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COMMERCE COMMISSION

DECISION NO. 308

Determination pursuant to the Commerce Act 1986 (the Act), and in accordance with a delegation given in terms of s 105 of the Act, in the matter of an application for clearance of a business acquisition involving:

FOOD SOLUTIONS LIMITED

and

HUTTONS NZ LIMITED

and

BEST CORPORATION LIMITED

- The Commission:** Alan Bollard
Kate Brown
- Summary of Proposal:** The acquisition by a new company, which is likely to be re-named Food Solutions Limited, or any interconnected body corporate, to acquire the businesses of:
- (a) Huttons NZ Limited; and
 - (b) Best Corporation Limited.
- Determination:** Pursuant to s 66(3)(a) of the Act, and in accordance with a delegation granted under s 105 of the Act, the Commission determines to give a clearance for the acquisition.
- Date of Determination:** 29 September 1997

AUT/BA H11/1
M 2351

MEMORANDUM

To: Alan Bollard
Kate Brown

From: Jeff Hamilton
John Preston
Jo Bransgrove

Date: 26 September 1997 (Working Day 9)

Subject **Commerce Act 1986: Business Acquisition:
Food Solutions Limited/Huttons NZ Limited/Best
Corporation Limited**

Working Day 8: 25 September 1997 Working Day 10: 29 September 1997
Confidential material in this report is contained in square brackets.

THE PROPOSAL

- 1 Clearance has been sought by a new company, which is likely to be re-named Food Solutions Limited (Food Solutions), to acquire the businesses of Huttons NZ Limited (Huttons) and Best Corporation Limited (Best).

PROCEDURES

- 2 Section 66 (3) of the Commerce Act (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. The proposal was registered on 15 September 1997, and therefore the date for a decision of the proposal is 29 September 1997.

THE PARTICIPANTS

Food Solutions Limited

- 3 Food Solutions is the likely name of a joint venture holding company which will be used to purchase the smallgoods businesses of Huttons and Best, and the New Zealand frozen convenience food business of Best. The company is to be owned as to 70% by Huttons, and as to 30% by Best.

Huttons NZ Limited

- 4 Huttons is involved in the manufacture of various smallgoods, including bacon, ham and salami from factories in Hamilton, Palmerston North and Christchurch. It markets the products under the “Huttons”, “Kiwi”, “Tenderkist” and “Brooks” brands. Huttons also has pig breeding, pig farming and pig production activities. Brierley Investments Limited is ultimately the parent company of Huttons.

Best Corporation Limited

- 5 Best is involved in the manufacture of bacon, ham and other smallgoods, which are marketed under the “Top Hat” brand; salami, which is sold under the “Miano” brand; and frozen convenience foods, including hamburger patties, fish cakes, hot dogs and other crumbed and battered products, which are marketed under the “Top Hat” brand. One of the companies has two Auckland plants, and a facility in Australia producing frozen convenience foods¹. Best was founded by the Huljich family, and operated by them until 1994 when it was acquired by Griffins Foods Ltd, a wholly owned subsidiary of the French multinational food and beverage company, Danone Group (formerly called BSN).

THE RELEVANT MARKETS

- 6 Both Huttons and Best are involved in the manufacture and distribution of smallgoods. In addition, Huttons operates pig farms in the North and South Islands, and runs a pig killing plant at Hamilton. Accordingly, the proposed acquisition would result in horizontal aggregation of market share in relation to the manufacture of smallgoods in New Zealand, and would strengthen existing vertical integration between the markets for the rearing and sale of pigs, the processing of pig meat, and the manufacture and distribution of smallgoods.

Frozen Convenience Foods

- 7 Best is engaged in the manufacture and distribution of frozen convenience foods, including hamburger patties, fish cakes, hot dogs and other crumbed and battered products. Huttons has an indirect ownership link (through Brierley Investments Ltd) with Sealords Group Ltd, which produces among other products, frozen fish products. However, we consider that the proposal is unlikely to cause any material change to the market situation for frozen convenience foods. Accordingly, we do not propose to consider this market in any further detail in this report.

