

## **PORK FARMS CASPIAN / KERRY FOODS MERGER INQUIRY**

### **Summary of hearing with Peter's Food Service Limited on 18 March 2015**

#### **Background and introduction**

1. Peter's Food Service Limited (Peter's) was established in 1997 when the business of Grand Met plc was taken into private ownership. Peter's really came into being when the food service business was sold to Brake Brothers in 2004, leaving Peter's as a sausage and savoury pastry manufacturing business.
2. Following private equity backing in 2007, the focus of the Peter's business had been to develop its manufacturing capacity in the factory and to focus on the retail market. Annual turnover in 2015 was about £85 million with approximately £53 million being sold to retailers.
3. Peter's sold chilled savoury pastry (CSP) products both to retailers direct and to food service outlets. There was very little product differentiation between these sectors, which enabled Peter's to innovate and manufacture bespoke products. Peter's said that it brought ideas to the own-label, branded and other styles of product to a category that had become stale. Peter's combined innovation with cost efficiencies, which gave it a platform to be very cost competitive. These innovations were not just to products but also to manufacturing methodology and equipment processes.
4. Peter's said it was a very strong regional brand in South Wales, however it also had a national branded footprint that complimented the regional brand.
5. Peter's said that it had a number of own-label customers, of which Asda was the largest. Peter's also made own-label products for other grocery retailers (Sainsbury's, Aldi and Lidl). [X] and the focus of its products was in the food-to-go/snacking market ([X]) rather than the main meal option ([X]).
6. Peter's said that it did not manufacture cold pies, as this was a very different manufacturing process and required different equipment. Additionally, Peter's believed that the cold pie market had been declining for a number of years since cold pie consumers tended to be older people. Conversely, currently and over the longer term, quiches, slices, pasties, and hot pies were more of

a mature market, which was mostly static with some movement between them. [redacted].

7. Peter's said that the protected geographical indication status for Cornish Pasties had caused a market change. As this product was concentrated in one particular region, consumers had gradually moved to other products as Cornish Pasties had become less available or more costly.
8. Avoiding seasonality issues was a core element of Peter's business strategy, and balancing its portfolio between summer and winter was key to that. For instance, for wholesale quiche manufacture, in May you would see large spikes in demand. Similarly, with sausage rolls (and pork pies) there were large Christmas demands. Peter's saw this as another reason not to enter the pork pie segment. Peter's believed that many manufacturers were dealing with these issues by freezing products, and recovering the frozen stock and selling it as fresh products. There were extensive freezing programmes in sausage rolls and pork pies during lower demand periods, which were then unfrozen at Christmas. This helped Peter's to stabilise production through the year.
9. Peter's said that, [redacted], it competed strongly to win business in these areas when the opportunity arose. Peter's also said that it was able to supply the discount retailers because Peter's was a very efficient operation. Since Peter's was only the fourth biggest competitor in the market it was difficult for it to win on price, so it emphasised innovation, bringing new ideas to own-label (eg a chicken korma slice). [redacted] Peter's was more unlikely to supply premium products to the retail sector because the volumes were too low, reducing Peter's efficiency. (But it did produce premium products for the food service sector – gastropubs.) [redacted].

### **Customer behaviour/Supply side substitution**

10. Peter's said that it was relatively easy for retailers to switch supplier, but this would involve risks and costs to the retailer. For instance, retailers would bear additional costs for product development with the new supplier (site visits, trials). These costs applied to own-label products, but not to branded product, where there was little cost involved in switching. There were few formal tenders, but suppliers conducted annual reviews and threatened to switch in order to force prices down.
11. One issue with changing supply of an own-label product would be that products would not look and be exactly the same if they were produced in two different factories. Retailers would not want a product that customers reacted

adversely to and consumers did not like variation in the taste of own-label product.

