Retail Bagged Flour Markets
Estimated Current Market Shares**

Company	Tonnage of Retail Bagged Flour Sold and % of Total			
	North Island		South Island	
Goodman Fielder Defiance				
Combined Entity Allied Canterbury Flour S Canterbury Mills Harraways Milligans South Flour				
Total	18,546	100%	8,171	100%

83 The following points should be noted regarding Table 5:

- The information is sourced from the applicant, Nielsen's market surveys, independent millers, and supermarkets. Tonnages shown are estimates only.
- Harraways' total production, stated at [] tonnes in Decision No. 289, has been changed to [] tonnes in the South Island market. Of this, [] tonnes is sold as Pam's (Foodstuffs (South Island)) housebrand flour and [] tonnes as proprietary brand flour;
- In September 1996 Harraways was advised that it had []
]; and
- The tonnage previously listed under Foodstuffs has been re-listed with the housebrand producer, []

84 Appendix 4 contains detailed market share analyses.

85 Over the last seven years, national sales of retail bagged flour by volume through supermarkets have been [] tonnes (1996: [] tonnes), equating to approximately []%. With the inclusion of route trade and other sales, the combined total volume of the North and South Island markets is estimated to be [] tonnes per annum, equating to approximately []%. The combined total volume of the North and South Island retail bagged flour markets' size assessed by staff is confirmed.

86 The seven year average price of standard retail flour is \$1.71. Proprietary brands sell at a 15%-20% premium over housebrands. Average prices have trended downward from 1991 to 1995 (\$1.88 per 1.5kg pack to \$1.64) but rose sharply in 1996/97 to \$1.85 as a result of the world price spike.

- 87 The retail bagged flour markets show light fluctuation around steady trends in market share averages over a seven year period. Based on national sales data from Nielsen's, the applicant's market share has been [], Defiance's market share has [], with housebrands []
- 88 The applicant argues strongly that housebrands should be regarded by the Commission as "floating", given the lack of control the miller has over virtually all aspects of the product (excluding costs). If this approach was adopted, the combined entity's market shares would reduce to [] in the North Island, and [] in the South Island.
- 89 The combined entity's high proprietary shares are likely to represent little previous interest or incentive from any other party to enter the markets. Allied has indicated that it intends to []
- 90 Housebrand tonnages have been demonstrated by Harraways to be within the reach of the small millers. This was not previously considered to be the case.

North Island Retail Bagged Flour Market

- 91 In Decision No. 289, Staff concluded that imports of retail bagged flour into the North Island were not likely to act as a constraint based on the costing and business feasibility information available at that time. Staff concluded that existing competitors, primarily Allied and supermarkets, might act as a constraint and that the potential threat of imports (foreign or from the South Island) would be likely to act as a constraint on the combined entity.

Market Shares

- 92 The figures in Table 5 show that the combined entity would have a [] market share in the North Island retail bagged flour market. The only competitors to the combined entity would be Allied with a [] share and Harraways with a [] share.

Constraint from Existing and Potential Competitors

- 93 The applicant has provided additional, detailed, costing information from both Goodman Fielder and Defiance. A summary of the costings is contained in Table 6.

Table 6: Retail Bagged Flour Costings

Source: Applicant and collated information.

Standard Retail Flour \$NZ per tonne	North Island*	South Island*
GF: Supply & deliver same region		
GF: Supply ex Chch, deliver in region		
GF: Supply ex Australia, deliver in region		
Def: Supply & deliver same region		
Def: Supply ex Chch, deliver in region		

* Cost delivered to retailer, excluding margin

94 [] In assessing the price differential between foreign imports ([]) and South Island imports ([]), and the North Island price ([]), Staff have used the more conservative Defiance prices. With the wheat cost accounting for approximately 45% of the final per tonne price of retail bagged flour ([] of []), a considerable short-term spike in world wheat prices of up to []⁵ could be tolerated before the economic viability of foreign imports became marginal. Excluding the recent major spike, fluctuations in the world wheat prices have consistently been below this level.