Market Definition

- 8 In the application, the relevant market is defined as that for the manufacture and distribution of smallgoods in New Zealand. Smallgoods is a generic term which is used to cover a range of processed meat products, including ham, bacon, sausages, luncheon sausage, salami and other boutique products (eg pastrami).
- 9 The smallgoods market was last reviewed in detail by the Commission in early 1993 when it considered the then proposed acquisition by Huttons of the brand names, and certain other assets of the Tenderkist business of AFFCO Meats Ltd, a subsidiary of AFFCO New Zealand Ltd (see AUT/BA H5/1).

Product/Function Markets

- 10 In the Huttons/Tenderkist staff report, it was noted that the smallgoods

products manufactured by the parties to the proposal were not fully substitutable, and that the product categories could be further sub-divided. For instance, it was considered that a distinction could be made between branded product for retail sale and unbranded product for retail sale and for sale to the catering trade. Also, it was considered that retail packs of sliced product and small items, such as chubs and bulk packs of these goods supplied for catering purposes, might be in separate markets, although the division between the two was not a rigid one.

- 11 Regardless of the above considerations, staff reached the view in the Huttons/Tenderkist report that a broad market definition was appropriate for the purpose of analysing the competition issues arising from the proposal. Specifically, the relevant market was defined as the production and wholesale distribution of ham, bacon and other smallgoods.
- 12 We consider that the market circumstances have not changed significantly since the Huttons/Tenderkist proposal to warrant making any significant modification to the earlier market definition. While each of the categories of smallgoods are not fully substitutable for each other, they have sufficient characteristics in common to be defined under the broad definition of smallgoods. We therefore propose to adopt a similar product market definition to that used previously for the purpose of competitive analysis in this report. At the same time, however, we acknowledge that certain other food products may act as substitutes in many circumstances.
- 13 Huttons delivers its range of smallgoods directly to supermarkets in the Auckland/Waikato region using its own fleet of temperature controlled vehicles. For the balance of sales, the company contracts owner-operator drivers to undertake delivery to customers. Best carries out the distribution of smallgoods to supermarkets in the Auckland region itself, but relies on chilled food distributors for delivery to all other areas in the country which it services.
- 14 The major types of outlets through which smallgoods are sold are:
 - frozen and chilled food distributors;
 - retail stores, including major supermarkets and independent grocery outlets such as dairies, service stations, butchers and food service outlets; and

- hotels, restaurants and institutions, including commercial caterers, hospitals and prisons.

Geographic Market

- 15 Huttons provides full national coverage from its plants at Hamilton, Palmerston North and Christchurch. Best distributes most of its product in the area extending from Taupo northwards, but has some presence in the lower North Island, and to a lesser extent in the South Island. With some minor exceptions, the remaining smallgoods producers supply regional or local markets. Although it is possible to supply smallgoods over relatively large distances, the costs and logistics associated with transporting such perishable products impose some limitations. However, we are aware of some North Island firms selling into the South Island, albeit in minor quantities, and we understand that one South Island company (Mainland Products Ltd) is supplying product extensively throughout the North Island.
- 16 In these circumstances, we consider that it is appropriate to adopt a national market for the consideration of the likely competitive effects of this proposal.

Conclusion on Market Definition

- 17 Having regard to the factors outlined above, we conclude that the principal relevant market is the manufacture and wholesale distribution in New Zealand of ham, bacon and other smallgoods (“the smallgoods market”). The markets for the rearing and sale of pigs, and the processing of pig meat will be examined also.

