THE MONOPOLIES AND MERGERS COMMISSION

Flour and Bread

A Report on the Supply
in the United Kingdom
of Wheat Flour and of Bread
made from Wheat Flour

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

Ordered by The House of Commons *to be printed*
14th July 1977

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Introduction

1. On 1 October 1973 the Department of Trade and Industry sent to the Commission the following reference:

The Monopolies and Mergers Acts 1948 and 1965

Reference to the Monopolies Commission

Flour and Bread

Whereas it appears to the Secretary of State that it is or may be the fact that conditions to which the Monopolies and Restrictive Practices (Inquiry and Control) Act 1948 (hereinafter called 'the Act of 1948') as amended by the Restrictive Trade Practices Act 1956 and the Monopolies and Mergers Act 1965, applies prevail as respects the supply of each of the two following descriptions of goods, namely:

(i) Wheat flour; and

(ii) Bread made from wheat flour:

Now, therefore, the Secretary of State in exercise of his powers under the Act of 1948, as so amended, hereby refers to the Monopolies Commission for investigation and report the supply within the United Kingdom of each of these descriptions of goods.

The Commission shall as respects the supply of each of these descriptions of goods investigate and report:

(*a*) whether the conditions to which the said Act, as so amended, applies in fact prevail and, if so, in what manner and to what extent;

(*b*) on the things which are done by the parties concerned as a result of, or for the purpose of preserving, those conditions; and

(*c*) whether the said conditions or all or any of the things done as aforesaid operate or may be expected to operate against the public interest.

In this reference 'bread' means bread in any form other than:

(i) breadcrumbs;

(ii) fruit loaves and fruit buns;

(iii) bun loaves; and

(iv) brioches and croissants

and includes the following or any part thereof:

(i) fancy loaves and milk loaves;

(ii) rolls and baps; and

(iii) wrapped sliced bread.

(*Signed*) C E Coffin
Under Secretary
Department of Trade and Industry
Dated this 1st day of October 1973

As the reference was made before the commencement of the Fair Trading Act 1973, our report is made, as provided for by paragraph 7 of Schedule 11 to the Act, in accordance with the enactments under which the reference was made.

2. On 8 October 1973 the Chairman of the Commission, acting under section 1 of the Monopolies and Mergers Act 1965 and paragraph 9 of the first schedule thereto, directed that the functions of the Commission in relation to the investigation under this reference should be discharged through a group consisting of seven members of the Commission. These included Mrs J Inchbald and Mr Lewis Robertson who, respectively, retired from membership of the Monopolies Commission on 31 January 1975 and 31 January 1976 and took no part in the investigation thereafter. On 8 October 1974 the Chairman, under the same provisions, appointed Mr J G Le Quesne QC to be a member of the group. Mr Le Quesne was appointed Chairman of the Commission with effect from 1 December 1975 on the retirement of Sir Ashton Roskill QC who had until then been a member of the group. The names of members of the Commission who formed the group responsible for this report are indicated in the list of members which prefaces the report.

3. We received written and oral evidence from Associated British Foods Limited, Ranks Hovis McDougall Limited and Spillers Limited (the groups). We also received evidence from other manufacturers, suppliers and users of reference products, including wholesale and retail interests, and from certain representative bodies concerned in the production and distribution of those commodities.

4. On 18 December 1975 we informed the groups separately of our provisional conclusion that conditions to which the 1948 Act (as amended) applies appeared to us to prevail as respects the supply in the United Kingdom of (i) wheat flour (flour) and (ii) bread made from wheat flour (bread). We notified each of them of the grounds for this provisional conclusion and of the matters which appeared to us to require consideration in determining whether the conditions, or all or any of the things done as a result of or for the purpose of preserving the conditions, operated or might be expected to operate against the public interest. Each of the three groups made certain representations to us in writing and their representatives attended hearings for the purpose of discussing these matters with us.

5. On 22 November 1976, having considered all the information then at our disposal, we informed each of the three groups that we proposed to take into account for the purpose of arriving at our final conclusion on the conditions under the Act as regards the supply of flour, the practice of each group whereby its flour-using subsidiaries obtain their requirements of flour solely from group sources, except in so far as those sources might for any reason be unable to supply them.

6. We wish to record our appreciation of the assistance given to us by Associated British Foods Limited, Ranks Hovis McDougall Limited and Spillers Limited and by all other witnesses who have provided us with the information required in our investigation. Some of the information 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

General background

7. In this chapter we give some background information together with some related comment on matters concerning the supply of flour and bread in the United Kingdom.

Introductory

8. There is an obviously close relationship between flour and bread in so far as demand for the latter must have a direct bearing on demand for the former. The relationship, however, falls short of absolute identity since flour is widely used in industries other than breadmaking. In this report, therefore, we have sought, for the most part, to consider milling and baking separately. But, especially when dealing with integrated enterprises which are engaged in both these industries, it has been necessary occasionally to depart from that practice.

9. Flour and bread are the sources of about one-sixth of the total energy and one-fifth of the total protein and iron consumed by the average household in the United Kingdom. It thus is perhaps not surprising that matters relating to the quality and price of bread and thus, incidentally, of the flour from which it is produced, have been of particular concern to governments for centuries. As long ago as 1266 the Assize of Bread sought to fix the weight and price of bread and bakers' profits, and political preoccupation with the relationship between wheat and bread prices in the nineteenth century culminated in a change in British fiscal policy which lasted until 1932.

10. More than one witness in giving evidence to us took the opportunity to suggest that, as bread accounts for little more than one per cent of the General Index of Retail Prices, the extent of official concern about the industry appeared to them to be excessive. (Bread and flour respectively have weights of 12 and 1 out of the total 1,000 points weighting of that Index.)

Flour

The supply of wheat

11. Although flour can be derived from rye, pulses and certain starchy roots, the term flour is defined in the Bread and Flour Regulations 1963[1] as applying to the product derived from the milling of wheat. Our reference is confined to wheat flour.

12. The use to which the flour of any particular variety of wheat, or flour of a particular grade, can be put is dependent on the characteristics of the wheat variety and of the flour grade. Breadmaking quality in wheat is related to the amount and quality of the protein component of the grain. The protein of wheat when hydrated (or when flour is mixed with water) changes its form, becoming sticky, cohesive and elastic. In this condition the hydrated protein is called gluten. The quality of gluten varies among wheat varieties, while the amount of protein in wheat is related both to variety and to the environmental conditions

[1] Statutory Instrument 1963, No 1435.

of soil and climate in which the wheat is grown and to the fertiliser treatment applied in fostering its growth.

13. The wheat types with the best breadmaking quality are described as hard or strong. These are spring-grown wheats grown mainly in Canada and the United States of America. The protein content of hard wheats of this type is generally from 11 to 15 per cent (on 14 per cent moisture basis), and the gluten strong and elastic in character. Types of wheat without the good breadmaking property are described as soft or weak. Many of these are particularly suitable for biscuit and cake flour manufacture. The soft wheats used in the United Kingdom are mostly home-grown or imported from other EEC countries, notably France. Protein contents of soft wheats are generally in the 8 to 12 per cent range (on 15 per cent moisture basis).

14. The blend of wheats used in producing a particular type of flour is known as the grist and the amount of flour derived from a given weight of wheat, expressed as a percentage, is referred to as the extraction rate. In the United Kingdom the extraction rate for white flour is normally between 72 and 74 per cent. The main by-product of flour milling is wheatfeed which is generally disposed of for use in the manufacture of animal feedingstuffs.

15. Grists for breadmaking flour generally require an average protein content of 12 per cent, and those for biscuits, cakes and pastry require protein contents of from 10 to 11, 9 to 9½ and 8 to 10 per cent respectively (on 14 per cent moisture basis). This enables soft wheat to be used, in limited proportions, in conjunction with hard wheat, to produce breadmaking flour and, either alone or in much higher proportions, to produce flour for other purposes (see also paragraphs 33 to 35). With the exception of crackers, grists for the majority of biscuit flours contain no imported high protein wheat. Household flours (see paragraph 34) are generally produced from grists composed of approximately 80 per cent home-grown and 20 per cent imported wheats.

16. Research and trial surveys aimed at identifying those varieties of home-grown wheat possessing optimum yield and baking qualities are made continually by a number of research institutes and by the industries themselves. Certain millers offer farmers a premium for growing quality varieties.

17. In 1975 about 3·5m tons of wheat were imported into the United Kingdom, over 80 per cent of it for flour production. The following table indicates the percentages of that total which originated in particular countries.

TABLE 1.1

United Kingdom imports of wheat (other than denatured wheat) in 1975: Countries of origin

	Percentages
Non-EEC	
Canada	39·6
USA	27·6
Other	0·1
	67·3
EEC	
France	21·6
Denmark	3·4
Netherlands	4·7
Other	3·0
	32·7

(*Source:* Based on statistics supplied by HM Customs and Excise)

18. All Canadian wheat exported is sold in the first instance by the Canadian Wheat Board. The price set by the Board at any time is the same for all wheat of similar grade and quality, irrespective of the quantity purchased. Under the terms of sale the purchaser is responsible for all charges associated with transport of the wheat from the various ports in Canada.

19. Although United Kingdom millers generally purchase Canadian wheat directly from the Board, they can also purchase it on the Baltic Exchange where parcels are resold by grain importers and traders. The operation of that market together with the London Corn Exchange (which is basically a market for indigenous grains) has the effect of ensuring that no miller can, for long, buy wheat significantly more advantageously than his competitors.

20. A United Kingdom miller who purchases wheat as a principal in North America and makes his own arrangements for its carriage to the United Kingdom may find that the cost of chartering a vessel for a single West–East voyage is greater than that incurred by a professional shipper, able to fix a series of charters in both directions. There is, too, the necessarily heavy capital outlay associated with the purchase and storage of large consignments. For these reasons it may sometimes be advantageous for a large miller to secure his supplies of wheat (particularly hard wheat) through a specialist grain trading and shipping company, perhaps within his own organisation, with that company acting as the principal in the supply operations. Smaller millers generally purchase imported wheat from international grain shippers and merchants who are able to arrange deliveries in suitable quantities to any convenient port in the United Kingdom from their stocks held at North European ports.

21. The Common Agricultural Policy of the EEC, which governs trade in wheat between the Community and third countries, provides for the collection of a levy which, in the case of new Member States, is reduced by a compensatory amount (known as accession compensatory amount (ACA) and due to decline to zero by the end of transition in 1978) and, in the case of countries with a depreciating currency, by a monetary compensatory amount (MCA). Trade between Member States is subject to adjustment by an MCA depending on the value of their respective currencies; and between old and new Member States by the ACA which operates as a subsidy on imports into the United Kingdom and as a levy on exports from the United Kingdom. The joint effect of these arrangements should result in broadly similar prices for comparable grades of wheats in all Member States, after allowing for transport, handling and other costs. However, it has happened in the past that when the value of the ACA has fluctuated, due to the rule that the level of ACA must not exceed the level of levy, it has been possible through judicious use of the facility whereby the rate of levy can be pre-fixed, to import French wheat at favourable prices. Such circumstances can only arise when the world price of wheat is at, or near, the EEC threshold price and in any case the scope for profitable trading of this kind has diminished as the ACA has decreased due to the progress of transition.

