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COMMERCE COMMISSION

PUBLIC VERSION

Decision No. 334

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

MAINLAND PRODUCTS LIMITED

and

FOOD SOLUTIONS GROUP LIMITED

The Commission:	P C Allport K M Brown E M Coutts
Summary of Proposed Acquisition:	Acquisition by Mainland Products Limited of up to 100% of the shares in Food Solutions Group Limited.
Determination:	Pursuant to s 66(3)(a) of the Act, the Commission determines to give clearance for the proposed acquisition.
Date of Determination:	21 December 1998

CONFIDENTIAL MATERIAL IN THIS REPORT IS CONTAINED IN SQUARE BRACKETS [ ]

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THE PROPOSAL

1 The business acquisition for which clearance is sought under section 66 of the Commerce Act is the proposed acquisition by Mainland Products Limited (Mainland) of up to 100% of the shares in Food Solutions Group Limited (Food Solutions).

THE PROCEDURES

2 The notice was registered on 9 December 1998.

3 Section 66(3) of the Commerce Act requires the Commission to clear, or to decline to clear, a notice given under the section within 10 working days, unless the Commission and the applicant who gave the notice agree to a longer period. As no extension has been agreed, a determination is required by 23 December 1998.

4 Mainland sought initial confidentiality for the fact of the proposal, but this requirement ceased when a press release was issued on behalf of Mainland on 10 December. Mainland also sought confidentiality for some of the information in the application, and a confidentiality order was made in respect of that information for a period of 20 working days from the Commission's determination. When the order expires, the provisions of the Official Information Act 1982 will apply.

5 The Commission's decision is based on an investigation conducted by staff and their subsequent advice to the Commission.

THE INVESTIGATION

6 The Commission contacted the following parties during the investigation:

<u>Industry groups</u>
New Zealand Pork Industry Board / Pork Processors Association, Wellington

<u>Smallgoods manufacturers</u>
Premiere Bacon Company Limited, Carterton
Wilson Hellaby Limited, Auckland
Vienna Continental Foods New Zealand Limited, Auckland
Bacon and Smallgoods HB Limited (t/a Medallion Foods), Napier
A Verkerk Limited, Christchurch
Apex Meats, Blenheim
Gould Bros Limited, Wellington.
Hellaby Meats (SI) Limited, Christchurch

<u>Supermarket operators</u>
Woolworths (NZ) Limited, Auckland
Progressive Enterprises Limited, Auckland
Foodstuffs (Wellington) Co-operative Society Limited, Wellington
Foodstuffs (Auckland) Limited, Auckland

Food Service Distributors
Fresh and Frozen Food Distributors Limited, Auckland
John Bourke Limited, Rotorua
Mainstream Foods Limited, Nelson

The applicant provided additional information on the proposal.

THE PARTIES

Mainland

7 Mainland is owned by Kiwi Co-operative Dairies Limited (83%) (Kiwi) and Aorangi Laboratories Limited (17%). Kiwi, which is based in Hawera, is the second largest dairy company in New Zealand. Aorangi is owned by six members of the McConnon family in equal shares, and the company has no direct involvement with the dairy or smallgoods industries.

8 Much of Mainland's business activities are associated with dairy products. In Decision 324 of 12 May 1998 the Commission cleared Mainland to acquire the fresh milk and cream, yoghurt and other cultured dairy food assets of South Island Dairy Farmers Co-operative Limited. Another business activity of Mainland is the production of the *Frasers* brand of smallgoods[1] at Oamaru, and the distribution of these products nationally.

Food Solutions

9 Food Solutions was formed to acquire the long-established smallgoods businesses of Huttons NZ Limited and Best Corporation Limited. This proposal was cleared by the Commission in September 1997, in Decision 308.

10 Food Solutions manufactures smallgoods at Hamilton, Palmerston North and Christchurch, and smallgoods and frozen convenience foods in Auckland.

11 Another activity of the company is the raising of pigs on farms in the South Island. The majority are processed for sale, but some are sold as breeding stock to other pig farmers.

