

Anticipated acquisition by Colomer Munmany Europe Company Ltd of Marshall Farmer Ltd

Decision on relevant merger situation and substantial lessening of competition

The CMA's decision on reference under section 33(1) of the Enterprise Act 2002 given on 17 August 2016. Full text of the decision published on 26 August 2016.

ME/6608/16

SUMMARY

1. Colomer Munmany Europe Company Ltd (**CMEC**) has agreed to acquire Marshall Farmer Limited (**MF**) (the **Merger**). CMEC and MF are together referred to as the **Parties**.
2. The Competition and Markets Authority (**CMA**) believes that it is or may be the case that the Parties will cease to be distinct as a result of the Merger, that the share of supply test is met and that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.
3. The Parties are both active in the procurement, processing and supply of sheepskins. However, while MF supplies sheepskins to UK traders and other customers, CMEC only supplies sheepskins to Henan Prosper (**HP**) in China.
4. The CMA considered whether UK consumers would be harmed if MF ceased to supply UK traders with processed sheepskins and diverted all of its supplies to CMEC or HP, ie if the Merger led to the foreclosure of UK traders from the supply of these particular sheepskins. Taking into account the global nature of the supply of sheepskins by traders to tanneries (and, in turn, the supply of finished leather goods to the UK) and that the sheepskins that MF supplies represent a very small percentage of total global supply, there is no realistic prospect of an SLC as a result of any adverse foreclosure effect within the UK.

5. The CMA also considered whether CMEC could be a potential competitor to MF in the supply of sheepskins to UK customers and whether this actual or potential threat of rivalry could be lost as a result of the Merger. It does not appear realistic that CMEC would begin to supply traders or tanneries in the UK, given the strong links between CMEC and HP and that CMEC has only ever supplied its UK sheepskins to HP. In addition, the CMA received no evidence from third parties in the course of its investigation to suggest that CMEC was considered a potential competitor to MF in the supply of sheepskins to UK customers.
6. Finally, in the UK, the Parties' activities overlap in the procurement of sheepskins, primarily from abattoirs. Some abattoirs were concerned that the Merger would reduce competition and that consequently they may receive a lower price for their sheepskins. This could be characterised as an increase in buyer power. The CMA notes that in many cases, an increase in buyer power is not likely to give rise to unilateral effects.¹ In addition, some of the benefits to purchasers from an increase in buyer power may be passed on to customers. The CMA also notes that several abattoirs were not concerned and some were in favour of the Merger. Overall, the evidence that the CMA obtained did not indicate that the increase in buyer power that is perceived by some abattoirs would lead to adverse effects on UK consumers.
7. The CMA therefore believes that the Merger does not give rise to a realistic prospect of a substantial lessening of competition.
8. The Merger will therefore **not be referred** under section 33(1) of the Enterprise Act 2002 (the **Act**).

ASSESSMENT

Parties

9. **CMEC** operates a group of Spanish companies specialising in the collection and processing of raw animal skins (known as 'green' animal skins). CMEC began operating in the UK through its acquisition of Zivana Skins (UK) Ltd (**Zivana**) in 2014. Zivana processes sheepskins for the leather industry by collecting raw skins from abattoirs and salting them. On 29 April 2016 CMEC acquired West Yorkshire Fellmongers Ltd and Eastern Counties Leather Limited which operated a number of skin traders in the UK. CMEC had a turnover of £1.8 million in the UK in the financial year ended 2015.

¹ Merger Assessment Guidelines, paragraph 5.4.19

10. **MF** collects green cattle hides and sheepskins from abattoirs and salts and processes them. MF had a turnover of £7.76 million in the year ended June 2015.

Transaction

11. CMEC proposes to purchase the entire issued share capital of MF. The merger is conditional on CMA clearance.

Jurisdiction

12. As a result of the Merger, the enterprises of CMEC and MF will cease to be distinct.
13. The Parties do not overlap in the supply of sheepskins to any UK customers as CMEC only supplies to HP in China. The Parties estimate, however, that they have a combined share of procurement of sheepskins in the UK of 35% with a 15% increment. The CMA therefore believes that the share of supply test in section 23 of the Act is met.
14. The CMA accordingly 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.
15. The initial period for consideration of the Merger under section 34ZA(3) of the Act started on 7 July 2016 and the statutory 40 working day deadline for a decision is therefore 1 September 2016.

Rationale

16. CMEC states that the rationale for the transaction is vertical integration to provide it with greater quality control and security of supply of salted sheepskins.
17. CMEC has one longstanding main customer in China, HP. HP is a global importer of sheepskins and operates a sole tannery in mainland China. Almost all of CMEC's sheepskin is supplied to HP. The merger notice states that *'while Henan Prosper has no direct equity in CMEC (or its group), there are close family ties between the individuals who ultimately own these companies which result in their operations being run with a common purpose.'*

Counterfactual

18. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). For anticipated mergers the CMA generally adopts the prevailing conditions of competition as the counterfactual against which to assess the impact of the merger unless the prospect of these conditions continuing is not realistic, or there is a realistic prospect of a counterfactual that is more competitive than these conditions.²
19. In this case, the CMA believes the prevailing conditions of competition to be the relevant counterfactual.