22. Freight rates for wheat consigned from North America to the main North European ports (Amsterdam, Rotterdam and Antwerp) are generally lower than if it were consigned direct to United Kingdom ports. This fact, in association with the circumstances referred to in paragraph 21, is understood

to account at least in some measure for the fact that in 1975 of 2·2m tons of Canadian and USA wheat imported into the United Kingdom only about 1·2m tons were directly consigned from those countries, the balance having been transhipped in European ports[1].

23. Although a number of factors combine to make difficult any exact comparison between the United Kingdom levy-paid prices of hard wheats of North America and soft wheats of EEC (including home-grown) origin, the former were, at approximately £116 per ton, almost £28 per ton the more expensive in February 1977.

24. We have found no evidence to show that small millers are, on account of the scale of their operations, at a price disadvantage in purchasing wheat although one of them told us that since United Kingdom membership of EEC he had lost the advantage of being able economically to buy distressed parcels of wheat anywhere in the world. But smaller millers generally regarded this as only a marginal disadvantage and indeed thought that they perhaps sometimes enjoyed an advantage over the major millers on account of the flexibility which they could exercise in their wheat purchasing arrangements. One of the major millers put his view in oral evidence to us in the following terms:

> 'I think there has always been considerable misunderstanding about economies of scale on the (wheat) buying side. All our evidence is that the small miller, intelligently running his business, is able to gain significant economies on the buying of his raw materials. He does not have to take a view for three months ahead or six months ahead. He is able to clean up the market at the prices that are left behind. He has a better basis of negotiation with local farmers around his mill. I believe he has got an advantage and I do not see that altering myself on his raw material acquisition if he is an efficient miller'.

25. The cost of wheat represents between about 80 and 85 per cent of total flour production costs. The price realised for the wheatfeed by-products of milling has a significant effect on net production costs of flour.

26. The siting of mills can have a material effect on inland transport costs for both wheat and flour. An indication of mill locations and of wheat-growing areas in the United Kingdom is given in Appendix 1.

Production and disposal of flour

27. Flour is produced by a partial dissection process whereby the whea grain is separated into three main constituent parts; these are the bran or outer skin, the germ or embryo, and the endosperm or reserve food supply for the embryo. Wheat flour is formed when the endosperm is reduced to a suitable particle size. The manner in which the endosperm fractures during milling reflects its degree of hardness.

28. The milling process requires the use of specialised equipment and the application of sophisticated technology. Essentially it comprises the cleaning and conditioning of the raw wheat and a series of operations involving break grinding, sifting, reduction grinding and treatment of the resulting flour.

[1] *Source:* Overseas Trade Statistics and HM Customs and Excise.

During these processes the wheat grains are broken open and the endosperm removed from the bran coats; the endosperm is then reduced to flour on roller mills. The milled white flour is enriched with iron, vitamin B1 and nicotinic acid or nicotinamide to the statutory levels prescribed for those nutrients, and chalk is also added, according to regulations. The addition of specified bleaching and improving agents is permitted by the Bread and Flour Regulations, 1963 and the Bread and Flour (Amendment) Regulations 1972[1].

29. Many factors, including advances in milling and baking technology, have contributed to a significant increase in the proportion of home-grown wheat used in flour production in recent years. The following table illustrates the trend.

TABLE 1.2

Wheat milled and flour produced in the United Kingdom: 1970 to 1976 (August/July)

'000 tons

	1970–71	1971–72	1972–73	1973–74	1974–75	1975–76
Wheat milled						
—home-grown	1,389	1,957	1,957	2,337	2,411	2,208
—imported	3,504	3,043	2,952	2,723	2,636	2,883
Total	4,893	5,000	4,909	5,060	5,047	5,091
Flour produced	3,644	3,713	3,651	3,741	3,771	3,795
Home-grown content (%)	28·3	39·1	39·8	46·1	47·8	43·4
Extraction rate (%)	74·5	74·3	74·4	73·9	74·7	74·5

(*Source:* Home-Grown Cereals Authority, based on monthly statistics prepared by the Ministry of Agriculture, Fisheries and Food)

30. The amount of flour supplied for all purposes in the United Kingdom has fallen for many years. As indicated in the subjoined table, flour disposals decreased by 21·2 per cent in the period 1951 to 1975 during which the population rose by 11·4 per cent. In the period 1967 to 1975 the decline was under 1 per cent whilst the population increased by about 2 per cent.

TABLE 1.3

United Kingdom: Flour disposals and population: 1951 to 1975

Calendar year	*Quantity ('000 tons)*	*Actual or estimated population ('000s)*
1951	4,716	50,225
1960	4,038	52,372
1967	3,746	54,800
1968	3,725	55,049
1969	3,794	55,263
1970	3,783	55,421
1971	3,802	55,610
1972	3,690	55,793
1973	3,721	55,933
1974	3,635	55,968
1975	3,781	55,962

(*Source:* Central Statistical Office: Annual Abstracts of Statistics)

[1]Statutory Instrument 1972 No 1391.

31. The amount of flour imported into the United Kingdom has fallen to negligible proportions in recent years as is indicated in the following table.

TABLE 1.4

Flour imported into the United Kingdom: 1970 to 1976

Year	*'000 tons*
1970	81·6
1971	73·2
1972	64·8
1973	18·1
1974	6·1
1975	3·3
1976	3·3

(*Source:* Overseas Trade Statistics)

32. The amount of flour exported from the United Kingdom in the years 1970 to 1976 is shown below.

TABLE 1.5

Flour exported from the United Kingdom: 1970 to 1976

Year	*'000 tons*
1970	11·4
1971	6·6
1972	5·3
1973	15·3
1974	35·3
1975	26·1
1976	29·1

(*Source:* Overseas Trade Statistics)

33. Flour is used chiefly in commercial breadmaking and in domestic baking and cooking. Amongst its other uses are the manufacture of a wide range of products including biscuits, cakes, rusks, pastries, pies, baby foods, beer, soups and petfoods. The following table shows the amount of flours of different types produced in each of three recent years.

TABLE 1.6

Flour production (by type) in the United Kingdom in the years 1973–74 to 1975–76 (July/June)

'000 tons

	1973–74	**1974–75**	**1975–76**
Total weight of wheat flour produced	3,716·7	3,673·8	3,757·8
Total weight by type			
Flour for breadmaking			
White	2,329·6	2,272·1	2,301·2
Brown	138·8	134·3	122·4
Wholemeal	23·5	29·8	31·9
Pre-packed household flour (excluding self-raising)	187·0	191·0	141·4
Self-raising flour	113·7	129·0	189·3
Biscuit flour	387·4	412·4	434·9
Cake flour	72·5	70·9	78·2
Other flour	464·2	434·3	458·5

(*Source:* Ministry of Agriculture, Fisheries and Food)

34. Flour supplied for use in commercial breadmaking is generally known as bakers' flour. Flour, including self-raising flour, for domestic use is known as household flour.

35. For the purpose of this report it is sufficient to regard flour as comprising three broad classifications of product, namely bakers' flour, household flour

and other flours. On that basis the respective percentage of the total United Kingdom market represented by each of them was approximately as follows in 1976:

Bakers' flour	65 per cent
Household flour	9 per cent
Other flours	26 per cent
	100 per cent

Bread

Bakers, baking processes and products

36. There are two broad classifications of commercial breadmakers: master bakers and plant bakers. There is no ready definition which precisely or universally fits either classification[1].

37. In general, however, master bakers may be regarded as those bakers who produce bread or flour confectionery products which they sell in their own shops. The scale of their operations accordingly is usually relatively modest and they generally use traditional baking methods. Their products are, in the main, of speciality non-standard types and the demand made on them for standard products such as wrapped bread loaves of 14 oz and 28 oz weight is often met from supplies bought in from plant bakers.

38. As their name implies plant bakers produce bread in bread factories by automated, mechanical processes. Their chief product is the standard loaf (see paragraph 49), though they usually also produce rolls, buns and other forms of bread. Practically all standard bread is produced by plant bakers.

39. It is the practice of some of the large food retailers to bake bread on their shop premises. Such bakeries are referred to as 'in-store' bakeries.

40. Another development, which like the in-store bakery, dates from the early 1970s, is the 'hot bread' shop. It is a self-contained unit, usually sited in a prominent trading position, where bread, rolls and other small bakery products are baked and sold. In many instances a catering business is associated with the baking activity.

41. In the case both of in-store bakeries and hot bread shops the close link between production and customer demands the use of short-time breadmaking methods. Accordingly the baking processes referred to in paragraphs 44 and 47 are widely used in such bakeries.

42. The basic ingredients of bread are flour, yeast, salt and water. The flour used may be white, brown or wholemeal and of different strengths, depending on the types of bread to be produced. Other ingredients as specified in the Bread and Flour Regulations 1963 may be used in small amounts for the purpose of imparting particular characteristics to the bread.

[1] Solely for the purposes of The Bread Prices (No 2) Order 1976 (Statutory Instrument 1976 No 2128) a master baker is therein defined as a manufacturer of bread or flour confectionery whose retail sales of bakery products (other than biscuits) account for not less than 40 per cent of his total cash turnover during a specified period.

43. Breadmaking essentially comprises seven stages from dough mixing, dividing, proving, moulding and baking to cooling (and slicing and wrapping if required). Traditionally dough mixing is a relatively long but relatively non-intensive process followed by a three-hour fermentation period before the dividing stage. A shortened version of this process is used by some bakers.

44. At least 75 per cent of all bread is now baked in plant bakeries by the Chorleywood Bread Process (CBP), which was introduced commercially in 1961. This process is highly mechanised and involves a short period of intensive mechanical working of the dough in place of the traditional lengthy bulk fermentation period. It requires the addition to flour of extra oxidising 'improver' above that normally added at the mill (see paragraph 28) as well as an emulsifying agent or fat. Water at the rate of about one gallon per sack (280 lb) of flour above that normally used in the traditional process is required to soften the dough to the consistency which the latter process achieves during fermentation.

45. A somewhat weaker, and hence cheaper, flour can be used in baking by the CBP. It is also generally accepted that more bread (about 4 per cent) can be made from a given amount of flour by using that process than by using traditional baking methods. This advantage is largely accounted for by avoidance of the fermentation losses which take place when dough, mixed by traditional methods, undergoes bulk fermentation prior to the dividing stage. Using the CBP, a sack of flour is sufficient to produce about 234 to 236 28 oz loaves of standard bread. There is evidence that CBP bread stales more slowly than conventional bread and that it contains on average slightly more water (0·5 per cent) than traditionally made bread.