MARKET DEFINITION

12 Section 3(1A) of the Commerce Act provides that:

> "… market is a reference to a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them".

13 The Commission's Business Acquisitions Guidelines provide information on how the Commission approaches the task of market definition. Identification of the relevant markets enables the Commission to examine whether the acquisition would result, or

[1] Smallgoods are defined in paragraph 17 below.

would be likely to result, in the acquisition or strengthening of a dominant position in terms of s 47(1) of the Act in any of those markets.

14 Markets are defined in relation to product type, geographical extent and functional level. The boundaries of the product and geographical markets are identified by considering the extent to which prospective purchasers would be likely to substitute other products and other geographical regions in response to a change in relative prices of the products concerned.

15 A properly defined market will include products which are regarded by buyers as being not too different ('product' dimension) and not too far away ('geographical' dimension). A market defined in these terms is one within which a hypothetical profit-maximising sole supplier of a product could impose at least a *s*mall yet *s*ignificant and *n*on-transitory increase in *p*rice (the "*ssnip*" test), assuming other terms of sale remain unchanged. It will also include those suppliers currently in production who are likely, in the event of such a ssnip, to shift promptly to offer a suitable alternative product.

16 Markets are also defined in relation to functional level, because it is usual for the production, distribution and sale of products to proceed through a series of levels. For example, the functional level between manufacturers and wholesalers might be called the "manufacturing" market, while that between wholesalers and retailers is usually known as the wholesaling market. Functional levels may be combined, and it is common for manufacturer to undertake the wholesaling function within their own organisations.

Product/Function Markets

17 Food Solutions produces frozen convenience foods, (which include hamburger patties, fish cakes, hot dogs and other crumbed and batter-coated products), and also operates pig farms. As these activities are not undertaken by Mainland, no horizontal aggregation would result from the proposal, and they will not be considered further in this report.

18 The word "smallgoods" does not have a precise definition, but it is a term which is used in New Zealand and Australia to describe a range of processed meat products. The raw material is generally pork, but this is not invariably the case, particularly with sausages which could use beef mutton or other meats. When sold by retailers, the products may be offered in delicatessens or in the delicatessen departments of supermarkets, or, when the products are pre-packed, from chilled storage cabinets. Some of the products are customarily consumed cold (eg ham, pastrami, salami and luncheon sausage) while some are usually cooked and served warm (bacon, saveloys and sausages). While these products are not necessarily direct substitutes, there is sufficient commonality for them to be treated together.

19 Mainland and Food Solutions both produce and distribute smallgoods to retailers and to some resellers.

Geographic Market

20 Food Solutions provides full national distribution of smallgoods from its plants. While Mainland's *Frasers* brand smallgoods have relatively greater sales in the South Island they are sold nationally. Some other producers sell their products widely, while some, particularly the smaller firms, sell only locally or regionally.

21 Representatives of major retailers said that it is generally, but not always, possible to source products economically from anywhere in New Zealand. This was said to apply more strongly to pre-packed products than to other smallgoods, partly because of the need for more stringent requirements which apply to distribution of the latter.

22 Some imported smallgoods are sold in New Zealand.

23 Given that some producers provide national distribution, and that major purchasers would usually consider purchasing from anywhere in New Zealand, the market appears to be national.

Conclusion on Market Definition

24 For the purpose of analysing the competition issues arising from the proposed acquisition, we conclude that the relevant market is that for the wholesale distribution of smallgoods in New Zealand.

COMPETITION ANALYSIS

Overview

25 Section 66(3) of the Act, when read in conjunction with s 47(1) of the Act, requires the Commission to give clearance for a proposed acquisition if is satisfied that the proposed acquisition would not result, and would not be likely to result, in a person acquiring or strengthening a dominant position in a market. If the Commission is not so satisfied, clearance must be declined.

26 In Port Nelson Ltd v Commerce Commission [ ] 3 NZLR 554, the Court of Appeal approved the following dominance standard, adopted by McGechan J in the High Court:

> … dominance involves more than high market power; more than mere ability to behave "largely" independently of competitors; and more than power to effect "appreciable" changes in terms of trading. It involves a high degree of market control.

