

THE MONOPOLIES AND MERGERS COMMISSION

Cat and Dog Foods

A Report on the Supply
in the United Kingdom
of Cat and Dog Foods

*Presented to Parliament in pursuance of
Section 83 of the Fair Trading Act 1973*

*Ordered by The House of Commons to be printed
19th July 1977*

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¹ These members formed the Group which was responsible for this report (see paragraph 2).

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Introduction

1. On 22 July 1975 the Director General of Fair Trading sent the following reference to the Commission:

Fair Trading Act 1973
Reference to the Monopolies and Mergers Commission
Supply of Cat and Dog Foods

The Director General of Fair Trading, in exercise of his powers under sections 47(1), 49(1) and 50(1) of the Fair Trading Act 1973, hereby refers to the Monopolies and Mergers Commission the matter of the existence or possible existence of a monopoly situation in relation to the supply in the United Kingdom of cat and dog foods.

The Commission shall upon this reference investigate and report on the questions:

- (i) whether a monopoly situation exists and, if so:
 - (a) by virtue of which provisions of sections 6 to 8 of that Act that monopoly situation is to be taken to exist;
 - (b) in favour of what person or persons that monopoly situation exists;
 - (c) whether any steps (by way of uncompetitive practices or otherwise) are being taken by that person or those persons for the purpose of exploiting or maintaining the monopoly situation and, if so, by what uncompetitive practices or in what other way; and
 - (d) whether any action or omission on the part of that person or those persons is attributable to the existence of the monopoly situation and, if so, what action or omission and in what way it is so attributable; and
- (ii) whether any facts found by the Commission in pursuance of their investigations under the preceding provisions of this paragraph operate, or may be expected to operate, against the public interest.

For the purposes of this reference:

‘cat and dog foods’ means foods specially manufactured for consumption by cats or by dogs or by both.

The Commission shall report on this reference within a period of eighteen months from the date hereof¹.

(Signed) JOHN METHVEN
Director General of Fair Trading
22 July 1975

2. On 28 July 1975 the then Chairman of the Commission (Sir Ashton Roskill QC), acting under section 4 of the Fair Trading Act 1973 and paragraph 10(1)(a) of the third Schedule thereto, directed that the functions of the Commission in

¹ The period allowed for making the report was subsequently extended to 22 April 1977.

relation to this reference should be discharged through a group consisting of seven members of the Commission. The membership of the group was reduced to five during the course of the inquiry; Sir Ashton Roskill ceased to be a member on his retirement from the Commission on 30 November 1975, and Lady Hall ceased to be a member on completing the term of her appointment as a regular member of the Commission on 30 June 1976. The names of those who formed the group at the time of signature are indicated in the list of members which prefaces this report.

3. We received evidence from the Ministry of Agriculture, Fisheries and Food; from the Pet Food Manufacturers' Association; from individual suppliers including the Pedigree Petfoods Division of Mars Ltd, Spillers Ltd, Quaker Oats Ltd, Carnation Foods Company Ltd and 37 smaller manufacturers and importers; from trade associations representing distributors; from a number of individual distributors; and from organisations concerned with animal breeding and welfare. Oral evidence was taken from a number of these witnesses. The views of distributors, trade associations and other organisations are summarised in Appendix 1.

4. On 20 July 1976 we informed the Pedigree Petfoods Division of Mars Ltd and Spillers Ltd of our provisional conclusion that a monopoly situation as defined in the Fair Trading Act 1973 existed in favour of both companies in relation to the supply in the United Kingdom of cat and dog foods as defined in the reference. We notified them of the matters which the Commission would need to consider when assessing the bearing on the public interest of the facts found by the Commission in pursuance of their investigations. Both companies made representations to us in writing, and on 22 December 1976 and 9 February 1977 their representatives attended hearings for the purpose of discussing these matters with us.

5. We are grateful to all those who provided evidence needed for our inquiry, and especially to the Pedigree Petfoods Division of Mars Ltd and to Spillers Ltd on whom the main burden fell. Some of the evidence relates to confidential business matters and we have been careful not to disclose it in our report unless it is essential for a proper understanding of the issues.

CHAPTER 1

The market for cat and dog foods

Definition of reference products

6. 'Cat and dog foods' are defined in the reference (paragraph 1) as foods specially manufactured for consumption by cats or by dogs or by both. Such foods currently comprise:

- (a) canned foods;
- (b) semi-moist foods;
- (c) complete dry (including rehydratable) foods;
- (d) biscuits and meal;
- (e) others, including quick-frozen products and cooked foods not supplied in cans.

Foods consumed by cats or dogs but not specially manufactured for that purpose, and therefore not covered by the reference, include:

- (f) fresh meat and fish;
- (g) household scraps;
- (h) milk.

7. It is arguable that the reference also covers pet treats such as chocolate drops, but as the production of these is relatively small and confined to a few specialist manufacturers we have not thought it necessary to consider them in our inquiry.

8. The reference products at (a) to (e) in paragraph 6 account at present for slightly under half the total estimated consumption of food by cats and dogs in this country. These products however play at least some part in the diet of most cats and dogs. They can be briefly described as follows:

- (a) Canned foods contain protein in the form of meat, fish or plant-based analogues. They may be in loaf form or they may consist of chunks of meat or other proteinous material in gravy or jelly. Some canned dog foods contain cereal and are complete foods, while others are intended to be mixed with dry meal or biscuit.
- (b) Semi-moist products are soft products based on animal protein and cereal with preservatives. They are packed in plastic or cardboard containers, and are complete foods.
- (c) Complete dry foods are based on cereal with added animal or plant-based protein meals. They may be intended to be fed dry or to be steeped in water beforehand (rehydratable).
- (d) Biscuits and meal are intended to be fed to dogs with suitable canned food, fresh food or scraps.
- (e) Other foods include quick-frozen products, dried meats, loose or packaged cooked meats, sausages and patés prepared and sold for consumption by cats or dogs.

Development of the industry

9. Dog biscuits were the earliest type of food to be manufactured specially for consumption by pets, originating in the nineteenth century. Spillers has long been the principal manufacturer of dog biscuits and meal in the United Kingdom, and its position was strengthened even more when it acquired its principal competitor, Spratt's Patent, in 1960 (paragraph 73). Its brands now represent over 70 per cent of total retail sales in this sector (paragraph 19).

10. Canned meat for dogs and cats appeared on the market in the inter-war years, and one of the small companies which pioneered this trade, Chappel Brothers Ltd, became the nucleus of Pedigree Petfoods, an American-owned business which is now responsible for over 60 per cent of total retail sales of canned cat and dog food (paragraph 19). The market for canned products expanded rapidly after about 1950, and in the 1960s Spillers built up a position as Pedigree Petfoods' principal competitor in this sector through a series of acquisitions (paragraphs 73, 74 and 76).

11. Since 1970 two other American-owned companies, Quaker Oats and Carnation, have attempted to challenge the market leaders by introducing the semi-moist and complete dry types of pet food which were new to the United Kingdom market though already familiar in the United States. The impact of these new products has not been very great so far, but with the increasing cost of tinplate and increasing processing costs for canned foods they are expected to become more important in the future. Pedigree Petfoods and Spillers have acknowledged this by introducing their own brands of dry and semi-moist products. Another American-owned company, Dinnodog, is in the market with frozen foods, but the outlook for this type of product is less certain (paragraph 128).

12. In addition to the companies named above, there is a large number of other suppliers of various types of cat and dog foods, some of whom cater for local demands, for the pet shop trade or for special customers such as breeders and institutions. The Northern Ireland market is largely in the hands of local suppliers.

13. Many large retail chains, voluntary groups and cash-and-carry wholesalers sell their own brands of canned and semi-moist pet food and dog meal, and manufacturing these forms a significant part of the business of some pet food manufacturers. More than 10 per cent of total sales of canned pet foods now consists of retailers' brands. The most important supplier is Spillers, through its subsidiary Lakeland Food Industries, but there is competition from some of the smaller companies who specialise in this type of business, eg Anglia Cannery (paragraphs 129-130) and Windsor Foods (paragraph 131).

Food consumption by cats and dogs

14. It is difficult to say how many dogs there are at present in the United Kingdom and the number of cats, which are not required to be licensed, is even more difficult to estimate. Pedigree Petfoods reckons that there are nearly 4 million cats and nearly 5½ million dogs in the United Kingdom today, and that the total quantity of food of all kinds consumed by cats and dogs rose from 913,000 tons in 1960 to 1,355,000 tons in 1975, an increase of 48 per cent. There

was a substantially greater increase over the same period in the consumption of prepared cat and dog foods¹ which therefore represented a larger proportion of total consumption in 1975 than in 1960:

	<i>Consumption ('000 tons)</i>		<i>Percentage increase</i>	<i>Percentage share</i>	
	<i>1960</i>	<i>1975</i>		<i>1960</i>	<i>1975</i>
Prepared	227	631	177	25	46
Fresh	153	156	2	17	12
Scraps and milk	533	568	7	58	42
Total	913	1,355	48	100	100

15. It is not possible to assign a value to the household scraps and milk consumed by cats and dogs as scraps are not articles of commerce and milk is not usually bought specifically for feeding to pets. The retail sales value of cat and dog foods other than scraps and milk sold in 1960 and 1975 is estimated as follows:

	<i>Retail sales value (£m)</i>		<i>Percentage increase</i>
	<i>1960</i>	<i>1975</i>	
Prepared	36.3	221.6	510
Fresh	24.9	110.4	343

16. The fivefold increase in retail sales value of prepared cat and dog foods since 1960 is made up of three elements:

- (a) higher prices²;
- (b) the increase in the cat and dog population indicated by the 48 per cent increase in total food consumption (paragraph 14);
- (c) the larger proportion of total consumption represented by prepared foods.

17. The reasons for (c) include:

- (a) the convenience of prepared pet foods which are easier to store and pleasanter to handle than fresh foods such as butcher's offals, and require no cooking;
- (b) the declining availability of household scraps because of the greater use of convenience foods for human consumption;
- (c) the efforts of pet food suppliers to stimulate interest in their products by continually bringing out and advertising new brands and varieties;
- (d) the advent of commercial television in 1955 which provided a highly effective medium for advertising pet foods and introducing new brands to the public³;

¹ 'Prepared cat and dog foods' here include canned food, semi-moist food, complete dry food, and dry meal and biscuits. Other reference products such as quick-frozen food and cooked meats not supplied in cans, patés and slabs are included in the figures for fresh food.

² Pedigree Petfoods' cat and dog food prices doubled from August 1965 to December 1975 (paragraph 52).

³ The fact that pet food advertisements naturally feature animals gives them a particular appeal to viewers.

- (e) the number and variety of retail outlets for prepared pet foods which are readily available in supermarkets, grocers, pet shops and variety and chemist chain stores throughout the country;
- (f) the fall in the average price of prepared pet foods relative to the price of fresh food for cats and dogs (paragraph 52).

Market shares

18. The following table showing the market shares of (a) Pedigree Petfoods, (b) Spillers and (c) other suppliers in 1972, 1973 and 1974 is based on information received from suppliers (manufacturers and importers) of reference products. The market share figures do not differ to any substantial extent from those calculated by Pedigree Petfoods and Spillers themselves.

	1972		1973		1974	
	<i>Net sales value (£m)</i>	<i>Per cent</i>	<i>Net sales value (£m)</i>	<i>Per cent</i>	<i>Net sales value (£m)</i>	<i>Per cent</i>
Pedigree Petfoods	44.3	51.5	55.7	50.2	69.1	49.2
Spillers	27.0	31.4	32.8	29.5	41.2	29.3
Other suppliers	14.7	17.1	22.5	20.3	30.1	21.5
Total	86.0	100.0	111.0	100.0	140.4	100.0

The figures suggest that the 'other suppliers', taken as a whole, increased their market share somewhat between 1972 and 1974 at the expense of both Pedigree Petfoods and Spillers. In broad terms, Pedigree Petfoods now has some 50 per cent of the market, Spillers 30 per cent, the next three largest suppliers (Quaker, Carnation and Windsor Foods) 13 per cent, and the remainder 7 per cent.

19. The degree of concentration is greater in particular sectors of the market than in the market taken as a whole. The following table shows the relative importance of the main types of cat and dog foods in 1974 and the market shares of Pedigree Petfoods, Spillers and other suppliers in each type:

	<i>Net sales value (£m)</i>	<i>Per cent</i>	<i>Per cent</i>
<i>Canned</i>			
Pedigree Petfoods	64.7	60.9	
Spillers	26.5	25.0	
Other suppliers	15.0	14.1	
	<u>106.2</u>	<u>100.0</u>	75.6
<i>Semi-moist</i>			
Pedigree Petfoods	1.3	22.4	
Spillers	0.1	1.7	
Quaker	4.2	72.4	
Other suppliers	0.2	3.5	
	<u>5.8</u>	<u>100.0</u>	4.1

	<i>Net sales value (£m)</i>	<i>Per cent</i>	<i>Per cent</i>
<i>Complete dry</i>			
Pedigree Petfoods	1.2	16.2	
Spillers	0.4	5.4	
Carnation	3.1	41.9	
Other suppliers	2.7	36.5	
	<u>7.4</u>	<u>100.0</u>	5.3
<i>Biscuits and meal</i>			
Pedigree Petfoods	1.9	9.6	
Spillers	14.2	72.2	
Other suppliers	3.6	18.2	
	<u>19.7</u>	<u>100.0</u>	14.1
<i>Others</i>			
Pedigree Petfoods	—	—	
Spillers	—	—	
Other suppliers	1.3	100.0	
	<u>1.3</u>	<u>100.0</u>	0.9
<i>Total</i>			
Pedigree Petfoods	69.1	49.2	
Spillers	41.2	29.3	
Other suppliers	30.1	21.5	
	<u>140.4</u>	<u>100.0</u>	<u>100.0</u>

Canned goods are by far the most important sector, accounting for over 75 per cent of the market in 1974. Biscuits and meal represented some 14 per cent, and the rest 11 per cent. Pedigree Petfoods had over 60 per cent, and Spillers 25 per cent, of the market for canned goods, while Spillers had well over 70 per cent of the market for biscuits and meal. In the case of semi-moist products, however, the principal supplier was Quaker Oats with over 70 per cent of the market, and in the case of complete dry foods Carnation with over 40 per cent.

20. While the figures indicate that the market for prepared cat and dog foods is dominated by a few suppliers, and particular sectors of the market even more so, there is evidence that cat and dog owners have a considerable tendency to vary the diet of their pets. We were shown the results of a survey carried out for Pedigree Petfoods which indicated that, out of a sample of 989 dog-owning households, 908 fed prepared food once a week or more and that, of these, 423 also fed fresh food and 747 also fed scraps. In the week prior to the survey, 696 of the households included in the sample fed canned dog foods and, of these, 486 also fed meal, 265 also fed biscuits, 23 fed complete dry food, 57 fed semi-moist food and 13 fed frozen food. In the case of cats, out of a sample of 755 cat-owning households 637 fed canned food and, of these, 225 also fed dry food, 54 fed semi-moist food and 16 fed frozen food. The evidence, therefore, is that owners generally are not strongly committed to particular types or brands of cat and dog food. This may be due in part to the responsiveness of owners to price changes and in part to the belief that pets, like their owners, prefer and need a varied diet.

Legislation relating to cat and dog foods

21. There is at present no specific legislative control in the United Kingdom over the marketing or quality of cat and dog foods, although their sale would be covered by the general provisions of the Trade Descriptions Acts. However the use of meat in the preparation of foods for dogs and cats and the sale of meat itself are subject to regulations made under the Food and Drugs Act such as the Meat (Sterilisation) Regulations 1969. These require all domestic meat which is unfit for human consumption to be sterilised before entering the chain of distribution. Similarly, imported meat unfit, or not intended, for human consumption must (with a few exceptions) be clearly labelled as such or be sterilised.

22. Specific legislation controlling food for dogs and cats is not a feature of law in many countries. However the EEC is developing controls for the marketing of animal feedingstuffs generally, which include special provisions where appropriate for cat and dog foods. These controls are likely to be applied in the United Kingdom within the next two or three years. Pet foods containing meat might also, in certain cases, be subject to general community requirements on meat hygiene.

Import charges

23. Reference products are classified as prepared animal feeds in tariff heading 23.07 of the United Kingdom Tariff. Products containing starch, glucose or glucose syrup, or milk products classified under tariff heading 23.07B are free of import duty but subject to levy under the Common Agricultural Policy of the EEC. The levy is made up of a fixed component (currently 2 per cent *ad valorem* plus £4.101 per tonne at the full rate) and, in the case of imports from non-EEC countries, a variable component which is adjusted frequently as world prices fluctuate. The fixed component will be discontinued in intra-Community trade as from 1 August 1977. From that date imports from third countries will pay the full EEC fixed component which is currently equal to £5.126 per tonne. Other products classified under tariff heading 23.07C are subject to import duty. This is currently 13 or 14 per cent *ad valorem* at the full rate depending on the type of product. Duty on imports from EEC countries is being phased out and will be eliminated with effect from 1 July 1977, when the full rate of duty on imports from other countries will be raised to 15 per cent in conformity with the EEC's Common External Tariff.

CHAPTER 2

Pedigree Petfoods Division of Mars Ltd

History and organisation of Pedigree Petfoods

24. The Pedigree Petfoods Division of Mars Ltd is one of seven operating divisions of the company. The others are: Confectionery, Dornay Foods, Four Square Catering and Vending, Mars Money Systems, Thomas's and Mars Group Services. Pedigree Petfoods is solely responsible, within the Mars Group, for the manufacture of cat and dog foods in the United Kingdom, and is the principal distributor of these products. Thomas's wholesales small quantities of dog biscuits and meal, including those manufactured by Pedigree Petfoods, as part of its pet accessories business (paragraph 30).

25. Mars Ltd is a wholly-owned subsidiary of Food Manufacturing (GB Company) Ltd, a non-trading company registered in England which is itself a wholly-owned subsidiary of Mars Incorporated. The latter, a Delaware corporation, is the parent company of the Mars Group and is controlled by members of the Mars family. The Mars Group is principally engaged in the manufacture and sale of confectionery, prepared pet foods, pet accessories and human food in the United States, Continental Europe and Australia, as well as in the United Kingdom.

26. The Mars Group originated in or about 1932 when Mr Forrest Mars came to this country from the United States and set up a small business, Mars Confections, on the Slough Trading Estate, manufacturing Mars Bars. In 1934 Mars Confections acquired the whole of the share capital of Chappel Brothers Ltd, a small company in Manchester which canned meat offcuts for sale as pet food under the brand name 'Chappie'. Manufacture was transferred to Slough, and between 1935 and 1939 the annual turnover of Chappel Brothers was increased from £19,000 to nearly £100,000. The name of the company was changed to Chappie Ltd in 1939.

27. Further progress was interrupted by the war, and thereafter until the 1950s the company was hampered by shortages of raw materials and cans. By 1951, however, annual sales had reached £1 million, and in view of the limited room for expansion at Slough the company moved to Melton Mowbray. To meet the continued increase in demand, and to make better use of assets, the company went over to shift working, 24 hours per day, 7 days per week, in 1953, and subsequently introduced a continuous sterilisation process in place of batch processing. In 1957, as the company by then was marketing a range of products in addition to the original 'Chappie', the name was changed to Petfoods Ltd, and in 1972 it was again changed to Pedigree Petfoods Ltd. Mr Forrest Mars, the founder of the Group, retired in 1972. In March 1975 the Group was re-organised, and as part of this re-organisation Pedigree Petfoods Ltd became the Pedigree Petfoods Division of Mars Ltd. Meanwhile the continued expansion of the business had made it necessary to build an additional factory at Peterborough which started operations in October 1974.

28. Pedigree Petfoods is currently organised into eight divisions: Commercial, Manufacturing (Melton Mowbray), Manufacturing (Peterborough), Marketing, Sales, Personnel, Research and Development, and Service and Finance. Each division is headed by a divisional director who is responsible to the Managing Director.

29. Each of the operating units (including Pedigree Petfoods) which make up the Mars Group is largely left to run its own business. Control by Mars Incorporated is exercised through the approval of annual plans and of capital expenditure (paragraph 43), through the appointment of the Managing Directors of the operating units, and through participation in the appointment of other senior executives in the operating units.

Acquisitions

30. Pedigree Petfoods has not acquired any interests in other manufacturers of reference products in the United Kingdom. In 1967 and 1968 Mars Ltd acquired three pet accessories businesses which included a small wholesale trade in cat and dog foods. The purpose of the acquisitions was to establish a pet accessories business. The three businesses were merged and now form the Thomas's Division of Mars Ltd.

Production

31. From 1951, when Pedigree Petfoods moved from Slough, to 1974 all manufacture of cat and dog foods was carried out at Melton Mowbray. At present all canned and dry products are manufactured at Melton Mowbray, and the new factory at Peterborough produces only semi-moist products ('Bounce Minced Dinner' and 'Cupboard Love'). The numbers employed at 7 January 1976 (including sales staff) were 2,446 at Melton Mowbray and 182 at Peterborough.

32. There are 8 canning lines at Melton Mowbray, 7 of which can be run simultaneously. The average capacity for the production and packaging of canned products in 1975, based on 4 shifts working 7 days a week round the clock, was about 375,000 tons. The average capacity for the production and packaging of dry products (dry meal/biscuit and complete dry food) was about 16,800 tons, based on 4 shifts working 7 days a week until October 1975 and thereafter on 3 shifts working 5 days a week.

33. The capacity of the Peterborough factory cannot be simply defined because the maximum output of the semi-moist dog food unit varies according to the mix of packaging sizes. In any case, no realistic figures are available for 1975 because the start-up problems were not overcome, and the training of labour not completed, until November 1975. In 1976 Pedigree Petfoods expected to sell about 9,100 tons of semi-moist products and considered that, on the existing shift pattern of 3 shifts working 5 days a week, it had sufficient installed capacity to produce that volume.