46. Particularly in Scotland and Northern Ireland much of the bread is not baked in tins but on trays or on the sole of the oven. The product, which has a thick crust on top and bottom of the loaf, is known as batch bread. The CBP has not yet been successfully applied to Scottish batch bread production on a large scale. The baking time for batch bread is 80 minutes as compared with 35 minutes for bread baked in tins.

47. The Bread and Flour (Amendment) Regulations 1972 permit the use in breadmaking of L-cysteine hydrochloride which enables a breadmaking process known as Activated Dough Development (ADD) to be employed. This process confers at least some of the advantages of the CBP without the need to employ high speed dough mixers. It is being used on an increasing scale in hot bread shops and also by master bakers.

48. Research is being conducted by the Flour Milling and Baking Research Association on the definition of conditions under which bread of normal properties (except for protein content) can be baked by means of combined microwave and thermal energy from certain flours derived from grists containing greatly increased proportions of soft wheat. Pending a commercially successful outcome of such research the scope for increasing beyond 50 per cent the soft wheat content of bread-making flour grists is at present regarded as limited.

49. The most common type of bread is the loaf of 14 oz or 28 oz baked in a tin to a standard recipe by plant bakers using the CBP and sold, wrapped or unwrapped, in sliced or unsliced form. Such bread is generally described as standard bread and is estimated to account for over 60 per cent of all bread

baked in the United Kingdom. Examples of this product, as supplied nationally, are marketed by the major plant bakers under such names as 'Sunblest', 'Mother's Pride' and 'Wonderloaf'. The same, or similar, products are often supplied by plant bakers for sale by supermarkets and other groups of retailers under their own brand labels. Loaves are generally referred to as 'large' or 'small' to denote weights of 28 oz and 14 oz respectively. Batch bread (see paragraph 46) is mainly supplied as 28 oz weight loaves. Brown or wheatmeal bread is available in the same forms and weights as standard white bread except that if unsliced it is generally supplied unwrapped. There is a limited demand for wholemeal bread. It is generally supplied in 14 oz weights, wrapped and sliced or as a loaf baked on the sole of the oven.

50. The types of bread referred to in paragraph 49 are amongst those eligible for bread subsidy[1] payment. Statistics indicating the average number of loaves of subsidised bread of various sizes produced weekly during a recent period are given in the following table.

TABLE 1.7

Number of loaves of subsidised bread[1] produced in the United Kingdom in the four weeks ended on 27 March 1976

Size of loaves	*Average numbers of loaves produced per week*
Over 28 oz	0·4m
28 oz	50·1m
14 oz	27·1m
8–10 oz	2·7m
	80·3m

(*Source:* Ministry of Agriculture, Fisheries and Food)

51. Rolls and baps form a substantial part of what is usually referred to in statistics as 'other bread'. They must be sold as soon as possible after production and, when supplied by plant bakers, can be produced at a rate of up to 20,000 per hour substantially by the same process as is used in standard breadmaking. Rolls and baps account for a relatively large part of bread consumption in Scotland where they are largely produced by master bakers.

52. Crusty breads include bloomers, cobs, French and Vienna breads. They are made in a range of weights sometimes of less than 10 oz. Such products are less well suited than are most other types of bread to wholesale distribution on account of their comparatively limited shelf life. They are produced in relatively large measure by master bakers and other non-plant bakers often using the traditional bulk fermentation process. Speciality breads are produced in many varieties, perhaps the best known being Hovis and VitBe which are made from proprietary flours supplied by Ranks Hovis McDougall Limited and Associated British Foods Limited respectively. Other speciality products are of the low-density dietary 'slimming' types (eg Slimcea and Procea made by Spillers Limited), milk bread and toast bread.

53. The following table shows, in percentage terms, estimated average household consumption by type of bread product and the relative percentage of total expenditure on bread represented by each type. The figures relate to households in Great Britain for the years 1967, 1971 and 1974.

[1] Subsidy is payable on eligible flour used in producing bread loaves for sale for human consumption of a weight of more than 10 oz or, in relation to a loaf baked in a tin, of not less than 8 oz.

TABLE 1.8

Average household consumption* of bread, by type, in Great Britain in the years 1967, 1971 and 1974

Per cent

Type of bread	*Quantities by weight*			*Expenditure*		
	1967	*1971*	*1974*	*1967*	*1971*	*1974*
Large white sliced and wrapped loaves	54·0	52·7	56·3	47·5	45·1	47·1
Large white unwrapped loaves	17·8	17·2	18·0	15·6	15·1	15·8
Small white sliced and wrapped loaves	4·0	5·8	3·3	4·6	6·4	4·1
Small white unwrapped loaves	8·8	7·8	6·7	9·5	8·4	7·9
Brown bread	7·0	7·2	6·2	8·0	8·0	7·3
Wholewheat and wholemeal bread	1·4	1·4	1·7	1·5	1·5	1·8
Other bread	7·0	7·9	7·8	13·3	15·5	16·0

(*Source:* National Food Survey)

*These statistics indicate that weight for weight 'other bread' (which includes rolls, baps, milk bread, 'slimming' bread, French bread, Vienna bread) is substantially more expensive than standard bread.

54. Among terms used in the baking industry are 'morning goods' which connotes rolls, baps and a wide variety of items such as doughnuts, currant buns and other non-bread products intended for consumption on the day of production; 'fermented goods' which indicates small items of a few ounces in weight which are yeast-raised (eg rolls, buns and fancy bread) and 'smalls' which includes, in addition to fermented goods, scones and crumpets.

Flour and Bread

Trends in demand

55. The decline in flour consumption as indicated in table 1.3 reflects aggregated flour usage for all purposes. The following table indicates *per capita* domestic consumption of household flour and bread in Great Britain in certain years.

TABLE 1.9

Great Britain: Weekly domestic *per capita* consumption of household flour and bread* in the years 1956 and 1967 to 1976

Year	*Household flour (oz)*	*Bread (oz)*
1956	7·89	51·08
1967	5·79	40·02
1968	5·38	38·31
1969	5·38	37·74
1970	5·68	38·11
1971	5·86	35·75
1972	5·42	34·44
1973	5·25	33·42
1974	5·30	33·50
1975	5·16	33·67
1976	6·02	33·17

(*Source:* National Food Survey)

*The types of bread measured in this table include, eg fruit bread which is excluded from the definition of bread used in the reference (paragraph 1). The effect of this is of no practical significance on the trend shown in the table.

56. Table 1.9 indicates the scale of the reduction which has taken place in the domestic *per capita* consumption of both household flour and bread particularly since 1956. Assuming the figures to be applicable to the whole United Kingdom (though the information in paragraph 62 suggests that bread consumption is somewhat higher in Northern Ireland than in the rest of the United Kingdom) and assuming its population in 1976 to be similar to that in 1975 (see table 1.3) it would appear that between 1967 and 1976 although domestic consumption of household flour rose by about 6 per cent that of bread

fell by over 15 per cent. Whilst statistics showing the amount of bread consumed non-domestically (eg in catering) are not available, it is estimated from information obtained from a number of trade sources that it may have increased during those years by an amount equivalent to about 4 per cent of the total domestic consumption, thus reducing to about 11 per cent the total decline in the demand for bread over that period. Sales of flour, supplied as such for use for example in catering, are estimated not to have varied to any significant extent during the same period.

57. Average weekly household expenditure in Great Britain on household flour and bread, both in actual terms and expressed as a percentage of average total weekly household food purchases, is shown below for the years 1956 and 1967 to 1976.

TABLE 1.10

Average weekly household expenditure on food in Great Britain (*per capita*) in the years 1956 and 1967 to 1976

Year	*Flour (a)*	*Bread* (b)*	*Total food purchases (c)*	*(a) plus (b) expressed as a percentage of (c)*
1956	3.46d	19·14d	327·4d	6·9
1967	1·18p	11·90p	188·3p	6·9
1968	1·09	12·33	193·5	6·9
1969	1·11	12·71	205·0	6·7
1970	1·20	13·97	211·0	7·1
1971	1·36	14·25	231·0	6·7
1972	1·33	14·88	240·8	6·7
1973	1·42	15·61	274·1	6·2
1974	2·13	19·60	309·6	7·0
1975	2·11	22·56	377·3	6·5
1976	2·46	24·93	441·0	5·7

(*Source:* National Food Survey)
*See footnote to table 1.7.

58. There is evidence, therefore, of a material decline in the amount of flour supplied in the United Kingdom for all purposes since 1951 (see table 1.3). There is also evidence of a steady erosion in the demand for bread (see paragraph 56). But as the demand for bread has fallen substantially during the years 1967 to 1976 and the amount of flour supplied has remained practically unchanged during those years (see table 1.3) it is evident that the amount of flour concurrently used for purposes other than breadmaking must have increased significantly.

59. Econometric studies[1] suggest that the demand for bread is inversely related to the level of national prosperity and of average disposable incomes. A period of recession, therefore, may lead to a temporary reversal of this trend as the figures for 1974 and 1975 in table 1.9 suggest. The significant increase in domestic consumption of household flour in 1976 (see table 1.9) may perhaps be accounted for, to at least some extent, by the shortage of potatoes and by increased home-baking as a consequence of pressures on family food budgets.

60. Variations exist regionally in the demand for certain types of reference bread other than standard bread loaves. These products principally include rolls,

[1] *Further analysis and Projections of the Demand for Bread* (John Eaton: London Graduate School of Business Studies, 1975).

baps, buns and tea bread. There is no ready, reliable method of assessing the size of this market.

61. The Ministry of Agriculture, Fisheries and Food have quoted a view that for England and Wales subsidised bread may account for as much as 90 per cent to 95 per cent of all bread consumed there. For Scotland and Northern Ireland the comparable figure is probably as low as 55 per cent to 60 per cent. The Scottish Association of Master Bakers told us that its independent (ie non-group) members now produce very little standard bread but that their estimated average sales of reference bread—mostly in the form of rolls, baps and tea bread—account for between 35 per cent and 40 per cent of their total sales. Noting that the subsidy scheme does not apply to these non-standard products it is clear that a relatively higher proportion of total bread consumption in Scotland and Northern Ireland (where a similar situation exists) is accounted for by such products than is the case in England and Wales.