Existing Competition

27 The Pork Processors Association estimates that there are between 70 and 80 smallgoods manufacturers in New Zealand. Of these, 23 are members of the Association. However, many of the non-members are very small producers, and the Association estimates that its members account for 80 to 85% of New Zealand smallgoods production.

28 Food Solutions is by far the largest New Zealand smallgoods producer. There is a large gap between its output, and that of each of the several small to medium sized producers which include Premiere Bacon Company Limited, Bacon and Smallgoods (HB) Ltd (Medallion Foods), Vienna Continental Foods NZ Limited, A Verkerk Limited, Gould Bros Ltd, Wilson Hellaby Limited and Apex Meats. The numerous very small producers include retail butchers who produce only for their local markets.

29 Some smallgoods are imported from Canada and Australia. However, the increase in the importation of pork products appears to have been more of materials for further processing, such as boneless shoulders used for bacon production, rather than finished products.

Market Shares

30 The available market share data does not give a complete view of the industry.

31 The most detailed figures are those derived from the AC Nielsen data based on the scanning of sales of branded bar-coded products at supermarket checkouts. Mainland has included information from this data in tables two and three in the application. These figures are likely to be highly accurate, and they account for a significant part of total sales. However, they do not include the sales of unbranded products from supermarket delicatessens, sale by retail butchers, sales by convenience stores, sales to the food service sector or sales to institutions.

32 In the application, Mainland states that the A C Nielsen data “appears to represent around 50% of the total NZ sales of smallgoods”. In supplementary information provided by Mainland, the company stated that accurate total data is difficult to assess. For example, there is no central collection of figures on supermarket delicatessen sales, or sales by retail butchers or other retailers. Mainland based its estimates on its sales experience in the period March-December 1998. A spokesperson for the Pork Processors Association confirmed to Commission staff the absence of reliable figures for total smallgoods production, but suggested that a 50-50 split between branded supermarket products and other forms of sale did not appear unrealistic.

33 In table one in the application, Mainland estimates the combined Food Solutions/Mainland market shares for bacon and ham based on the Statistics New Zealand figures for total New Zealand production. [

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34 The Nielsen data utilised in Table two in the application shows the following market shares:

	% (quantity)
Food Solutions	43.9
Mainland	4.3
Sub-total	48.3
Eight small/medium producers	29.3
Housebrands	18.7
All other producers	3.7
Total	100.0

35 Further information obtained from Mainland established that most of the housebrand sales [ ] are of products produced by Food Solutions, with a small quantity [ ] being produced by Mainland. The Commission's approach to market shares in cases involving other food industries has been to include housebrand sales as part of the market share of the producers. While there is no certainty that a producer will continue to be awarded contracts to produce a housebranded product for a supermarket, and while changes of producer do occur at times, there is in practice a reasonable degree of stability in the pattern of this business. Conversely, a producer does not have a guarantee that a branded product will continue to be stocked by any particular supermarket; changes do occur.

36 In our view, it is appropriate to include housebrand production as part of the market shares of the parties. The effect of doing so is to increase the combined Mainland/Food Solutions share to over 60% [ ]. However, this figure relates to branded products sold by supermarkets,[

]

Entry and Expansion Conditions

37 Most of the smallgoods producers and supermarket representatives spoken to by the Commission considered that entry conditions are not onerous. One supermarket representative added that "there are always willing entrants". The only exception was one producer who suggested that quality and hygiene requirements for smallgoods production have been raised appreciably in recent years, and that this imposes much higher capital requirements on prospective entrants.

38 Some of the existing medium sized producers have expanded their geographic coverage in recent times. Gould Bros Limited of Wellington commenced selling in the South Island about six months ago, while Premiere Bacon Company of Carterton has done so from the beginning of 1998. Medallion Foods of Napier, which was initially a regional producer, now distributes throughout the North Island, and has

commenced selling in the South Island. Medallion's output has doubled in the past three years.