12. Peter's said that it believed it had recently lost its sausage roll business with Asda to Pork Farms. As far as Peter's was aware, Asda switched because Peter's could not manufacture the whole of Asda's product range and Asda wanted all products in the range to be consistent. Peter's chose not to increase capacity to retain the Asda business in the absence of a longer-term commitment from Asda to buy from Peter's. [✂]
13. Peter's said that, in this particular case, the products lost to Pork Farms were not big lines, this meant that Peter's could absorb some of the losses by capturing efficiency gains because Peter's was quite strong on dealing with long-run products. Peter's also saw the loss of business as an opportunity for it to go out and win other, more profitable, business [✂].
14. Peter's said that over the last ten years the frequency of retailers going out to tender had decreased. It was not always invited to tender, for instance Peter's [✂]. If Tesco chose to do so it could work with Peter's. However, buyers at large retailers deal mainly with the big suppliers. The other suppliers that were likely to be invited to most retail tenders (in sausage rolls, pasties and slices) were Samworth, Pork Farms, and Kerry.
15. Peter's said that it believed it retained its customers (Sainsbury's, Aldi, Lidl) in the face of overrider<sup>1</sup> discounts because of the quality of its product. Market inefficiencies caused by cross-subsidising subcategories meant it was harder to gain new business than retain it. For example, Peter's believed that Pork Farms had a strong hold on Asda's business. If any core business moved then the overrider discount went down on all categories because of the cross-subsidisation. However, Peter's found that product innovation was often a good way to break into a new supplier. [✂].
16. Peter's said that overriders sometimes existed to promote business growth. They usually were introduced by retailers, although Peter's, and other suppliers, offered them as well. However, as Peter's had overrider arrangements in place with all the major retailers that were negotiated on an annual basis, it was irrelevant who offered them or asked for them in the first place. Overriders could be structured in different ways. [✂].

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<sup>1</sup> An 'overrider' is a retrospective discount agreement commonly sought by major supermarkets and other retail multiples for target achievement. Overrider discounts are normally paid in addition to other additional contract costs such as: listing fees, promotional costs or advertising rebates.

17. Regarding manufacturing capability, Peter's said that size was important as, if you had capability to produce a wider product range, then you could win more business. Therefore, as Peter's did not manufacture family pies, this often barred it from discussion over smaller pies if customers wanted both. Similarly on sausage rolls, because Peter's could not offer the whole range, it could only tender for business where customers were prepared to have variations as opposed to those who wanted commonality across the range. [X]. At one point or another, Tesco's, Asda, and Sainsbury's had all wanted their whole CSP range made by a single supplier, which had resulted in large portions of these contracts still being with a single supplier. In contrast to sausage rolls, there was less pressure to supply the full range in relation to slices because there was very wide variation in slices.
18. Peter's said that the CSP market reflected customers' buying habits, whereas the ability for a retailer to switch CSP manufacturers reflected manufacturing capability. However, there were CSP products that Peter's would target as these were more profitable because of the production costs. [X]
19. Pork Farms had bigger production lines than Peter's and, because of this, Pork Farms would get better economies of scale that Peter's could not match.
20. Peter's said that it did not always rate its competitors equally for sausage rolls as for pasties and slices because smaller competitors had different capabilities and the retailer requirements were different.
21. Peter's believed that the cold pie market was in decline. It would be possible for Peter's to make the investment to move onto the pork pie market, but strategically, Peter's did not think this was a good move as the market was going to decline and become more competitive. If Peter's was going to invest, it was unlikely to invest into an area that had a declining top line and overcapacity. [X].

### **Existing competition in the supply of CSP products**

22. Pre-merger, Peter's said that it competed with Pork Farms and Kerry with virtually all retailers in every CSP sector. For instance, for Sainsbury's slices and hot pies business it was in a competitive tender with both parties. [X]. Pork Farms and Kerry also routinely competed with Peter's at Asda, and twice a year various elements of its product range would go out for tender. [X]. Pork Farms did not have such a presence for Lidl and Aldi business, and so that was something that had changed. In relation to smaller discounters, such as Spar, Kerry was more likely to be a competitor than Pork Farms was.

23. As well as Pork Farms, Kerry, and Samworth, Peter's believed there were a number of competitors in the own-label CSP market. In particular, Peter's believed that Welsh Pantry and Yorkshire Baker (supported by Cranswick) were major competitors for sausage rolls, pasties and slices. In other areas Greencore were a major competitor in quiches and Vale of Mowbray were a competitor in pork pies, though Peter's were not active themselves in this segment.
24. In the branded sector, Peter's believed that there were a larger number of competitors.
25. Large suppliers had reason to want to consolidate the market because size allowed flexibility, for example, to increase volumes if a retailer put a product on promotion. Consolidation had been ongoing over the past few years.