Existing Competition in the Smallgoods Market

- 18 According to the applicant, there are at least 80 manufacturers of smallgoods in New Zealand. Huttons is by far the largest producer and supplier, and is the only company which provides full national coverage. Best manufactures smallgoods for distribution primarily in the Auckland region, although it does supply product in other parts of the North Island, with a very small proportion of its sales being made in the South Island.
- 19 The remaining manufacturers comprise a large number of medium- to small-

sized manufacturers. These include Medallion Foods Ltd (Napier), Gould Bros Ltd (Lower Hutt), Premiere Bacon Co Ltd (Carterton), Daleys Sensational Foods Ltd (Auckland, Wellington and Christchurch), and Frasers Bacon (Oamaru), a division of Mainland Products Ltd. For the most part, these companies supply principally to local or regional markets (eg a local town or city, or a greater part of the North or South Islands), although some (eg Frasers Bacon) provide national coverage.

- 20 In addition, there are some smallgoods imported from Australia and Canada on a periodic basis, but the quantities are relatively small. We have been told that Woolworths NZ Ltd (Woolworths) has imported Christmas hams from Australia as well as bacon from Canada.

Market Shares

- 21 There is no reliable market share data on the sale of smallgoods. While figures are available for retail branded product sold through supermarkets, there is no similar data for product sold through the delicatessen and butchery sections of supermarkets, independent grocery outlets, caterers and other outlets.
- 22 In the application, Huttons provided the following estimates of market shares for the manufacture of smallgoods in New Zealand, and for the sale of retail branded smallgoods undertaken by supermarkets in New Zealand.

Manufacture of Smallgoods

	% (Approx)
Huttons	[]
Best	— []
	[]
Other local producers	[]
Imports	— []
	100.0

- 23 These figures are based on Huttons' own estimates of the volume of smallgoods which are manufactured for distribution to the retail and catering segments of the smallgoods market. Huttons estimates that the total size of the

smallgoods market is about [] tonnes, of which the retail segment accounts for [] tonnes, and the catering segment accounts for [] tonnes.

Sale of Branded Smallgoods in Supermarkets

	% (Actual)
Huttons	[]
Best	[]
	[]
Medallion Foods	[]
Daleys Sensational Foods	[]
Gould Bros	[]
Mainland Products Ltd	[]
Others	[]
	100.0

- 24 The above figures relate to proprietary brands sold through supermarkets, and were extracted from A C Nielsen data.
- 25 Several of the parties contacted by staff commented that the market shares provided by the parties to the proposal appear to be understated. The view of those parties was that the combined entity would account for well in excess of 50% of the smallgoods market.
- 26 We have attempted to calculate market shares on the basis of sales turnover figures for 7 of the larger producers and suppliers of smallgoods together with an estimate of the remaining 70-75 suppliers. These figures, which are outlined below, include sales of branded and non-branded product, and retail and bulk packs, but exclude sales made by retail butchers, delicatessens and other relatively minor players.

% (Approx)

Huttons	[]
Best	[]
	[]
Medallion Foods	[]
Mainland Products	[]
Gould Bros	[]
Premier Bacon Co	[]
Daleys Sensational Sausages	[]
Others	[]
	100

- 27 On the basis of our estimates, we consider that the market shares for the combined entity might be in the mid-50% range at the upper limit. Huttons' view is, however, that such a figure overstates the position. That view is supported by data provided by Statistics New Zealand which indicates that Huttons and Best together account for less than 40% of total New Zealand production of ham, bacon and other smallgoods (actual about []).

Entry/Expansion Conditions

- 28 Entry on a small scale into the manufacture and distribution of smallgoods is possible for a relatively modest outlay of capital. There are many examples of small scale producers who have entered the market.
- 29 Entry on a larger scale requires a substantially greater capital outlay to cover the investment in plant and equipment, refrigerated vehicles and chilled storage facilities. If branded product is to sold by a new entrant, it would be necessary to commit resources to promotion. Also, it would be necessary to invest significant resources to meet and maintain MAF, and other related requirements.
- 30 Given the significant expenditure requirements, and the strong level of competition which exists in the smallgoods market at present, our view is that *de novo* entry on a large scale is unlikely. However, there do not appear to be any significant impediments to those existing small- to medium-sized

incumbents increasing their market share, should the circumstances justify this. We note that some companies, such as Medallion Foods, have steadily built up their market presence from a small base. Further, Mainland Products which itself is a major supplier of dairy products, has been expanding its smallgoods sales throughout the country.

