

Anticipated acquisition by Bakkavor Group HF of Geest Plc

The OFT's decision on reference under section 33 given on 28 April 2005. Full text of decision published 11 May 2005.

Please note that square brackets indicate information excised, or exact figures replaced by a range, at the parties' request for reasons of commercial confidentiality.

PARTIES

1. **Bakkavor Group HF (Bakkavor)** is an Icelandic company that specialises in the production of chilled prepared convenience foods. Over 99 per cent of Bakkavor's sales are in the UK and are mainly own label supplies to the major supermarkets (the 'national multiples').
2. **Geest Plc (Geest)** is primarily a producer of own label produce for the national multiples. Geest's UK turnover in its last financial year was £795.5 million.

TRANSACTION

3. Bakkavor currently holds a 20 per cent shareholding in Geest, although the shareholding does not give Bakkavor any material influence over Geest. The proposed transaction to acquire the remaining shares would be by way of a recommended cash offer.
4. Bakkavor notified the transaction on 1 March 2005. The administrative deadline is 29 April 2005.

JURISDICTION

5. As a result of this transaction Bakkavor and Geest will cease to be distinct. The UK turnover of Geest exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

RELEVANT MARKET

6. The parties overlap in the production of four products:
 - A. chilled ready meals;
 - B. dips;
 - C. salad dressings; and
 - D. sauces.

Product market

7. The relevant product scope for each of the four areas of overlap will be considered separately in turn below.

Geographic market

8. The parties submit that the relevant geographic scope for the overlapping products is the UK. They state that the majority of customers are national multiples, who are supplied on a national basis. Third parties have confirmed that national contracts for supply are in place.
9. Previous OFT and European Commission decisions¹ have concluded that the relevant geographic scope for consumer food products is national.
10. For the purposes of this investigation, the geographic scope for the overlapping products is considered to be no wider than the UK.

A. CHILLED READY MEALS

Product scope

11. Chilled ready meals can be described as either (a) complete meals which can be heated up and do not require an accompaniment or (b) part meals or meal centres to which the consumer can add items such as vegetables, pasta or rice.
12. The parties suggest that chilled ready meals form part of a wider product market which includes frozen meals, ready to cook ranges and food from take-away outlets. However, they did not provide any further analysis of this view on the basis that, even within the narrow definition of chilled ready meals only, the

¹ Including Heinz/CSM (Case COMP/M.2302, 2001/C, 35/05), Unilever/Bestfoods (Case COMP/M.1990, 2000/C, 242/03) and the OFT's decision on the anticipated acquisition by Young's Bluecrest Seafood Ltd of Macrae Food Group Ltd and Pan European Seafoods UK Ltd (27 September 2004).

parties' combined share of supply is low. Third parties did not suggest that chilled ready meals form part of a wider product market.

13. For the purposes of this investigation, the relevant product scope is considered to be no wider than chilled ready meals.

HORIZONTAL ISSUES

Shares of supply

14. Figures are not available for the overall size of the chilled ready meals sector at the manufacturing level. In light of this, the parties have used Mintel data from the retail level to derive the following estimated shares of supply at the manufacturing level.²

Table 1: Shares of supply of chilled ready meals in the UK in 2004

Company	Share of manufacturer sales (%)
Bakkavor	[1-10]
Geest	[1-10]
<i>Combined</i>	<i>[10-20]</i>
Northern Foods	[10-20]
Oscar Meyer	[10-20]
RHM	[1-10]
S&A Foods	[1-10]
Kerry	[1-10]
Noon	[1-10]
Greencore	[1-10]
Others	[10-20]

Source: The parties

15. Post-transaction, there will remain several major producers and numerous smaller producers of chilled ready meals. Customers confirm that all of the firms listed above are credible competitors, capable of meeting their needs in terms of price, quality, innovation, service and consistency of supply. Third parties note that Bakkavor and Geest both compete in the sale of own label goods to the national multiples, and therefore, branding is not a consideration.

² The parties estimate that a margin of between 30 per cent and 40 per cent is achieved on the sale of chilled ready meals at the retail level. Third party information suggests that these estimates are reasonable. The parties have used these margins to estimate the total value of sales at the manufacturing level. The figures in Table 1 are based on a margin of 40 per cent.