62. Although expenditure is not a wholly reliable yardstick by which to measure bread consumption in the different regions of the United Kingdom such evidence as does exist would appear to support the proposition that *per capita* domestic bread consumption is higher in Scotland and Northern Ireland than in the rest of the United Kingdom. Thus the Department of Employment Family Expenditure Survey for 1975 shows that whilst the average weekly household expenditure on bread (including milk loaves, rolls, baps) in the United Kingdom as a whole was 60p, comparable expenditure in Scotland was 72p and in Northern Ireland £1·02. To obtain a precise basis for quantifying household bread consumption in volume terms some adjustment to these figures would be necessary to provide for the fact that, for example, morning goods are, weight for weight, significantly more expensive than bread bought in the form, say, of subsidised bread loaves. Also the costs of producing and distributing bread (and therefore its price) are higher in Northern Ireland than in other regions of the United Kingdom[1]. But even if appropriate allowances were made for such factors it is evident that *per capita* bread consumption in volume terms is higher in Scotland and Northern Ireland than in the rest of the United Kingdom.

[1] *Sources:* The Price Commission: *Bread Prices and Costs in Northern Ireland and Great Britain* (1976).
Northern Ireland Department of Commerce: *Report of Working Party on Bread Costs and Prices in Northern Ireland* (1976).

CHAPTER 2

An outline of the development of the milling and baking industries and of their structures and markets

Flour

Concentration of the milling industry

63. The grain milling industry, as classified in official statistics, includes both the milling of wheat and the milling of barley, oats, rye and rice. In 1975 sales of wheat products accounted for 76 per cent of the total sales of the industry (by value).

64. According to the Census of Production there were in 1935 over 2,600 establishments engaged in grain milling in Great Britain. In that year the mills of the three largest producers—Ranks Limited, Spillers Limited and the Co-operative Wholesale Society Limited—accounted for 39 per cent of total output. These producers had achieved their predominant position largely by absorbing other firms in the conditions of over-capacity which had existed in the industry after the first world war. In 1948 there were 1,126 mills operating in Great Britain. In 1963 there were 529; in 1968 352 and in 1972 (the latest year for which there are statistics) 335. In 1972 255 firms operated grain mills and the largest five of them accounted for 57 per cent of sales in that year.

65. Concentration in flour milling has been greater than in the grain milling industry as a whole. Thus it was estimated that in 1939 the three largest millers then accounted for two-thirds of total flour production. (The trade regarded that estimate as being somewhat overstated.) Between 1939 and 1951 this degree of concentration was relaxed to some extent but thereafter it again intensified. According to official statistics the five largest millers accounted for 79 per cent of sales of white flour in 1963 and for 81 per cent in 1968.

The evolution of the major integrated milling and baking groups

66. Major changes in the structures of both the flour milling and baking industries can be clearly traced to the arrival in England of Mr Garfield Weston in 1932. Mr Weston had already established successful bakery businesses in Canada and in the United States of America and intended to do so in the United Kingdom. At that time the Co-operative movement in the United Kingdom supplied about 20 per cent of the market for flour and over 25 per cent of the market for bread. Ranks and Spillers then had a combined share of the flour market approximately equal to the Co-operatives but they had no baking interests. In contrast to the powerful and integrated milling and baking interests of the Co-operative movement the rest of the baking industry was fragmented and under-capitalised chiefly due to the prevailing economic depression.

67. Between 1932 and 1935 Mr Weston bought several bakeries and in 1935 formed a company, Allied Bakeries Limited. Until 1939 the company had imported its requirement of flour from Canada. During the war that arrangement was suspended and Allied Bakeries then obtained its flour from United

Kingdom millers, notably Ranks and Spillers. By 1954, after the flour industry had been decontrolled and Canadian flour was again available, Allied Bakeries resumed the importation of Canadian flour to meet the major part of its bakeries' requirements. Meanwhile the company was acquiring more bakeries.

68. In these circumstances Ranks and Spillers decided to safeguard their outlets for flour by themselves entering the baking industry. Accordingly in 1954 each of them set about acquiring established bakery businesses on a large scale.

69. By 1961 Allied Bakeries Limited decided to enter the flour milling industry. This decision recognised the possibility that, if the United Kingdom entered the Common Market and Canadian flour were then to be no longer available under preferential fiscal arrangements, the company might have to rely for its supplies on those millers (Ranks and Spillers) who had by now become its principal competitors in baking.

70. Essentially, therefore, Allied Bakeries Limited integrated backwards into milling whilst Ranks Limited and Spillers Limited integrated forward into baking. More details of the scale and timing of how each of them did so are set out in Chapter 3. As the result of this evolution the three major enterprises now engaged in flour and bread supply in the United Kingdom are Associated British Foods Limited (ABF); Ranks Hovis McDougall Limited (RHM) and Spillers Limited (Spillers). They are henceforth jointly referred to in this report as the Big Three groups.

The Millers' Mutual Association

71. It is appropriate here to note that rationalisation of the milling industry in England and Wales has been materially assisted since 1929 by a voluntary body, the Millers' Mutual Association (MMA). It was founded with the object of securing a better balance between milling production capacity and the potential demand for flour. One of the ways whereby it sought to achieve this was a quota system whereunder each of its members was allocated a production quota and required to pay into a central fund an excess premium on additional quantities of flour actually delivered. From the outbreak of war in 1939 until the flour milling industry was decontrolled in 1953, the activities of the Association were suspended. Following enactment of Restrictive Trade Practices legislation in 1956, the quota system had to be abandoned and in 1960 MMA introduced a levy based on its members' deliveries of flour. The purpose of this levy, and of the excess premium arrangement which preceded it, was to provide MMA with funds to enable it to acquire the goodwill, plant and machinery of millers wishing to withdraw from the industry. A schedule showing the extent of MMA's operations in this connection during the years 1953 to (November) 1976 is at Appendix 2.

The Big Three groups and the independent millers

72. The position as at January 1977 was that, in addition to the Big Three groups, there were only 39 flour millers in the United Kingdom whom we refer to as independent millers to distinguish them from the Big Three group millers. We were informed by the National Association of British and Irish Millers Limited in 1976 that the six largest of these independent millers accounted for

about 10 per cent of total United Kingdom flour production (ie for about 370,000 tons). The remaining 33 independent millers therefore would appear jointly to have produced approximately the same amount (see table 2.2).

73. In July 1976 the geographical locations of independent millers as defined in paragraph 72 is shown in table 2.1 (see also Appendix 1).

TABLE 2.1

Location, by regions, of independent millers in the United Kingdom as at July 1976

In England and Wales	34
In Scotland	2
In Northern Ireland	2
In Isle of Man	1
Total number of independent millers	39

(*Source:* National Association of British and Irish Millers Limited)

74. The following table shows the estimated approximate division of the flour market as between the Big Three groups and the independent millers for 1975. It has been constructed largely from basic data provided by the Big Three groups. That data has been adjusted to reflect the probable position for the calendar year rather than for each of the individual financial years of those groups. In estimating the volume of the market for each type of product, the percentages in paragraph 35 have been applied to the total flour disposals figure of approximately 3·7m tons in 1975 (see table 1.3).

TABLE 2.2

Estimated shares of the market for flour supplied for use in the United Kingdom in 1975 by the Big Three and by independent millers

Type of product	*Market volume ('000 tons)*	*Estimated volume ('000 tons) supplied by*		*Estimated percentage of market supplied by*	
		Big Three	*Independents*	*Big Three*	*Independents*
Bakers' flour	2,405	2,118	287	88·1	11·9
Household flour	333	233	100	70·0	30·0
Other flour	962	617	345	64·1	35·9
All flour	3,700	2,968	732	80·2	19·8

It will be noted from the table that the independent millers' share of the household and other flour market (principally biscuit and cake flour) is substantially greater than is their share of the market for bakers' flour.

Milling capacity: utilisation and adequacy

75. Each flour milling plant has an installed, rated or nominal capacity. Such capacity is expressed in terms of sacks per hour and represents the amount of flour which the mill is, in the opinion of its designer, capable of producing, on average, over a range of different grists. Many flour mills consist of more than one plant. In considering whether total available plant capacity is in balance with the industry's requirements it would obviously be insufficient to have regard only to the rated capacity of plant. The extent to which it is used is equally material.

76. There are significant economies of scale in flour milling which are reflected in a reduction in both capital and operating costs, particularly labour costs, per unit of rated capacity as scale is increased. It is generally agreed that economies of scale have become more important in recent years as a result of the introduction of bulk handling facilities and automated control of plant

operations. The optimal capacity of a particular flour mill will depend, however, upon a number of factors including the product mix and the location of the mill in relation to its market. Distribution costs may limit the extent to which scale economies can be exploited. The general view of those giving evidence to us was that a capacity of 60 sacks per hour would be the minimum efficient scale for a mill located at a port, and that further economies are achievable up to a rated capacity of 100 sacks per hour in mills producing a narrow range of flours. For inland mills producing a wide range, optimum size is understood to be lower, say, 40 sacks per hour.

77. The major millers have secured a high degree of product rationalisation in that some of their largest mills are now geared to produce a single product, bakers' flour. Smaller millers require to make grist changes on their mills to produce the varied requirements of their customers. Such changes take time in 'letting the mill run out'. One miller told us that, before he modernised his plant, this took up to two hours whereas it now takes about 20 minutes. Nevertheless any change necessarily involves a break in production continuity and their number varies according to product demand. One of the larger of the independent millers said that whilst in a 'good' week only two changes might be required, they could be as frequent as one a day in a 'bad' week.

78. The rated capacities of mills owned by the Big Three groups are shown in Chapter 3. The following statistics, which relate to the mills operated by the 39 independent millers, clearly show that most of them have a capacity of less than 40 sacks per hour. Where more than one mill is operated by the same miller their aggregated capacity is used for the purpose of the subjoined table.

TABLE 2.3

Independent millers

Estimated sacks per hour milling capacity

Capacities	*Milling companies*	*Number of mills operated*	*Observations*
Less than 10 sacks per hour	10	10	
10–29 sacks per hour	15	16	One company operates 2 mills
30–39 sacks per hour	4	4	
40–49 sacks per hour	5	5	
60–79 sacks per hour	3	6	One company operates 3 mills One company operates 2 mills
80–99 sacks per hour	1	2	
100 and over per hour	1	4	
Totals	39	47	

(*Source:* The National Association of British and Irish Millers Limited)

79. A broad survey of the flour milling industry shows that the intensity of working varies from single shift operation with a measure of overtime working in some of the smaller mills to four shift working in some of the largest, thus representing a range of from about 60 to 160 hours' operation weekly. It is, however, generally considered that about 100 hours' operation, or perhaps slightly more, represents the best practical arrangement. In Chapter 3 details are given of the extent to which the Big Three groups utilise milling capacity. No such particulars are available in respect of independent millers.

80. There are many factors which combine to determine the extent to which millers use their plants and all of them are economic. On the one hand there are the highly automated port mills geared to producing a single product for delivery in bulk to a tied, assured market. On the other, a small mill, located in a rural wheat-growing area, may produce flour for sale in relatively small lots to meet the requirements of local master bakers or own brand household flour retailers. Given the constraint of his transport costs he must necessarily operate within a limited radius. He can only seek to supply such demand as exists there: he cannot increase it. For such a miller single shift working will often be the most economic arrangement.