39 The Commission was informed that there is substantial unused capacity throughout the smallgoods manufacturing industry, and that this is likely to continue to be the case.

Imports

40 Some smallgoods are imported, and there are no major impediments to their importation from Canada or Australia. The perishable nature of the products is one factor which may limit the growth of smallgoods imports, although it was suggested to the Commission by one manufacturer that this would not be a problem with imports from Australia. Another factor is that the prices of New Zealand made smallgoods appear to compare reasonably favourably with the landed cost of imports. New Zealand manufacturers make substantial use of imported frozen pork which is processed into smallgoods here.

41 One supermarket representative informed the Commission that while no detailed studies had been done, imports from Australia were considered likely to be a feasible alternative to New Zealand products if any problem developed with domestic supply. One other supermarket group has imported hams.

42 The possibility of increased imports of finished products seems likely to provide some constraint on the parties to the proposal.

Countervailing Power of Purchasers

43 The major supermarket chains purchase large quantities of smallgoods, and producers compete strongly for their orders. The supermarket representatives spoken to by the Commission indicated that if the proposal is implemented, they consider they would continue to have adequate alternatives to Food Solutions and Mainland as suppliers. While the allocation of supply contracts for housebranded products is relatively stable, supermarket chains do have the option of changing suppliers if they find their present supplier unsatisfactory. That is, they would be able to find other suppliers which could provide products of the required quality and packaging standards. None of the supermarket representatives suggested that ownership of recipes would be a problem in changing suppliers.

44 Some smallgoods, such as sausages, are produced by some supermarkets. One supermarket chain produced a range of smallgoods in its own factory until recently, but discontinued this because it was able to obtain better prices from other suppliers. Internal production of at least some smallgood lines by supermarket chains does appear feasible.

45 In view of these factors, the Commission considers that supermarket chain do have significant countervailing power in their capacity of purchasers of smallgoods.

Assessment of Dominance

46 Food Solutions is by far the largest smallgoods producer. In terms of sales of branded products sold through supermarkets (including housebrands) it is over seven times as large as the second largest producer, Medallion Foods. While Mainland is a relatively small producer, the addition of its production would increase this ratio to over seven and a half times. [

] Several market participants suggested to the Commission that Mainland would not necessarily retain all of the combined market share of Food Solutions and itself, as some purchasers would be likely to diversify their sources of supply.

47 The two parties to the proposal have brands which are well known and well regarded.

48 While a high market share is a necessary condition for dominance to result from an acquisition proposal, it is not a sufficient condition, and it is necessary to take account of other factors which influence levels of market power.

49 Although Food Solutions is very much larger than all of its competitors individually, there are several small to medium sized producers, as well as numerous very small producers. The small/medium producers have shown an ability in recent times to increase the volume of their production and to increase the geographic extent of their distribution. It does not seem likely that the proposal would eliminate this ability. There appears to be substantial existing capacity among the producers to allow them to increase production if opportunities arose.

50 Entry conditions do not appear onerous, and new entry, at least on a small scale, appears feasible.

51 The most significant purchasers, the supermarket groups, have substantial countervailing power as they could change their sources of supply with little difficulty. The supermarkets consider that they would continue to have effective alternatives. This countervailing power is strengthened to some extent by the possibility that products might be sourced from Australia.

52 While implementation of the proposal would give the merged companies additional market share, the Commission does not consider that this would be sufficient to result in dominance. If, after the proposal were put into effect, Mainland were to increase prices above the competitive level, several competitors have the ability increase their supply.

CONCLUSION

53 The Commission has concluded that implementation of the proposal would not result in Mainland acquiring or strengthening a dominant position in the relevant market.

DETERMINATION ON NOTICE SEEKING CLEARANCE

54 Accordingly, pursuant to section 66(3) of the Commerce Act 1986, the Commission gives clearance for the acquisition by Mainland Products Limited of up to 100% of the shares in Food Solutions Group Limited.

Dated this day of December 1998

P C Allport
Chairman