16. Customers do not normally have written contracts in place, and consider that switching between suppliers is very likely in the event of a price increase of 5 to 10 per cent.

Barriers to entry and expansion

17. The parties submit that barriers to entry into the chilled ready meals sector are low. Since the relevant products are own label, a new entrant would not need to incur advertising expenditure in order to enter the sector successfully, although some investment in product development is required to meet consumer demand.
18. Third parties state that the sector is relatively labour intensive, reducing the level of capital costs for a new entrant. Third parties estimate that a new entrant would face costs of several million pounds, which is considered low in relation to the value of the sector. Some third parties consider that margins are currently low due to customer buyer power and this may hinder new entry.
19. Third parties suggest that spare capacity exists in the sector (one estimate put the level at 50 per cent) and there are no barriers to such capacity being deployed in the event of an increase in demand.
20. Overall, it appears that the threat of new entry, and/or expansion by existing players, may act as a competitive constraint in the chilled ready meals sector.

Buyer power

21. The parties submit that countervailing buyer power will act as a competitive constraint post-transaction, with national multiples threatening to cease purchasing other products supplied by the parties if they attempted to exercise market power in relation to chilled ready meals.
22. The parties' main customers in this, and all other relevant product categories, are national multiples. Sales to these customers account for [the majority] of Bakkavor's turnover and [the majority] of Geest's turnover. Customers (including those accounting for a smaller share of the parties' sales) consider that a unilateral price increase in chilled ready meals is extremely unlikely.

B. DIPS

Product scope

23. The parties submit that dips compete in an overall sector for appetisers generally. In this regard, they refer to the results of a recent customer survey carried out by

Geest which suggests that a wide range of products are popular in a range of scenarios (such as 'vegging out', entertaining and as sandwich fillers).³ Although this survey shows the popularity of a range of products, it does not necessarily demonstrate substitutability between them.

24. The parties also refer to an econometric model produced for Geest which suggests that a [] per cent increase in the price of dips would result in a [] per cent reduction in sales. Whilst suggesting some price sensitivity, the study does not indicate where sales would be lost to and does not assist in the definition of the product scope.⁴
25. A product scope narrower than dips does not appear appropriate as national multiples tend to purchase a wide range of dips from a supplier and can ask their supplier to begin producing other dips, if they are required.
26. The parties submit that branded dips compete with the own label products of the national multiples at the retail level. At this stage, we do not have sufficient evidence to include branded dips within the product scope. However, national multiples state that there is not a significant brand presence in the dips sector. On that basis we do not believe that their exclusion has a significant impact on the analysis below.
27. National multiples purchase own label dips from the parties and do not consider other products to be substitutes. For the purposes of this investigation, the product scope is taken to be no wider than own label dips.

HORIZONTAL ISSUES

Shares of supply

28. Figures are not available for the size of the dips sector at the manufacturing level. In light of this, the parties have used Mintel data from the retail level to derive the following estimated shares of supply at the manufacturing level.⁵

³ Survey carried out by Expressions Planning Ltd in December 2004 and January 2005.

⁴ The study was conducted by Business Economics Ltd and covered the period from January 2000 to July 2003. The actual model is not available.

⁵ The parties have used the same methodology for dips as for chilled ready meals above (see footnote 2). Again, a retail margin of 30 to 40 per cent has been assumed.

Table 2: Shares of supply of dips in the UK in 2004

Company	Share of manufacturer sales %
Bakkavor	[20-30]
Geest	[20-30]
<i>Combined</i>	<i>[50-60]</i>
Uniq Plc	[10-20]
Zorba Delicacies	[1-10]
Others	[20-30]

Source: The parties

29. Post-transaction there will remain two main alternative suppliers of own label dips and a number of smaller, regional players. Some third parties expressed concern that the number of suppliers of own label dips will be reduced in a sector where the parties are the main suppliers. However, some customers stated that they would consider switching to smaller suppliers if they are unsatisfied with the merged entity, or they would consider investing to develop smaller players. The reduction in the number of suppliers in this sector is also mitigated by the fact that barriers to entry are low and there appears to be countervailing buyer power (see below).