Background

20. Sheep are reared in the UK principally for their meat. In 2015, around 14.7 million sheep were slaughtered in the UK. Sheepskin is an abattoir by-product which can be used to produce leather goods. Green or unprocessed sheepskins are purchased directly from the location of the animal carcass and need to be salted³ within 24 hours of slaughter in order to preserve them for preparation for tanning for use in garments, footwear and other end uses. In the UK, green sheepskins are usually collected from an abattoir and salted by a trader although some abattoirs are capable of salting their sheepskins themselves.
21. The Parties submitted that, in the UK, there are no large sheepskin tanneries and that only one very small tanning operation remains (Devonia Sheepskins). Sheepskins are traded globally. The Parties submitted that almost all UK skins from animals slaughtered each year are now exported, with an estimated 69% of UK sheepskins sent to China in 2014.⁴ Similarly, the Agriculture and Horticulture Development Board (AHDB) Beef & Lamb estimated that around 97% of UK sheepskins were exported in 2013.⁵ The UK is estimated to account for around 3% of all sheepskins produced globally and around 11% of global sheepskin exports.⁶

² *Merger Assessment Guidelines* (OFT1254/CC2), September 2010, from paragraph 4.3.5. The *Merger Assessment Guidelines* have been adopted by the CMA (see *Mergers: Guidance on the CMA's jurisdiction and procedure* (CMA2), January 2014, Annex D).

³ Salting a sheepskin is a process which enables it to be preserved for onward transportation.

⁴ The majority of skins not going to China either go to Spain or until more recently to Turkey.

⁵ www.beefandlamb.ahdb.org.uk/market-intelligence-news/difficult-sheep-skin-market/

⁶ Based on preliminary figures for the number of sheepskins and lambskins produced in 2015 and preliminary figures for the export values of sheepskins and lambskins in 2014. *World Statistical Compendium for raw hides and skins, leather and leather footwear 1993-2015* Food and Agriculture Organization of the United Nations, 2016.

Frame of reference

22. The CMA considers that market definition provides a framework for assessing the competitive effects of a merger and involves an element of judgement. The boundaries of the market do not determine the outcome of the analysis of the competitive effects of the merger, as it is recognised that there can be constraints on merger parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others. The CMA will take these factors into account in its competitive assessment.⁷
23. The Parties are active in the supply of sheepskins and cattle hides.

Cattle Hides

24. The Parties are both active in the procurement, processing and supply of cattle hides. The Parties estimated that they have a combined share of supply of less than 15%.
25. Given these low shares, the CMA has not considered the frame of reference for cattle hides further.

Sheepskins

Product scope

26. The Parties both supply sheepskins although they do not currently overlap in the UK as only MF supplies sheepskins to UK customers. The CMA considered whether the frame of reference could be broader than sheepskins to include the supply of other skins such as cattle hides. The Parties indicated that it is not possible for a tannery to easily switch between producing leather from sheepskins to cattle hides (or vice versa) as the tanning of sheepskin and cattle hide use different processes and machinery. Demand by traders is derived from their tannery customers, and therefore, on a cautious basis, the CMA does not consider it appropriate to widen the product frame of reference to include the supply of cattle hides.
27. The CMA considered whether the frame of reference should be delineated further within sheepskins, by for example the type or grade of sheepskin. No third party contacted indicated that this would be an appropriate delineation and it was not considered further.

⁷ [Merger Assessment Guidelines](#), paragraph 5.2.2.

28. Two third parties described there being some differentiation between sheepskins depending on their country of origin although another said that it was not possible to identify the origin of the sheepskin used in leather goods. The CMA notes that the country of origin of sheepskin leather products is often not clearly indicated. Taking the above evidence into account, the CMA considers that UK sheepskins are not likely to constitute a relevant product market.
29. The CMA considers that the appropriate frame of reference is the supply of processed sheepskins.

Geographic scope

30. In relation to the supply of processed sheepskins, the Parties submitted that although salting of sheepskins necessarily takes place in the UK, almost all processed sheepskins are exported as the UK has virtually no tanning industry⁸ with the majority going to China. The Parties have submitted that the supply of processed sheepskins is therefore a global market. The CMA has taken the global aspects of the supply of salted sheepskins into account in its competitive assessment, and considers that the relevant frame of reference is at least UK-wide, but did not find it necessary to conclude on the precise scope of the geographic market.

Conclusion on frame of reference

31. The CMA considers that the appropriate frame of reference is the supply of processed sheepskins and is at least UK-wide.