34. The total quantities of cat and dog food produced in each of the six years 1970-75¹ were:

¹ Since 1972 Pedigree Petfoods' accounting year has coincided with the calendar year. Before 1972 the accounts were prepared for the year ended 31 July.

<i>Year ended</i>	<i>Tons</i> (<i>'000s</i>)
31 July 1970	236.3
31 July 1971	245.1
31 December 1972	306.6
31 December 1973	343.0
31 December 1974	328.2
31 December 1975	348.3

35. Pedigree Petfoods makes extensive use of assets hired from third parties. Such assets include cold stores, dry materials stores, distribution warehouses and vehicles. The policy of the Mars Group is that operating units in the Group should invest directly only in those activities where control by the operating unit is essential and where present value calculations indicate that it is not more economical to make use of a third party's assets than to buy them.

Raw Materials

36. Pedigree Petfoods' general policy is to acquire raw materials, particularly meat and fish, only if they are unsuitable for human consumption or surplus to human requirements. Pedigree Petfoods considers that the pet food industry performs a public service in providing an economic use for by-products of the human food industry which would otherwise have little or no value or be difficult to get rid of (eg blood from abattoirs). Pedigree Petfoods stopped using whale-meat in 1971 because of its belief that continued hunting of the whale was unjustified.

37. Purchases of product raw materials by Pedigree Petfoods in 1975 for the production of cat and dog foods were:

	<i>Tons</i>	<i>Expenditure</i> (<i>£'000s</i>)	<i>Percentage of</i> <i>total expenditure</i>
Meat and offals	113,239	16,382	56.4
Fish	37,956	2,459	8.5
Grain	23,149	2,024	7.0
Milk products	3,750	118	0.4
High protein meals	12,381	2,879	9.9
Jellies and gums	3,381	3,329	11.5
Vegetables	2,329	62	0.2
Flavourings, supplements and miscellaneous	7,557	1,781	6.1
Total	203,742	29,034	100.0

38. As a percentage of total raw material costs, the use of meat and fish has decreased since 1970¹ whilst that of cereals and other ingredients has increased:

<i>Year ended</i>	<i>Meat</i> (per cent)	<i>Fish</i> (per cent)	<i>Cereal*</i> (per cent)	<i>Other</i> (per cent)
31 July 1970	69.5	10.0	10.6	9.9
31 July 1971	67.2	10.5	12.9	9.4
31 December 1972	69.1	9.5	11.0	10.4
31 December 1973	67.8	7.3	13.1	11.8
31 December 1974	52.3	10.2	19.5	18.0
31 December 1975	57.4	7.4	15.5	19.7

* 'Cereal' includes the following plant protein: vital wheat gluten, soya grits and flour.

¹ See footnote to paragraph 34.

39. The geographical sources from which product raw materials were derived in 1975 were:

	<i>Expenditure</i> (£'000s)	<i>Percentage of</i> <i>total expenditure</i>
United Kingdom	13,314	45.9
Other EEC	6,136	21.1
Australia	1,017	3.5
New Zealand	2,675	9.2
United States	2,635	9.1
South Africa	590	2.0
Other	2,667	9.2
Total	<u>29,034</u>	<u>100.0</u>

Packaging

40. Expenditure on packaging materials in 1975 was as follows:

	<i>Expenditure</i> (£'000s)
Cans and covers	17,346
Cases and corrugated material	1,714
Cartons and labels	2,890
Bags, sacks, films, laminates, etc.	319
Total	<u>22,269</u>

41. Pedigree Petfoods used about 2.6 million cans per working day in 1975. As storage space at Melton Mowbray is very limited, the factory there requires a delivery of cans every 30 minutes, day and night, in order to remain in production. About two-thirds of the cans and covers required are supplied by The Metal Box Company Ltd, and about one-third by Reads Ltd (a subsidiary of American Can Company). Pedigree Petfoods was entirely dependent on Metal Box for supplies of cans up to 1958 when Reads began manufacture in this country. Pedigree Petfoods encouraged the growth of Reads as a second supplier and paid higher prices for a number of years to assist Reads to get established¹. Pedigree Petfoods told us that the prices quoted by Reads are now very close to those quoted by Metal Box.

Planning and performance measurement

42. Pedigree Petfoods attributes its successful growth to a meticulous attention to the efficiency of the business as a whole and of each of its divisions, and considers that the key to efficiency is detailed planning. Each year an operating plan and a capital budget are prepared for the following year. Performance is continuously monitored against the operating plan, and assessments are made of the significance of any variances and their possible implications for overall profitability, raw material requirements and stocks, production requirements and finished goods stocks. Pedigree Petfoods gave details of its daily, weekly and monthly monitoring process, and pointed out that the primary overall control document, the 4-weekly (period) financial accounts, was submitted on the eleventh working day after the period end. If circumstances change substantially during the course of the year, the operating plan may be formally revised. Every other year a five-year plan is prepared consisting of the operating plan for the

¹ See the Commission's report on the Supply of Metal Containers, paragraph 88.

following year and an outline plan for the remaining four years; this is known as the Medium Term Plan. In alternate years, an operating plan is prepared for the first year and the outline plan for the last three years of the previous Medium Term Plan is updated.

43. The capital budget, which covers capital expenditure on land and fixed assets, agreements for the rental of assets and options to acquire or lease assets, is submitted with the operating plan to a committee of the Board of Mars Incorporated for outline approval. Submission of capital budgets by all the operating units enables Mars Incorporated to allocate its financial resources and establish priorities between projects. When outline approval has been given, the Managing Director of Pedigree Petfoods is free to undertake minor projects (currently defined, in the case of projects involving expenditure on fixed assets, as those costing less than \$100,000) provided in the capital budget without further reference to Mars Incorporated. Major projects outside the authority delegated to the Managing Director must be approved by a Group President.

44. The basic concept used by Pedigree Petfoods and by the other operating units in the Mars Group for measuring performance is the Return on Total Assets (ROTA)¹. ROTA has two constituent elements, Asset Turnover Ratio (ATR) and Earnings to Sales Percentage (ESP). The aim is to achieve the standard ROTA by maintaining ATR at a high level while retaining a modest ESP. This requires the minimisation of the assets used in the business and meticulous attention to cash and credit control. The use of ROTA as a measure of performance was introduced by the Mars Group in 1957 and the standard, originally set at 22 per cent, was progressively raised because of inflation to 28 per cent for 1976. The operating units are expected to achieve the standard ROTA but not significantly to exceed it, as this would be likely to jeopardise their competitiveness and growth. The remuneration of associates (the term used by Pedigree Petfoods to denote its employees²) is linked in part to ROTA.

Sales and distribution

45. Total United Kingdom sales of cat and dog foods, including retailers' brands, by Pedigree Petfoods in 1970-76³ were as follows:

<i>Year ended</i>	<i>Tons</i> (^{000s})	<i>Net sales value</i> (£ ^{000s})
31 July 1970	224.2	30,958
31 July 1971	235.6	33,961
31 December 1972	284.3	44,302
31 December 1973	320.8	55,723
31 December 1974	322.6	69,133
31 December 1975	323.5	81,384
31 December 1976	359.5	98,824

¹ Defined as the percentage that earnings bear to total assets where earnings are defined as profits before tax plus depreciation plus interest plus leasing charges, and where total assets are defined as fixed assets at undepreciated cost plus the capital value of leased assets plus current assets.

² Pedigree Petfoods attaches particular importance to its personnel policies which are designed 'to attract and retain people of above average calibre and to create for them a working environment, and to motivate them, in such a way that results which are substantially above average can be achieved'.

³ See footnote to paragraph 34.

46. The above figures include sales of secondary products, ie products which, though nutritionally acceptable for feeding to cats or dogs, are below standard in appearance or texture. These are sold to a number of wholesalers on condition that they will be resold only to breeders, kennels, security organisations, vets, greyhound kennels and charities, and under no circumstances to any outlets where they might find their way directly or indirectly into the retail trade. The proceeds of sale of secondary products (including scrap) amounted to £703,936 in 1975.

47. Sales of the principal brands in 1975 were:

	<i>Tons</i> (‘000s)	<i>Net sales value</i> (£’000s)
<i>Dog food</i>		
Chum	69.0	18,884
Bounce	41.1	8,399
Chappie	35.8	6,479
Pal	26.5	6,614
Lassie Meaty Chunks	19.7	4,463
Mick	7.4	1,596
<i>Cat food</i>		
Whiskas	65.6	20,264
Kitekat	25.2	5,818
Katkins	15.8	3,086
Bounce	4.6	1,083
Other brands	12.8	4,698
Total	<u>323.5</u>	<u>81,384</u>

48. The proportions by quantity of sales of cat and dog food to the main types of customers in 1975 were:

	<i>Per cent</i>
Grocery wholesalers	37.8
Retail multiples	42.4
Co-operative societies	13.3
Independent grocers (direct sales)	3.2
Pet trade (wholesalers and retailers)	3.3
	<u>100.0</u>

49. The sales force, headed by the Sales Director, is organised in three divisions dealing respectively with national accounts (wholesalers, multiples, voluntary groups and co-operative societies) and with the northern and southern areas. The latter are split into sales regions corresponding broadly to television areas; in the north, Granada, Trident and, together, Scotland and Ireland, and in the south, Thames, Harlech and the Midlands. A separate unit handles sales to breeders, vets and institutions such as the Ministry of Defence, police forces and dogs’ homes.

50. The distribution of finished products involves delivering 100,000 cases per day to retail customers. Pedigree Petfoods employs no capital in warehousing or transport; it rents or hires all that it requires (paragraph 35). It believes that this practice secures flexibility of service and competitive rates while leaving Pedigree

Petfoods the responsibility for co-ordinating order processing with physical delivery of goods. Finished products are palletised and despatched from the factories in 20-ton loads to one of four Main Distribution Centres, all of which are owned by third parties. Delivery to customers takes place on the instructions of Pedigree Petfoods, orders under 2 tons being made up for delivery in 7-ton vehicles and those over 2 tons in 20-ton vehicles. About 200 vehicles are used; the majority of these are owned and operated by the owners of the Main Distribution Centres and paid for by Pedigree Petfoods on a basis related to mileage and tonnage, but some 50 vehicles are leased from Eastern British Road Services Ltd (the owner of one of the Main Distribution Centres) at a fixed charge plus a mileage charge. Ad hoc arrangements are sometimes made with other vehicle operators. Deliveries to remoter areas are made through transshipment depots owned by third parties.

Price and discounts

51. Prices are determined in the light of the availability and cost of fresh foods, household scraps and milk, which still account for somewhat over half the total quantity of food consumed by cats and dogs (paragraph 14), and actual and potential competition from other suppliers of prepared foods and from companies which might at some stage enter the industry. The principal pricing objective is to maintain the relationship between the costs of Pedigree Petfood's products and their prices so that each product makes about the average contribution to profit required to achieve the standard ROTA (paragraph 44). This objective is generally realised in the case of established products, but it cannot always be realised in relation to new products where economies of scale have not yet been fully achieved and where the initial advertising and promotion costs are high in proportion to the level of sales. This is particularly the case at present with the new semi-moist and complete dry foods which are still encountering technical problems and consumer resistance, though Pedigree Petfoods considers it vital for the future to persevere with them.

52. Pedigree Petfoods states that between August 1965 and December 1975 the average price of its products, weighted by reference to sales volume, fell in real terms by 17 per cent in comparison with the Retail Price Index (all items) and 25 per cent in comparison with the Retail Price Index (food):

	<i>December 1975</i> (August 1965 = 100)	<i>Pedigree Petfoods</i> <i>compared with other</i> <i>product indices</i>
Pedigree Petfood's products	208	100.0
Retail Price Index (all items)	250	83.2
Retail Price Index (all food)	279	74.6
Retail Price Index (meat and bacon)	286	72.7
Retail Price Index (fish)	354	58.8
Fresh meat for cats and dogs	316	65.8
Fresh fish for cats and dogs	396	52.5

Pedigree Petfoods attributes the favourable comparison to the measures which it has taken to increase efficiency and to restrict the use of high-cost ingredients such as lung, liver and muscle meat without loss of palatability or nutritional value.

53. Pedigree Petfoods will sell to any distributor who is credit-worthy and who orders not less than the required minimum quantity (20 cases in Great Britain, 10 cases in Northern Ireland). The same system of prices and discounts applies to all distributors, whether they are wholesalers or retailers. There are separate price lists for Great Britain and for Northern Ireland, but except for the lower minimum quantity in Northern Ireland the differences are not significant. Certain smaller pack sizes are at present available only in Northern Ireland, Scotland and cash and carry outlets.

54. The price of each product depends on the size of the order, measured by the number of cases of all products (including non-reference products such as bird seed) included in the order. The discount scale by the number of cases and the price differentials at the various case rates are:

<i>Rate</i>	<i>Number of cases</i>	<i>Price index</i> (Rate F = 100)
A	20-39	107.3
B	40-99	103.6
C	100-199	101.9
D	200-349	101.2
E	350-599	100.5
F	600+	100.0

Almost 90 per cent of sales are made at Rates C to F and the difference between Rates C and F is less than 2 per cent. The quantity discount system, based on studies carried out in 1974, is designed to reflect the costs incurred and to yield a substantially even profit per case on orders of all sizes.

55. Pedigree Petfoods ceased publishing retail prices for its pet foods in 1965, but re-introduced recommended retail prices in 1968 because of the effect of the Trade Descriptions Act 1968 on 'price off' offers, including manufacturers' promotional price reductions shown on the product label. Since 1976 the prices recommended have been maximum retail selling prices. The recommended maximum retail selling prices (including VAT) are shown in the price lists.

56. A retailer who bought direct from Pedigree Petfoods and resold at the recommended retail price¹ would obtain the following gross margins:

<i>Rate</i>	<i>Gross margin</i> (per cent)
A	22.4
B	25.1
C	26.3
D	26.8
E	27.3
F	27.7

Pedigree Petfoods estimates, however, that in 1974-75 about 75 per cent of retail sales of its products was made at below the recommended retail prices, and that the average retail price was 91 per cent of the recommended price. The average margins (excluding VAT) taken by different types of retail distributors on Whiskas, one of the higher priced brands, and on Chappie, one of the lower priced brands, are estimated to be as follows:

¹ Net of VAT and not including the prompt payment discount (paragraph 58).

	<i>Whiskas (large can)</i> (per cent)	<i>Chappie (large can)</i> (per cent)
Multiples	19.02	21.30
Co-ops	22.32	22.07
Independents	20.76	22.30
Average of all distributors	20.06	21.80

57. Wholesalers normally buy at Rate F; if they resell at Rate A their gross margin is 6.85 per cent of their realised selling price, but it may be as little as 5.5 per cent or as much as 9 per cent, depending on their competitive position.

58. All customers are allowed a discount off the invoice price for payment within 10 days of invoice. The prompt payment discount was 2½ per cent until late in 1974 when it was reduced to 2 per cent but, despite the reduction, it is still more favourable than the corresponding discounts given by major competitors. Pedigree Petfoods stated that it was designed to ensure the quickest possible turn-round of cash, and not in any way to match other special terms given by competitors. It was taken on slightly over 90 per cent of sales, and debtors had, as a consequence, been reduced to an amount equivalent to 2.2 weeks' sales.

59. There are separate arrangements for sales of specially packed and unlabelled cat and dog foods to breeders and vets at concessionary rates on condition that the products are not resold.

Variety of brands and flavours

60. Taking all brands and flavours into account, the November 1975 price list included 17 varieties of dog food and 15 varieties of cat food. Details are shown in Appendix 2.

Retailers' brands

61. Pedigree Petfoods aims to market its products under its own brand names as far as possible but, subject to capacity being available, it is prepared to supply products for sale under their labels to distributors who are willing to take them in substantial volume and at prices which will provide a full contribution to profit after taking account of all applicable overhead costs. The quantity supplied in 1975 was about 4,800 tons, representing approximately 1.4 per cent of total sales in that year.

Agreements and arrangements

62. Between 1966 and 1970 Pedigree Petfoods participated in the Government's early warning system, and there was an informal arrangement between it and Spillers to exchange information about proposed price increases. Exchanges of information continued after the ending of the early warning system in 1970 until the imposition of the price freeze in November 1972. Again when the Price Code was introduced in 1973 there were exchanges of information which also included Quaker. All such contacts and exchanges of information between Pedigree Petfoods and its competitors ceased in March 1975.

63. Other agreements or arrangements to which Pedigree Petfoods is or has been party are:

- (a) In August 1970 Spillers informed Pedigree Petfoods that it was limiting its marketing expenditure to 11 per cent of sales, and Pedigree Petfoods informed Spillers that it was doing the same. This arrangement is stated to have lapsed before the end of 1971 (see paragraph 203).
- (b) Pedigree Petfoods is party to a sales promotion agreement with Glendinning Associates International Consultants Ltd relating to 'Bonus Money'.
- (c) An agreement made in 1973 between Pedigree Petfoods and Robert Wilson & Sons (Ireland) Ltd provided for the latter to be Pedigree Petfoods' exclusive supplier of meat and offals from Northern Ireland and the Irish Republic, but to be at liberty to sell up to 30 tons per week of petfood materials to other customers. In 1976 the agreement was amended to become non-exclusive on both sides.
- (d) Oakleigh Animal Products Ltd ('OAP') is Pedigree Petfoods' sole supplier of meat and offal in England and Wales. Pedigree Petfoods formerly also bought from other sources in England and Wales, and until some time before 1970 there was an arrangement between it and OAP that OAP should largely confine its purchasing operations to abattoirs and collectors south of a line from Bristol to London.
- (e) When Pedigree Petfoods buys in plant, it sometimes provides its suppliers with technical know-how and confidential information required in connection with the development and construction of the plant. In such cases an undertaking is commonly obtained from the suppliers that confidentiality will be respected and that similar plant will not be supplied to competitors, at least for a period.

64. Pedigree Petfoods submitted to the Office of Fair Trading particulars of arrangements and agreements arising from some of the matters mentioned in paragraph 62 and paragraph 63(a), (b) and (c). After an investigation, the Office has concluded that the arrangements mentioned in paragraph 62 and paragraph 63(a) are not registrable under the Restrictive Trade Practices Act 1976. The agreement in paragraph 63(c) has been registered, but the Director General has decided not to take any proceedings in respect of it.

Advertising and promotion

65. Pedigree Petfoods' advertising costs relate almost entirely to television advertising, while the cost of promotions relates mainly to the provision of free samples, the supply of other goods under coupon or mail-in schemes, the payment of associated costs of special artwork and label design, and contributions to customers' own advertising. (Promotional price reductions are dealt with separately in paragraph 67.) Expenditures on advertising and promotion of reference products in the years 1970 to 1976¹ were as follows:

¹ See footnote to paragraph 34.

<i>Year ended</i>	Advertising		Promotion		Total	
	<i>Expendi- ture</i>	<i>Per- centage of net</i>	<i>Expendi- ture</i>	<i>Per- centage of net</i>	<i>Expendi- ture</i>	<i>Per- centage of net</i>
	(£'000s)	<i>sales value</i>	(£'000s)	<i>sales value</i>	(£'000s)	<i>sales value</i>
31 July 1970	1,512	4.9	545	1.7	2,057	6.6
31 July 1971	1,868	5.5	364	1.1	2,232	6.6
31 December 1972	2,207	5.0	761	1.7	2,968	6.7
31 December 1973	1,967	3.5	536	1.0	2,503	4.5
31 December 1974	1,628	2.4	473	0.6	2,101	3.0
31 December 1975	2,390	2.9	656	0.8	3,046	3.7
31 December 1976	2,926	3.0	639	0.6	3,565	3.6

66. About 45 per cent of the expenditure on advertising and promotion in 1975 was on the two principal brands, Chum and Whiskas, and a further 31 per cent on three other brands:

	<i>Expenditure (£'000s)</i>	<i>Percentage of net sales value</i>
Chum	689	3.6
Whiskas	685	3.4
Kitekat	349	6.0
Pal	294	4.4
Lassie Meaty Chunks	290	6.5

Three brands, Bounce (Dog), Chappie and Katkins, are unadvertised.

67. The figures for promotional expenditure above do not include the value of promotional price reductions which result in lower prices to the customer. In the years 1970 to 1976¹ these price reductions amounted to:

<i>Year ended</i>	<i>Amount (£'000s)</i>	<i>Percentage of sales before reduction</i>
31 July 1970	1,087	3.4
31 July 1971	987	2.8
31 December 1972	1,022	2.3
31 December 1973	687	1.2
31 December 1974	893	1.3
31 December 1975	2,346	2.8
31 December 1976	2,949	2.9

Research and development

68. The Research and Development Division of Pedigree Petfoods has a staff of 163, including qualified veterinarians, chemists, food technologists, microbiologists, biochemists and animal behaviourists. The Division's facilities include the Animal Studies Centre at Waltham, near Melton Mowbray, and laboratories and pilot plants at the Melton Mowbray and Peterborough factories.

69. Information is freely exchanged between the individual research units based at each of the petfood businesses in the Mars Group, and the Group Research Director is responsible for overall liaison to avoid duplication of effort and to ensure that innovations are made available throughout the Group.

¹ See footnote to paragraph 34.

70. Pedigree Petfoods keeps in touch with, and in some cases contributes financially to, work done by outside organisations including Universities. It supports the Pet Food Manufacturers' Association whose Technical Committee collaborates with the veterinary profession in promoting the welfare of pet animals.