81. It is, therefore, difficult to measure capacity or to determine whether at any time there is, or is not, genuinely excess capacity in the flour milling industry. One of the largest millers said that his group was closing down mills in the course of its rationalisation programme and that, therefore, it was obvious that there still exists scope for eliminating some capacity. The general view was that whilst there is some under-utilisation of existing capacity there is relatively little genuine excess capacity.

Entry into milling

82. One witness said that there had not been a new entrant (as opposed to entry by takeover) to the flour milling industry in the last 20 years. Another said 40 years. In writing to us an independent miller said:

> '. . . Most independent millers are in business because their companies were formed very many years ago. With today's costs of setting up a mill no one would dream of starting in the trade as it would just not be possible to obtain a worthwhile return on the capital involved. This position can never really change as long as the flour and bread trade is dominated by the three giants.'

83. Another witness referred to a major biscuit manufacturer's known financial interest in a number of flour milling companies and expressed a personal opinion that in certain circumstances biscuit manufacturers might decide to enter the milling industry more directly.

Flour distribution

84. Flour distribution is, to an increasing extent, now being effected by bulk tankers. Deliveries made in this way qualify for a bulk delivery discount (see paragraph 265). The extent to which bulk deliveries of bakers' flour are possible is obviously conditioned by the facilities available at the receiving bakeries. The Big Three plant bakeries and most independent plant bakeries are now largely equipped with bulk storage facilities. On the other hand most master bakers still require deliveries to be made in bagged form.

85. The precise extent to which bakers' flour is now delivered in bulk is not readily determined but from information acquired from a variety of sources we estimate it currently to be at least 60 per cent of all such flour supplied. Of deliveries made to their own group bakeries, the volume delivered in bulk by the Big Three groups is, of course, much higher. In one case at least it is almost 80 per cent.

86. The cost of delivering flour has been described to us by Spillers as being 'small' whilst RHM estimated that in 1974 such costs (including the upkeep and depreciation of transport used) accounted for only 2 per cent of total flour costs. Independent millers have told us that the Big Three group millers are often prepared to make deliveries in very small amounts as required by particular customers and have wondered how this could be justified on economic grounds. Whilst the average cost of delivery by the larger groups may be small, it is undoubtedly significantly higher in respect of deliveries made by them to the smaller master baker type of customer. Independent millers who have no tied outlets within their own organisation regard the cost of delivering flour as a significant factor in their businesses.

Bread

Changes in the structure of the baking industry

87. According to Census of Production figures there were some 24,000 bakers and confectioners in Great Britain in 1935 of whom it has been estimated only 40 were units having more than 500 employees. The three largest of them accounted for about 10 per cent of total bakery output. By 1938 the bread market, in expenditure terms, was supplied approximately as to 55 per cent by master bakers, 25 per cent by plant bakers and 20 per cent by co-operative societies.

88. The increased importance of plant bakers which is implicit in these figures reflected advances in technologies concerning the production, slicing and wrapping of bread. Such advances reduced unit costs and gave plant bakers an advantage over master bakers. But in order to secure the maximum economies of scale it was necessary for them to have assured retail outlets for their production. In this respect the master bakers had an advantage in that they generally sold their output in their own shops. The plant bakers sought to do the same and multiple bread shops sprang up. At the same time the development of motor transport was making it possible to supply bread outlets efficiently and regularly, subject always to the maximum radius of distribution being governed by costs. Retail roundsmen were also employed to deliver bread to consumers' homes. The overall effect of these developments was to reduce the influence of master bakers in the more densely populated urban areas.

89. The decline in the number of master bakers producing bread (as opposed to flour confectionery) was influenced by a number of other factors. One was the continuing fall in bread consumption. Another was the bread subsidy scheme which operated during the period 1939 to 1956. The master bakers regarded that subsidy as making the production of bread by them unprofitable. There were, no doubt, other reasons too (eg manpower shortage) but the fact is that whilst there had been 20,646 subsidy claimants in 1942 there were only 12,522 in 1948.

90. In an endeavour to maintain outlets for their production some of the flour millers acquired plant, and other, bakery interests. (The Co-operative Wholesale Society had for long been integrated into both industries.) By 1958 the number of enterprises engaged in bread and flour confectionery production in the United Kingdom was 2,037 but by 1972 it had fallen to 741 of which only 263 employed more than 25 persons. The largest five enterprises accounted for 70 per cent of sales of bread and flour confectionery in 1972. The present

position is that there are three major groups and less than 45 other firms engaged in plant baking in the United Kingdom.

91. It was estimated by the National Association of Master Bakers, Confectioners and Caterers that in England and Wales 3,400 of its members in 1976 were engaged in breadmaking to some degree and that its membership probably represented between 80 and 90 per cent of all master bakers in those regions.

92. The Scottish Association of Master Bakers told us that it had, at March 1976, 470 members (excluding Co-operatives and the Big Three groups and their subsidiaries) who produced some form of reference bread. That membership was estimated to represent about 75 per cent of all those Scottish master bakers eligible for membership of the Association. We have been unable to obtain statistics of the number of master bakers (known as home bakers) in Northern Ireland who produce some form of reference bread but we consider that they are unlikely significantly to exceed 300.

93. Adopting the most generous interpretation of these estimates the total number of master bakers engaged in producing reference bread in the whole of the United Kingdom would appear to be about 5,210. (One of the Big Three milling groups has told us that it supplied flour to some 5,400 'small baker customers of whom master bakers are a large proportion'. That number is, however, likely to include at least some bakers producing flour confectionery only.)

94. Subsidy claimants, other than plant bakers, according to Ministry of Agriculture, Fisheries and Food records, numbered about 4,800 in 1975. That figure, however, did not include those master bakers (mainly in Scotland and Northern Ireland) who produced only rolls and other forms of non-subsidised reference bread. Making reasonable provision for them, the result again points to a figure in excess of 5,000.

95. In all the circumstances we think that a figure of 5,500 can for practical purposes be regarded as the approximate number of master bakers who were producing some form of reference bread in the United Kingdom in 1975 and 1976.

Market shares: the Big Three groups, the independent plant bakers and master bakers

96. There are no official statistics so far as we know which show with accuracy the division of the reference bread market as between the various classes of bakers. This is perhaps not surprising as, for example, master bakers' operations generally concern the production of many products other than reference bread. There is, too, the fact that reference bread does not include all the products which, in different contexts, are usually referred to generically as bread.

97. We, therefore, asked the Federation of Bakers for their estimate. In providing it in October 1976 the Federation said 'Our figures . . . do differ from certain other published figures of quite recent origin, but we are more confident of our own answer in that we have based it on the statistics of flour consumption within our own records, slightly modified by certain practical

considerations'. The Federation's figures are as shown below and, although the 'total bread market' may not include the entire production of rolls and related types of bread, this is thought unlikely to have a significant effect on the percentages of the market deemed to be held by the different groupings of supplier. The term 'supplied' as used in the table means 'supplied from own production' (see also paragraphs 331 and 338 regarding the purchase of standard bread by master bakers for re-sale).

TABLE 2.4

Estimated shares of the total bread market supplied by various bakery groupings as at October 1976

The Big Three bakery groups	62 per cent
Independent plant bakers	11 per cent
Master bakers	27 per cent

(*Source:* The Federation of Bakers)

The market for subsidised and standard bread

98. Although there are no precise statistics to show what percentage of total bread production is represented by subsidised bread, the Ministry of Agriculture, Fisheries and Food have suggested that it varies a good deal regionally (see paragraph 61). On the basis of their estimate and having regard to the population of the individual regions and also making some allowance for the fact that more bread *per capita* is consumed in Scotland and Northern Ireland than in the rest of the United Kingdom (see paragraph 62) subsidised bread probably accounted for something of the order of 85 to 90 per cent of all bread consumed in the whole United Kingdom in 1976.

99. On the assumption that subsidy was claimed on almost all bread entitled to it in the year ended 31 March 1976, figures supplied by the Ministry of Agriculture, Fisheries and Food suggest that the Big Three groups supplied about 66 per cent of the total market for such bread in that year. If this figure is taken in conjunction with the higher of the figures (90 per cent) quoted in the preceding paragraph, it would appear that the Big Three share of the total bread market was, in round figures, about 60 per cent. This rough approximation compares reasonably closely with the Federation of Bakers' estimate (paragraph 97) of 62 per cent and with the Big Three group's aggregate share of 61·5 per cent as estimated by themselves for the year 1975 (see paragraph 280).

100. The Federation of Bakers also provided us with its estimate of how the market for standard bread is divided as between the Big Three bakers, the independent plant bakers and the master bakers. (In this connection it should be noted that the term subsidised bread is not necessarily synonymous with standard bread. The former relates to loaves of particular weights and may include bread in addition to what is generally regarded as standard bread.) It estimated that standard bread accounted for about 64 per cent of the total bread market. The following table is its estimate of how the market for such bread was divided at October 1976 as between the several bakery groupings.

TABLE 2.5

Estimated shares of the standard bread market supplied by various bakery groupings as at October 1976

The Big Three bakery groups	84 per cent
Independent plant bakers	15 per cent
Master bakers	1 per cent

(*Source:* The Federation of Bakers)

101. Using the figures in tables 2.4 and 2.5 we estimate that the shares of the total bread market held by each class of baker in terms of standard and non-standard bread were as shown in the following table.

TABLE 2.6

Estimated shares of the markets for standard and non-standard bread held by various bakery groupings as at October 1976

Class or grouping of baker	*Percentage of total bread market held*	*Share held (expressed as a percentage of total bread market)*	
		Standard bread	*Non-standard bread*
	(*a*)	(*b*)	(*c*)
The Big Three groups	62	53·7	8·3
Independent plant bakers	11	9·6	1·4
Master bakers	27	0·6	26·4
Total	100	63·9	36·1

Note: The figures in column (*b*) are derived by applying to those in table 2.5 the percentage factor of 64 referred to in paragraph 100. The figures in column (*c*) represent the differences between those in columns (*a*) and (*b*).

102. Notwithstanding the estimations and approximations which are inherent in the calculations from which table 2.6 has been constructed, it is evident that the type of products overwhelmingly supplied by the plant bakers (the Big Three groups and the independents) on the one hand, and those supplied by the master bakers on the other, are different. Essentially they are catering for different sectors of the bread market.