Competitive assessment

32. On a cautious basis the CMA has considered the impact of the Merger in the supply of processed sheepskins in the UK.

Vertical effects

33. The CMA considered whether UK consumers would be harmed if MF ceased to supply UK traders with processed sheepskins and diverted all of its supplies to CMEC or HP. A third party expressed concerns regarding a potential reduction in the number of sheepskins currently supplied by MF to UK customers as a result of the merger. The CMA acknowledges that it is

⁸ Environmental regulation, low transportation costs and the availability of cheaper processing in third countries has led to the decline in the tanning industry in the UK

possible that all sheepskins collected and processed by MF could, post-merger, be supplied to CMEC or HP and the incentive to do so may be increased as a result of the Merger. This could potentially foreclose some UK customers from the supply of these particular UK sheepskins.

34. However, the CMA considers that there is no realistic prospect of an SLC as a result of any adverse foreclosure effect within any UK market. The CMA has based this view on there being a global trade in the supply of sheepskins and the fact that the sheepskins that MF supplies represents a very small percentage of total global supply of sheepskins. In this way, any reduction in the supply of UK sheepskins to UK customers of sheepskins would be highly unlikely to reduce the volume of sheepskins supplied to the global market or to give rise to harm to consumers in relation to the leather goods they may purchase and which are sourced globally.

Horizontal unilateral effects

35. Horizontal unilateral effects may arise when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm profitably to raise prices or degrade quality on its own and without needing to coordinate with its rivals.⁹ Horizontal unilateral effects are more likely when the merger parties are close competitors.

Supply of processed sheepskins in the UK

36. The Parties do not overlap in the supply of sheepskins in the UK as CMEC only supplies sheepskins to HP in China and not to customers in the UK. Therefore, the Merger does not give rise to concerns regarding the loss of current competition. On a cautious basis, the CMA looked at whether competition in the supply of sheepskins could be affected in other ways despite the lack of UK overlap between the Parties.
37. The CMA considered whether CMEC could be a potential competitor in the supply of sheepskins in the UK which could be lost as a result of the Merger. The CMA did not find evidence that CMEC had considered starting to supply to UK customers or that MF considered CMEC to be a potential competitor in the supply of sheepskins in the UK. Given the lack of such evidence, the strong links between CMEC and HP and the historic evidence of CMEC supplying all of its sheepskins to HP, it does not appear realistic that CMEC would begin to supply traders or tanneries in the UK. In addition, the CMA received no evidence from third parties in the course of its investigation to suggest that CMEC was a potential competitor and might supply

⁹ [Merger Assessment Guidelines](#), from paragraph 5.4.1.

traders/tanneries in the UK. Therefore the CMA does not consider that CMEC is a potential competitor that will be lost as a result of the Merger.

38. The CMA notes that, although the Parties do not overlap in the UK, their sheepskins may be imported back into the UK as finished leather goods. Some third parties stated that HP has a high share of supply of finished leather goods to the UK and the merger would increase this. The CMA believes that the number of sheepskins that MF supplies is very small in a global context (less than 1% of global production) so the merger effect on the supply of finished leather goods will not be significant.

Procurement of sheepskins in the UK

39. Four abattoirs were concerned that the Merger would reduce competition in the procurement of sheepskins and that they may receive a lower price for them post-merger. This could be characterised as an increase in buyer power. In many cases, an increase in buyer power is not likely to give rise to unilateral effects.¹⁰ Moreover, some of the benefits to purchasers from an increase in buyer power may be passed on to customers.
40. In this case, the CMA also notes that four abattoirs were not concerned by the merger. One abattoir told the CMA that the merger did not make much difference as other traders remained and, whichever trader they sell their sheepskins to, the final tannery customer remains the same. Two abattoirs stated that there may be some benefits to working directly with HP. Overall, the evidence that the CMA obtained did not indicate that the increase in buyer power that is perceived by some abattoirs would lead to adverse effects on UK consumers.
41. As set out above, the CMA found that the Merger does not give rise to a realistic prospect of a substantial lessening of competition as a result of horizontal unilateral effects or vertical effects in relation to the procurement or supply of sheepskins in the UK.

Barriers to entry and expansion

42. Entry, or expansion of existing firms, can mitigate the initial effect of a merger on competition, and in some cases may mean that there is no substantial lessening of competition. In assessing whether entry or expansion might

¹⁰ [Merger Assessment Guidelines](#), from paragraph 5.4.19.

prevent a substantial lessening of competition, the CMA considers whether such entry or expansion would be timely, likely and sufficient.¹¹

43. In this case the CMA has not had to conclude on barriers to entry or expansion as the Merger does not give rise to competition concerns on any plausible basis.

Third party views

44. The CMA contacted customers and competitors of the Parties.
45. Third party comments have been taken into account where appropriate in the competitive assessment above.

Decision

46. Consequently, the CMA 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.
47. The Merger will therefore **not be referred** under section 33(1) of the Act.

Stephanie Canet
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Competition and Markets Authority
17 August 2016

¹¹ [Merger Assessment Guidelines](#), from paragraph 5.8.1.