71. Research and development expenditure by Pedigree Petfoods over the six years to 1975¹, including sums paid to outside organisations, was as follows:

<i>Year ended</i>	<i>Expenditure</i> (£'000s)	<i>Total net sales value*</i> (£'000s)	<i>Expenditure as percentage of net sales value</i>
31 July 1970	315	33,371	0.94
31 July 1971	343	36,502	0.94
31 December 1972	546	48,196	1.13
31 December 1973	611	61,205	1.00
31 December 1974	748	75,331	0.99
31 December 1975	1,002	88,997	1.13

* The figures include non-reference products.

¹ See footnote to paragraph 34.

Spillers Ltd

History and organisation of the pet food interests of Spillers Ltd

72. Spillers was established as a flour milling business in 1829. A bakery in Cardiff was acquired in 1856 to make ships' biscuits, and subsequently some lines were introduced for feeding to dogs. By 1914 the company was producing 18 varieties of dog biscuits at factories in Cardiff, Bristol, London, Newcastle and Birkenhead. Shapes, a coloured biscuit for dogs, was introduced in 1907 and Winalot, a dog meal, in 1927, and both soon developed into major brands. The company has continued to occupy a dominant position in the market for dog biscuits and meal with over 70 per cent of the total United Kingdom market in 1974 (paragraph 19).

73. In 1958 the company made a first attempt to enter the expanding market for meat-based canned pet foods with a product for dogs named Wagalot which was manufactured under contract. The product was not successful and was withdrawn. In 1960 Spratt's Patent Ltd, a company represented both in the flour-based pet foods market and in canned pet foods, was acquired at a cost of £3.94m. The assets included a factory at Aintree for biscuit production, a factory at Wisbech for canning, and a dog meal factory in East London operated by W G Clarke & Sons (1929) Ltd, a subsidiary of Spratt's. The acquisition enabled Spillers to increase its range of dry dog foods and to gain a foothold in the canned section of the pet foods market. Spratt's range of pet foods and its sales organisation were merged with the then Spillers Grocery Division, and in 1968 Spratt's name was changed to Spratt's Patent (Holdings) Ltd. Spratt's subsidiary companies continued to trade separately.

74. Further acquisitions took place in the 1960s. In 1964 the company trebled its canned pet food interests by the acquisition, at a cost of £6.8m, of Scottish Animal Products Ltd, a subsidiary of Robert Wilson & Sons (1849) Ltd, with canneries at Barrhead near Glasgow and at Malone in Northern Ireland. The sales forces of Spillers Grocery Division and Scottish Animal Products were merged in 1968, while W G Clarke & Sons (1929) Ltd, renamed Spratt's Patent Ltd, was made responsible for pet product interests other than food and for sales of pet food to specialist outlets and customers such as pet shops, breeders and kennels. Meanwhile Tyne Brand Products Ltd, a company engaged in canning food for both human and animal consumption was acquired for £4.36m in 1967. Tyne Brand's pet foods were confined to 'own label' products which were manufactured at a cannery at North Shields. Management of this business was transferred to the Grocery Division. In 1969 Wright & Company (Liverpool) Ltd, a dog meal manufacturer with a factory in Liverpool, was acquired for £0.53m.

75. The imposition of purchase tax in 1969, and the consequent reduction in the rate of growth in the pet food market, led to a re-organisation of Spillers' production. The dog meal factory in East London (ex Clarke), the North Shields pet food cannery (ex Tyne Brand) and the old Spillers biscuit factory at Newcastle

were closed. In 1971 a new biscuit factory was opened at Seacombe (Birkenhead) while the dog meal factory in Liverpool (ex Wright) and the old Spillers biscuit factory at Birkenhead were closed. In 1974 the production of pet foods was resumed at North Shields where another ex Tyne Brand cannery, formerly used for human food, was converted to pet foods.

76. Meanwhile in 1972 the company acquired the business of Stamina Foods Ltd from Ranks Hovis McDougall Ltd for £1m. Stamina Foods was purchased for its 'own label' business; its factory at St Helens was closed prior to acquisition and the use of its brand names 'Stamina' and 'Paws' was subsequently discontinued.

77. Certain acquisitions in the field of offal collection were designed to strengthen the company's access to raw materials. In 1967 Gland Supplies Ltd and A J Ross (Endocrine) Ltd were acquired from Fisons Ltd for £0.18m, and in 1972 The Manor Produce Company Ltd, an offal supply company in the Irish Republic, was acquired for £0.2m.

78. In 1972 Spratt's Patent (Holdings) Ltd changed its name to Spillers Foods Ltd and took over the management of all the trading operations of the Grocery Division of Spillers Ltd. Lakeland Food Industries Ltd, a Tyne Brand subsidiary, became responsible for the 'own label' business.

79. Spillers Ltd is a quoted public company with an issued capital of £39,420,000. The pet foods business of the company is managed by Spillers Foods Ltd which is a wholly-owned subsidiary of Spillers Ltd, and is carried on in the names of:

- (a) Spillers Foods Ltd—manufacture of pet foods and sale of branded products principally to grocery outlets;
- (b) Lakeland Food Industries Ltd—sale of 'own label' products to grocery customers under the brand names of those customers;
- (c) Spratt's Patent Ltd—sale of products under the 'Spratt's' brand names, and of certain 'own label' products.

Spillers Foods also manufactures and distributes foods for human consumption. Lakeland Food Industries, but not Spratt's Patent, is involved in the distribution of foods for human consumption.

80. The companies at (a)–(c) in the preceding paragraph form part of the Spillers Foods Group which comes under the ultimate management control of Spillers Ltd. The day to day control of the trading operations of the Group is the responsibility of the Board of Spillers Foods Ltd which meets weekly and submits monthly and quarterly reports and accounts to the Board of the parent company. The Chairman and Chief Executive of Spillers Foods Ltd is a member of that Board.

81. Spillers companies not forming part of the Spillers Foods Group whose activities include the sale of reference products or the supply of materials for their manufacture are:

- (a) Newgrain Ltd, a subsidiary of Spillers Farm Feeds Ltd in the Spillers–French Group, sells canned and dry cat and dog foods, among other things. The products which it sells are proprietary brands produced by Spillers Foods and by a number of competitors and are purchased on an arm's length basis.

- (b) Spillers-French Milling Ltd, a subsidiary of Spillers-French Holdings Ltd which is 75.1 per cent owned by Spillers Ltd, supplies flour and wheat offals which are used in the production of biscuits and meal and as ingredients in some canned pet foods.
- (c) Gland Supplies Ltd and The Manor Produce Company Ltd, subsidiaries of Spillers Ltd within the Meade-Lonsdale Group, collect and sell animal offals used in the manufacture of canned pet foods. Their customers include Spillers Foods, sales to which are made on an arm's length basis. (The acquisition of these companies is referred to in paragraph 77.)
- (d) Certain other companies in the Meade-Lonsdale Group procure supplies of animal offals for Spillers Foods from time to time on a commission basis.

Production

82. At 31 December 1975 the company owned and operated 4 canned pet food factories and 4 biscuit and meal factories in the United Kingdom. Since then the smallest of the biscuit and meal factories (Avonmouth) has ceased production. The normal weekly capacities of the 7 factories currently operating are as follows:

<i>Canned pet foods</i>	<i>Normal weekly capacity</i> (*000 cases)
Barrhead	130
Wisbech	100
North Shields	40
Malone	20
Total	<u>290</u>
<i>Semi-moist</i>	
North Shields	6
<i>Dry pet foods</i>	(tons)
Aintree	470
Bermondsey	460
Birkenhead	910
Total	<u>1,840</u>

- Notes: (1) One case of canned pet foods is equivalent to 12 giant cans, 24 large cans or 48 handy cans, representing about 21lb product weight excluding packaging.
- (2) One case of semi-moist product is equivalent to 12 2-sachetpacks, representing about 9 lb product weight.
- (3) The capacity figures relate to the product mix and manning levels at 30 September 1975. Most factories operate a 3-shift, 5-day, 47-week year.
- (4) One canning line at Barrhead is dormant owing to insufficient demand. When this line is in operation the capacity at Barrhead is about 200,000 cases per week.

83. The quantities of cat and dog foods actually produced in the five years to 1975-76¹ were:

¹ The company's accounting year ends on the Saturday nearest to 31 January.

	<i>Canned</i> (‘000 cases)	<i>Semi-moist</i> (‘000 cases)	<i>Dry</i> (tons)
1971-72	11,212	—	74,294
1972-73	11,146	—	72,988
1973-74	12,072	—	82,932
1974-75	10,580	58	84,616
1975-76	11,850	57	87,756

84. The number of persons employed at each factory¹ at 31 January 1976 were

	<i>Full time</i>	<i>Part time</i>
<i>Canned pet foods</i>		
Barrhead	513	44
Wisbech	405	—
North Shields*	299	6
Malone	91	19
Total	1,308	69
<i>Dry pet foods</i>		
Aintree	174	96
Bermondsey	112	2
Birkenhead	207	33
Total	493	131
Grand total	1,801	200

* Including production employees on the semi-moist process.

85. All the plant and equipment used for the production of cat and dog foods is owned by the company except for certain hired items the estimated cost of which, if purchased, would be £728,000.

Raw materials and packaging

86. Meat and offals are obtained direct from abattoirs or from abattoir collectors. About 70 per cent is derived from sources in the United Kingdom and the rest from overseas. About 45 per cent is supplied by Meade-Lonsdale, a wholly-owned subsidiary of Spillers, and the balance by third parties. All fish supplies are purchased from third parties, 93 per cent from Scotland and the rest from Denmark. Flour and other cereal products are obtained from Spillers-French Milling except for a small percentage of flour which is bought on the open market. Soya bean, fish and meat and bone meals, milk powder and molasses are purchased through Spillers Farm Feeds.

87. Cans and can ends are supplied principally by the Metal Box Company Ltd and the balance by Reads Ltd.

Measurement of efficiency

88. An annual budget is prepared covering the activities of the Spillers Foods Group as a whole, and the performance of the Group is measured by the Board of Spillers Foods by means of a regular review in which profits (or losses), the return on capital employed and the margin on sales to date are compared with the budget and with the performance for the previous year. The actual results for the

¹ Including production, maintenance, quality control, warehouse and factory administration.

financial year are predicted in the form of a forecast which is prepared each month following the first month of the year, and this forecast is compared with the previous forecast, with the annual budget and with the previous year's actual results.

89. Spillers Foods is divided into five product groups of which two—canned pet foods and biscuits and meal—are concerned with reference products. The performance of each group is reviewed at the monthly meetings of the product group management committee. The efficiency of individual functions and services—marketing, selling, distribution, supplies and production—is assessed by performance in relation to agreed budgets.

90. The capital expenditure projects of the Spillers Foods Group are financed by Spillers. The Group submits a capital expenditure budget to the Board of Spillers, seeks the Board's approval for individual projects and periodically reviews the progress of each project.

Sales and distribution

91. The company's total United Kingdom sales of cat and dog foods, including retailers' own brands, at list prices in the five-year period to 1974-75¹ were as follows:

	<i>Cat foods</i> (£'000s)	<i>Dog foods</i> (£'000s)	<i>Total</i> (£'000s)
1970-71	7,491	16,338	23,829
1971-72	7,424	17,303	24,727
1972-73	8,358	19,135	27,493
1973-74	9,463	23,677	33,140
1974-75	11,162	30,396	41,558

92. The division of sales between Spillers Foods, Spratt's and Lakeland Food Industries in 1974-75 was as follows:

	<i>Cat foods</i> (£'000s)	<i>Dog foods</i> (£'000s)	<i>Total</i> (£'000s)
Spillers Foods	8,729	23,859	32,588
Spratt's	308	3,163	3,471
Lakeland	2,125	3,374	5,499
Total	11,162	30,396	41,558

93. Sales of the principal brands in 1974-75 were:

	<i>Cat foods</i> (£'000s)	<i>Dog foods</i> (£'000s)
Winalot		7,450
Kennomeat		4,393
Bonus		4,357
Kattomeat	3,630	
Choosy	3,153	
Choice Cuts		2,333
Bonio		1,835
Shapes		1,674
Top Cat	1,569	

¹ See footnote to paragraph 83.

	<i>Cat foods</i> (£'000s)	<i>Dog foods</i> (£'000s)
Spratt's Big Value		1,280
Other brands	685	3,434
Own label	2,125	3,640*
Total	<u>11,162</u>	<u>30,396</u>

* Includes sales of 'own label' products through Spratt's (£266,000).

94. The approximate proportions by value of sales in 1974-75 to each of the main types of customer were as follows:

	<i>per cent</i>
<i>Spillers Foods</i>	
Wholesalers	46.6
National multiples	30.7
Co-operative societies	9.0
Retail buying groups	0.4
Local multiples	8.3
Other retailers	3.9
Feed distributors	1.1
	<u>100.0</u>
<i>Lakeland Food Industries</i>	
Voluntary group wholesalers	41.2
National multiples	46.7
Co-operative societies	1.1
Non-grocery retailers	11.0
	<u>100.0</u>

Information about Spratt's customers is not readily available.

95. Spillers Foods sells all products, whether for human or animal consumption, through one integrated sales organisation which comprises a national accounts department dealing with national multiples, voluntary groups and the CWS, and a field force divided into six regions. Lakeland's sales, which are entirely 'own label', are handled by a small unit based at Spillers' Head Office. Spratt's has two separate national sales forces, one of which deals with the grocery and pet shop trades and the other with establishments not connected with the retail trade such as breeders, greyhound tracks, zoos and research units.

96. Finished products, including cat and dog foods, are delivered either direct to customers when the quantities are large enough or to Spillers' distribution depots for storage and eventual delivery to customers. Eight of Spillers' 21 distribution depots are operated by Spillers and the remainder by outside contractors. In the case of multiple retailers having central warehouses, delivery is mainly made to those warehouses. Spratt's uses the same vehicles and hauliers as Spillers Foods, but does not use all the distribution depots. Some 'own label' customers collect direct from factories.

Prices and discounts

97. The company's pricing policy is governed by four factors:

- (a) *the effect of prices upon demand*, having regard to competition not only from other prepared pet foods but also from foods other than prepared pet foods, such as household scraps and fresh meat and fish, as well as to the long term effects of prices on the size of the pet population;
- (b) *profitability*. Before the Price Code was introduced, the company aimed to achieve a gross contribution to overheads and profit of between 35 and 40 per cent, depending on the product, after charging the variable costs of production, selling and distribution. The Price Code limited price increases because of the labour productivity deduction and the exclusion of some other costs, such as advertising, and had the effect of reducing the gross margin;
- (c) *prices of competitive products*. In pricing its products, the company seeks to ensure that they are not at a competitive disadvantage in terms of the combination of price and quality;
- (d) *trade discounts*. Spillers Foods encourages distributors to sell its products at the lowest possible prices through a trade discount structure related to the whole range of its products, for both human and animal consumption.

98. Spillers Foods and Spratt's both have trade price lists, and Spratt's also has separate price lists for products supplied (not for resale) to breeders and kennels and to specialist services. There is a minimum size of order for a single delivery (25 cases for Spillers Foods), and the price of each product depends on the size of the order, measured by the number of cases of all the company's products, including non-reference products, included in the order. The following are some examples of the discount scales by the number of cases and the price differentials at the various case rates:

<i>Scale</i>	<i>Number of cases</i>	<i>Kennomeat (large)</i>	<i>Kattomeat (large)</i>	<i>Winalot (large)</i>	<i>Bonio (large)</i>
1	1-25	115.5	115.6	112.6	112.8
2	26-49	110.3	110.6	110.2	110.9
3	50-74	109.4	109.5	108.3	107.7
4	75-224	104.2	104.4	102.9	103.6
5	225-499	100.7	100.9	100.7	100.9
6	500+	100.0	100.0	100.0	100.0

99. Wholesalers and retailers of the company's products derive their remuneration from the difference between the price at which they buy and the price at which they sell, and the price at which they buy depends on the quantity bought (paragraph 98). Additional discounts, bonuses and allowances are paid as follows:

- (a) A prompt payment discount of 1 per cent is given for payment within 14 days of date of invoice.
- (b) Over-riding discounts on the sale of all products are offered by the Spillers Foods group to major customers with a minimum turnover of £400,000 per annum (£30,000 in the case of Spratt's customers). These discounts, expressed as percentages of total turnover, are paid retrospectively at the end of the financial year on all trade in excess of an agreed figure. For this purpose, purchases from Spillers Foods and from

Spratt's are treated separately. As a percentage of gross sales of prepared pet foods, including biscuits and meal, the amount paid out in overriding discounts varied between 0.6 and 0.9 per cent in the period 1973-76.

- (c) Promotional bonuses are given to individual retailers for limited periods to enable them to feature a particular brand at a specially reduced price. These bonuses are sometimes supported with advertising allowances which are paid to retailers to advertise their special offers of Spillers Foods' products.
- (d) Long term bonuses, either on an annual or a quarterly basis, are paid to four 'discount operators' whose policy is to maintain very low retail prices on a permanent basis rather than to make short-term special offers.
- (e) Spratt's appointed distributors (paragraph 107(b)) are allowed 10p off the net price of Dog Diet.

100. The company shows recommended retail prices in its trade price lists. The purpose of this is:

- (a) to provide the trade with an indication of the prices at which they would need to retail the products to achieve normal margins;
- (b) to give the retailer a bench mark by which he can illustrate any price reductions he cares to make.

Where a retailer displays recommended retail prices, this indicates to the consumer the maximum price which he needs to pay for a particular article. The recommended retail price is not normally marked on the article itself; the company says that this is not practicable because of increasingly frequent price changes.

Variety of brands and flavours

101. Taking all brands and flavours into account, the current price list of Spillers Foods includes 21 varieties of dog food and 10 varieties of cat food. Details are shown in Appendix 2. The products sold by Spratt's are distinguished mainly on the basis of the nutritional needs of the ultimate consumers (eg large dogs, small dogs, puppies), though here too there is some differentiation by flavours in the case of canned products.

Retailers' brands

102. The Tyne Brand business which the company acquired in 1967 (paragraph 74) included the manufacture of 'own label' canned pet foods. In 1970 the company decided to build up a major stake in this sector, using surplus canning capacity.

103. In 1974-75 sales of 'own label' represented some 14 per cent by value of the company's total sales of pet foods. Most of these sales were in the name of Lakeland Food Industries whose business consists exclusively of 'own label' products, but some 'own label' products were also supplied by Spratt's. Prices are individually negotiated, depending on the nature and cost of the product, the volume ordered and the bargaining power of the parties. Prices of 'own label'

products supplied to members of Symbol groups are negotiated with the group headquarters which receives a rebate. Payment of invoices is due 28 days after the invoice date. No minimum annual quantity is stipulated, and the agreement to supply can be terminated by the customer at any time on the understanding that packed stocks held by the company are cleared and that packaging materials are either used or paid for by the customer.

104. Promotional allowances were given to some 'own label' customers in 1975. Previously such allowances had rarely been given.

Agreements and arrangements

105. Since the counter-inflation legislation was introduced in 1973 the company has on occasion exchanged information with Pedigree Petfoods and Quaker on the approximate overall amounts of cost increases incurred by the three companies and on the timing of applications to the Price Commission.

106. For about the last five years there have been discussions between the company and Pedigree Petfoods about the world-wide supply of offal and fish. The company told us that the purpose of these discussions, covering prices, quantities and sources of supply, had been 'to prevent unnecessary competition in buying', and that their effect had been to stabilise raw material prices (see paragraph 174).

107. Other agreements to which the company is a party are:

- (a) An agreement with an offal producer in Denmark under which the latter undertakes to offer a certain proportion of his output to the company, and the company undertakes to buy a certain proportion of the producer's output. Each party undertakes to advise the other before selling to or buying from a third party.
- (b) Spratt's has agreements with distributors of Dog Diet under which the distributors undertake to maintain stocks and order not less than a certain annual quantity, and Spratt's undertakes to appoint no other distributor within a certain area. Distributors are not precluded from supplying competitors' products, and Dog Diet is also sold through the pet trade as well as through the appointed distributors who cater for breeders and kennels.
- (c) An agreement with a distributor authorises the latter to sell certain of the company's canned cat and dog foods and dog biscuits and meal to professional customers, eg breeders and kennels, in the United Kingdom. The agreement provides that the distributor shall not sell any similar product to such customers without Spillers' consent.

Advertising and promotion

108. The company's advertising costs relate almost entirely to television advertising on account of Spillers Foods; Spratt's advertises only in the trade press, while Lakeland does not advertise at all. Promotions take the form of:

- (a) consumer offers—'money-off' packs, coupons entitling the consumer to a price reduction on a subsequent purchase, and offers of other goods in return for labels;

- (b) general trade bonuses—'per/case' bonuses are often given on all deliveries made in a period of usually four weeks in connection with the launch of new products, varieties or pack sizes;
- (c) individually negotiated trade bonuses—'per/case' bonuses given to individual retailers for short periods to enable them to feature a brand at a specially reduced price, and sometimes supported by advertising allowances (also mentioned at (c) in paragraph 99).

109. The company's expenditures on advertising and promotion of reference products in the five years to 1975-76¹ were:

	Advertising		Promotion		Total	
	<i>Expenditure</i> (£'000s)	<i>Percentage of net sales value</i>	<i>Expenditure</i> (£'000s)	<i>Percentage of net sales value</i>	<i>Expenditure</i> (£'000s)	<i>Percentage of net sales value</i>
1970-71	1,402	5.9	2,044	8.6	3,446	14.5
1971-72	828	3.3	1,236	5.0	2,064	8.3
1972-73	1,232	4.6	1,523	5.6	2,755	10.2
1973-74	1,025	3.1	1,489	4.6	2,514	7.7
1974-75	1,079	2.6	1,428	3.5	2,507	6.1
1975-76	1,030	2.2	2,019	4.2	3,049	6.4

110. About 85 per cent of the company's expenditure on advertising and promotion in 1974-75 was on its seven top selling lines, as follows:

	<i>Expenditure</i> (£'000s)	<i>Percentage of sales value at list prices*</i>
Winalot	501	6.7
Kennomeat	274	6.2
Bonus Dog	160	3.7
Kattomeat	296	8.2
Choosy	113	3.6
Choice Cuts	652	27.9†
Top Cat	157	10.0

* See paragraph 93.