Baking capacity: utilisation and adequacy

103. As with milling, and for much the same reasons, there is difficulty in assessing true capacity in the baking industry. That difficulty, however, is compounded by two additional factors peculiar in the main to the plant baking industry. These are the degree of freshness of standard bread when sold to the public and the fact that the demand for bread is not constant throughout the week. It is estimated that, of all bread consumed, 25 per cent is supplied on Saturdays. As regards freshness the general view as expressed to us was that the oldest bread for sale on Saturday should not be out of the oven more than 28 hours at 8 am that day. To increase that age by 3 hours would, we were told, be equivalent to adding 10 per cent to the capacity of the plant bakeries.

104. The general view appeared to be that the minimum efficient size of a bakery plant is not less than 12 sacks an hour and may well be 18 sacks an hour. The extent to which economies from the installation of larger scale plants can be exploited is limited by distribution considerations (see also paragraphs 112 and 293). Large bakeries generally consist of more than one plant. This provides for flexibility in the production of bread of different types.

105. The rated capacities of plant bread bakeries owned by the Big Three groups are shown in Chapter 3. The information in table 2.7 below relates to bread bakeries owned by independent or partially independent plant bakers in December 1976. It has been furnished to us by the Federation of Bakers whose members at that date totalled 41, but of whom 4 were not then engaged in breadmaking. The term 'independent' indicates independence from the Big Three groups and 'partially independent' indicates those bakery companies in which one or other of the Big Three groups has a financial interest.

TABLE 2.7

Independent and partially independent plant bakeries: rated capacities as at 8 December 1976

Rated capacity	*Number of bakeries* Independently owned	Partially independently owned
Up to 6 sacks per hour	6	1
7–11 sacks per hour	4	4
12–18 sacks per hour	3	4
19–26 sacks per hour	4	1
27–50 sacks per hour	4	2
	21	12

In addition one independent baker operated 4 bakeries whose aggregated capacity was 54 sacks per hour.

(*Source:* The Federation of Bakers)

106. The average period during which plant bakeries are operated is about 100 hours weekly. Witnesses pointed out that should demand so require it this could be extended to 135 hours fairly readily without much danger to quality of product, at least in the short term. The extent to which the Big Three groups utilise their baking capacity is indicated in Chapter 3. It has not been possible to obtain similar information concerning independent plant bakers.

107. Given that the total demand for bread is not expanding, any swing in public preference towards non-standard or speciality types of bread would seem bound to result in some additional excess capacity in plant bakeries. Whether or not the increased demand for non-standard bread would be entirely met by master bakers outside the Big Three groups would no doubt depend on the policies adopted by those groups (cf, for example, paragraph 111).

108. Witnesses were unanimous that there was substantial under-utilisation of capacity in the plant bakeries and that this was unavoidable if only because of the variations in the daily levels of demand. In addition they all agreed that there was some genuinely excess capacity but none of them was able to quantify its extent. The Big Three groups continue to rationalise their plant bakery production capacity and that process is not yet complete. Indeed the feeling is that it never will be complete because declining demand for standard bread is being accompanied by an increase in demand for non-standard products which are being supplied to increasing extent by master bakers, in-store bakeries and hot bread shops. There is, too, the likelihood of technical developments, the effects of which may in due course have an influence in reducing plant bakery capacity requirements (cf paragraph 48).

109. As regards independent plant bakers the position was said to be similar to that of the Big Three. But, as a class, they were said to be more reluctant to eliminate excess capacity because, owning probably only one plant, to do so would involve going out of business. As bakery plants have a life of up to 30 years there was, we were told, a tendency for marginal producers to continue to trade with written-down assets and obsolete or obsolescent plant.

Entry into baking

110. The cost of entry into plant baking is high and there are unlikely in present circumstances to be many completely new entrants. This view was

conveyed to us in oral evidence by the chairman of one of the Big Three groups who, when speaking of the production of standard bread said: 'We do not see growth in this market: we see only a decline but this is not the end of the market that anybody in his right mind would go after anyway. . . . I think that anyone who wants a bigger share of the (standard) bread market anywhere in the world would need his head read. . . .'

111. On the other hand we were told that cost of entry into the non-plant baking industry is not high. We were told that the cost of plant for a small hot bread shop may cost as little as £8,000. ABF said of the small hot bread shop owner: 'Small he may be, but we have paid him the compliment of copying. We have got involved in this hot bread store (business)'.

Bread distribution

112. Bread is for the most part distributed through bakers' and grocery shops, including supermarkets and hypermarkets, as well as by house to house delivery. House to house delivery by their own retail roundsmen has become increasingly costly for the major plant bakers and in consequence they have been progressively disengaging from it. In a number of instances plant bakers have entered into arrangements whereby milk roundsmen deliver their bread. It is also the practice of the major plant bakers to sell bread at substantial discounts off the retail list price to franchisemen who, in accordance with the conditions of specific agreements, become responsible for the door to door retail operation. Although the National Board for Prices and Incomes (NBPI) recommended in 1965[1] that a specific charge be made for delivering bread to customers' homes, bakers said that they generally found it impossible in contemporary conditions to make such a charge.

113. Census of Distribution statistics show that the number of retail grocers' shops in Great Britain fell from 146,777 in 1961 to 105,283 in 1971. It has been estimated that by 1975 the number of grocery shops had fallen to 93,650[2] and this trend is expected to continue.

114. In accordance with the classification as used in the Census of Distribution, retailers can be divided into three types. These are co-operatives, multiples and independents and for this purpose a multiple is defined as an organisation with ten or more outlets and an independent as having less than ten. The shares of the retail grocery market held by each at particular dates show the increasing importance of the multiples in grocery distribution.

TABLE 2.8

Percentage shares of retail grocery turnover by type of organisation

	1961	*1966*	*1971*	*1972*	*1973*	*1974*	*1975*
Co-operatives	20	16	13·2	13·0	13·0	13·3	13·7
Multiples	27	36	44·3	46·4	47·6	48·4	48·9
Independents	53	48	42·5	40·6	39·4	38·3	37·4

(*Source:* Census of Distribution and A C Nielsen)

115. An important development in grocery retailing has been the growth of the voluntary or symbol groups. In the grocery trade these are much more than mere associations of wholesalers or retailers formed for buying purposes.

[1] National Board for Prices and Incomes: *Prices of Bread and Flour: Report No 3* (Cmnd 2760) HMSO, 1965.

[2] Institute of Grocery Distribution: *The Structure of the Retail Grocery Trade*, 1976.

Such groups also provide a wide variety of services for their retail members aimed at improving their operating efficiency and the leading groups organise the supply of many own brand products to their members. According to an NBPI[1] report about one-third of all independent grocers were in 1969 associated with voluntary groups. By 1970 that fraction had been increased to one-half[2].

116. The concentration of retailers' buying power was emphasised to us by the chairman of one of the Big Three groups who told us that '30 per cent of the grocery trade is now in the hands of six buyers'. The following table shows the extent of the reduction in the number of central grocery buying points between 1971 and 1975.

TABLE 2.9

Central grocery buying points: numbers and shares, 1971, 1973 and 1975

	No of central buying points			*Percentage share of grocery retail sales*		
	1971	*1973*	*1975*	*1971*	*1973*	*1975*
Co-operative societies	336	240	227	15	14	14
Multiples head offices	202	74	62	43	47	49
Symbol wholesalers	109	92	94	23	20	19
Total	647	406	383	81	81	82

(*Source:* A C Nielsen)

Note: As bread forms an essential part of grocery business, it can reasonably be assumed that the bread market has been influenced generally in the manner indicated in this table.

117. Adopting the convention that all self-service food stores with 2,000 or more square feet of selling space are supermarkets, it has been estimated by the Institute of Grocery Distribution that there were 5,840 supermarkets in 1973. Over 2,000 of them were owned by only 5 multiple groups. At mid-1975 a television consumer survey made by Audits of Great Britain Limited found that multiple groups accounted for 38·3 per cent of the retail grocery trade; other multiples for 16·9 per cent and all non-multiples for the remaining 44·8 per cent. According to some forecasts supermarkets are expected to number 8,000 during this decade. Hypermarkets are still few in number in the United Kingdom. At October 1975 there were (according to NPC & Associates) only 4 as against 366 in France and 632 in West Germany. Whilst the hypermarket share of the United Kingdom grocery trade is at present minimal it, too, may well increase. Although not all forecasts of the future pattern of grocery trade distribution give identical results they all appear to point towards a still greater concentration of buying power in the grocery trade.

[1] National Board for Prices and Incomes: *Prices, Profits and Costs in Food Distribution: Report No 165* (Cmnd 4645 HMSO, 1971).

[2] A C Nielsen.

CHAPTER 3

The Big Three milling and baking groups

118. In this chapter we set out the salient features of the development and organisation of each of the Big Three milling and baking groups together with details of the nature and extent of its operations in regard to the supply of flour and bread. Related matters such as market shares held by these groups, pricing, discounting and tied trade are dealt with in Chapters 5 and 8.

Associated British Foods Limited (The Group/ABF)

Growth and present structure

119. Associated British Foods Limited is a quoted public company and is a close company as defined in the Corporation Tax Acts. Ultimate control of it is vested in Wittington Investments Limited which, together with certain of its subsidiaries, owns 73 per cent of the group's issued ordinary share capital. The group is principally engaged in the production and marketing of a wide variety of food products both in the United Kingdom and overseas.

120. The group's business in the United Kingdom is organised in seven main operating divisions each of which, with its own executive chairman and board of directors, is responsible for a defined area of activity. The divisions concerned with the supply in the United Kingdom of flour and bread are known respectively as Allied Mills and Allied Bakeries.

121. The origin of the group has already been referred to in Chapter 2 in the context of tracing the changing structures of the milling and baking industries. Its history may be briefly recapitulated by noting that between 1932 and 1935 Mr Weston bought several bakeries and in 1935 formed a company, Allied Bakeries Limited, which in 1962 was renamed Associated British Foods Limited. Until 1939 the company had imported its requirements of flour from Canada. By 1954, when the flour industry had been decontrolled, the company was operating 70 plant bakeries, of varying age and efficiency.

122. Between 1954 and 1958 Allied Bakeries Limited acquired further bakery businesses including some 16 plant bakeries and 900 bakery shops. In the period from 1958 to 1961 it acquired more bakery and shop businesses principally to secure additional retail outlets for its products. One such acquisition in 1961 concerned some 234 shops and 14 small bakeries. These bakeries were closed in 1963 and 1964. Many acquisitions were subsequently either modernised, replaced or closed as part of the group's programme of rationalising and improving its production and distribution activities.

123. In 1961 ABF entered the milling industry for the reasons briefly outlined in Chapter 2. Between 1961 and 1963 it bought 30 mills. By building new mills, modernising and extending existing capacity and vigorous marketing, together with the acquisitions referred to below, it had acquired some 21 per cent of the market for flour by 1974.