Barriers to entry and expansion

30. Both the parties and a number of their competitors state that entry into other sectors by existing suppliers of chilled foods would be very easy and may be likely in the future. Supermarket standards would already have been met and a logistics structure would be in place. One producer of chilled ready meals suggests that entry costs to the dips sector would be less than £1m, within an existing production facility. The cost appears relatively low in relation to a sector worth approximately £120m at the manufacturing level. Competitors in chilled ready meals state that they have spare capacity and would consider entering the other sectors under consideration if demand and financial returns were sufficient. Mintel forecasts that the sector will grow by 41 per cent between 2003 and 2007, suggesting that an incentive for new entry may exist.
31. The national multiples also consider that barriers to entry by existing suppliers are low and would consider sponsoring new entry if a greater choice of suppliers was required. The parties have provided several examples of national multiples sponsoring entry from existing food suppliers into the dips sector. It therefore appears likely that entry from existing suppliers of chilled foods into new sectors will act as a competitive constraint on the parties post-transaction.

32. The parties submit that suppliers of products to industrial customers could start supplying dips to the national multiples with relative ease. Third parties have mixed views on this point. Suppliers to the retail sector generally state that such entry would be relatively easy, provided that a supplier was able to package the product into consumer sized units and had sufficient capacity to run a business that was able to deliver the economies of scale required to meet the cost expectations of supermarkets. Industrial suppliers state that national multiples could be supplied, although margins are currently not attractive.
33. Third parties note that there is currently spare production capacity in the dips sector that could be readily deployed.

Buyer power

34. The parties have provided data which suggests that customer switching takes place in this sector. There are not normally written contracts and customers have indicated that they would switch supplier following a price increase of 5-10 per cent.
35. Several national multiples have recently re-tendered business, resulting in price reductions of up to [] per cent a year, suggesting that they are exercising a degree of buyer power in the dips sector.

C. SALAD DRESSINGS

Product scope

36. Bakkavor and Geest both produce chilled salad dressings for sale under national multiples' own labels. Bakkavor also produces chilled salad dressings under licence for [].

Dressings and creams

37. The parties submit that salad dressings for retail sale fit within the sector for salad accompaniments, which also includes mayonnaise and salad creams.⁶
38. Some customers note that consumers may see dressings and creams as substitutes on the basis that they can both be used for certain purposes (such as dressing salads), although a price differential exists and there are differences in storage characteristics. Other customers do not believe that salad creams are

⁶ The parties note that the European Commission has previously taken a narrower approach by analysing salad dressings and salad creams together: Unilever/Bestfoods (Case COMP/M.1990, 2000/C, 242/03).

substitutes for salad dressings for UK consumers. On the supply side, substitution may be possible with some investment, although competitors could not quantify the cost of this.

39. Overall, whilst salad creams may provide a limited competitive constraint, there is insufficient evidence to include them in the product scope in this case.

Chilled and ambient dressings

40. The parties also submit that chilled and ambient dressings should be considered together, due to the fact that they are substitutable from a consumer perspective.⁷
41. On the demand side, the evidence suggests that a significant proportion of consumers are prepared to buy both types of dressing. Since the product demand for the national multiples is derived from consumer demand, it is possible that national multiples will consider substituting between the products.
42. On the supply side, it is not clear that substitution between chilled and ambient dressing production is straightforward. One producer of ambient dressings notes that barriers include developing a chilled supply chain and investing in equipment to allow efficient manufacture in high volumes. Although both types of dressings include similar ingredients, different manufacturing techniques are required. Substitution into chilled dressings is more likely to come from producers of other chilled foods, who state that entering the chilled dressings sector would be very easy and cost less than £1m.
43. In our analysis of this transaction, separate consideration has been given to chilled dressings.

Inclusion of branded products

44. According to Mintel data, own label dressings account for only 33 per cent of national multiples' total dressing sales. The parties therefore submit that a significant competitive constraint results from the sales of branded dressings, which are substitutable with own label products at the consumer level.
45. Some national multiples do stock branded dressings, but generally cannot use such producers if an own label product is required. Competitors suggest that some national multiples can switch to taking brands instead of own label, but this would not normally be the strategy pursued as buyer power can be achieved

⁷ Whilst the parties overlap in chilled dressings, there is no overlap in ambient dressings.

through other means. At retail level, branded and own label goods are likely to be substitutes.