† Choice Cuts, a premium canned dog food, was launched in 1974.

Research and development

111. The company's research and development work is mainly performed at its research and technology centre at Cambridge which also carries out some basic research, for example research into food analogues and artificial flavours. Feeding and palatability trials are carried out at the company's nutritional centre at Kennett, near Cambridge. Process development takes place at the company's pet food factories and canneries. About 45 staff are directly concerned with pet food development with another 14 providing support services such as packaging development, analysis and microbiology.

112. Expenditure incurred on pet food research and development over the five years to 1974-75¹ was as follows:

¹ See footnote to paragraph 83.

	<i>Research and development</i> (£'000s)	<i>Process engineering</i> (£'000s)	<i>Factory development</i> (£'000s)	<i>Total</i> (£'000s)
1970-71	91.0	—	—	91.0
1971-72	125.0	—	9.9	134.9
1972-73	149.7	—	38.1	187.8
1973-74	192.2	42.0	52.4	286.6
1974-75	269.9	51.0	42.5	363.4

Notes: (1) Research and development: new product development and evaluation of products at Kennett.

(2) Process engineering: development of detailed engineering proposals to implement the new products and processes.

(3) Factory development: eg material costs involved in factory trials.

113. The company has contributed to the cost, and shared the benefits, of some outside research, such as studies concerning feline urolithiasis and meat analogue technology. The company also subscribes to the British Food Manufacturing Industries Research Association, the Campden Food Preservation Research Association and the Packaging Industries Research Association.

CHAPTER 4

Other suppliers

114. In addition to the information obtained from the two main suppliers, we obtained evidence from 39 other suppliers (34 manufacturers and 5 importers) of cat and dog foods as defined in the reference. The evidence consisted of factual information about their products and sales levels, supplemented in some instances by more general comments elicited at hearings or in the course of interviews by the staff.

115. We estimate that the net sales value of sales of reference products in the United Kingdom by these suppliers in the five years from 1970 to 1974 was:

	(£m)
1970	7.2
1971	10.1
1972	14.7
1973	22.5
1974	30.1

The types of products supplied in 1974 were:

	(£m)
Canned	15.0
Semi-moist	4.4
Complete dry	5.8
Biscuits and meal	3.6
Other	1.3
Total	<u>30.1</u>

116. The information obtained about a selection of the more important suppliers is summarised below.

Quaker Oats Ltd

117. The Quaker Oats Company of Chicago established a London agency in 1893 to handle imports of porridge oats from Canada. Quaker Oats Ltd was incorporated as a wholly-owned subsidiary in 1899. After the First World War small manufacturing plants were established at Ware, Hertfordshire, and at Rotherhithe. The present works at Southall was built in 1936.

118. Quaker entered the pet food market in 1957 with Ful-O-Pep, a dry dog food. This product, along with other dry dog foods—Gravy Dinner and Mor-Meat—achieved a modest degree of success, while other canned and biscuit-type products manufactured by the parent company in America were imported for test marketing under the brand name 'Ken-L'. A new canned dog food, Chunky, was introduced in 1964; the product was initially imported from an associated company in Holland, but following satisfactory performance in test market it was decided to establish a plant at Southall. This plant came into operation in 1967.

119. In 1970 the company acquired the business of Felix Catfood Ltd and its non-trading subsidiary, Felix Pet Foods Ltd. Felix Catfood had a small plant at Biggleswade where it produced a dry cat food. The manufacturing process and formulation were improved, and production was subsequently transferred to Southall.

120. In recent years the company has extended its range by introducing a canned cat food (Felix) and two semi-moist products (Chunky Minced Morsels for dogs and Felix Tender Morsels for cats).

121. The types of cat and dog foods currently supplied by the company are:

<i>Cat foods</i>	Felix (canned) Felix (complete dry) Felix Tender Morsels (semi-moist)
<i>Dog foods</i>	Chunky (canned) Chunky Minced Morsels (semi-moist)

In 1975, the company's sales of canned products represented some 60 per cent of its total pet food sales by value, and were more profitable than the dry product, while losses were incurred on all the semi-moist products. Over two-thirds of the company's advertising and promotion expenditure in 1975 was on the semi-moist products, though some benefit accrued to other products because of the common brand names 'Chunky' and 'Felix'.

122. The company told us that, in general, the market price for pet foods was set by the two largest suppliers. Quaker could not generally hope to sell at a price above that set by the large suppliers and would invite retaliation if it sold much below that level. In any case, there would be little point in setting prices much below the market level as the company could not hope to meet the consequent demand for its products.

123. The company said that, following the introduction of the price freeze in 1972, the member firms of the Pet Food Manufacturers Association submitted a joint claim early in 1973 for a price increase. This was done through the Association with the approval and co-operation of the Government Department concerned. Subsequently, when the price freeze was followed by price control in May 1973, Quaker took part in discussions with other pet food manufacturers about the interpretation of the Price Code in relation to pet foods, and exchanged information with them about the technicalities of the Code in the light of their dealings with the Price Commission; in other words, what was allowed to be passed on in price increases and what was not. These discussions and exchanges of information ceased about the end of 1974 or early in 1975. To the best of the knowledge and belief of the present management of Quaker, the company did not divulge to its competitors any information about its costs or about the precise magnitude of any price increase application to the Price Commission. Quaker does not consider that it is or has been a party to any registrable agreement.

Carnation Foods Company Ltd

124. The company is a wholly-owned subsidiary of Carnation Company of America whose extensive interests in human and animal foods include the manufacture and sale of complete dry pet foods. It was decided to develop this

relatively neglected sector of the United Kingdom market, using the expertise of the parent company and relying in the first instance on imports from the United States and from an associated company in France. Go-Cat was introduced in 1970 and Go-Dog in 1973. A plant to manufacture the products in this country was established at Worksop, Nottinghamshire, and came into operation in November 1975.

125. While the company has had some degree of success in developing the market for complete dry pet foods, its operations so far, based (until the plant at Worksop came into operation) on the sale of imported products, have not been profitable. The installation of manufacturing facilities in the United Kingdom may improve the position by reducing costs.

Dinnodog Products Ltd

126. The company was incorporated in 1960 and was acquired by Fisons Foods Ltd in 1965. In 1969 Fisons Foods Ltd with its subsidiaries, including Dinnodog, was acquired by H J Heinz Company Ltd.

127. The company manufactures deep-frozen raw and cooked meats for cats and dogs which are sold under the trade name 'Bellboy'. The company has a factory at Tisbury, Wiltshire. Fish, biscuit meal, bone meal and milk powder are also bought in to provide a balanced range of pet foods.

128. The company does not spend much on advertising and its activities, though modestly profitable, are on a limited scale. It sees scope for expansion for frozen products in the pet food market as refrigerator and freezer ownership increase among householders, though that expansion could be hindered by the cost of refrigerated van delivery and storage in retail freezers, coupled with the need on the part of the pet owner to allow three or four hours for thawing out the product.

Anglia Cannery Ltd

129. The main business of Anglia Cannery Ltd, which is a wholly-owned subsidiary of Associated British Foods Ltd, is the canning of fruit and vegetables. In 1965, with the growth in sales of canned pet foods and the growing interest of retailers in 'own label' pet foods, the company acquired Warrington Cannery Ltd which specialised in the production of canned cat and dog foods for sale to the pet trade and a limited number of grocery wholesalers and retailers.

130. The company's production of pet foods, at a factory at Warrington, is confined to canned goods and is almost entirely for specific customers under their own labels. Prices are individually negotiated. The company spends nothing on advertising and promotion, and its low overheads and willingness to cater for the individual requirements of 'own label' customers enable it to compete with the larger suppliers. It might be vulnerable if the larger suppliers had excess capacity which prompted them to take 'own label' business at uneconomic prices. We were told that the company had lost an 'own label' contract to Spillers because of the over-riding discount given by Spillers to a retail chain on the total of all its purchases from Spillers. The company's price increases are tied in timing and amount to those announced by the brand leader, Pedigree Petfoods, and in some cases the company has had to absorb a cost increase while waiting for Pedigree Petfoods to increase its prices.

Windsor Foods Ltd

131. General Foods Ltd, a subsidiary of General Foods Corporation (USA), entered the United Kingdom pet food market in 1970 when it acquired Windsor Foods Ltd. The company's production of pet foods is confined to canned goods which are produced at Portadown, Northern Ireland. Products are marketed under the brand names of 'Master McGrath' dog food and 'Fussy' cat food (the latter is sold only in the Irish Republic), but approximately half of the company's production is for 'own label' customers. The company's activities appear to be moderately profitable despite the higher distribution costs resulting from the location of the factory in Northern Ireland.

John Morrell & Co Ltd

132. The company, a subsidiary of United Brands Company (USA), produces a range of canned dog foods under the brand names 'Butch', 'Red Heart' and 'Gala'. It also produces canned fruit and vegetables and a number of other food products. Production of pet foods is at a factory at Bardney, Lincolnshire.

133. Morrell's pet food business started before the Second World War, and in the early post-war period 'Red Heart' and Pedigree Petfoods' 'Chappie' were the brand leaders in canned dog food. The company's products subsequently lost market share as a result of Pedigree Petfoods' heavy investment in plant and marketing, but since 1970 sales have improved. Between 1970 and 1974 the company's sales of canned dog food increased considerably in volume terms, attributable, in the main, to the success of its new product 'Butch', which competes at the low price end of the market and is little advertised.

134. The company believes that the advertising by the two major pet food companies has benefited all manufacturers and consumers by expanding the market for prepared pet foods. Morrell's advertising expenditure is limited; if it were aiming to increase its market share greatly, or to enter the premium priced market, it would have to advertise more extensively.

Pickerings Foods Ltd

135. The principal business of the company, which is a wholly-owned subsidiary of H J Heinz Company Ltd, is the manufacture and distribution of canned fruit and vegetables and of milk products. The company also imports canned cat foods, mainly from another Heinz subsidiary in the United States, for sale under the brand name '9-Lives'. Sales have expanded steadily since the product was first introduced into the United Kingdom in 1968-69. The range has been extended by adding mackerel, pilchard and 'seafood platter' varieties to the original tuna flavour.

136. Sales were initially, and are still principally, through the pet trade, but an increasing proportion is now going to grocery outlets. The growth in sales has been achieved with virtually no expenditure on advertising except some small advertisements in the pet trade press. The company attributes this to the appeal of the product which is one of the highest priced cat foods on the market with no strong competitors at the same level of quality. Pricing depends on the cost of imports rather than on the price levels of other canned cat foods, and the timing of price increases is quite independent of other manufacturers.

Jenks Brothers Foods Ltd

137. The Ralston Purina Company, the largest manufacturer of prepared pet foods in the United States, has been represented in the United Kingdom by Jenks Brothers Foods Ltd since 1967. Purina products, consisting of complete dry cat and dog foods and semi-moist cat foods, are imported from North America and Western Europe. The cat foods are sold to the grocery trade, while the dog foods are distributed to dog breeders, kennels and private owners through a network of self-employed agents.

CHAPTER 5

Financial information

Profits

138. We set out at Appendix 3 the net profits before interest and tax earned by Pedigree Petfoods and by Spillers expressed as a percentage of sales and average capital employed, together with the average return obtained by the United Kingdom food manufacturing industry and by United Kingdom manufacturing industry as a whole on an historic cost basis and, where available, on an inflation accounting basis¹ for the four years 1972 to 1975.

Pedigree Petfoods

139. Pedigree Petfoods' trading includes some exports and non-reference activities but, as more than 90 per cent of total trading falls within the terms of the reference, it seems reasonable to consider that the profits of the business as a whole reflect within an acceptable margin the return from reference activities only.

140. Pedigree Petfoods' total sales, costs and profits expressed in percentage terms for the years ended 31 July 1966, 1970 and 1971 and 31 December 1972 to 1976 are set out in some detail in Appendix 4 together with the return on capital employed on an historic cost and an inflation accounting basis. The relatively high return in 1972 was due to a substantial increase in the volume of turnover mainly in the last quarter of the year when Pedigree Petfoods was operating at above normal capacity by using all eight production lines simultaneously (see paragraph 32). As a result, capital employed in relation to turnover was some 5 percentage points less than in the preceding year owing to the more intensive utilisation of fixed assets and low level of stocks of finished goods at the year end. Stocks of raw materials were also abnormally low following a dock strike in August 1972. Conversely the decrease in return in 1974 was primarily due to increased costs resulting from the 'three-day week', the introduction on to the market of new dry and semi-moist products and the capital cost of the new factory at Peterborough (which came on stream in October of that year).

141. A breakdown by quartiles of the average return on capital employed, the return on sales and the ratio of sales to capital employed of quoted companies in the United Kingdom food manufacturing industry and in United Kingdom manufacturing industry as a whole (historic cost basis) and of Pedigree Petfoods and Spillers on the same basis for the years 1971 to 1974 is set out in Appendix 5.

142. Some 90 per cent of Pedigree Petfoods' total sales and substantially the whole of the profits relate to canned products. Pedigree Petfoods produced a breakdown of sales and direct costs including advertising and promotional expenditure which indicated that profit margins on individual established brands

¹ The inflation accounting used in this report is in accordance with the proposals in *Inflation Accounting: Report of the Inflation Accounting Committee*, Cmnd. 6225, HMSO.

were broadly in line with each other in accordance with the stated policy that, once established, each product is required to make a predetermined contribution as a percentage of the selling price toward fixed overheads and profit (paragraph 51). The two most highly promoted and principal selling lines were Chum and Whiskas (paragraph 47), both premium brands, which accounted for 42 per cent of total sales in 1975 and which, by reason of their higher price, provide a larger contribution in money terms than cheaper brands. Pedigree Petfoods' other reference products, namely dry and semi-moist, amounted in 1975 to some 5 per cent of total sales. The established dry products appear to have attained the required level of contribution, but the comparatively new semi-moist products, which are still in the early stages of development, traded at a loss.

143. The following table sets out Pedigree Petfoods' sales and costs in respect of reference goods for 1975 expressed in terms of pence per lb of product; in the case of canned pet foods this is approximately equivalent to a 'large' can:

	<i>Canned</i> (p per lb)	<i>Dry</i> (p per lb)	<i>Semi-moist</i> (p per lb)
Raw materials and bought-in goods	3.86	6.16	14.09
Cans and packing	2.77	1.94	4.04
Distribution	0.37	0.49	0.52
Direct labour and variable overheads	0.60	0.97	2.73
Advertising and promotion	0.65	1.74	6.76
Total variable costs	8.25	11.30	28.14
Contribution to fixed overheads and profit	3.13	1.51	[3.57]
Average net selling price	11.38	12.81	24.57

The table is an average of sales of various sized cans or packs of different brands, each with a different formula of raw materials and advertised or promoted to varying degrees. For example, total variable costs of Chum and Whiskas averaged 8.14p and 9.45p respectively but contributed 3.63p and 3.85p respectively to fixed overheads and profits. In the case of 'dry' the table aggregates dry meal/biscuit and complete dry foods. Canned products as a whole averaged a profit of approximately 1p per lb (equivalent to a large can) after allocation of overheads on the arbitrary basis of sales value; established dry goods also produced a similar profit, but this was more than offset by the loss on a new product, Loyal, introduced in 1974 but since withdrawn. The net selling price of semi-moist products did not cover variable costs. However, the tabulation for each product is not comparable with that of other products because they differ in their nature and nutritional value.

Spillers

144. Some 65 per cent of Spillers' total turnover in pet foods excluding non-reference trading consists of canned products and 35 per cent of dry goods, referred to as biscuits and meal. It therefore seemed pertinent to our inquiry to consider the two types of pet food separately for purposes of comparison with Pedigree Petfoods which is primarily a manufacturer of canned products. Spillers' sales, costs, profits and return on capital employed, expressed in percentage terms for the years ended 31 January 1973 to 1976, are set out in some detail in Appendix 6. The company provided a limited amount of information in respect of the years ended 31 January 1966 and 1971 but, as most of the

costing records for the period had been destroyed, and as at that time the pet food activities formed part of Spillers' Grocery Division which did not extract information relating to capital employed, the data supplied were of little value.

145. The summary at Appendix 3 indicates that, over the four years 1972-73 to 1975-76, the company's average profit in relation to sales from its total pet foods activities (6.4 per cent) was below that for United Kingdom manufacturing industry as a whole (7.7 per cent), but was better than that for quoted companies in the United Kingdom food industry (5.4 per cent). Canned products provided a lower return (5.3 per cent) than biscuits and meal (8.6 per cent).

146. The following table sets out Spillers' sales and costs for the year to 31 January 1976 expressed in terms of pence per lb:

	<i>Canned</i> (p per lb)	<i>Biscuits and meal</i> (p per lb)
Raw materials	2.39	3.89
Cans and packing	2.91	1.05
Distribution	0.72	0.66
Production, labour and overheads	2.13	1.47
Advertising and promotion	0.83	0.32
Total direct costs	<u>8.98</u>	<u>7.39</u>
General overheads	0.88	0.80
Profit	0.40	0.67
Average net selling price	<u>10.26</u>	<u>8.86</u>

The above table, like the corresponding table for Pedigree Petfoods (paragraph 143), is an average of total sales and costs. The lower average selling price per lb for canned goods compared with Pedigree Petfoods was partly due to the inclusion of lower priced 'own label' business which accounted for 15 per cent of the total tonnage sold, but the main reason was that Spillers' principal selling line appears to have been the lower priced economy brand Bonus; higher priced premium brands accounted for only about 24 per cent of sales tonnage. Canned goods include semi-moist products, but the amount was small and not material. Spillers does not maintain records of costs and profit contributions by brands.

Comparison with other competitors

147. After Pedigree Petfoods and Spillers, the next largest supplier of proprietary brands of pet food is Quaker Oats Ltd from whom we obtained information on sales, costs, profits and capital employed on an historic cost basis for the three years to 30 June 1973, 1974 and 1975, brief particulars of which are as follows:

	<i>Year to 30 June</i>		
	1973	1974	1975
Net sales (£'000s)	7,434	11,130	13,549
Net profit [loss] (£'000s)	[287]	[67]	173
Net profit [loss] as a percentage of net sales	[3.9]	[0.6]	1.3
Return on capital employed (per cent)	[15.8]	[1.9]	4.0

The company told us that there were insufficient data available at the time of our inquiry to calculate profit and return on capital employed on a current cost basis.

148. The figures conceal the fact that gross profits (net selling price minus variable costs) on canned products, which averaged some 62 per cent of the company's sales of pet foods, are higher than on semi-moist and dry products. The company stated that, short of a detailed examination and analysis, there was no realistic basis for the allocation of indirect costs and capital employed between products. If we made the purely arbitrary assumption that indirect costs are proportional to net sales value, the return on capital employed (historic cost) for each of the three years 1973-75 would be:

<i>Year to 30 June</i>	<i>Canned</i>	<i>Semi-moist and Dry</i>	<i>Total pet foods</i>
1973	15.5	[83.8]	[15.8]
1974	48.5	[76.9]	[1.9]
1975	56.9	[72.3]	4.0

The relatively low return on canned products in 1972-73 and the losses on semi-moist in each of the years are primarily due to a high level of advertising in relation to sales.

149. We set out below sales and costs for the year to 30 June 1975 in terms of pence per lb.

	<i>Canned</i> (p per lb)	<i>Dry</i> (p per lb)	<i>Semi-moist</i> (p per lb)
Variable costs	6.74	11.52	15.34
Advertising and merchandising	0.99	3.27	8.54
Indirect costs	2.42	3.67	4.29
Profit [loss]	2.24	0.37	[6.22]
Net selling price	<u>12.39</u>	<u>18.83</u>	<u>21.95</u>

Sources and application of funds

150. A summary of sources and application of funds of Pedigree Petfoods for the period from 1 August 1965 to 31 December 1975 (10 years and 5 months) is set out below.

	(£m)
<i>Sources</i>	
Funds generated from operations	31.4
Bank advances and hire purchase	5.4
Total funds	<u>36.8</u>
<i>Applications</i>	
Reinvested—net fixed assets	13.6
funded by depreciation (deduct)	6.3
additional investment	7.3
working capital	4.7
Tax paid	9.2
Payments to Mars Ltd—dividends	10.0
advances	5.6
Total applied	<u>36.8</u>

Some £11 million of the expenditure on fixed assets was incurred during the four years 1972 to 1975 and no dividends have been paid to Mars Ltd since 1972.

151. No statement of sources and application of funds was made available by

Spillers on the grounds that, as pet foods were only one of the activities of the Spillers Foods Group, such a statement would not be meaningful. Funds generated by pet foods during the four years to 31 January 1976 amounted to £11.7 million, during which period working capital increased by some £3 million, but fixed assets remained fairly constant, implying that investment had been broadly in line with the £2.6 million charged in respect of depreciation.

Forecasts for future years

152. Pedigree Petfoods supplied us with a copy of its operating plan (see paragraph 42) prepared during the last quarter of 1975 which set out the estimated trading results for 1975 (based on the actual results for the first eight months) and the medium-term plan for the following five years to 1980 with 1976 and 1977 shown in detail and 1978 to 1980 in terms of sales, profit and return on total assets (ROTA). Pedigree Petfoods subsequently provided actual results for 1976 (shown in Appendix 4) and updated forecasts for return on capital employed on both historic cost and inflation accounting bases.