124. In 1968 ABF acquired from the Scottish Co-operative Wholesale Society 51 per cent of the equity in Chancelot Mill Limited, a company which was then erecting a new flour mill, with a capacity greater than its own needs, at Leith. In 1972 ABF also acquired Cranfield Brothers Limited—an East Anglian enterprise which, in addition to owning two medium and four small bakeries, also owned a large modernised double flour mill geographically favourably located for obtaining supplies of both home-grown and imported wheat.

125. The group's principal investments in new mills have been the Sunblest mill at Tilbury costing £1·3m (opened in 1969) and the Seaforth mill at Liverpool costing £2·3m (opened in 1973). The building of these mills together with substantial expenditure in modernising and enlarging the capacity at other plants and the acquisition in 1968 of a substantial interest in the Chancelot mill enabled a number of outdated mills to be closed. ABF closed 14 mills between 1966 and 1973.

Milling

126. In 1976 the group was producing reference flour at 21 mills in the United Kingdom. Ownership of these mills was vested in the group either directly or through its subsidiary Allied Mills Holdings Limited, except as regards one mill (Chancelot) in which the Co-operative Wholesale Society holds 49 per cent of the issued share capital. Eighteen of the mills were located in England; two (including Chancelot) were in Scotland and one was in Northern Ireland.

127. The group's requirements of hard wheats (mostly Canadian but also partly of USA origin) are purchased exclusively from its wholly-owned subsidiary, Mardorf, Peach and Company Limited. Supplies of imported soft wheat (almost wholly of French origin) are similarly acquired whilst home-grown wheat is purchased by the group directly from merchants, farmers and other sources.

128. The group supplies a wide range of flours suitable for use in bread, biscuit, cake and general food production. Its total flour production in 1976 was about 800,000 tons, the major portion of it being for use in breadmaking (bakers' flour). About 68 per cent of output is supplied to the group's own subsidiaries, principally in the bakeries division (Allied Bakeries). The remaining 32 per cent substantially comprises sales of bakers' flour to external customers including the Scottish Co-operative Society and plant and master bakers, specialised flours for use by biscuit and food manufacturers and own label pre-packed household flour sold to national supermarkets, food chains and voluntary groups. The group's sales of household flour account for about 3 per cent of its total flour production.

129. It is group policy that its bakeries shall obtain their flour supplies, save with minor exceptions in the case of certain speciality products, from the group's mills.

130. The group supplied approximately 190,000 tons of flour (including approximately 24,000 tons of household flour) to external customers in 1975. This is estimated to have accounted for about 11 per cent of the total free market in flour (see also paragraphs 236 to 238). About 5 per cent of the group's

flour production is sold to the Scottish Co-operative Wholesale Society with whom it jointly owns Chancelot mill (see paragraph 124). Such sales have not been regarded as external sales for the purposes of this paragraph.

Milling productivity, capacity and capacity utilisation

131. ABF says that installation of larger automated milling units, combined with significant management effort in modernisation and reorganisation has enabled substantial increases in productivity and cost reductions to be achieved at its mills. This is said to have been achieved to a considerable extent through the maintenance of a continuous, close relationship between the milling and baking divisions involving constant monitoring of performance and fine tuning to produce optimum results. Measured in terms of sacks of flour produced, output of Allied Mills had increased per employee between 1968–69 and 1975–76 by 50·6 per cent. The total number of mill employees (including production, despatch, transport, selling and administration personnel) decreased as a result of modernisation and rationalisation from 1,598 (excluding Cranfield) in March 1969 to 1,562 (including Cranfield) in March 1976, during which period the group's mills (including Cranfield mill which was acquired in 1972) had raised production from about 590,000 tons to 798,000 tons per annum.

132. The group has achieved substantial economies since 1967 by delivering flour from the group's mills in bulk. The entire production of its Tilbury and Seaforth mills is now so delivered. Of total group production about 61 per cent, and of deliveries to its own bakeries about 77 per cent, is delivered in bulk. At its new mills the wheatfeed by-product is processed into pelletised form thus effecting economies in its storage and transport and improving the overall profitability of the mills.

133. The group has supplied the following information about the rated capacities of its mills.

TABLE 3.1

Number of mills and their rated capacities as at 18 September 1976

ABF

Rated capacity	*Number of mills*	*Percentage of total installed rated capacity*
100 sacks per hour and over	2	26·6
80–99 sacks per hour	1	9·5
60–79 sacks per hour	2	14·7
40–59 sacks per hour	4	19·1
Less than 40 sacks	12*	30·1
	21	100·0

*Including one mill out of production undergoing reconstruction.

134. ABF said that it regarded 126 hours as the minimum number of running hours which any of its flour mills should work. This requires 3-shift working plus overtime of 6 hours on Saturday. The maximum practicable number of running hours which could be worked, assuming no hindrances, is slightly more than 160 and, provided running schedules can be consistently maintained at this high level, it is, in the group's view, then economic to work a 4-shift system. In practice only a minority of its mills are operated on this basis. In some cases mills are worked up to as much as 160 hours per week for a high

proportion of the year on the basis of 3 shifts plus overtime because adoption of 4-shift working is not economically justified. (Limiting factors are the necessary commitment to an enlarged work force and the adequacy of handling facilities, especially at mills delivering their output in sacks rather than in bulk.) Most of the group's mills operate 3 shifts giving from 136 to 150 running hours per week.

135. In assessing production performance at its mills ABF divides the total output achieved at each mill by the total number of running hours worked there in the year. This figure is then expressed as a percentage of that mill's rated capacity. It will be noted that rated plant capacity assumes literally continuous running and makes no allowance for stoppages or running changeovers. On the other hand the running hours include in most cases a very small proportion of time lost for these reasons. (Thus the quantity of flour produced per hour of actual running time will have been slightly understated.)

136. The capacity utilisation of the group's mills, calculated in accordance with the procedure referred to in paragraph 135, is as shown below.

TABLE 3.2
Capacity utilisation of flour mills as at 8 December 1976*
ABF

Rate of capacity utilisation	*Number of mills*
100 per cent and over	19
80–99 per cent	—
Less than 80 per cent	1

*At 8 December 1976 one mill was closed for re-model. The mill showing under 80 per cent utilisation had just re-opened after complete re-model and was being 'run-in'.

Milling industry associations: membership

137. The group is a member of the Incorporated National Association of British and Irish Millers Limited. Its subsidiary, Cranfield Brothers Limited, is a member of the Millers' Mutual Association.

Baking

138. As at December 1975 the group owned 43 bread bakeries of which 37 were in England and Wales, 4 in Scotland and 2 in Northern Ireland. At many of these bakeries non-reference types of bread and flour confectionery are produced in addition to reference bread. Operations at the bakeries are controlled by wholly-owned trading subsidiaries of Allied Bakeries Limited, which is itself a wholly-owned subsidiary of the group.

139. The group supplies bread nationally through its own specialist bakers' shops and retail rounds, and to independent grocery outlets, bakers' shops and caterers. In addition, it operates 'Light Bites', catering establishments with a strong bakery orientation. In October 1976 the group owned 1,778 specialist bakery shops. Allied Bakeries is the sole supplier of standard bread to the Fine Fare group and is a supplier to Stewart Supermarkets Limited of Belfast. These comprise the ABF group's grocery retailing activities, and in 1976 together operated some 900 supermarkets and other shops.

140. The group says that having had its origins in baking it continues to regard that aspect of its composite activities as of the greatest importance. By a decision taken in 1967 the group reversed its previous policy of diversifying outside baking and related activities. (In 1970 it disposed of its interests in the animal feeds business.)

141. The group markets its bread products under a wide variety of brand names some of which are used nationally and others locally. The best known of these is 'Sunblest', the name used for over 70 per cent of all the group's sales of wrapped bread. (Supermarkets and multiple grocery chains are said to find it easier to promote a range of products (eg bread of various types) if they are all sold under the same nationally-known brand name.)

142. In many of its retail outlets the group is currently installing hot bread units. The number of such units increased from 50 at March 1974 to 236 by October 1976. Further installations were, in 1976, being completed at the average rate of two per week. The group said that this development reflected its policy of extending its product range and distribution methods to meet competition and consumer demand, in this case the emerging demand for newly-baked, crusty, non-standard bread.

143. In 1967 ABF embarked on a programme of substantial investment involving the rebuilding and re-equipping of its bakeries. By 1974 it had closed 37 bakeries without any significant reduction of the group's total bread production. During that period two new bakeries costing about £4·2m were built and three existing bakeries were modernised and extended at approximately similar cost. In the eight years to March 1976 a total of £68m had been spent by the group on building and modernising its bakeries and a forward commitment of approximately £16m had been entered into for the same purpose. In 1976 a new plant bakery was opened, its cost being £4·3m.

Baking productivity, capacity and utilisation

144. The total number of bakery employees in the group (including, in addition to production workers, personnel engaged in plant maintenance, distribution and administration) decreased as a result of modernisation and rationalisation from 38,033 as at November 1969 to 29,239 by October 1976. The number of bread delivery routes operated by the group was reduced from 4,585 to 3,085 in the period 1966 to 1976. This was accounted for by a reduction of 2,054 in the number of increasingly unremunerative retail and mixed rounds and by an increase of 554 in wholesale rounds. The level of door-to-door sales has been maintained partly through arrangements made with certain major dairy companies who have increasingly sought to improve their margins by selling non-milk products.

145. The group has provided the information in the following table about the nominal capacities of its bread bakeries.

TABLE 3.3

Number of bread bakeries* and percentages of available capacity† represented by bakeries of various scales as at 18 September 1976

ABF

Nominal capacity	*Number of bread bakeries*	*Percentage of total available capacity*
36 sacks per hour and over	6	27·4
31–36 sacks per hour	2	6·6
25–30 sacks per hour	7	20·3
19–24 sacks per hour	13	29·7
15–18 sacks per hour	7	10·1
12–14 sacks per hour	2	2·8
7–11 sacks per hour	2	2·3
6 sacks and under per hour	1	0·8
	40	100.0

*Some bakeries are multi-plant. For the purposes of this table the nominal capacity of a bakery is the aggregated capacity of its plants.

†'Available capacity' is the plant capacity available for bread (excluding rolls and similar products) production only.

146. A note indicating the manner in which the group assesses bakery production capacity is at Appendix 5. On the basis of that method of assessment the group provided the following information about its bread bakeries.

TABLE 3.4
Capacity utilisation of bread bakeries at 18 September 1976
ABF

Rate of capacity utilisation	*Number of bread bakeries*
100 per cent and over	26
90–99 per cent	7
80–89 per cent	6
70–79 per cent	1
	40

Baking industry association: membership

147. The group is a member of the Federation of Bakers.

Research

148. The group established its own research laboratories in 1936 (renamed Weston Research Laboratories Limited in 1956). The laboratories conduct scientifically-based research and development into all aspects of milling and baking. It is also a prominent supporter of the Flour Milling and Baking Research Association and of other bodies undertaking research directly or indirectly concerned with the flour and bread industries. In the year 1973-74 expenditure by the group on research and development amounted to approximately £310,000.