Imports

- 31 There are no major impediments to the importation of smallgoods from either Australia or Canada. As noted above, some imports of ham and bacon have already occurred from those countries, albeit in small quantities, and on an irregular basis. It appears that the major factors constraining imports have been freight costs, and the perishable nature of the product. However, the introduction of a mutual recognition of food standards codes between New Zealand may provide some scope for imports from Australia. Under a transitional regime, which came into effect on 1 July 1996, food products which conform to either the relevant New Zealand or Australian food standards code can be imported into New Zealand from Australia without restriction, subject to meeting quarantine and other border control requirements.

Countervailing Power of Acquirers of Smallgoods

- 32 The major supermarket chains, which include various banner groups in the Woolworths, Foodstuffs and Progressive Enterprises groups of companies, are substantial purchasers of smallgoods, and there is currently intense competition among smallgoods producers for access to supermarket shelf space. The supermarket chains appear to have the necessary buying power to switch with relative ease from one smallgoods supplier to another, subject to price and other considerations (eg compliance with health standards). In addition, most supermarkets have their own house brand products which are offered alongside branded product.
- 33 In view of these factors, staff consider that supermarket owners can (and do) exercise significant countervailing power in their capacity as purchasers of smallgoods.
- 34 Other major outlets for smallgoods include hotels, caterers, restaurants and

institutions. One major catering company told us that the supply of smallgoods is intensely competitive, and that the proposed acquisition would have no detrimental effects in relation to the purchase of these products.

ASSESSMENT OF DOMINANCE

- 35 Implementation of the proposal would lead to the aggregation of the market shares of the two leading manufacturers of smallgoods in New Zealand. As noted above, Huttons is clearly the largest producer of smallgoods, and is the only company that undertakes national distribution on a significant scale. The company's products enjoy a strong brand awareness, and have a significant market presence, especially in the retail segment of the market. Best's smallgoods are manufactured primarily for distribution in the Auckland region where its brands have achieved a high level of recognition, but the company has some market presence elsewhere in the country.
- 36 While it is difficult to estimate precisely the likely post-acquisition market share of the combined Huttons/Best, our calculations indicate that the upper limit might be in the mid-50% range. However, on the basis of data supplied by Statistics New Zealand, the percentage market share figure of the merged company is likely to be significantly lower. Nevertheless, the combined entity would hold a relatively high market share, with the next largest competitors having significantly lower market shares, possibly in the 5% to 10% range.
- 37 Although high market shares might be indicative of potential competition issues, they do not necessarily mean that acquisition or strengthening of a dominant position will result. There is a range of additional factors which must be taken into account in assessing dominance. These factors are discussed below in relation to the proposed acquisition.

Constraint from Existing Competitors

- 38 We consider that the combined entity would be constrained post-acquisition by a number of mainly regionally-based competitors supplying a range of smallgoods products. These include Medallion Foods, Gould Bros, and Premier Bacon Co, all of which compete primarily in the North Island. All these companies appear to have the capacity to expand production. Of the South Island-based suppliers, Mainland Products is an example of a supplier

which has been expanding its presence in the North Island, and it appears to have the potential to develop further given the appropriate incentives.