95 Figures in Table 6 confirm the conclusion in Decision No. 289 that imported retail bagged flour provides a constraint on the combined entity. Foreign or South Island imports can be supplied into the North Island retail bagged flour market at prices that are competitive with retail bagged flour sourced from within the North Island. No party was able to fully explain why the clear price advantage held by imported retail bagged flour had not been exploited. Staff's assessment is that []

96 Staff have been advised by both the applicant and by Allied that the business feasibility of importing Australian sourced retail bagged flour has been recently analysed. Both parties have independently indicated that importing Australian sourced retail bagged flour is an economic proposition. []

Constraint by Suppliers

97 Wheat used in the production of retail bagged flour is readily available in New Zealand and from overseas, with all flour millers paying similar prices. Staff do not believe that suppliers of wheat will constrain the combined entity.

Constraint by Acquirers

98 Decision No. 289 concluded that supermarkets, by promoting housebrands over proprietary brands, and through their control of shelf space, could exert some control over the post-acquisition behaviour of the combined entity. Staff further believe that supermarkets could economically import retail bagged flour in quantities that would provide minimal disruption to their current distribution methods and at a competitive price. Staff conclude that the prospect that supermarkets could adopt this approach would of itself be likely to ensure that the supermarkets maintain countervailing power and therefore constrain the combined entity.

Conclusion on the North Island Retail Bagged Flour Market

99 In the circumstances of this case, the assessment of dominance was not easy. However, on balance, Staff conclude that due to constraint from existing competitors, from potential competitors (including imports), and from supermarkets as acquirers, the proposed acquisition would not result, and would not be likely to result, in the combined entity

⁵ Derived from the difference between the North Island price and the imported price divided by the cost of wheat. This resolves to: []

acquiring a dominant position in the market for the production and sale of retail bagged flour in the North Island.

South Island Retail Bagged Flour Market

100 In Decision No. 289, Staff concluded that neither existing nor potential competition would act as a constraint on the combined entity and that neither suppliers nor acquirers would act as a sufficient constraint on the combined entity in the South Island retail bagged flour market.

Market Shares

101 The figures in Table 5 show that the combined entity would have a [] market share in the South Island retail bagged flour market. The combined entity's largest competitor would be Harraways with a [] share. Allied, with less than [] of the market, has not been a significant competitor in the South Island retail bagged flour market.

Constraint from Existing Competitors

102 The independent South Island flour millers currently compete in the South Island retail bagged flour market on a localised, small-scale basis. While Staff had previously discounted their ability to compete on a wider basis, Harraways [] suggests they may pose some degree of constraint on the combined entity.

103 Allied, with its minimal level of spare capacity, had indicated little interest in competing in this market. However, with the purchase of the Christchurch mill, Allied will have supply of flour available and has indicated that [] The revised mill sale agreement provides []

104 []

105 In the circumstances, Allied can be viewed as a "new" entrant to the South Island retail bagged flour market. Staff believe that Allied's entry is likely, would be timely, of sufficient extent, and sustainable.

106 Existing competitors, particularly Allied, are likely to act as some constraint on the combined entity in the South Island retail bagged flour market.

Constraint from Retail Bagged Flour Imports

107 Decision No. 289 considered two alternative scenarios:

- foreign (Australian) retail bagged flour imports into the South Island; and
- North Island retail bagged flour imports into the South Island.

108 With respect to these scenarios, Decision No. 289 concluded that:

- there is currently no retail bagged flour imported from overseas mills into the South Island; and

- imports of retail bagged flour into the South Island (either from overseas or North Island mills) are not likely to be feasible.

109 The applicant has provided detailed costings (shown in Table 6), that indicate that Australian imports into the South Island could be competitive. While Staff accept the costings as they apply to the North Island, Staff believe that once the current world wheat price spike effect has been removed from the market, foreign imports into the South Island are likely to become only marginally competitive.

110 It is not likely that imports of retail bagged flour could be landed into the South Island (foreign imports or from the North Island) at prices consistently competitive with those of the South Island mills. Accordingly, Staff conclude that retail bagged flour imports into the South Island are unlikely to provide an effective constraint on the combined entity in that market.

Constraint from Potential Competitors

111 Decision No. 289 concluded that any new entry to the retail bagged flour market by way of a new flour milling facility was unlikely based on a range of factors such as the large sunk costs, the combined entity's size and reputation, the excess capacity in the industry, and access to supermarket shelves. Staff confirm the conclusions of Decision No. 289.