153. Pedigree Petfoods forecast continued real growth in its sales of prepared pet foods with the new dry and semi-moist products increasing in importance. Both the proportion of total pet feeding accounted for by prepared pet foods and Pedigree Petfoods' share of the sales of prepared pet foods were expected to increase.

154. The inflation of most cost components was forecast to increase by approximately 70 per cent in 1980 over the 1975 level, but estimated selling prices were restricted to a 63 per cent increase as a result of estimated increased efficiency, arising in part from capital expenditure averaging some £7 million a year for the next five years on specified projects to be financed out of profits. Advertising and promotion were expected to continue at the same level as in 1975, taking into account the high forecast inflation in the cost of advertising.

155. The updated forecasts for 1977-80 showed that the return on capital employed was expected to average 20 to 25 per cent on an inflation accounting basis and 35 to 40 per cent on an historic cost basis. Pedigree Petfoods said that it needed at least such a rate of return to sustain and attract investment in expansion, innovation and technical improvement. It argued that the return was to be viewed in the light of its unusual efficiency in the use of capital and of its exceptional productivity and innovation in general, and that its standard of performance could not be maintained if it were deprived of the possibility of earning such a return.

156. We did not receive any information on Spillers' annual budget forecast referred to in paragraph 88.

Efficiency

157. The reasons given by Pedigree Petfoods for the exceptional standard of efficiency which it claimed, and its assessment of the effect of certain commercial practices on its profits, capital employed and return on capital employed, are summarised in paragraphs 183 and 184. The table in paragraph 184 indicates that, in the absence of the commercial practices described at (c) in paragraph 183, the average return on capital employed in 1972-75 would have been 25.4 per cent on historic cost as against 46.7 per cent using unadjusted figures. A corresponding

adjustment of the ratio of profit to sales would increase the average return on sales for the same period from 7.1 per cent to 9.3 per cent:

	1972	1973	1974	1975	Average 1972-75
<i>Actual financial results</i>					
Profit (£'000s)	4,183	4,115	4,187	6,681	
Sales (£'000s)	48,196	61,205	75,331	88,997	
Return on sales (per cent)	8.7	6.7	5.6	7.5	7.1
<i>Adjusted financial results</i>					
Profit (£'000s)	5,331	5,535	5,795	8,248	
Sales (£'000s)	48,196	61,205	75,331	88,997	
Return on sales (per cent)	11.1	9.0	7.7	9.3	9.3

Pedigree Petfoods did not agree, however, that it was legitimate to make this adjustment (see paragraph 189).

158. The comparative efficiency of Pedigree Petfoods, Spillers and Quaker from the latest figures made available to us may be gauged from the following ratios per employee:

<i>Year ended</i>	Pedigree Petfoods 31 December 1975 <i>Canned, semi-moist and dry</i>	Spillers 31 January 1976 <i>Canned Biscuits and meal</i>	Quaker 30 June 1975 <i>Canned, semi-moist and dry</i>
<i>Per employee</i>			
Sales			
Quantity (tons)	137	82	107
Value (£'000s)	34	19	21
Capital employed			
Fixed (£'000s)	4	3	5
Current (£'000s)	3	2	2
Value added (£'000s)	8	4	5
Remuneration (£'000s)	5	3	3
Net value added (£'000s)	3	1	2

Price changes for canned cat and dog foods supplied by Pedigree Petfoods and Spillers

159. Appendix 7 shows the changes in the recommended retail prices of four pairs of canned cat and dog foods supplied by Pedigree Petfoods and Spillers during the period from January 1970 to December 1976. Changes in trade prices are excluded. The products are two premium quality canned cat foods ('Whiskas' and 'Kattomeat'), two medium quality canned cat foods ('Kitekat' and 'Choosy'), two premium quality canned dog foods ('Chum' and 'Kennomeat') and two economy canned dog foods ('Bounce' and 'Bonus').

CHAPTER 6

The case for the principal suppliers

160. In this chapter we summarise the submissions made by Pedigree Petfoods and Spillers relating to the public interest issues of the inquiry. Their comments on the complaints and criticisms made by third parties (Appendix 1) are summarised under the appropriate subject headings.

(1) Pedigree Petfoods

Market share

161. Pedigree Petfoods agreed that it accounted for more than 25 per cent, and in fact for approximately 50 per cent, of the supply in the United Kingdom of prepared cat and dog foods as defined in the reference. It pointed out, however, that on a wider definition including fresh meat and fish sold for consumption by cats or dogs it accounted for only about a third of the market:

	Prepared		Fresh		Total	
	<i>Total retail sales value</i> (£m)	<i>Pedigree Petfoods</i> (per cent)	<i>Total retail sales value</i> (£m)	<i>Pedigree Petfoods</i> (per cent)	<i>Total retail sales value</i> (£m)	<i>Pedigree Petfoods</i> (per cent)
1970	102.9	49.1	56.1	—	159.0	31.8
1971	110.5	50.1	54.7	—	165.2	33.5
1972	127.0	51.8	71.1	—	198.1	33.2
1973	154.6	52.1	96.3	—	250.9	32.1
1974	192.4	50.2	97.3	—	289.7	33.4
1975	221.6	51.3	110.4	—	332.0	34.2

Furthermore, total consumption of food by cats and dogs included substantial quantities of household scraps and milk (see paragraph 14), the value of which could not be quantified. Pedigree Petfoods estimated that, on a tonnage basis, its contribution to the total feeding of cats and dogs, including scraps and milk as well as fresh and prepared foods, was not much more than 20 per cent.

Competition

162. Pedigree Petfoods claimed that it had built up its business by marketing products which were competitive with the traditional diet of fresh food and scraps in terms of price, palatability, nutritional value and convenience, and that in addition it had faced, and might be expected to continue to face, effective competition from other suppliers of prepared pet foods. There was competition not only between prepared pet food and other food fed to pets, but also between different kinds of prepared pet food and between different prepared pet foods of the same kind. Moreover, the prepared pet food industry was part of the total food processing industry; many suppliers of prepared pet foods had substantial interests in the manufacture of food for human consumption, and massive resources were available in the food processing industry as a whole which could be directed towards the processing, marketing, and distribution of pet food if the existing suppliers failed to meet users' needs efficiently.

163. While total food consumption had increased substantially over the past 15 years in keeping with the increase in the cat and dog population, there had been a significant shift of demand from fresh food to prepared food which accounted for nearly half the total quantity consumed in 1975 compared with one quarter in 1960 (paragraph 14). However, the fact that in 1975 some £100m of fresh food was bought specifically to be fed to cats and dogs (paragraph 15) indicated that fresh food was still a substantial force in the market. It could not be assumed that the shift of demand to prepared food (for the reasons summarised in paragraph 17) would necessarily continue. Relative price movements would be an important factor, though not the only one, determining choice between fresh and prepared foods.

164. Canned goods, which represented some 75 per cent of the market for prepared pet foods in 1974 (paragraph 19), would be likely to face increasing competition from the new semi-moist and complete dry products which were introduced to this country in the 1970s. The main advantages of the latter were:

- (a) they contained a higher proportion of cheaper, plant-based proteins;
- (b) they dispensed with the need for cans which had increased in price and were likely to become even more expensive in the future;
- (c) the processes of canning and packaging had become more expensive owing to the rise in the cost of energy.

While the dry and semi-moist products had so far met with some consumer resistance in this country, further advances in their formulation and marketing, combined with their economic advantages, would be likely to result in their gaining further ground in the pet food market.

165. Pedigree Petfoods pointed out that competition between products of different kinds or of the same kind was enhanced by the low unit price of prepared pet foods, the ready availability of many different brands and the belief of owners that a varied diet was good for their pets. It was therefore easy for owners to experiment and to provide a diet containing different kinds of reference and non-reference foods (see paragraph 20). No product enjoyed a secure franchise and the market shares of individual brands, including those of Pedigree Petfoods, had varied greatly over the years. Pedigree Petfoods had succeeded in holding its substantial share of sales of prepared pet food only by paying constant attention to the price and palatability of its products, to the cost of the ingredients and processes used and to the efficiency of all aspects of its operations.

166. Pedigree Petfoods maintained that the strength of the competition faced by itself and Spillers was shown by the growth in sales of other suppliers such as Quaker. Between 1959 and the present, the aggregate market shares of suppliers other than Pedigree Petfoods, Spillers and the companies acquired by Spillers after 1959 had increased from under 10 to over 20 per cent (see paragraph 18). All the evidence demonstrated that the market was highly competitive, and that significant changes had taken place in it as a result of competitive pressures: sales of prepared pet food had grown substantially at the expense of fresh food for pets; some suppliers of prepared pet food had grown more rapidly than others; some brands had grown at the expense of others; brands had been substantially reformulated to keep down prices; and new brands and product types had been introduced. There were no artificial barriers to new entry into, or

expansion in, the industry. The minimum cost of production plant of an economic size to produce canned, semi-moist or complete dry pet foods was about £100,000. This included all capital equipment except for land, building and fork lift trucks which were assumed to be leased. The capital cost would be much less than £100,000 if second-hand equipment were used. Pedigree Petfoods had achieved and maintained its position in the market by fair competition and providing good value for money; it had not resorted to anti-competitive practices of any kind and had not imposed, or sought to impose, unfair terms on its suppliers of materials or on its customers.

Prices and discounts

167. Competition from alternative food sources and from the products of other suppliers was the main determining factor in the general level of prices and the prices of individual products. Pedigree Petfoods stated that its objective (as explained in paragraph 51) was to maintain the relationship between the costs of each of its products and their prices so that each product made around the average contribution to profit required in order to achieve the standard ROTA (see paragraph 44). This objective was generally attained in the case of established products; for new products, however, the low level of sales across which to spread the cost of initial advertising and promotion, combined with the fact that economies of scale of manufacture and supply had not yet been fully achieved, could result in substantial deviations from the average contribution to profit. This was particularly true of the new semi-moist and complete dry foods, the successful development of which Pedigree Petfoods considered to be of the utmost importance to the future of its business.

168. By improvements in efficiency, productivity and formulation, Pedigree Petfoods had substantially reduced the price of its products to the pet owner in real terms and in comparison with the price of fresh food (see paragraph 52). This had been an important factor in the increasing acceptance of prepared pet food as an alternative to fresh food and scraps. Even if Pedigree Petfoods stood alone in the industry, it would be under pressure to keep the prices of its products at levels which did not render them uncompetitive with alternative forms of pet feeding or act as a deterrent to keeping cats or dogs. But Pedigree Petfoods did not stand alone; it had to take into account both the existing level of competitors' prices and also whether cost pressures on competitors were likely to be such that they would take advantage of a price increase by Pedigree Petfoods to increase their prices. As the leading supplier of prepared pet food in the United Kingdom, Pedigree Petfoods accepted, and indeed claimed credit for, the fact that it had an important influence on prices and that its policies of restraining prices had been a significant factor in the creditable record of the pet food industry in this country. Pedigree Petfoods did not however agree that it operated as a price leader if that term implied any deviation from competitive pricing on its part, nor did it accept that our comparative table of price changes for selected brands supplied by Pedigree Petfoods and Spillers (Appendix 7) was evidence of parallel pricing.

169. Pedigree Petfoods did not feel able, in the absence of specific details, to comment on the claim by a distributor that he was importing an own label dog food from the United States 'far cheaper than a similar item produced in the United Kingdom' (Appendix 1, paragraph 4), except that it indicated that the United Kingdom industry was subject to effective competition from imports. As to the complaint by another distributor that the major suppliers had too many

'money off packs' (*ibid*), Pedigree Petfoods said that these were a normal feature of the grocery trade; they were not peculiar to, nor specially prevalent in the case of, prepared pet food. They provided a means of ensuring that a promotional price reduction was passed on to the customer. The complaint that pet food manufacturers did not allow distributors the same sterling margin on 'money off packs' (*ibid*) was not true in the case of Pedigree Petfoods.

170. With regard to the complaints by a wholesaler and by the National Federation of Wholesale Grocers and Provision Merchants about the quantity discounts allowed when manufacturers were unable to supply the full amount ordered (Appendix 1, paragraphs 5 and 8), Pedigree Petfoods said that its normal practice was to allow the discount appropriate to the size of order and not the size of delivery. In the particular situation of the three-day week, mentioned by the wholesaler, distributors had been informed of any temporary shortages and asked not to order the products in question. A few of them had continued to do so and had claimed a quantity discount that took into account the inclusion of these products in their orders. In fairness to other distributors who had refrained from ordering products which were known to be unavailable, Pedigree Petfoods on that occasion allowed the discount applicable to the size of order delivered.

171. Pedigree Petfoods noted that, while a large retail organisation had complained that the discount terms which it received from pet food suppliers were insufficiently favourable to large retailers, two trade associations had complained that the terms were too favourable to large retailers and placed the small retailers, whom they represented, at a competitive disadvantage (Appendix 1, paragraphs 5 and 9). It was clearly not possible to satisfy everybody; the quantity discounts allowed by Pedigree Petfoods were cost-justified, and it believed that this was fair as between different purchasers and in the public interest.

172. Pedigree Petfoods expressed concern about the statement by the National Federation of Wholesale Grocers and Provision Merchants alleging a 'take it or leave it' attitude by pet food manufacturers, and Pedigree Petfoods in particular, in dealings with the distributive trade (Appendix 1, paragraph 8). Information from other sources did not suggest that this was either a fair or a representative view; nevertheless, Pedigree Petfoods would carefully review its sales and marketing methods in the light of this criticism. As to the specific examples cited by the Federation:

- (a) As explained in paragraph 170, the normal practice so far as Pedigree Petfoods was concerned was to allow the quantity discount appropriate to the size of order and not the size of delivery.
- (b) Pedigree Petfoods had not so far been able to make the 24-can case generally available because of space and capacity limitations, but a capital investment programme, costing in the aggregate about £3 million, was in hand which would make this possible.
- (c) In 1975 the promotional price reductions allowed by Pedigree Petfoods amounted to £2.3 million. This did not indicate 'resistance to promotional activities designed to reduce consumer prices'.
- (d) Pedigree Petfoods had reviewed its policy about the length of notice of price increases, and had decided to increase it from one week to two weeks.

Restrictive agreements

173. The exchanges of information with Spillers, and later with Spillers and Quaker, about proposed price increases referred to in paragraph 62 materially affected only the administration of Pedigree Petfoods' prices and not their level. The exchanges of information had no influence at all on Pedigree Petfoods' pricing policy, and prices would not have been any lower if they had not taken place.

174. Pedigree Petfoods did not comment directly on the discussions reported by Spillers (paragraph 106) about the world-wide supply of offal and fish, but implied that any such discussions did not involve an agreement to restrict competition.

Advertising and promotion

175. Pedigree Petfoods said that the aim of its advertising and promotion policies was to increase sales of its products. New products were advertised to bring them to the attention of pet owners and encourage trial, and some advertising of established products was undertaken, at a lower ratio of advertising expenditure to sales, to maintain and increase their usage. The aim of promotion, as of advertising, was to encourage pet owners to try the promoted product, and in addition to induce retailers to draw attention to it in their stores, to increase demand for it and so obtain a better matching of demand and manufacturing capacity, to encourage price-cutting by retailers and to compete with promotions by other suppliers. Both advertising and promotion affected not only the pet owner but also the retailer, by encouraging him to stock the product. They differed in that promotional activity tended to be more flexible than advertising, and because, unlike advertising, it ordinarily benefited the pet owner directly through price reductions or through the opportunity to try a product free of charge, by sampling. Promotion enabled demand to be matched with capacity in the short-term, whereas advertising helped to justify investment in capacity by building up consumer demand in the longer term.

176. Pedigree Petfoods argued that its advertising and promotional expenditure should not be considered in isolation from its total marketing expenditure. In 1966 the latter (including not only advertising and promotion but also all marketing overheads and the whole of the cost of the sales force) represented about 14 per cent of net sales value. By 1975 it had fallen to only about 6 per cent. Over the ten-year period advertising, promotional and marketing expenditure per ton of pet food sold in constant 1965-66 prices fell by over 61 per cent. During the same period the prices of Pedigree Petfoods' products also fell in real terms by 17 per cent by reference to the Retail Price Index (all items) and 25 per cent by reference to the Retail Index (food) (see paragraph 52). There was no evidence that selling costs had been increased as an alternative to price competition, resulting in costs and prices being higher than they otherwise would have been.

177. Taking advertising and promotional expenditure in isolation, Pedigree Petfoods' expenditure on advertising, expressed as a percentage of net sales value, had fallen from 4.9 per cent in 1970 to 3 per cent in 1976, and its expenditure on promotion (including the value of promotional price reductions) from 5.1 per cent to 3.5 per cent. The reason why higher expenditure in relation to sales was incurred in the past was that the pet food industry was then at an early stage in its

development and pet owners needed to be made aware of the advantages of prepared pet food as an alternative to more traditional ways of feeding cats and dogs. The higher level of expenditure in the past had contributed to the overall growth in demand for prepared pet food from which not only Pedigree Petfoods itself, but also other suppliers had benefited. The expansion of the industry and of Pedigree Petfoods had in turn made possible the investment in research, development and facilities which had brought down costs and prices in real terms to the benefit of the pet owner. The level of advertising and promotional expenditure incurred by Pedigree Petfoods had in no way inhibited price competition and had been reasonably related to the development of the industry and to the potential growth in demand for its own products.

178. Pedigree Petfoods contended that its advertising and promotional expenditure was not intended to, nor did it in fact, impede competition in the pet food industry. It had not prevented the smaller suppliers from increasing their aggregate share of the market (paragraph 166). Many brands were marketed substantially without advertising support by Pedigree Petfoods (Chappie, Bounce for Dogs and Katkins) and by other suppliers, as were the house brands sold by many of the large retailers. Pedigree Petfoods estimated that nearly 50 per cent by volume of canned pet food was accounted for by sales of unadvertised brands. In recent years much of Pedigree Petfoods' advertising and promotional activity had been directed to the new semi-moist and complete dry foods, and the expenditure incurred in communicating to pet owners the value of these new product types had benefited not only Pedigree Petfoods but also its smaller competitors.

New brands and flavours

179. Pedigree Petfoods said that it had introduced only three new brands of dog food and three new brands of cat food in the last seven years:

Dog food

Loyal	Complete dry ¹
Bounce Minced Dinner	Semi-moist
Bounce Wheatmeal	Dog biscuits ²

Cat food

Munchies	Complete dry
Cupboard Love	Semi-moist
Whiskas Neptune Superfish	Canned

Pedigree Petfoods maintained that there were good objective reasons for the introduction of each of these new products. The complete dry and semi-moist products needed to be backed in the early years by adequate advertising, but such advertising by Pedigree Petfoods had benefited other suppliers as well as itself by stimulating demand for these new forms of prepared pet food. Pedigree Petfoods intended to reduce advertising costs on these new products as soon as they became established. The purpose and effect of introducing the complete dry and semi-moist products had been to reduce production costs to the benefit of pet owners by using cheaper plant-based proteins and cheaper packaging materials

¹ Subsequently withdrawn.

² Subsequently withdrawn from retail distribution, but still supplied in 56 lb bags to breeders and veterinarians.

and processes (see paragraph 164). The only new brand of canned pet food (Whiskas Neptune Superfish) had been introduced to take advantage of a change in the availability of raw materials which had made it possible to supply a premium quality cat food which was significantly different from other products then supplied by Pedigree Petfoods and its competitors.

180. The reason why many of the brands supplied by Pedigree Petfoods were supplied in two or more varieties and flavours (see Appendix 2) was that market research had shown that pets and their owners wanted them. There was a substantial demand for each of the varieties sold by Pedigree Petfoods, none of which had a net sales value of less than £½ million in 1975. The differences between varieties were genuine differences which could be objectively tested and were perceived by the animal. Pedigree Petfoods did not accept that the complaints by some distributors (see Appendix 1, paragraph 2) were justified. They appeared to be based on a feeling that it would be less trouble if the manufacturers would produce, and the public would buy, fewer products. Distributors did not stock products because the manufacturers produced them, but because the public bought them. No distributor was compelled to stock a wider range of products than he thought necessary to satisfy the demands of his customers and to give him an adequate return. In Pedigree Petfoods' experience a distributor would not allocate shelf space to a product unless it was purchased in sufficient quantities to earn its keep. The only pressure on the distributor was the success of the products.

181. As to the effect on production and distribution costs of the number of brands and varieties, Pedigree Petfoods explained that the brand, variety or size being manufactured on each line was changed, on average, every two shifts. The change did not result in any loss of capacity since it was carried out during meal breaks. The total cost of all product change-overs, made up of the extra labour cost and the loss of raw material resulting from the cleaning of the system, amounted to no more than one quarter of one per cent of the direct manufacturing cost. If the number of change-overs were reduced by, say, 25 per cent the total cost saving would be about 0.05 per cent of direct manufacturing cost. The effect on distribution costs of a reduction in the number of brands and varieties handled was more difficult to calculate, but Pedigree Petfoods estimated that the maximum saving resulting from a 25 per cent reduction would be of a similar order of magnitude to the saving of production costs.

182. As regards the comment by the Consumers' Association (Appendix 1, paragraph 11), Pedigree Petfoods said that the formulation of its brands differed substantially one from another; there was no question of a 'basic recipe' for two or more brands. It had been the practice of Pedigree Petfoods for a number of years to print on the labels of its products the ingredients in descending order by weight. It had been the first British pet food manufacturer to do so, and had since been followed by many other pet food manufacturers in this country. However, the suggestion by the Laboratory Animal Breeders' Association that an analysis of the protein, fat, vitamin and water content should also be printed on the label (Appendix 1, paragraph 10) would not be helpful, and could even be misleading, to the average pet owner. The Association was not representative of the ordinary cat or dog owner, but Pedigree Petfoods would willingly supply detailed product analyses and descriptions of product testing trials to anyone, including members of the Association. An invitation to write for such information was printed on every Pedigree Petfoods label.