46. On the supply side, the parties consider that producers of branded chilled dressings could begin supplying the national multiples with own label produce. This option has been confirmed by third parties and has happened in the past.
47. Overall, it appears that branded and own label products may fall within the same product scope. However, in order to examine own label supply options to the national multiples, the supply of own label products has also been considered.

HORIZONTAL ISSUES

Shares of supply

48. Figures are not available for the size of the salad dressings sector at the manufacturing level. In light of this, the parties have used Mintel data from the retail level to derive the following estimated shares of supply at the manufacturing level.⁸

Table 3: Share of supply of salad dressings in the UK in 2004

Company	Share of manufacturer sales %
Bakkavor	[1-10]
Geest	[10-20]
Combined	[10-20]
Kraft Foods (Kraft dressings)	[30-40]
Unilever Bestfoods (Hellmans)	[1-10]
Premier Foods (Waistline)	[1-10]
Heinz UK	[1-10]
Others	[30-40]

Source: *The parties*

49. If branded products are included, a number of competitors will remain post-transaction. Customers could switch to supplying branded goods if this was in line with their strategy, although some have dedicated facilities in place with own label suppliers.

⁸ The parties have used the same methodology for salad dressings as for the previous two sectors (see footnote 2). Again, a retail margin of 30 to 40 per cent has been assumed.

50. If branded products are excluded, the parties estimate that their combined share of supply would be approximately [50-60] per cent (an increment of [20-30] per cent). Customers are satisfied that sufficient choice of own label producers of ambient dressings will remain post-transaction. Further, one supplier of branded dressings stated that it could begin to supply own label.
51. One third party put the view that own label chilled salad dressings is a separate sector and the transaction brings together the two major suppliers. However, there are a number of smaller, regional firms in the sector and the parties provided an example of one of these smaller producers supplying the national multiples. Some national multiples would consider sponsoring entry into chilled dressings if another supplier was desired, although one notes that some capital costs would be incurred.
52. Overall, the national multiples and competitors are unconcerned about the effect of the transaction in the salad dressings sector, and the vast majority of smaller customers are not supplied by the parties.

Barriers to entry and expansion

53. Existing suppliers of chilled foods state that they could enter the dressings sector with relative ease at a cost of less than £1m, which is relatively low in relation to a sector worth approximately £42m.
54. Customers and competitors have confirmed that the chilled sub-sector is relatively new and is growing fast. Competitors consider that entry into this sub-sector is likely, with existing suppliers of chilled food already having the required infrastructure. Producers of chilled ready meals confirm that they would consider entry if the conditions were right. One consideration would be meeting the efficiency requirements and low price demands of the national multiples. However, third parties note that national multiples can induce entry through sponsorship, and consider that there would be no shortage of firms prepared to enter. It therefore appears likely that new entry will act as a constraint on the parties post-transaction.
55. Producers of ambient dressings state that they could enter the chilled sector, although they would wait for more growth in the sector before it became worthwhile to make the capital expenditure.
56. Both the parties and several of their competitors submit that industrial suppliers may begin to start supplying national multiples. One industrial supplier notes that it already provides chilled salad dressings in small packs for caterers and supply to national multiples may be considered, although no current plans are in place.

57. The parties note that there is spare production capacity that could be readily deployed in the salad dressings sector.

Buyer power

58. The parties have been unable to provide examples of switching in the salad dressings sector, but note that prices of chilled dressings have not increased despite significant increases in the prices of ingredients (of up to 10 per cent). This may indicate that some degree of buyer power is being exercised.
59. Whilst the choice of alternative suppliers is limited to small regional players whose entry may be sponsored, customers state that they can still credibly exercise buyer power in the dressings sector through actions in relation to other products supplied by the parties. For this reason customers are generally unconcerned and state that a price increase in this sector would be extremely unlikely.

D. SAUCES

Product Scope

60. Bakkavor and Geest both produce chilled sauces. In addition to the distinction between chilled and ambient sauces, a distinction can be drawn between cold and hot sauces.⁹ Cold sauces will be chilled before serving, whilst hot sauces must be heated before serving. Therefore, in their shelf state, both hot and cold sauces may be classed as chilled or ambient.
61. The only area of overlap between the parties is in the production of stir fry sauces, which is a type of hot sauce.
62. Since no competition concerns arise on any definition, it is not necessary to reach a conclusion as to the extent of the product scope within the sauces category.