Constraint by Suppliers

112 Wheat used in the production of retail bagged flour is readily available in New Zealand and from overseas, with all flour millers paying similar prices. Staff do not believe that suppliers of wheat will constrain the combined entity.

Constraint by Acquirers

113 Supermarkets exert considerable control over the promotion and sale of retail bagged flour. In addition to sourcing supply from the combined entity they can, and do, operate their own housebrands.

114 Post-acquisition, supermarkets are likely to use the presence of Allied in the South Island, with its significant spare capacity and [], to maintain a high degree of countervailing power over the combined entity.

115 Supermarkets have the potential to pack (or contract pack), their own brand(s) of retail bagged flour. For example, Foodstuffs (Wellington) has its own retail flour housebrand, and its own packing equipment, while Foodstuffs (South Island) has a contract with [] to mill and pack its housebrand retail flour. The prospect that supermarkets could pack their own housebrand flour, and could ensure that housebrand flour was stocked and promoted at the expense of proprietary brands, could result in supermarkets acting as a constraint on the combined entity.

116 Supermarkets have both an interest in, and an opportunity to, maintain significant countervailing power over the combined entity. Staff believe that the presence of Allied and the presence of housebrands will result in this countervailing power being retained.

Conclusion on the South Island Retail Bagged Flour Market

- 117 In the circumstances of this case, the assessment of dominance was not easy. However, on balance, Staff conclude that due to constraint from current and potential competitors (primarily Allied), and from supermarkets as acquirers, the proposed acquisition would not result, and would not be likely to result, in the combined entity acquiring a dominant position in the market for the production and sale of retail bagged flour in the South Island.

Premium Pastry Flour Markets

- 118 Separate North and South Island markets were identified in Decision No. 289 for the production and acquisition of premium pastry flour.
- 119 In Decision No. 289, Staff concluded that neither existing nor potential competitors, nor imports, nor suppliers, nor acquirers would constrain the combined entity in either market.

Market Shares

- 120 At present, Champion supplies close to [] of premium pastry flour. Accordingly, the combined entity would have close to [] market share in each market. An estimated [] tonnes of premium pastry flour is produced each year to meet their requirements.

Constraint from Existing Competitors

- 121 A large scale manufacturing facility with modern milling equipment is required to produce sufficient quantity and quality of premium pastry flour. []
- 122 The applicant has identified a number of millers who have tendered for the recent [] supply contract and argue this is indicative of the number of competitors in this market. []
- 123 Staff believe that with the purchase of a mill that [], Allied represents a potential constraint on the combined entity. As a result of the purchase of the Christchurch mill, which has been producing [] tonnes of premium pastry flour per annum, Allied is likely to have the potential to compete in both the North and South Island markets. The applicant has stated that based upon the Christchurch mill's capacity of [] tonnes, the mill could stream between [] and [] tonnes of premium pastry flour. However, even were these levels to be achieved, which would totally satisfy the demand for premium pastry flour in both markets, Allied might still need to convince major purchasers of premium pastry flour that they can provide the necessary flour quality, consistency, and technical assistance. Staff consider that it is realistic to expect that Allied could do so. The Christchurch mill has been producing premium pastry flour of sufficient quality to satisfy consumer demands, and Allied is expected to retain the services of the mill's key employees.
- 124 Staff conclude that Allied is likely to act as a constraint on the combined entity in both the North and South Island premium pastry flour markets.

Constraint from Imports

- 125 Decision No. 289 concluded that premium pastry flour imports do not represent a viable alternative based on current prices, and therefore are unlikely to provide a sufficient constraint on the combined entity in either the North or South Island markets. Current information suggests that this conclusion remains valid.

Constraint from Potential Competitors

- 126 New entry by way of a flour milling facility is considered unlikely to occur because of the large sunk costs in establishing a sufficiently sized facility. If entry was to occur, the relatively small size of the markets would not make such entry sustainable. An entrant would also need to find outlets for the much larger quantities of ordinary flour produced.
- 127 Staff do not consider that new entry to the premium pastry flour markets would be likely, of sufficient extent, timely or sustainable so as to constrain the combined entity.