Efficiency

183. Pedigree Petfoods contended that its efficiency set a standard for others to follow by reason of:

- (a) Its development and application of detailed planning and control systems by which it constantly measured and monitored performance using a wide range of operational controls, many computer-based, to equip management daily with detailed information relating to the operation of all divisions.
- (b) Involvement of employees at all levels in the achievement of the objectives and job satisfaction together with remuneration linked with the level of sales and achievement of a pre-determined standard return on total assets (ROTA).
- (c) The impact of certain commercial practices, namely:
 - (i) The working of assets as intensively as possible which was exemplified by the 24-hour, 7-day week operation of the canning plant at Melton Mowbray.
 - (ii) Maintaining stocks of raw materials and finished goods at the lowest possible levels. Detailed co-ordinated systems had been established which informed management every day of orders, stocks, production and despatches of each brand, enabling the operating divisions to work with a highly flexible production programme, thereby meeting variations in sales demand without requiring high stock levels.
 - (iii) Efficient customer service and account collection combined with the application of a discount of 2 per cent of sales value for settlement within 10 days.
 - (iv) The restriction of investment as far as practicable to essential fixed assets where Pedigree Petfoods' special skills gave it the greatest comparative advantage, leaving service activities such as storage and distribution to specialist sub-contractors using capital provided by them.

184. Pedigree Petfoods carried out an exercise to quantify the effect of the commercial practices outlined at (c). It calculated the effect of these practices on profits, capital employed and return on capital as follows:

<i>Historic cost</i>	1972	1973	1974	1975	<i>Average 1972-75</i>
<i>Actual financial results</i>					
Profit (£'000s)	4,183	4,115	4,187	6,681	
Capital employed (£'000s)	5,634	8,520	14,314	19,029	
Return on capital employed (per cent)	74.2	48.3	29.3	35.1	46.7
<i>Adjusted financial results</i>					
Profit (£'000s)	5,331	5,535	5,795	8,248	
Capital employed (£'000s)	15,667	21,582	30,325	35,965	
Return on capital employed (per cent)	34.0	25.6	19.1	22.9	25.4

185. Pedigree Petfoods drew attention to its efficiency during the past ten years in reducing costs expressed in £'s of constant value by:

- (a) reducing the cost of raw materials through changes in formula while maintaining the quality of the product;
- (b) reducing marketing expenditure per ton;
- (c) increasing labour productivity from 103 tons per employee in 1965-66 to 137 tons in 1975; and
- (d) increasing machine productivity in canning lines from 36 tons a shift in 1965-66 to 75 tons in 1975.

186. In support of its contention that its efficiency set a standard for others to follow, Pedigree Petfoods compared its net output per employee with other industrial categories as follows:

	<i>Net output per employee*</i>					
	1968	1970	1971	1972	1973	1974†
	£	£	£	£	£	£
All manufacturing industry	1,972	2,307	2,535	2,909	3,497	4,218
Biscuit manufacturers	1,580	1,697	1,833	2,086	2,342	2,813
Meat and fish products	1,672	2,012	2,300	2,382	2,935	3,591
Food, drink and tobacco	2,446	2,958	3,252	3,734	4,441	5,100
Pedigree Petfoods	5,948	6,063	7,614	9,751	9,898	11,646

* The figures for the industrial categories are taken from the Census of Production. The figures for Pedigree Petfoods are taken from returns submitted to the Business Statistics Office as part of the Census of Production.

† Except for Pedigree Petfoods the figures for 1974 are provisional.

The above figures expressed in relation to all manufacturing industry are set out below:

	1968	1970	1971	1972	1973	1974
All manufacturing industry	1.00	1.00	1.00	1.00	1.00	1.00
Biscuit manufacturers	0.80	0.74	0.72	0.72	0.67	0.67
Meat and fish products	0.85	0.87	0.91	0.82	0.84	0.85
Food, drink and tobacco	1.24	1.28	1.28	1.28	1.27	1.21
Pedigree Petfoods	3.02	2.63	3.00	3.32	2.99	2.76

Profit

187. Pedigree Petfoods agreed that its return on capital employed was substantially higher, on the face of it, than that of quoted companies in the food industry or indeed British industry generally (Appendix 3). The reason for the disparity was not that Pedigree Petfoods' profits were exceptionally high, but that its capital employed was exceptionally low. This was due to the commercial practices referred to at (c) in paragraph 183 which had the effect of approximately halving the asset base that a concern such as Pedigree Petfoods might normally be expected to have. If allowance was made, as in paragraph 184, for the abnormal depression of the asset base, the disparity between Pedigree Petfoods' return on capital employed and the average return of other manufacturing companies was greatly reduced¹.

¹ Profitability in 1972 and 1974 was affected by the special circumstances described in paragraph 140.

	1972 (per cent)	1973 (per cent)	1974 (per cent)	1975 (per cent)	Average 1972-75 (per cent)
<i>Historic cost basis</i>					
Pedigree Petfoods (unadjusted)	74.2	48.3	29.3	35.1	46.7
Pedigree Petfoods (adjusted)	34.0	25.6	19.1	22.9	25.4
UK manufacturing industry	15.0	17.4	17.0	15.2	16.2
UK food manufacturing industry	16.3	16.8	17.1	18.6	17.2
<i>Current cost basis</i>					
Pedigree Petfoods (unadjusted)	43.1	20.4	11.2	16.5	22.8
Pedigree Petfoods (adjusted)	23.0	13.4	8.7	11.0	14.0
UK manufacturing industry	8.6	7.4	2.0	2.1	5.0
UK food manufacturing industry	10.2	6.3	2.6	3.7	5.7

188. Even the adjusted figures showed that Pedigree Petfoods had done significantly better than the average, a fact which Pedigree Petfoods attributed to its own exceptional efficiency (see paragraphs 185 and 186) and to the unacceptably low average return of United Kingdom manufacturing industry which provided an unsatisfactory standard of comparison. Pedigree Petfoods, as a successful company, should not be compared with the average but with other successful companies in the top quartile (see Appendix 5). That comparison showed that Pedigree Petfoods' average adjusted return on capital employed for the years 1972-74 was 26.2 per cent compared with 28.8 per cent for the top quartile of manufacturing industry as a whole.

189. Pedigree Petfoods criticised the adjusted figures for profits on sales given in paragraph 157. One of the main elements in the adjustment was the reduction in current costs resulting from an assumed change to working 5 days a week instead of 7 days. In practice, however, this would completely alter the pay structure, reducing incentive payments and therefore depressing productivity and profits. It was unrealistic to suppose that the return on sales would be greater if assets were used less intensively. Pedigree Petfoods had suggested an adjustment to allow for the increase in capital employed which would be necessary in the absence of the special practices, eg 7-day working and leasing instead of buying equipment and storage space, and had identified the revenue effects in terms of cost savings and additional costs. But, if the business were in fact operated on that basis, the consequential effects upon the whole organisation and cost structure would be so far-reaching that the results shown by a purely arithmetical calculation of the return on sales were completely misleading. No realistic conclusion could therefore be drawn from the adjusted figures. On the unadjusted basis, Pedigree Petfoods' average return on sales for the years 1971-74 as shown in Appendix 5 was 7.1 per cent compared with 6.7 per cent for all manufacturing companies in the third quartile and 13.7 per cent for those in the top quartile.

190. Pedigree Petfoods argued that its profits should not be condemned unless

it could be demonstrated that they resulted from an unreasonable use of monopoly power. It was therefore necessary to consider:

- (a) whether Pedigree Petfoods enjoyed monopoly power; and
- (b) whether its profits resulted from the use of such power or from some other cause.

191. On (a) in paragraph 190, Pedigree Petfoods denied that it enjoyed monopoly power because:

- (a) Prepared cat and dog foods as defined in the reference represented not quite half of the total market for cat and dog foods (paragraph 14). Pedigree Petfoods had only a third of the market for both fresh and prepared foods, and accounted for little more than a fifth of the total consumption of food by cats and dogs (paragraph 161).
- (b) The existence of monopoly power did not depend on a company's arithmetical market share but on whether it was able to set prices without regard to market forces or to impede competition. The evidence showed that Pedigree Petfoods did not have that ability, and that Pedigree Petfoods, Spillers and the other suppliers of prepared pet foods were all in effective competition with each other, including competition in pricing and in product formulation. Consequently Pedigree Petfoods did not enjoy monopoly power, and its profits could not be the result of an unreasonable, or any, use of such power.

192. On (b) in paragraph 190, Pedigree Petfoods argued that its profits resulted not from the use or abuse of monopoly power but from its exceptional performance and efficiency. They ought not to be compared with the average results of other manufacturing companies, but rather with those of the efficient and successful ones in the top quartile (paragraph 188). By that standard, Pedigree Petfoods' return on sales was not exceptional (paragraph 189) and required no justification. Its return on capital employed was, at first sight, well above the norm even for companies in the top quartile, but it had been explained that this was attributable to the unusually low asset base resulting from the commercial practices described in paragraph 183(c). If the figures were adjusted to allow for these practices, the return on capital employed would be no more than 25.6 per cent in 1973 and 19.1 per cent in 1974 (Appendix 5); this was by no means exceptional for a successful manufacturing business, and was not unreasonably high, particularly if account was taken, as it should be, of the effects of inflation. Indeed the most recent figures showed that in 1974-76 Pedigree Petfoods' average return on capital employed on a current cost basis was 12.8 per cent (unadjusted) or 9.3 per cent (adjusted). So far from being unreasonably high, such a rate of return, if it continued, would seriously jeopardise the future modernisation and development of Pedigree Petfoods' business. If Pedigree Petfoods was to be able to finance the investment required to provide for continuing expansion in the demand for prepared pet foods, the (unadjusted) return on capital employed would need to be restored to between 20 and 25 per cent on current costs.

193. Finally, Pedigree Petfoods represented to us that any conclusion that we might reach about the level of its profits would also have a bearing on the rest of the pet foods industry. If an exceptionally efficient manufacturer were denied the just reward for his efficiency, competitive forces in the rest of the industry would be distorted and the whole industry would suffer.

(2) Spillers

Market share

194. Spillers agreed that it accounted for more than 25 per cent of the supply in the United Kingdom of prepared cat and dog foods as defined in the reference.

Acquisitions

195. Spillers, long established and still pre-eminent as a manufacturer of dog biscuits and meal, first tried in 1958 to enter the trade in meat-based canned pet foods with a product manufactured under contract, but this was not successful. The acquisition of Spratt's Patent Ltd in 1960 provided a foothold in that trade, while the acquisition of Scottish Animal Products Ltd in 1964 gave Spillers the broad base and technology that it required to enable it to compete on a national scale in the supply of canned pet foods. The acquisition of Tyne Brand Products Ltd in 1967 encouraged Spillers to develop an 'own label' business in pet foods.

196. Spillers explained that these acquisitions had been followed by a process of rationalisation. The sales forces of Spillers and Scottish Animal Products had been merged, and biscuit and meal factories in London, Newcastle, Liverpool, Birkenhead and Avonmouth, and a cannery at North Shields, had been closed. Canned pet food production was now concentrated at two major canneries, Barrhead and Wisbech, which together accounted for about 80 per cent of Spillers' total canned production. The balance was located at two smaller canneries at North Shields and Malone (Northern Ireland). Production of dry pet foods was concentrated at three factories, Seacombe (Birkenhead), Aintree and Bermondsey.

197. Spillers said that, by concentrating manufacture in a smaller number of efficient factories, it had been able to lower the unit costs of production. There had also been savings in the sales and marketing fields. The acquisitions, so far from reducing competition in the supply of cat and dog foods, had increased it by substituting one effective competitor for a number of small and ineffective competitors, though the results for Spillers in terms of profits and the return on capital employed could not at present be considered satisfactory.

Prices and discounts

198. Spillers said that there was substantial competition between prepared cat and dog foods and fresh food and scraps, and between different types of prepared cat and dog foods. In any competitive market the market share of one product was affected by the price of that product and the prices of competitive products. Since manufacturers were generally anxious to maintain or increase the market shares of their products, the prices which they charged were necessarily affected by the prices charged for competitive products. In that general sense the prices charged by Spillers for its pet foods were influenced by the prices charged by Pedigree Petfoods, but it was not part of Spillers' policy necessarily to follow price changes introduced by Pedigree Petfoods. Spillers denied that the comparisons set out in Appendix 7 showed any particular pattern in which Spillers followed price changes effected by Pedigree Petfoods. If Spillers' prices were not influenced by those of Pedigree Petfoods the market would be less competitive and, other things being equal, Spillers would probably increase its prices a little sooner to get a more satisfactory return on capital employed, but the extent to which this happened in practice would depend on what other competitors did.

199. The practice of Spillers in granting over-riding discounts originated with

the object of increasing overall sales. Spillers could not afford to withdraw them now because large customers had come to expect them and Spillers would suffer a loss of goodwill and of sales if they were withdrawn. In any case, what mattered was the total package of concessions offered to customers; while Pedigree Petfoods did not grant over-riding discounts, its cash settlement terms were substantially more generous than those granted by Spillers. Spillers doubted whether over-riding discounts had any effect on opportunities for competition from smaller suppliers of pet foods, because large customers tended not to deal with smaller suppliers.

200. Spillers did not accept the statement by a distributor that he was importing an own label dog food from the United States 'far cheaper than a similar item produced in the United Kingdom' (Appendix 1, paragraph 4). He might have imported job lots, but Spillers did not believe that he could be importing on a regular basis. Spillers saw no reason why 'money off packs' should lead to confusion (*ibid*) provided that the retailer's staff and his customers knew the price at which the retailer normally sold the product; the amount of money off was clearly stated on the package. Spillers did not accept the complaint by a wholesaler that pet food manufacturers did not allow the same sterling margin on 'money off packs' (*ibid*). If the promotion was a success, it should increase the wholesaler's turnover and his total profit. The manufacturer, the wholesaler and the retailer all contributed to the reduction in margin from which the customer benefited. Spillers saw no reason why a wholesaler should have a larger percentage margin on a product simply because the price was reduced; he would not be pleased if he obtained a smaller percentage margin if the price were increased. No wholesaler was obliged to stock 'money off' items if he did not wish to do so.

201. Spillers did not accept the complaint by a large retail organisation that the discount terms which it received from pet food suppliers did not fully reflect the cost savings to the suppliers of the large deliveries to its depots (Appendix 1, paragraph 5). The organisation in question could not know what the cost savings were. As to the complaint from two trade associations (Appendix 1, paragraph 9), small pet shops would be allowed the same quantity discounts as supermarkets if they earned them. With regard to the length of notice of price increases given by the manufacturers (Appendix 1, paragraph 8), Spillers said that its own practice was to give the trade not less than a fortnight's notice. This was normal in the grocery trade and, in Spillers' view, quite adequate to enable the trade to make the necessary arrangements.

Restrictive agreements

202. The exchanges of information with Pedigree Petfoods and Quaker referred to in paragraph 105 related solely to the approximate overall amounts of cost increases and the timing of applications to the Price Commission. Information about unit costs was not exchanged. So far as Spillers was concerned, the exchanges did not affect the amounts of the cost increases submitted to the Price Commission or the way in which they were presented. They might have affected the timing of such price increases as were allowed, but not the amounts of the increases that were allowed or that took place.

203. Spillers did not accept that there was an agreement between itself and Pedigree Petfoods in 1970-71 to limit marketing expenditure (see paragraph 63(a)).

Advertising and promotion

204. Spillers said that the level of expenditure incurred in advertising its pet foods was not high in comparison with the levels incurred in advertising many other products. The cost of media advertising of Spillers' proprietary canned pet foods represented some 0.3p per large can. Advertising helped to maintain and increase the size of the market as a whole and, as unit costs were critically dependent upon volume, a substantial reduction of expenditure on advertising and a consequent fall in sales volume would increase unit costs. Hence unit costs and prices would not be less in the absence of advertising. Nor were the levels of advertising expenditure that prevailed in the pet foods market such as to constitute exceptional barriers to new entry or to the expansion of existing smaller producers.

205. Much of Spillers' expenditure on forms of promotion other than advertising led to reductions in retail prices. The effect of the trade bonuses referred to at (c) in paragraph 108 was a more significant price reduction than could otherwise have been achieved if the same amount of money had been used to reduce the official price list. Pricing research had suggested that during such promotions the average retail price paid for Spillers' pet foods was about 1½p per large can below the normal recommended price and that the promotional cost to Spillers was substantially less than 1½p. Spillers said that the statement by the National Federation of Wholesale Grocers and Provision Merchants that pet food manufacturers were less willing than food manufacturers in other areas to undertake promotional activities designed to reduce consumer prices (Appendix 1, paragraph 8) was patently untrue.

206. Advertising expenditure was not an alternative to price competition. The price of a product, whether it bore advertising costs or not, was one of its competitive features. Advertised products competed on price and in other respects with other advertised products and with non-advertised products. Spillers, like its competitors, supplied both advertised and non-advertised products, and the customer was free to choose between them.

New brands and flavours

207. Spillers said that the introduction of new brands and flavours led to an increase in the choice available to the public. If Spillers and its competitors had not introduced new brands and flavours and informed the public of their existence by means of advertising, the product would have remained static. Spillers did not believe in the 'any colour so long as it is black' philosophy, which in any case could only be put into practice by a monopolist. It was the forces of competition in this highly competitive market, coupled with the public's demand for variety, which had led to innovations and to the number of varieties of product available to the public.

208. Spillers agreed that, for a given total volume, an increase in the number of varieties of product entailed some increase in unit costs of production and distribution. However, a supplier's total volume depended upon the variety of products that he offered. Moreover, no retailer was bound to stock all the varieties that any one manufacturer supplied. He would stock such varieties as in his opinion would economically meet public demand.

CHAPTER 7

Conclusions

I The monopoly situation

209. The terms of the reference require us to report whether a monopoly situation exists and, if so, by virtue of which provisions of sections 6–8 of the Fair Trading Act 1973 it is to be taken to exist and in favour of what person or persons it exists.

210. As is stated in paragraph 18, net sales of reference goods by the Pedigree Petfoods Division of Mars Limited constituted about 50 per cent and Spillers' sales about 30 per cent of total sales of reference goods in the United Kingdom from 1972 to 1974. Both companies accept that in 1975, when the reference was made, each of them separately supplied more than one-quarter of the reference goods supplied in the United Kingdom. We conclude, therefore, that monopoly situations exist by virtue of the provisions of section 6(1)(a) of the Act and that they exist in favour of Mars Limited, Food Manufacturing (GB Company) Limited and Mars Incorporated and of Spillers Foods Limited and Spillers Ltd.

II The public interest

211. First, we have considered the effect on the public interest of the monopoly situations existing in favour of Pedigree Petfoods and Spillers under three main headings:

- (a) the effectiveness of competition between reference goods and other forms of cat and dog foods (ie fresh food and scraps);
- (b) the effectiveness of competition between suppliers of reference goods;
- (c) the general level of profits and prices of Pedigree Petfoods and Spillers and their efficiency.

212. Secondly, we have considered the following policies and practices of Pedigree Petfoods and Spillers which might constitute steps taken for the purpose of exploiting or maintaining the monopoly situations:

- (a) the level of advertising by Pedigree Petfoods and Spillers;
- (b) the wide range of flavours and brands produced and sold by Pedigree Petfoods and Spillers;
- (c) the nature and level of discounts given by Pedigree Petfoods and Spillers to the distributors.

Competition from fresh food and scraps

213. The share of the market for cat and dog foods in terms of quantity accounted for by fresh food and scraps decreased markedly between 1960 and 1975 (paragraph 14). The total quantity of fresh food and scraps consumed remained static while consumption in quantity terms of prepared cat and dog foods increased by over 170 per cent. The reasons for the relative decline in consumption of fresh food and scraps are set out in paragraph 17. Pedigree Petfoods said that, although the consumption of fresh food and scraps and

milk by cats and dogs had remained almost static between 1960 and 1975, these sources of nutrition still accounted for over half of total food consumption by cats and dogs. The growth in the proportion of total feeding accounted for by prepared cat and dog foods was, according to Pedigree Petfoods, principally a result of the ability of the prepared pet foods manufacturers to hold down the increase in the prices of their products. Pedigree Petfoods' prices for its cat and dog foods approximately doubled between 1965 and 1975 whereas the prices of pets' fresh meat and fish respectively trebled and nearly quadrupled over this period (paragraph 52). Although in this period the price of fresh meat and fish has risen more than that of prepared pet foods, both Pedigree Petfoods and Spillers considered that competition between prepared and fresh cat and dog foods remained strong, and that the sales of prepared cat and dog food were highly sensitive to movements in the relative prices of prepared and fresh cat and dog foods.

214. We are satisfied that there is continuing competition between fresh and prepared foods for cats and dogs. The effect of this competition upon the price of prepared foods is difficult to isolate, for prepared foods enjoy other advantages. They can be bought in a wider range of shops, they are more easily stored, they need no cooking and they are less disagreeable to handle. Nevertheless, the very considerable use of fresh food, milk and scraps for feeding cats and dogs must impose some limit on the freedom of manufacturers of prepared foods to increase their prices without losing sales.

Competition between suppliers of prepared cat and dog foods

215. Pedigree Petfoods and Spillers supply about 50 per cent and 30 per cent respectively of total prepared cat and dog foods. The next three largest suppliers, Quaker, Carnation and Windsor Foods, together supply a further 13 per cent. The market shares of Pedigree Petfoods and Spillers vary between the different types of prepared cat and dog foods (see paragraph 19). In canned products, which account for about three-quarters of the market, Pedigree Petfoods has 61 per cent and Spillers 25 per cent; in dog biscuits and meal Spillers is the major supplier, while in semi-moist and complete dry foods the respective market leaders are Quaker and Carnation.