### **Countervailing buyer power**

26. Peter's believed that retailers controlled competition in the CSP market to some extent. Retailers generally reviewed a manufacturer's performance every six or twelve months and, as a result of that review could decide to vary the contract with the manufacturer. This could be a good thing as the retailer could decide to increase the number of products, or the volume of current products that it ordered from the manufacturer, though volumes would often be driven by consumer demand.
27. The review would consider a number of factors under the control of the manufacturer, such as the manufacturers' reliability, quality and price. However, the retailer would also consider other factors outside of the manufacturer's control, such as whether it had received better offers from other manufacturers. As a result of the review, a manufacturer could find all, or part, of its retailer product being put out to tender and not always be sure as to the reason why.
28. If products were put out to tender, the retailer would decide which manufacturers to invite to bid. Retailers would not always invite Peter's even though the retailer knew Peter's produced these products. Peter's also believed that it had sometimes been asked to bid, or put in a price, as a stalking horse to persuade the incumbent manufacturer to reduce its price. [X]. Retailers made the final decision on who they would award the contract to, it was not clear to Peter's the basis on which these decisions were made. Peter's believed price was a key factor, but was not always the key factor.
29. Peter's had made a number of independent approaches to retailers to try to win business. Retailers would listen to Peter's proposals and sometimes new

business would be won as a result. Peter's thought that this approach was more successful if it was offering an innovative product.

30. Buyers could use smaller competitors to discipline their existing suppliers. [redacted], Peter's believed that playing at the margins could exert significant pressure on incumbents because the smaller supplier was a perceived potential competitor. Peter's thought that the retailer needed to move 10% of its business to bring the incumbent to heel. Peter's often served as a stalking horse because it could potentially take on significant amounts.
31. [redacted].

### **Capacity expansion/entry**

32. Capacity had been reduced to some extent in the past few years by exit, but at the same time increased efficiency had added some capacity.
33. Peter's said that the CSP manufacturing footprint was categorised as very heavy in capital; it cost a lot to get started and operate in, and the returns over the years had been below that expected. Building the Peter's factory today would cost about £50 million, [redacted]. Entry was therefore not rational, but expansion was possible. Materials had also been volatile and it was difficult to recover increased costs for commodities from retailers. The only significant recent expansion or entry had been by Welsh Pantry (backed by state aid from the Welsh government) and Cranswick. This suggested that backing would be required from a retailer for capacity to expand significantly. Most suppliers used legacy investments with few very modern plants. Capital intensity was high while returns were volatile, and so entry had not been that attractive.
34. Peter's said that entry could be possible from other suppliers in the food service sector (historically this was the area where Peter's had developed from). These manufacturers had similar equipment to those producing for the retail sector and would require less investment to switch production to supply retailers. However, these companies lacked the contacts that were important for building up confidence and reputation with retailers. Peter's concluded that although entry from this sector was possible, it was not likely.
35. [redacted]. It would take approximately six months from order to delivery if a new line were to be ordered. [redacted]. Peter's would not be interested in buying second hand equipment because it was likely to be less efficient than new equipment. Peter's could expand its CSP output to some extent by switching away from producing sausages. However, it would need a new site if it wanted to expand

significantly by adding new production lines. It would not be economical to add one new line. If Peter's adds new lines it would add two lines. [✂].

## **Effects of the acquisition**

36. Peter's said that the future was turbulent in the CSP market at the moment.
37. Peter's said that it did not know how the merger would affect competition. On the one hand it was quite concerned about the merger as you would end up with two very large competitors (the merged entity and Samworth). However, Peter's would find ways around it. For example, it could focus more on the food service sector. It was also possible that the merger could be an opportunity for smaller suppliers, such as Peter's, as retailers could react to the merger by putting more business out to smaller suppliers. Peter's thought the merger was intriguing and took the view that it would sit on the fence rather firmly in relation to the merger's likely effect on competition as it would depend on how things panned out.
38. Peter's said it would have had the same views regarding a merger situation of any combination of Pork Farms, Kerry, and Samworth since all three were much bigger than Peter's.
39. Peter's did not know how the merger would end up affecting consumers.
40. Peter's said that the merger had already had an impact on competition. For example, market participants were waiting to see whether there would be a site closure.