Constraint by Suppliers and Acquirers

- 128 There appear to be no constraints which suppliers (wheat growers) could impose on the combined entity. Acquirers, [], would likewise be unable to continue to constrain the combined entity, unless a strong competitor to the combined entity emerged. As Allied is likely to assume this role, Staff consider that acquirers are likely to retain a considerable degree of countervailing power.

Conclusion on Premium Pastry Flour Markets

- 129 Staff conclude that existing competitors and countervailing power held by acquirers would constrain the combined entity in both markets. Accordingly, Staff conclude that the proposed acquisition would not result, and would not be likely to result, in the combined entity acquiring or strengthening a dominant position in the market for the production and acquisition of premium pastry flour in the North Island and in the market for the production and acquisition of premium pastry flour in the South Island.

Bran and Pollard Markets

- 130 Markets were identified in Decision No. 289 for the production and acquisition of bran and pollard in the North Island and the production and acquisition of bran and pollard in the South Island.
- 131 In Decision No. 289, Staff did not believe that any dominance concerns would arise in the bran and pollard markets post-acquisition due to the constraints on the combined entity. As a result of the purchase of the Christchurch mill, Staff believe Allied will likely acquire additional bran and pollard market share, thereby further lessening any dominance concerns. Staff confirm the conclusions of Decision No. 289.

Bread Markets

- 132 The following three bread markets were identified in Decision No. 289 and remain relevant for the purposes of dominance assessment:
- the market for the production and sale of packaged bread in the upper North Island;

- the market for the production and sale of packaged bread in the lower North Island; and
- the market for the production and sale of packaged bread in the South Island.

Upper and Lower North Island Bread Markets

- 133 On 28 May 1997, a fire destroyed Allied's Auckland bakery. According to Allied, the bakery will be re-located and fitted with new equipment within nine months. It was noted in Decision No. 289 that Allied were spending [] of the old Auckland bakery. The equipment to complete this []
- 134 Staff do not believe that Allied will lose material market share while re-establishing an Auckland bakery, and that after opening the new bakery they are likely to be in a better competitive position as the new bakery should be better located with more modern equipment.
- 135 In Decision No. 289, Staff did not believe that any dominance concerns would arise in the upper or lower North Island packaged bread markets post-acquisition due to the constraints on the combined entity. Staff do not believe the fire at Allied's Auckland bakery has materially changed these beliefs. Staff confirm the conclusions of Decision No. 289.

South Island Bread Markets

- 136 In Decision No. 289, Staff concluded that neither existing nor potential competitors would act as a constraint on the combined entity, and that supermarkets' countervailing power would be significantly reduced, thus removing their ability to act as a sufficient constraint on the combined entity in the South Island packaged bread market.
- 137 Set out in Table 7 are estimates of the market shares of industry participants in the South Island packaged bread market as established in Decision No. 289. Nielsen market analysis for the January to April 1997 period confirms that the only substantial change in market share has occurred as a result of the Foodstuffs (South Island) housebrand contract. Nielsen's figures show that the benefit to Goodman Fielder of this contract has been around [] of total market share, compared to the expected []. This [] share represents [].

**Table 7: Estimated South Island Packaged Bread Sales
Year to 29 December 1996**

Baker	Sales \$(m)	Share
Goodman Fielder GF Housebrand Defiance Def Housebrand Ex Allied Housebrand		
Combined Entity Allied Allied Housebrand In-store Housebrand		
Total	87.8	100%

Source: Applicant and collated information. Sales are estimates only.

- 138 The following points should be noted about the estimates in Table 7:
- housebrand and in-store supermarket bakery sales have been calculated from information provided by the applicant; and
 - the combined entity's share has been adjusted to allow for Goodman Fielder securing the contract to bake housebrand bread for Foodstuffs (South Island) effective from 29 December 1996 (from [] to []). Allied's share in that market has decreased correspondingly from [] to [] after it lost that contract. This revision was shown in Table 10 in Decision No. 289.
- 139 The applicant has advised that it has received [] The term of the contract is []. While the applicant argues that this supports their belief that housebrand shares should be treated as "floating", Staff continue to adopt the conservative, and consistent, view that housebrand shares should be amalgamated with that of the producer. On this basis, Goodman Fielder's market share is likely to fall to around [], and Allied's market share is likely to rise to around [].
- 140 The movement in the housebrand contract is indicative of the constraint provided by Allied, and the countervailing power of supermarkets, which are discussed further below.
- Constraint from Existing Competitors
- 141 No independent plant bakers or Goodman Fielder franchisees operate in the South Island market. Several of the larger supermarkets have started producing packaged bread in their in-store bakeries. Currently, their combined market share of the South Island market is small at [].
- 142 The only significant competitor to the combined entity in the South Island packaged bread market is Allied. The applicant has provided clarification on figures submitted in their initial application relating to Allied's surplus South Island capacity. []. Allied's Christchurch and Dunedin bakeries have a [] loaves per week (or [])