216. In view of the evidence that owners generally are not strongly committed to a particular type of prepared cat or dog food (paragraph 20), we considered all types as competing within a single market. Although about 80 per cent of the market for prepared cat and dog foods is held by Pedigree Petfoods and Spillers, most of the distributors who have presented evidence have expressed the view that the market is highly competitive. This competition takes a number of forms. Competition is very active in the development of new forms of prepared cat and dog foods (such as semi-moist and complete dry cat and dog foods), in improvements in formulation and palatability of existing types of product, in the offering of new flavours of existing types of product and in advertising and marketing.

217. Is there also price competition between Pedigree Petfoods and Spillers? We have examined the movements of the prices of the products of the two companies, and particularly the prices of the products included in Appendix 7 (see paragraph 159). Pedigree Petfoods challenged the validity of the comparisons made in this Appendix. It is true that the paired products are based upon different formulations and so are not identical. Each pair, however, consists of one

product of each company, both canned, both intended for the same animal and both, at the beginning of the period taken, offered at the same (or almost the same) price. We therefore consider that these comparisons are to a sufficient degree between like and like, and the relative movement of the prices of these particular products might justify certain general inferences.

218. The figures in Appendix 7 show that over a certain period increases of price were usually initiated by Pedigree Petfoods, with Spillers following fairly closely with increases of the same amount. This period extended generally from 1970 to the first half of 1975, though it started later for some of the products and for others went on a little longer.

219. Several distributors and smaller suppliers told us that they regarded Pedigree Petfoods as a price leader. Pedigree Petfoods recognised (paragraph 168) that, as the leading supplier of pet foods, it has an important influence on prices, and Spillers accepted that its prices are influenced by the prices charged by Pedigree Petfoods although it did not accept that it necessarily follows all Pedigree Petfoods' price changes. Pedigree Petfoods pointed out that its prices must necessarily be affected by prices of competitive products, and maintained that, since it is anxious to expand the market for prepared pet foods, it has exercised a restraining influence on prices.

220. The weighted average price of Pedigree Petfoods' products fell in real terms between 1965 and 1975 (see paragraph 52).

221. In considering the movements of the prices of these products it is necessary to bear in mind the following factors. The products of Pedigree Petfoods and Spillers are in broad terms similar, and important price increases (eg those of ingredients, containers and fuel) are likely to have similar effects upon them both. Since Spillers has a smaller market share, it is naturally reluctant to increase its prices before Pedigree Petfoods, and it is difficult for Spillers to undercut Pedigree Petfoods' prices in view of its present comparatively low return on capital (see paragraph 235). Pedigree Petfoods, like other producers, faces the competition of fresh foods and scraps, and has been anxious to maintain its prices at a level to encourage the sales of prepared pet foods.

222. Weighing up all these considerations, we do not consider that the price movements between 1970 and 1975 justify any inference of uncompetitive behaviour on the part of Pedigree Petfoods or Spillers. Both companies appear to have fixed their prices for the purpose of maintaining, and if possible improving, their position both as against each other and as against suppliers of fresh food. There is no evidence that Pedigree Petfoods has used its influence on its competitors' prices to maintain its pet foods prices above the level that would prevail in the absence of any price leadership. In fact, Spillers said that, in order to achieve a better return on capital, it would raise its prices more if it were not restrained by the level of Pedigree Petfoods' prices.

223. An assessment of the competitive position in the market for reference goods must also take account of any advantages enjoyed by Pedigree Petfoods and Spillers over existing smaller competitors and new entrants. We examine these questions in the following paragraphs.

224. Entry into the industry does not require exceptional capital resources as the minimum size of plant necessary to operate on the same level of efficiency as existing producers is comparatively small. It was suggested to us that such a

plant could be set up at a cost between £100,000 and £300,000 according to the type of product and whether the land and buildings were leased or bought. Hence, even if working capital is included, the costs of entry for new producers are not very high. In general, expansion of capacity in pet food production involves replication of production lines and so offers only limited opportunities for economies. In distribution, on the other hand, cost economies arising from a greater volume of sales are more important, particularly where the greater volume of sales allows larger average delivery quantities.

225. The number of different products that a retailer can sell is limited by the amount of shelf space at his disposal, and there are certain extra costs in having additional suppliers. As a result, several retailers and smaller suppliers have told us that there is a reluctance to accept new reference products unless they possess some clear advantages over the products of established suppliers or are well supported by advertising.

226. We consider that the difficulties of smaller suppliers seeking to increase their sales, or of entrants to the market, are increased by the cost of national advertising which bears more heavily on them than on a supplier with a large share of the market.

227. Smaller suppliers and new entrants do, therefore, face disadvantages. These disadvantages arise from common features of the grocery trade, but in the market for prepared pet foods they are not insurmountable. Established food manufacturers can form subsidiaries to enter this market. Their resources are adequate for the advertising and promotion necessary to introduce their subsidiaries' pet food products, and for bearing initial losses. They can distribute the pet foods together with their other products. Quaker and Carnation are two companies of this kind which have entered the market for prepared pet foods in recent years.

228. Smaller concerns can maintain themselves in the market, or achieve entry into it, in two ways. First, they can limit their sales to a particular locality. This minimises costs of distribution, and enables the manufacturers to acquire a local reputation without great expenditure on advertising. Within their chosen localities such manufacturers do succeed in maintaining a share of the market in competition with the large suppliers. Secondly, the small manufacturer can supply his products to multiple retailers for sale under the retailers' 'own brand' labels.

229. It is, therefore, possible to this extent for new suppliers to enter the market for reference goods, and for small suppliers to maintain themselves in that market, in spite of the advantages which Pedigree Petfoods and Spillers enjoy.

Prices, profits and efficiency

230. We have received no general complaints that Pedigree Petfoods' and Spillers' prices are unduly high. Pedigree Petfoods provided evidence showing that the prices of its products to the pet owner had been reduced in real terms and in comparison with the price of fresh food (paragraph 52). This is attributed to its efficiency in production and to its success in substituting low cost for high cost ingredients without loss of palatability or nutritive value of the product.

231. Pedigree Petfoods had an average return on capital employed of 44.0 per cent on historic costs and 20.4 per cent on current costs over the period 1972-76.

Its profits on sales during this period averaged 7.1 per cent on historic costs and 4.3 per cent on current costs. In Appendix 5 we compare Pedigree Petfoods' figures for percentage return on capital and on sales and the ratio of sales to capital employed during the period 1971-74 with corresponding figures for United Kingdom manufacturing industry and for the food industry divided into quartiles. This Appendix is based on historic costs and on pre-tax figures.

232. The following table, which is based on Appendix 5, summarises the results of Pedigree Petfoods, compared with the average results of all manufacturing industry and of the food industry in the United Kingdom, during the period 1971-74. Figures for 1975 have been added for purposes of comparison. Pedigree Petfoods derives great advantage from its use of capital and financial control of a kind exceptional among large companies in this country (see paragraph 183(c)). Pedigree Petfoods, at our request, calculated how its return on capital employed would be reduced if the figure of capital employed were adjusted to allow for these practices. We made corresponding calculations to show how the return on sales would then be increased. Both the unadjusted and the adjusted figures for return on capital employed and for return on sales are given in Appendix 5 and in the following table. However, the adjustments presuppose so great a change of Pedigree Petfoods' methods of doing business that they must be treated with reserve. We prefer to concentrate on the unadjusted figures.

		<i>Return on capital employed (per cent)</i>	<i>Return on sales (per cent)</i>	<i>Sales/capital employed ratio</i>
1971	All manufacturing industry	12.5	6.4	1.6
	Pedigree Petfoods—unadjusted	44.5	7.4	6.0
	Food industry	12.4	5.0	2.1
1972	All manufacturing industry	15.0	8.1	1.5
	Pedigree Petfoods—unadjusted	74.2	8.7	8.6
	adjusted	34.0	11.1	3.1
	Food industry	16.3	5.7	2.0
1973	All manufacturing industry	17.4	8.5	1.7
	Pedigree Petfoods—unadjusted	48.3	6.7	7.2
	adjusted	25.6	9.0	2.8
	Food industry	16.8	5.4	2.5
1974	All manufacturing industry	17.0	7.3	2.0
	Pedigree Petfoods—unadjusted	29.3	5.6	5.3
	adjusted	19.1	7.7	2.5
	Food industry	17.1	5.2	3.0
Average 1971 to 1974				
	All manufacturing industry	15.5	7.6	1.7
	Pedigree Petfoods—unadjusted	49.1	7.1	6.8
	Food industry	15.7	5.3	2.4
Average 1972 to 1974				
	All manufacturing industry	16.5	8.0	1.7
	Pedigree Petfoods—unadjusted	50.6	7.0	7.0
	adjusted	26.2	9.3	2.8
	Food industry	16.7	5.4	2.5
1975	All manufacturing industry	15.2	6.9	2.2
	Pedigree Petfoods—unadjusted	35.1	7.5	4.7
	adjusted	22.9	9.3	2.5
	Food industry	18.6	5.1	3.7

233. Pedigree Petfoods' return on capital employed compares very favourably with the overall averages for manufacturing industry and for the food industry, and even with the averages for the top quartiles of those two sectors. Pedigree Petfoods' return on sales, on the other hand, is below the average for manufacturing industry and not greatly in excess of the average for the food industry. The explanation of this contrast is Pedigree Petfoods' very high ratio of sales to capital employed; and this, we believe, is due to its high level of efficiency in the respects set out in paragraphs 183-186.

234. We conclude that Pedigree Petfoods' high return on capital employed is the result of its high level of efficiency. Bearing in mind that the prices of Pedigree Petfoods' products have been reduced in real terms (paragraph 230) and that Pedigree Petfoods is exposed to competition from fresh foods and from both new suppliers of pet foods and other existing suppliers, we do not consider that Pedigree Petfoods' high profits result from monopolistic exploitation of the market. Consequently, we see nothing in Pedigree Petfoods' rate of return on capital employed which is adverse to the public interest.

235. Spillers' average return on capital employed for the four years ended 31 January 1976 was 19.2 per cent and its average return on sales was 6.4 per cent on an historic cost basis. Current cost figures are available only for the single year ended 31 January 1976 when Spillers' return on capital employed was 2.7 per cent and its return on sales 1.2 per cent compared with 18.3 per cent and 5.2 per cent respectively on historic cost. In Appendix 5, Spillers' return on capital employed and on sales and the ratio of sales to capital employed on historic cost during the period 1971-74 are compared with corresponding figures for the United Kingdom food industry and United Kingdom manufacturing industry as a whole and as divided into quartiles. Spillers' rate of return on capital employed and profit on sales are moderate, and we see nothing in them adverse to the public interest.

236. We now consider whether the particular policies and practices set out in paragraph 212 are likely to affect the public interest.

(a) *Advertising*

237. The tables below show respectively the percentages of the net value of Pedigree Petfoods' and Spillers' sales of reference goods represented by advertising (which is almost entirely on television) and the percentages spent on promotions:

Advertising as a percentage of sales value		
	<i>Pedigree Petfoods</i> (1)	<i>Spillers</i> (2)
1971	5.5	3.3
1972	5.0	4.6
1973	3.5	3.1
1974	2.4	2.6
1975	2.9	2.2
1976	3.0	N/A

Notes: (1) For Pedigree Petfoods the figures relate to the 12 months ended 31 July 1971 and thereafter to calendar years.

(2) For Spillers the figures relate to the 12 months ended 31 January of the following year.

Appendix 8 compares figures of advertising expenditure on certain branded consumer goods including prepared cat and dog foods.

Promotion as a percentage of sales value

	<i>Pedigree Petfoods (1)</i>	<i>Spillers (2)</i>
1971	3.9	5.0
1972	4.0	5.6
1973	2.2	4.6
1974	1.9	3.5
1975	3.6	4.2
1976	3.5	N/A

Notes: (1) For Pedigree Petfoods the figures relate to the 12 months ended 31 July 1971 and thereafter to calendar years.

(2) For Spillers the figures relate to the 12 months ended 31 January of the following year.

Pedigree Petfoods' sales promotions consist largely of temporary price reductions for particular products or retailers and, to a less extent, of free samples, gift coupons etc (paragraphs 65 and 67). The forms of promotion used by Spillers are 'money off' packs and special trade bonuses to retailers to assist them in the launching of new products and to enable them to feature particular brands at specially reduced prices (paragraph 108).

238. The figures in Appendix 8 suggest that the advertising expenditure of Pedigree Petfoods and Spillers is by no means unusually high. Such advertising must nevertheless represent some obstacle to suppliers wishing to enter the market or to enlarge their share of it, but suppliers other than Pedigree Petfoods and Spillers have in fact increased their aggregate share from 17.1 per cent in 1972 to 21.5 per cent in 1974 (paragraph 18).

239. Pedigree Petfoods' and Spillers' advertising is concentrated largely on their higher priced brands (paragraphs 66 and 110). The cheaper brands supplied by Pedigree Petfoods and Spillers are for the most part not advertised; nor are the products supplied by many of the smaller producers and those supplied under retailers' own brands. The purchaser can choose between advertised and unadvertised brands of cat and dog foods.

240. The present scale of advertising by Pedigree Petfoods and Spillers does not appear to us unreasonable, and we consider that it does not operate and may not be expected to operate against the public interest.

(b) Range of flavours and brands

241. The frequent introduction of different flavours within each brand and of new brands could operate against the interest of consumers if the demand were artificially created by advertising and if the range of flavours and brands significantly raised costs of manufacture and distribution. Pedigree Petfoods, however, stated that costs of changing machinery from the production of one flavour or brand to another were not significant (paragraph 181). Some retailers complained that the number of flavours and brands complicated their task, but they did not produce any figures sufficient to show that the costs of distribution

were significantly raised thereby. Spillers, while admitting that there was some increase in production costs, argued that a variety of products was likely to increase total sales and so to reduce unit costs (paragraph 208). Pedigree Petfoods and Spillers both argued that the variety of flavours and brands offered is in response to consumer demand (paragraphs 180 and 207), and we see no grounds for not accepting this contention. We conclude, therefore, that the range of flavours and brands offered does not operate and may not be expected to operate against the public interest.

(c) *Discounts*

242. Pedigree Petfoods gives discount according to the number of cases of its products (whether reference or non-reference products) included in an order. On orders of less than 40 cases no discount is allowed, while the maximum discount of 6.8 per cent is allowed on orders of 600 cases or more (paragraph 54). Spillers also gives discount according to the number of cases of its products (whether reference or non-reference products) included in an order. On orders of less than 26 cases no discount is allowed. The maximum discount, which on pet foods varies from 11.2 per cent to 13.5 per cent according to product, is allowed on orders of 500 cases or more (paragraph 98). Pedigree Petfoods' discounts appear to us to be as closely related as is practicable to savings in delivery costs; Spillers' discounts may somewhat exceed these savings.

243. In addition, Spillers allows large customers over-riding discounts based on their total turnover of all products of the Spillers Foods Group sold by Spillers Foods and Spratts respectively. These discounts are open to the objection that they are not directly related to savings in distribution costs and that they give Spillers an advantage over suppliers whose production is confined to prepared cat and dog foods. Spillers replied that large customers now expected them and that Spillers would suffer a loss of sales if it abandoned them (paragraph 199). The over-riding discounts granted by Spillers must secure to Spillers a larger market share than it would otherwise possess. However, we recognise that the granting of such discounts by Spillers is partly a reflection of the bargaining power of major customers, and we note that these discounts, which average 0.7 per cent of Spillers' gross sales, have not been sufficiently advantageous to Spillers to prevent the loss of market share to other suppliers of prepared pet foods. In the circumstances, we consider that these over-riding discounts do not operate and may not be expected to operate against the public interest.

III Conclusions

244. We conclude that:

- (a) monopoly situations exist in the supply in the United Kingdom of prepared cat and dog foods as defined in the reference by virtue of section 6(1)(a) of the Fair Trading Act 1973 because Mars Limited and Spillers Foods Limited each supplies at least one-quarter of the reference goods supplied in the United Kingdom;
- (b) the monopoly situations exist in favour of Mars Limited, Food Manufacturing (GB Company) Limited and Mars Incorporated and of Spillers Foods Limited and Spillers Limited;

(c) none of the facts found by us in pursuance of our investigations operate or may be expected to operate against the public interest.

J G LE QUESNE (*Chairman*)

ROGER FALK

T P LYONS

C T H PLANT

H STREET

Y LOVAT WILLIAMS (*Secretary*)

29 March 1977

APPENDIX 1

(first referred to in paragraph 3)

Views of distributors, trade associations and other organisations

1. We invited evidence from a considerable number of distributors of cat and dog foods, from trade associations representing the interests of distributors and users and from other organisations concerned with animal welfare and breeding. In addition to the written evidence received, oral hearings were held with some of these witnesses, while a number of others were interviewed by the Commission's staff. The views expressed are summarised below.

Distributors

2. Several distributors complained about the number of different varieties and flavours in which some of the products were produced. One said that 'the number of varieties current, and being continuously introduced, causes considerable problems, both in capital tied up in stock and display opportunities'. Another distributor pointed out that 'some products have three, four, even five flavours, and we consider that this multiplicity of flavours makes the selling operation unwieldy and increases costs'. This distributor considered that the main reason why manufacturers brought out multiple varieties of their products was their desire to increase the amount of shelf space devoted to their brands rather than the demands of customers for greater variety. A third distributor considered that the numerous 'new' lines, frequently re-vamps of old ones or different flavours or variations of existing products, led to serious shelf space problems, while a fourth stated similarly that it would be easier for his trading operations if there were fewer brands and varieties on the market.

3. Not all distributors shared this view. One said that all the major suppliers were 'committed to a programme of perpetual research of the brands within the context of the market climate, and therefore there is a constant replacement of popular brands taking place as new brands are introduced'. This 'keeps the market generally in a healthy state'.

4. Some distributors complained, however, about the pricing of cat and dog foods. One commented that prices were 'far too high', and claimed that he was importing an own label dog food from the United States 'far cheaper than a similar item produced in the United Kingdom'. Another said that the major suppliers had too many 'money off packs' which could lead to confusion at store level for both staff and customers. A wholesaler complained that pet food manufacturers, unlike the suppliers of some grocery products, maintained only percentage gross profits on 'money off' stock and did not allow wholesalers to retain the same sterling margin on reduced selling prices. While this practice assisted the sales of suppliers, it did not help wholesalers to maintain profitability.

5. A few distributors complained about quantity discounts. A wholesaler said that, following the three-day week when there was a temporary product shortage, Pedigree Petfoods was unable to supply maximum case quantities but the higher price structure relating to smaller quantities was enforced. A large retail organisation complained that the discount terms which it received from pet food suppliers

did not fully reflect the cost savings to the suppliers of the large deliveries to its depots. Pedigree Petfoods' highest discount was for deliveries of 600 or more cases; since 600 cases represented between 30 and 62 per cent of a truck load, a higher discount should be offered for a full load.

6. Other distributors were less critical of the suppliers. A multiple retailer said that the prices charged by the two main groups compared favourably, quality for quality, with those of smaller suppliers. He had never felt the market to be unduly restricted because of the weight of Pedigree Petfoods and Spillers. His biggest individual line was a cat food from a minor supplier, and this seemed to him to confirm that the two market leaders held their share on merit. A retail multiple said that its requirements of cat and dog foods were met in a generally efficient manner by its suppliers. The market was highly competitive and competition between brands was strong to secure good display representation on pet food shelf space.

7. The Parliamentary Committee of the Co-operative Union also considered that the market was highly competitive with a range of well-known brands which were acceptable to the consumer. Most of the major brands were heavily price promoted and a good percentage of the product was purchased at promotional prices. The consumer appeared to be quality conscious and high standards of quality were observed within the industry. The semi-moist foods which had been introduced in recent years had achieved a reasonable level of success, but did not as yet appear to have reduced the demand for canned foods. Despite the rapidly escalating prices of all foodstuffs in the last two or three years, there did not so far appear to be any substantial fall in demand for pet foods.

Trade associations

8. The National Federation of Wholesale Grocers and Provision Merchants felt that the complexity of the market had been aggravated by the dominant position of Pedigree Petfoods and Spillers. Smaller suppliers trying to break into the market had been compelled to specialise in new products because of the strength of the traditional sectors which were dominated by the two market leaders. This had led to the continual introduction of new brands coupled with heavy advertising support. The Federation also complained about the 'take it or leave it' attitude of cat and dog food manufacturers in dealings with the distributive trade, naming Pedigree Petfoods in particular. They gave the following examples:

- (a) If the manufacturers were out of stock of lines ordered by the Federation's members, resulting in the order falling into a lower case range carrying a smaller discount, the manufacturers insisted on the lower discount even though the fault was theirs.
- (b) The manufacturers had not shown themselves to be willing even to discuss trade recommendations on types of packs. The Federation complained in particular about the refusal of Pedigree Petfoods to make the 24-tin case size generally available.
- (c) Compared with food manufacturers in other areas, cat and dog food manufacturers were very resistant to promotional activities designed to reduce consumer prices.

(d) The manufacturers, especially Pedigree Petfoods, did not give enough notice of price increases.

9. The National Food and Drink Federation complained about the arbitrary way in which Pedigree Petfoods could alter its price list without any concern for independent retailers. They said that on two recent occasions the price list had been adjusted to the detriment of small retailers by imposing proportionately larger increases on the purchase of small quantities. They felt that if a price increase was warranted it should be applied at the same rate throughout the price structure. The National Association of Pet Trade Wholesalers and the National Boarding Kennels Federation expressed concern about the beneficial quantity discounts allowed to supermarkets which were not given to small pet shops so that the latter were at a competitive disadvantage.