HORIZONTAL ISSUES

63. Figures are not available for the size of the sauce sector at the manufacturing level. In light of this, the parties have used Mintel data from the retail level to derive the following estimated shares of supply at the manufacturing level.¹⁰

⁹ For example, the European Commission made this distinction in Unilever/Bestfoods (Case COMP/M.1990, 2000/C, 242/03).

¹⁰ The parties have used the same methodology for sauces as for the previous three sectors (see footnote 2). Again, a retail margin of 30 to 40 per cent has been assumed.

Table 4: Share of supply of chilled sauces in the UK in 2004

Company	Share of manufacturer sales %
Bakkavor	[1-10]
Geest	[20-30]
<i>Combined</i>	<i>[25-35]</i>
Greencore Group	[30-40]
Sauce Company	[1-10]
Glanbia Plc	[1-10]
Northern Foods	[1-10]
Pasta Reale Ltd	[1-10]
Others	[10-20]

Source: *The parties*

64. The increment to the combined share of supply resulting from the transaction is small. Bakkavor is a minor player in the supply of chilled sauces and the only overlap in this sector is in stir fry sauces. Third parties confirm that the parties are not close competitors in this sector, and consider that a number of credible alternative suppliers of sauces will remain post-transaction.

Barriers to entry and expansion

65. The same entry costs and considerations apply as in dips and dressings. Also in common with those sectors, third parties indicate that there is currently spare production capacity that could be readily deployed in the sauces sector.

Buyer power

66. Customers have a range of alternative supply options and state, as in other sectors, that countervailing buyer power will act as a constraint on the parties in the sauces sector post-transaction.

CO-ORDINATED EFFECTS

67. Whilst a considerable number of competitors will remain post-transaction in chilled ready meals and sauces, there will be a smaller number of competitors in the supply of dips and dressings.
68. However, the dips and dressings sectors do not appear conducive to co-ordinated effects. Customers state that a number of smaller, regional firms exist that are capable of disrupting any co-ordination. The offering of own label suppliers is not homogeneous as producers compete on a wide range of factors, including innovation, product quality and service. Further, barriers to entry from existing

chilled food suppliers are low and the national multiples may consider sponsoring entry. The buyer power possessed by the national multiples would also be likely to disrupt coordination.

69. Even if these sectors were regarded as conducive to co-ordinated effects, it is not clear that this transaction would increase the likelihood of coordination.

VERTICAL ISSUES

70. There are no vertical issues arising from the transaction.

THIRD PARTY VIEWS

71. None of the customers contacted has major concerns. Those noting the reduced number of suppliers in dips and dressings are unconcerned because they believe that barriers to entry are low and that buyer power is prevalent.
72. The majority of competitors contacted are unconcerned. Various suppliers of products to the industrial sector were also contacted and they were not concerned about the transaction.

ASSESSMENT

73. The parties overlap in the supply of chilled ready meals, dips, salad dressings and sauces. Products are own label and almost all are supplied to the national multiples. There are few branded products present in any sector, with the exception of salad dressings.
74. In chilled ready meals, there is limited overlap between the types of products supplied by the parties. Post-transaction, there will remain numerous credible competitors to which customers could switch. New entry is possible, and the sector is large enough to warrant the cost. No third parties have raised concerns in this area.
75. In dips, the parties' combined share of supply will be [50-60] per cent. However, two significant competitors will remain and the national multiples have in the past sponsored entry and could sponsor further entry by other firms. Entry from existing suppliers of chilled foods is straightforward and would be considered. The dips sector is forecast to grow, and existing firms currently have some spare capacity. Few customers have raised concerns in this sector, but those that have feel that the prospect of new entry and buyer power mitigates any concern.

76. In salad dressings, a number of branded competitors are present. Third parties indicate that branded goods are substitutable on both the demand and supply side. Customers are mostly unconcerned, even if chilled dressings are taken as a separate sector, on the basis of new entry and buyer power. Even if the number of supply options is low, customers state that buyer power can be exercised through actions in relation to other products supplied by the parties.
77. In sauces, Bakkavor is a minor player and the increment to the combined share of supply is small. A number of credible alternative supply options will remain post-transaction and third parties have no concerns in this area.
78. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

79. This merger will therefore not be referred to the Competition Commission under section 33(1) of the Act.