surplus capacity. Decision 289 noted that Allied would require flour supply in order to utilise the surplus capacity. The new Christchurch mill provides sufficient flour capacity to expand baking production while still providing Allied with an adequate supply of flour to compete in North and South Island flour markets. This fact supports the conclusion in Decision No. 289 that Allied has sufficient South Island baking capacity to raise its output in that market significantly.

- 143 In Decision No. 289 Staff were not convinced that Allied would have sufficient market presence to constrain the combined entity in the South Island market, other than recapturing the market share which it lost to Goodman Fielder through the housebrand contract. Staff accept that Allied has the capacity to produce at significantly higher levels.

[
]

- 144 While Allied is the only competing plant baker, Staff believe that it is now likely to provide constraint on the combined entity.

Constraint from Potential Competitors

- 145 Decision No. 289 identified no new competitors likely to enter the South Island packaged bread market. While the applicant identified several parties who expressed interest in acquiring bakery assets if Goodman Fielder were to sell these as part of a divestment, no potential new entrant has expressed any desire to invest the capital (estimated at \$15-\$20 million) required to build new plant. Staff consider it unlikely that Rivermill or Yarrows would establish South Island bakeries, but that new in-store bakeries would provide some constraint.

Constraint by Suppliers and Acquirers

- 146 Suppliers of flour and other inputs are unlikely to be able to impose any significant constraint on the combined entity in the South Island packaged bread market.
- 147 The applicant notes that housebrands controlled by the supermarkets nationally comprise a [] share of bread sales. Those sales are concentrated in the South Island market with a [] share. It is argued that the extent of housebrand bread sales in the South Island market has provided the supermarkets with a degree of countervailing power. In addition, bread has become a source of price competition between supermarkets. As a result, competition on bread prices, driven by supermarkets, is much greater in the South Island than the North Island.
- 148 The applicant argued that some supermarkets exercise a further degree of countervailing power through their ability to award national supply contracts, in which they demand low prices and other discounts and concessions consistently, in all bread markets.
- 149 Currently, as acquirers of packaged bread in the South Island market, supermarkets have a considerable degree of countervailing power, primarily derived from there being three competing plant bakers. Post-acquisition, Allied would be the only significant competitor, with no independent plant bakers, and no likely new entrants. While supermarkets are likely to play a pivotal role, Staff conclude that Allied's presence as a major alternative supplier to the combined entity will be sufficient to ensure that the supermarkets retain countervailing power to constrain the combined entity in the South Island market.

Conclusion on South Island Packaged Bread Market

- 150 Staff conclude that due to constraint from Allied and from supermarkets as acquirers, the proposed acquisition would not result, and would not be likely to result, in the combined entity acquiring or strengthening a dominant position in the market for the production and sale of packaged bread in the South Island.

VERTICAL INTEGRATION

- 151 Decision No. 289 provided a detailed analysis of the impact of vertical integration on the proposed acquisition. As no dominance concerns now exist in any of the relevant markets, no additional comment on the issue of vertical integration is made.

CONCLUSION

- 152 Staff conclude that the proposal would not result, and would not be likely to result, in the combined entity acquiring or strengthening a dominant position in any relevant market.

RECOMMENDATION

- 153 Having had regard to the factors set out in section 3(9) of the Act, Staff conclude that the proposed acquisition would not result, and would not be likely to result, in the combined entity acquiring or strengthening a dominant position in any relevant market.
- 154 It is recommended that, in terms of section 66(3)(a) of the Act, the Commission give clearance, inclusive of the applicant's undertaking, for the proposed acquisition.

Andrew Brice
Chief Investigator
17/6/1997