10. The Laboratory Animal Breeders' Association of Great Britain claimed that the omission of printed nutritional values (eg protein, fat, vitamin and water content) on labels could contribute to the monopoly situation in the supply of cat and dog foods. These foods were offered as a complete diet for breeding and maintenance, and publication of nutritional values would indicate that as a sole source of diet they were not adequate for breeding.

Other organisations

11. The Consumers' Association suggested that the Commission should question how much reality there was in the apparent wealth of choice of cat and dog foods on the market, whether the various flavours were produced from a basic recipe with artificial or natural flavours added and, if so, whether such flavour distinctions had any value for the animal or whether they were marketing distinctions aimed at the pet's owner, and whether this increased or decreased the total costs of the trade. The Association did not express an opinion on those matters themselves.

12. Organisations concerned with animal welfare generally expressed warm appreciation of the assistance afforded to them by the leading pet food manufacturers and their scrupulous concern for quality and for educating pet owners. The Royal Society for the Prevention of Cruelty to Animals said that in their experience the larger manufacturers were only too anxious to formulate their foods to maximise the health of the animals that eat them, and to this end they employed experts such as veterinary surgeons, nutritionists, behaviourists and researchers. They provided valuable educational material for pet owners and they were generous with their funds in supporting animal welfare projects and scientific symposia for learned societies. The Guide Dogs for the Blind Association said that they found a good selection of foods available for dogs, and that they received much help and co-operation from the present suppliers. In addition, the useful information distributed by Pedigree Petfoods in the form of lectures, pamphlets and other publications was a great asset to the dog world. The British Small Animal Veterinary Association requested the Commission 'to take into consideration when assessing their findings the support given by the manufacturers of cat and dog food and especially those who subscribe to the Pet Food Manufacturers' Association to research in diseases of cats and dogs and to the further education of veterinary surgeons and the general public by their sponsorship of meetings on a local or national level, and the issue of

educational leaflets and films on the responsibilities of pet ownership including their day-to-day management, first aid and the simple ailments of small animals in general'. The Association considered that the research promoted by the industry, and notably the Pet Food Manufacturers' Association, was in the public interest and was fulfilling a need which had been neglected by the Government.

13. Similar views were expressed by the British Veterinary Association and by the National Dog Owners' Association.

APPENDIX 2

(first referred to in paragraph 60)

Brands and flavours supplied by Pedigree Petfoods and Spillers

Pedigree Petfoods

<i>Brand</i>	<i>Flavour</i>
<i>Dog food</i>	
Chappie	—
Lassie	Liver Rabbit and chicken Oxtail With beef
Bounce	—
Pal	With beef Liver Rabbit
Chum	Original Liver/heart Chicken Lamb
Bounce Minced Dinner	— With cheese
Loyal	—
Mick	—
<i>Cat food</i>	
Kitekat	Fish and liver Meat and liver
Katkins	—
Whiskas Supermeat	With liver With beef With rabbit With heart
Whiskas Neptune Superfish	With pilchard With salmon
Bounce	—
Cupboard Love	Meat and liver Tasty fish
Munchies	Pilchard Beef and liver Chicken and rabbit

Spillers

<i>Brand</i>	<i>Flavour</i>
<i>Dog food</i>	
Kennomeat	Meat and liver Beef Rabbit
Jock	—
Top Dog	—
Bonus	—
Choice Cuts	Original Liver and kidney
Champ	—
Balance	—
Moist and Meaty	Beef Liver
Winalot	—
Puppy food	—
Saval	—
Bonus	—
Shapes	—
Mixed Ovals	—
Bonio	— Cheese Beef
<i>Cat food</i>	
Kattomeat	Meat Rabbit Heart
Topcat	Fish and meat With salmon With rabbit
Choosy	Original Herring Cod
Bonus	—

APPENDIX 3

(first referred to in paragraph 138)

Return on sales and capital employed

	1972	1973	1974	1975	Simple average 1972-75
Profit (a) as a percentage of:					
<i>Sales</i>					
<i>Historic cost basis</i>					
Pedigree Petfoods (b)	8.7	6.7	5.6	7.5	7.1
Spillers (c) (d)	8.9	5.8	5.6	5.2	6.4
All manufacturing industry (e)	8.1	8.5	7.3	6.9 (f)	7.7
Food industry (g)	5.7	5.4	5.2	5.1 (f)	5.4
<i>Current cost basis (h)</i>					
Pedigree Petfoods	7.0	3.8	2.7	4.7	4.5
Spillers (c)	N/A	N/A	N/A	1.2	N/A
All manufacturing industry	5.4	4.3	1.1	1.3 (f)	3.0
Food industry	4.3	2.5	1.0	1.3 (f)	2.3
<i>Capital employed</i>					
<i>Historic cost basis (i)</i>					
Pedigree Petfoods	74.2	48.3	29.3	35.1	46.7
Spillers (c)	25.1	16.8	16.8	18.3	19.2
All manufacturing industry	15.0	17.4	17.0	15.2 (f)	16.2
Food industry	16.3	16.8	17.1	18.6 (f)	17.2
<i>Current cost basis (h)</i>					
Pedigree Petfoods	43.1	20.4	11.2	16.5	22.8
Spillers (c)	N/A	N/A	N/A	2.7	N/A
All manufacturing industry	8.6	7.4	2.0	2.1 (f)	5.0
Food industry	10.2	6.3	2.6	3.7 (f)	5.7

Notes: (a) Profit is before charging interest and corporate taxation.

(b) See Appendix 4, notes (a) and (b).

(c) Spillers' figures relate to the financial years ended 31 January 1973 to 1976.

(d) See Appendix 6, note (a).

(e) These rates are derived from information contained in Business Monitor, and are based on the accounts of quoted companies engaged mainly in the United Kingdom in manufacturing activities with net assets of £2 million or more or gross income of £0.2 million or more.

(f) The Commission's report on *Diazo Copying Materials* (HC165), HMSO gave provisional rates of return on capital employed for quoted companies in United Kingdom manufacturing industry for 1975 on historic cost and current cost accounting bases. Since the completion of the Diazo Copying Materials inquiry, information has become available from further companies. As a

result, the rates for 1975 stated above are based on information relating to about four-fifths of the total number of companies qualifying for inclusion (see note (e)).

- (g) These rates relate to companies in United Kingdom manufacturing industry (see note e) whose main activity is the manufacture of food.
- (h) Profit and capital employed on a current cost basis have been calculated in accordance with the recommendations contained in *Inflation Accounting: Report of the Inflation Accounting Committee* (Cmnd. 6225), HMSO.
- (i) Capital employed on an historic cost basis comprises tangible fixed assets at original cost less accumulated depreciation and net current assets before deducting bank overdrafts and loans, future tax and proposed dividends.

APPENDIX 4

(referred to in paragraph 140)

Pedigree Petfoods: sales, costs, profit and return on capital employed (a)

	Twelve months to 31 July				Twelve months to 31 December			
	1966	1970	1971	1972	1973	1974	1975	1976
Net sales (b) (£'000s)	27,600	33,371	36,502	48,196	61,205	75,331	88,997	108,994
Costs (per cent)								
Raw materials	40.1	40.4	37.3	37.4	43.1	44.8	37.1	36.6
Cans and packing	21.8	21.8	22.6	22.1	20.6	21.8	24.2	25.5
Delivery	3.5	3.7	3.9	3.7	3.5	3.6	3.3	3.5
Employees' remuneration	11.7	12.9	13.2	12.7	12.4	12.3	14.4	14.7
Advertising and promotion	9.4	6.4	6.4	6.3	4.5	3.1	3.6	3.5
Other	7.0	8.0	9.2	9.1	9.2	8.8	9.9	9.0
Profit (per cent) (c)								
historic cost basis	6.5	6.8	7.4	8.7	6.7	5.6	7.5	7.2
current cost basis	5.5	5.9	6.1	7.0	3.8	2.7	4.7	3.4
Return on capital employed (per cent) (d)								
historic cost basis	29.9	41.6	44.5	74.2	48.3	29.3	35.1	33.3
current cost basis	22.2	29.7	29.0	43.1	20.4	11.2	16.5	10.6

Notes: (a) Including non-reference trading such as sales of bird seed etc and exports which have only a marginal effect on the trading of the company.

(b) Net sales are after deduction of all discounts and allowances and special price reductions.

(c) See Appendix 3, note (a).

(d) See Appendix 3, notes (h) and (i).

APPENDIX 5

(first referred to in paragraph 141)

**Return on sales and capital employed on historic cost basis
analysed by quartiles**

A. Return on capital employed by quartiles (historic cost basis)

		Average—per cent				Total
		Quartiles				
		1	2	3	4	
1971	All manufacturing industry (834 companies)	26.9	19.3	12.3	6.7	12.5
	Pedigree Petfoods <i>unadjusted</i>	44.5				
	Food industry (38 companies)	21.0	15.4	13.3	8.3	12.4
1972	All manufacturing industry (786 companies)	28.9	19.3	13.8	8.6	15.0
	Pedigree Petfoods <i>unadjusted</i>	74.2				
	<i>adjusted</i>	34.0				
	Spillers	25.1				
	Food industry (34 companies)	21.2	19.8	15.4	9.0	16.3
1973	All manufacturing industry (762 companies)	29.9	21.6	17.1	9.8	17.4
	Pedigree Petfoods <i>unadjusted</i>	48.3				
	<i>adjusted</i>	25.6				
	Spillers			16.8		
	Food industry (33 companies)	26.1	19.3	14.1	5.5	16.8
1974	All manufacturing industry (780 companies)	27.6	20.3	15.5	8.5	17.0
	Pedigree Petfoods <i>unadjusted</i>	29.3				
	<i>adjusted</i>		19.1			
	Spillers			16.8		
	Food industry (32 companies)	23.8	18.9	12.5	4.2	17.1
Average	All manufacturing industry	28.3	20.1	14.7	8.4	15.5
1971	Pedigree Petfoods <i>unadjusted</i>	49.1				
to						
1974	Food industry	23.0	18.4	13.8	6.8	15.7
Average	All manufacturing industry	28.8	20.4	15.5	9.0	16.5
1972	Pedigree Petfoods <i>unadjusted</i>	50.6				
to						
1974	<i>adjusted</i>	26.2				
	Spillers		19.6			
	Food industry	23.7	19.3	14.0	6.2	16.7

B. Return on sales by quartiles (historic cost basis)

		Average—per cent				Total
		Quartiles				
		1	2	3	4	
1971	All manufacturing industry (834 companies)	12.8	8.5	5.6	2.1	6.4
	Pedigree Petfoods <i>unadjusted</i>			7.4		
	Food industry (38 companies)	7.7	5.3	4.2	1.2	5.0
1972	All manufacturing industry (786 companies)	14.5	9.1	6.3	3.3	8.1
	Pedigree Petfoods <i>unadjusted</i>			8.7		
	<i>adjusted</i>		11.1			
	Spillers			8.9		
	Food industry (34 companies)	7.9	6.6	5.1	3.3	5.7
1973	All manufacturing industry (762 companies)	14.4	10.5	8.1	4.1	8.5
	Pedigree Petfoods <i>unadjusted</i>				6.7	
	<i>adjusted</i>			9.0		
	Spillers				5.8	
	Food industry (33 companies)	8.9	5.9	3.7	0.3	5.4
1974	All manufacturing industry (780 companies)	13.2	9.0	6.9	3.2	7.3
	Pedigree Petfoods <i>unadjusted</i>			5.6		
	<i>adjusted</i>			7.7		
	Spillers			5.6		
	Food industry (32 companies)	8.1	5.7	2.9	1.0	5.2
Average 1971 to 1974	All manufacturing industry	13.7	9.3	6.7	3.2	7.6
	Pedigree Petfoods <i>unadjusted</i>			7.1		
	Food industry	8.2	5.9	4.0	1.5	5.3
Average 1972 to 1974	All manufacturing industry	14.0	9.5	7.1	3.5	8.0
	Pedigree Petfoods <i>unadjusted</i>			7.0		
	<i>adjusted</i>		9.3			
	Spillers			6.8		
	Food industry	8.3	6.1	3.9	1.5	5.4

C. Ratio of sales to capital employed (historic cost basis)

(Based on the data attributable to each of the quartiles in section A)

		Average				Total
		Quartiles				
		1	2	3	4	
1971	All manufacturing industry (834 companies)	2.0	2.0	1.6	1.3	1.6
	Pedigree Petfoods <i>unadjusted</i>	6.0				
	Food industry (38 companies)	3.6	2.4	1.8	1.7	2.1
1972	All manufacturing industry (786 companies)	2.0	1.7	1.6	1.1	1.5
	Pedigree Petfoods <i>unadjusted</i>	8.6				
		<i>adjusted</i>				
	Spillers	2.8				
	Food industry (34 companies)	3.2	1.8	2.3	1.6	2.0
1973	All manufacturing industry (762 companies)	2.3	1.8	1.6	1.5	1.7
	Pedigree Petfoods <i>unadjusted</i>	7.2				
		<i>adjusted</i>				
	Spillers	2.9				
	Food industry (33 companies)	3.0	3.5	1.8	2.3	2.5
1974	All manufacturing industry (780 companies)	2.4	1.8	2.0	2.0	2.0
	Pedigree Petfoods <i>unadjusted</i>	5.3				
		<i>adjusted</i>				
	Spillers	3.0				
	Food industry (32 companies)	3.2	3.5	2.9	1.5	3.0
Average 1971 to 1974	All manufacturing industry	2.2	1.8	1.7	1.5	1.7
	Pedigree Petfoods <i>unadjusted</i>	6.8				
	Food industry	3.3	2.8	2.2	1.8	2.4
Average 1972 to 1974	All manufacturing industry	2.2	1.8	1.7	1.5	1.7
	Pedigree Petfoods <i>unadjusted</i>	7.0				
		<i>adjusted</i>				
	Spillers	2.9				
	Food industry	3.1	2.9	2.3	1.8	2.5

Notes: (a) The rates shown for all manufacturing industry (including food) and for the food industry are derived from lists prepared by the Central Statistical Office in connection with information published in Business Monitor and are based on the accounts of quoted companies engaged mainly in United Kingdom manufacturing activities with net assets of £2 million or more or gross income of £0.2 million or more. There are insufficient data currently available for the calculation of quartile rates in respect of 1975.

(b) Pedigree Petfoods' rates of return and ratios for 1971 relate to its accounting year to 31 July 1971. Since 1972 its accounting year has coincided with the calendar year.

(c) Spillers' figures relate only to its pet food activities for the accounting years ended 31 January 1972 to 1976.

(d) See Appendix 3, notes (a) and (i).

APPENDIX 6

(referred to in paragraph 144)

Spillers: sales, costs, profit and return on capital employed

	<i>Twelve months to 31 January</i>			
	<i>1973</i>	<i>1974</i>	<i>1975</i>	<i>1976</i>
Net sales (£'000s) (a)	26,973	32,792	41,226	47,315
Costs (per cent)				
Raw materials	32.3	38.9	35.9	30.9
Cans and packing	18.2	17.8	21.2	22.3
Delivery	7.6	7.3	7.2	7.2
Employees' remuneration	12.1	12.0	12.5	14.3
Advertising and promotion	10.2	7.7	6.1	6.4
Other	10.7	10.5	11.5	13.7
Profit (per cent) (b)				
<i>historic cost basis</i>	8.9	5.8	5.6	5.2
<i>current cost basis</i>	N/A	N/A	N/A	1.2
Return on capital employed (per cent) (c)				
<i>historic cost basis</i>	25.1	16.8	16.8	18.3
<i>current cost basis</i>	N/A	N/A	N/A	2.7

Notes: (a) Net sales, which relate only to reference products, are after deduction of all discounts and allowances but before deduction of special price reductions which are included under promotion costs.

(b) See Appendix 3, note (a).

(c) See Appendix 3, notes (h) and (i).

APPENDIX 7

(first referred to in paragraph 159)

**Price changes for selected brands of cat and dog foods supplied
by Pedigree Petfoods and Spillers**

<i>Date</i>	<i>Pedigree Petfoods</i>	
	<i>Whiskas (handy)</i>	<i>Kattomeat (handy)</i>
2.3.70	1/6d	1/6d
30.11.70		1/4d
18.1.71	7½p	
16.8.71		6½p
6.12.71		7p
21.8.72		7½p
11.9.72	8p	
1.4.73		8p
12.11.73	8½p	
10.12.73		8½p
11.2.74	9½p	
18.2.74		9½p
3.6.74	10½p	
24.6.74		10p
29.7.74	10p	9½p
7.10.74	10½p	
14.10.74		10½p
6.1.75	11p	
24.2.75		11p
24.4.75	12p	
28.7.75	12½p	
27.10.75		11½p
19.1.76	13p	
8.3.76		12½p
21.6.76	13½p	
26.7.76		13p
6.9.76	14½p	
13.9.76		14p
29.11.76		14½p
	<i>Kitekat (handy)</i>	<i>Choosy (handy)</i>
6.7.70	1/0d	
13.7.70		1/0d
22.11.71	5½p	
6.12.71		5½p
16.7.73	6p	6p
11.3.74		6½p
1.4.74	6½p	
3.6.74	7½p	
24.6.74		7½p
7.10.74	8p	
14.10.74		8p
6.1.75	8½p	
21.3.75		8½p

APPENDIX 7—*contd.*

<i>Date</i>	<i>Pedigree Petfoods</i>	<i>Spillers</i>
	<i>Kitekat (handy)</i>	<i>Choosy (handy)</i>
24.4.75	9p	
28.7.75	9½p	
27.10.75		9p
8.3.76		9½p
24.5.76		10p
21.6.76	10p	
26.7.76		10½p
6.9.76	10½p	
1.11.76	11p	
29.11.76		11½p
	<i>Chum (large)</i>	<i>Kennomeat (large)</i>
2.3.70	2/8d	2/8d
30.11.70		2/6d
18.1.71	13½p	
26.7.71	13p	
16.8.71		12½p
6.12.71		13p
13.3.72		13½p
27.3.72	13½p	
1.4.73	14p	14p
16.7.73	14½p	14½p
12.11.73	15½p	
10.12.73		15½p
11.2.74	16p	
11.3.74		16p
3.6.74	17p	
24.6.74		17p
29.7.74	16½p	16½p
7.10.74	17½p	
14.10.74		17½p
6.1.75	18½p	
24.2.75		18½p
24.4.75	19p	
28.7.75	19½p	
19.1.76	20½p	
24.5.76		19p
21.6.76	21½p	
26.7.76		19½p
4.9.76	22½p	
13.9.76		20½p
29.11.76		22p
	<i>Bounce (large)</i>	<i>Bonus (large)</i>
11.5.70	1/11d	
19.10.70		1/6d
4.1.71		8½p
18.1.71	9½p	
22.3.71		9p
11.9.72	10p	

APPENDIX 7—*contd.*

<i>Date</i>	<i>Pedigree Petfoods Bounce (large)</i>	<i>Spillers Bonus (large)</i>
30.10.72		9½p
16.7.73	11p	11p
12.11.73	11½p	
10.12.73		11½p
11.2.74	12½p	
18.2.74		12p
11.3.74		12½p
3.6.74	13½p	
24.6.74		13½p
29.7.74	13p	13p
7.10.74	13½p	
14.10.74		13½p
6.1.75	14p	
24.2.75		14p
24.4.75	14½p	
2.6.75		14½p
28.7.75	15p	
8.3.76		15p
26.7.76		15½p
6.9.76	16p	
13.9.76		16½p
1.11.76	16½p	
29.11.76		17½p

APPENDIX 8

(referred to in paragraph 237)

Press and television advertising expenditure as a percentage of sales revenue for certain consumer products, 1974 and 1975

	1974			1975		
	Sales (£m)	Advert- ising expend- iture (£m)	Advert- ising sales ratio (%)	Sales (£m)	Advert- ising expend- iture (£m)	Advert- ising sales ratio (%)
Toothpaste and tooth powder	21.5	3.72	17.3	28.8	4.93	17.1
Razor blades and razors	14.4	1.33	9.2	12.6	0.99	7.9
Coffee	81.4	3.21	3.9	96.5	3.45	3.6
Chocolate and chocolate confectionery	318.5	12.24	3.8	365.2	13.30	3.6
Cat and dog foods	132.0	4.99	3.8	156.3	5.43	3.5
Toilet soap	58.3	2.97	5.1	65.0	2.15	3.3
Yoghurt	19.1	0.678	3.5	26.9	0.888	3.3
Margarine	95.5	2.71	2.8	100.1	2.71	2.7
Detergents (soap powders and synthetic detergent powders)	112.1	4.71	4.2	141.3	3.11	2.2
Tea (incl. bags)	135.7	3.39	2.5	162.0	3.73	2.3
Biscuits	279.6	4.47	1.6	330.0	5.76	1.7
Ice cream and water ices	72.3	0.808	1.1	107.0	0.814	0.8
Butter	292.6	.71	0.2	448.0	1.66	0.4
Breakfast cereals	90.0	6.1	6.8	116.6	6.8	5.8

Notes: (a) Estimates of press and television advertising expenditure by product are taken from IPC marketing manuals which are based on data compiled by MEAL. Since these estimates make no allowance for the discounts received by manufacturers on their advertising expenditure, the estimates exceed actual advertising expenditure.

(b) Estimates of the United Kingdom sales value of individual products are at manufacturers' prices and are from the Business Monitor PQ series, adjusted to take account of the imports and exports of these products. In the case of coffee, tea and detergents, imports have not been added to manufacturers' sales since most imports are believed to be by United Kingdom manufacturers.

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