- 39 In addition, there is a large number of smaller competitors, some of which are active in the manufacture of a specific range of smallgoods products (eg bacon or salami), and which compete successfully in those segments. Others may focus on a particular locality and/or customer category.
- 40 Concern was expressed by certain parties that the proposal would lead to the creation of a very large supplier of smallgoods, accounting for a substantial volume of product. This, it was argued, would enable the combined entity to strengthen its existing market position, particularly in respect of the major supermarket chains, and thereby squeeze out other suppliers. As a consequence, these parties considered that the proposal is likely to have a detrimental impact on the competitive position of the medium- to smaller-sized suppliers.
- 41 While staff acknowledge that the effect of the proposal would be to reinforce the market position of the parties to the acquisition, we consider that the new company would not accrue such market power that would enable it to acquire dominance. Our view is that if the combined Huttons/Best were to raise its prices above the normal competitive level, there would be no major impediments facing many of its existing competitors from increasing their existing market presence. Also, it is considered that the strong countervailing power of the supermarket chain operators would further limit the ability of the merged company to exercise any undue market influence (see paras 32, 33 and 43 for further details).

Constraint from Potential Competitors.

- 42 Staff consider that entry into the manufacture and supply of smallgoods is possible on a small scale. However, larger scale entry does not appear likely under the present trading conditions. Although there is some scope for imports to provide a potential constraint in this market, imports do not appear significant, at least at the present time, and therefore we cannot attach any significant weight to this factor as a constraining influence.

Countervailing Power of Purchasers of Ham, Bacon & Smallgoods

- 43 As noted above, we consider that the supermarket chains would continue to exercise a major discipline on the merged Huttons/Best, and that other purchasers of smallgoods products will continue to have many supply options available to them post-acquisition.

Constraint from Substitute Products

- 44 In this report, we have adopted a narrow market definition for the purpose of examining the impact of this proposal. However, if the market definition were extended, this would introduce a competitive constraint from the suppliers of certain other food products (eg some fresh meat products).

Vertical Integration Issues

- 45 Staff have also examined the likely impact of the strengthening in vertical integration which would result from the proposal between the markets for the rearing and sale of pigs, the processing of pig meat, and the manufacture of smallgoods.
- 46 Although Huttons has pig farming activities in both the North and South Islands, it accounts for only a relatively minor percentage of the national demand for pig meat. Apart from selling pigs to the local producers of smallgoods, farmers may sell to fresh meat suppliers, and to other outlets.
- 47 In relation to pig killing facilities, Huttons operates one plant which is located at Hamilton. There are many other pig processing facilities located throughout the country. In addition, there do not appear to be any major restrictions on importing pig meat from certain countries, and already there is a significant volume of product imported from Australia and other countries.
- 48 Taking the above factors into account, along with the findings in respect of the smallgoods market, we do not consider that the strengthening of vertical integration arising from this proposal would lead to the combined entity acquiring or strengthening a dominant position in any of the affected markets.

OVERALL CONCLUSION

- 49 Our overall conclusion is that implementation of the proposal would not lead to the combined entity acquiring or strengthening a dominant position in any of the relevant markets identified above.

RECOMMENDATION

- 50 We recommend that you give clearance to the proposed acquisition under s 66 (3) (a) of the Act, and in terms of the delegation granted to you in accordance with s 105 of the Act.

Investigator

Chief Investigator

Manager

DETERMINATION TO GRANT NOTICE OF CLEARANCE:
FOOD SOLUTIONS LIMITED/HUTTONS NZ LIMITED/BEST CORPORATION LIMITED

We agree/disagree with the recommendation.

We are satisfied/not satisfied that implementation of the proposed acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in a market.

Accordingly, pursuant to s 66(3)(a) of the Commerce Act 1996 (the Act), and in accordance with a delegation granted under s105 of the Act, we hereby give clearance for Food Solutions Group Limited, or any interconnected body corporate, to acquire the business of

- (a) Huttons NZ Limited; and
- (b) Best Corporation Limited.

In terms of s 66(5) of the Act, this clearance shall expire twelve months after the date of this notice. Brief particulars of this clearance will appear in the Commission's public register.

This clearance is given only to the proposed acquisition described in the notice seeking clearance dated 15 September 1997.

Dated at Wellington this day of 1997

A E Bollard
Chairman

K M Brown
Member

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¹ The Australian frozen convenience foods business of Best does not comprise part of the proposed transaction.