Ranks Hovis McDougall Limited (The Group/RHM)

Growth and present structure

149. Ranks Hovis McDougall Limited is the holding company of a group of companies (the majority of which are wholly-owned) which carries on business, among other things, as a supplier in the United Kingdom of flour and bread. For management purposes the entire group organisation is divided into five trading divisions. The activities of three of those divisions have particular relevance to our investigation. Those divisions and their respective management companies are:

Division	*Management company*
Flour milling	RHM Flour Mills Limited
Bakeries	RHM Bakeries Limited
General products (grocery, catering, pre-packed flour)	RHM General Products Limited

150. Overall control of policy is exercised by the group's board of directors. Each divisional management company has its own board of directors headed by a managing director who, whilst enjoying a substantial degree of autonomy in respect of the division's commercial operations, is accountable to the group managing director for the total profitability of the subsidiary companies allocated to his division.

151. The group is the largest flour milling and also the largest bakery enterprise in the United Kingdom.

152. Ranks Hovis McDougall was incorporated in November 1933 under the name of Ranks Limited, as a public company to acquire the share capital of Joseph Rank Limited, a private company which itself had been incorporated in 1899 to acquire the family flour milling and animal feedingstuffs business founded in 1875 at Hull by the late Mr Joseph Rank.

153. During the second world war the group's mills suffered extensively from enemy action. That damage had been made good by 1953 by which date a new mill had also been built at Gateshead.

154. The circumstances in which RHM decided in 1954 to buy suitable bakery businesses have been referred to at paragraphs 67 and 68. In the late 1950s it also acquired companies engaged in marketing pre-packed flour; in the production and supply of certain flour-based products for use in the meat and fish trades and in the production of starch-reduced rolls.

155. An important development in the history of the group's interests in flour milling and baking was the acquisition by it in 1962 of Hovis McDougall Limited, a company which had substantial flour milling interests and also interests in baking and associated activities. That acquisition brought into the group two important proprietary products—Hovis flour, which was sold to nearly every bakery in the country, and McDougall's pre-packed flour, the largest-selling brand of pre-packed flour.

156. Since 1954 the group has purchased at a cost of some £32m over 200 businesses concerned with baking and the goodwill of about 500 wholesale and retail bread rounds at the cost of approximately £0·7m.

Milling

157. The group has carried out extensive reorganisation, rationalisation and modernisation of its flour mills in the last 20 years and over the last 13 years has spent some £18m on them. In 1973 it acquired the mill of Hudson, Ward and Company Limited at Tilbury.

158. In November 1976 the group owned and operated 18 flour mills of which 16 were in England and Wales, one was in Scotland and one in Northern Ireland. In addition it had a financial interest in two other companies engaged in flour milling. In the 12 years to 1976 the group closed 14 mills.

159. In recent years RHM Flour Mills Limited has purchased Canadian wheat direct from the Canadian Wheat Board at f.o.b. prices and has sought the most competitive quotations for shipment of the wheat from shippers, including Powell Union Produce Limited, which is a partly-owned group subsidiary. The group told us that its policy in the USA wheat market is to use the international grain shippers exclusively. As regards the purchase of European wheat, now almost entirely EEC wheat, RHM Flour Mills Limited uses the brokerage services of Anglo Belgian Produce Company (ABC) SA, which is a wholly-owned group subsidiary. Home-grown wheat is bought from merchanting companies within the group's Agricultural Division or from independent sources.

160. In 1976 the group produced about 1,168,000 tons of flour which it supplied to four main categories of customer, namely, bakers of bread and confectionery, biscuit manufacturers, manufacturers of convenience foods and pet foods and, in the case of pre-packed flour, grocers. About 68 per cent of its total production was supplied to companies within the group (principally in the bakeries division) for further processing into bread and other flour-based products or for packing and distribution as pre-packed household flour. Household flour production amounted to about 100,000 tons. Over 5 per cent of all flour produced by the group is 'Hovis' which is the principal national proprietary branded flour and is said to be used by almost all bakers. About 60 per cent of all its flour production is delivered in bulk.

161. Group policy requires that its flour-using subsidiaries shall obtain their flour supplies from the group's mills in so far as this is possible.

162. The group's share of the free market (see paragraphs 236 to 238) for flour was estimated to be somewhat in excess of 23 per cent in 1975. It told us that in 1974 its share of the market for branded pre-packed flour was about 37 per cent.

Milling productivity, capacity and capacity utilisation

163. Productivity at the group's mills has been increased substantially in recent years as evidenced by the fact that whilst in 1967 they produced about 1·2m tons with 4,946 employees, in 1973 they produced about 1·15m tons with 3,373 employees. This represents a productivity increase of about 42 per cent. When giving oral evidence to us in July 1976 the group's representative said that by then a productivity increase of 52 per cent had been achieved.

164. The group provided the following information about the installed rated capacities of its mills.

TABLE 3.5

Number of mills and their rated capacities for the financial year ended 1 September 1973*

RHM

Rated capacity	*Number of mills†*	*Percentage of total installed capacity*
100 sacks per hour and over	7	61·4
80–99 sacks per hour	1	5·1
60–79 sacks per hour	6	25·2
40–59 sacks per hour	—	—
Less than 40 sacks per hour	7	8·3
	21	100·0

*The group declined our invitation to provide more recent data.
†In some instances a mill is comprised of two plants. In such cases the rated capacity shown in the table is the aggregate of the capacities of both plants. The number of mills in operation in November 1976 was 18 (see paragraph 158).

Capacity utilisation of mills

165. For the purpose of assessing capacity utilisation of its flour mills RHM computes a national 'installed capacity per year' for each mill and measures actual production against that figure. In computing the 'installed capacity per year' figure a formula is used. It assumes that a full year, less statutory and annual holidays, is 49·3 weeks and that the net weekly working time on 3-shift working is 115 hours and on 4-shift working is 152 hours. The product of 49·3

and 115 or 152 gives an annual factor (5669·5 or 7493·6) which, as appropriate, is then multiplied by the installed rated capacity of each mill to determine its installed capacity per year. That figure represents 100 per cent capacity usage. The group said in June 1976 that it had planned to adopt 4-shift working at seven of its mills (as compared with four mills at October 1974). The group provided the information in the following table about the capacity utilisation of its mills as computed on the foregoing basis.

TABLE 3.6

Capacity utilisation of flour mills for the financial year ended 1 September 1973*

RHM

Rate of capacity utilisation	*Number of mills*
100 per cent and over	6
95–99 per cent	8
90–94 per cent	2
85–89 per cent	1
80–84 per cent	2
Less than 80 per cent	2†
	21‡

*The group declined our invitation to provide more recent data.
†Both of these mills were in the course of being run down prior to closure.
‡The number of mills in operation in November 1976 was 18 (see paragraph 158).

Milling industry associations: membership

166. The group is a member of the Millers' Mutual Association and of the Incorporated National Association of British and Irish Millers Limited.

Baking

Nature and extent of operations

167. At June 1974 the group owned 94 bakeries of which 75 were engaged wholly or partly in the production of reference bread. By June 1975 the total number of bakeries had been reduced to 83 (of which 66 were in England and Wales, 14 in Scotland and 3 in Northern Ireland) and of that total some 64 were mainly baking reference bread. In addition it owned through a subsidiary 50 per cent of the ordinary share capital in 7 associated bakery companies (only 5 of which are now trading) and all the preferred ordinary share capital and 30 per cent of the ordinary share capital in another bakery company. The group's bakeries division in June 1974 included 73 trading subsidiaries and sub-subsidiaries of which 70 operated one or more bakeries; two were concerned solely with retailing bread and one operated as a depot only.

168. About 70 per cent of bread produced by the group's bakeries is standard bread, sold mainly as loaves under the 'Mothers Pride', 'Red Seal', 'Milanda' brand names. The remaining 30 per cent of production comprises a range of speciality or fancy breads.

169. The group's bakeries division supplies bread by wholesale to grocers, supermarkets, master bakers, caterers and institutions as well as to agents (ie independent roundsmen) and to franchisemen (ie salesmen who operate defined retail rounds under agreements with bakeries). It also retails bread by house-to-house delivery and through its own shops. At 1 June 1975 the bakeries division was operating 1,063 bakery shops of which about one-half

provided a catering take-away service and some 330 additionally provided a range of in-shop catering services from coffee bars to self-service restaurants. The group said that it is expanding its catering business.

170. An extensive programme involving the closure of many bakeries and the modernisation, re-equipment and extension of others as well as the building of new bakeries cost the group some £62m in the period from 1958 to 1975.

Baking productivity, capacity and capacity utilisation

171. The number of employees engaged in all the group's bread bakeries has fallen by about 14 per cent from 39,312 in June 1971 to 33,826 in June 1975 during which period its estimated share of the total bread market fell by only about one-half per cent. The number of its employees concerned in selling bread also fell from 9,025 to 6,046 during this time reflecting the group's policy of converting suitable retail rounds to franchise operations.

172. RHM provided the information in the following tables about the nominal capacities of its bakeries.

TABLE 3.7

Number of bread bakeries* and percentage of nominal capacity represented by bakeries of various scales as at June 1975

RHM

Nominal capacity	*Number of bakeries*	*Percentage of total nominal capacity*
36 sacks per hour and over	2	9·7
31–35 sacks per hour	1	3·8
25–30 sacks per hour	2	5·9
19–24 sacks per hour	11	25·9
15–18 sacks per hour	14	24·7
12–14 sacks per hour	9	12·1
7–11 sacks per hour	7	6·9
6 sacks per hour and under	18	11·0
	64	100·0

*Some bakeries are multi-plant. For the purposes of this table the nominal capacity of a bakery is the aggregated capacity of its plants.

173. The following table shows the capacity utilisation of its bread bakeries in 1973. A note indicating the basis adopted by the group in determining bakery capacity utilisation is at Appendix 5.

TABLE 3.8

Capacity utilisation of bread bakeries as at April–May 1973*

RHM

Rate of capacity utilisation	*Number of bread bakeries*
100 per cent and over	24
90–99 per cent	19
80–89 per cent	12
70–79 per cent	8
Under 70 per cent	8
	71

*The group declined our invitation to provide more recent data.

Baking industry associations: membership

174. The group is a member of the Federation of Bakers and of the Scottish Association of Master Bakers.

Research

175. Until the early 1960s the group itself conducted little in the way of research work preferring to support and rely on work carried out by various research bodies connected with the flour milling and baking industries. With the acquisition of Hovis-McDougall Limited in 1962 its interests in food and food manufacturing became more diverse. Accordingly in 1963 it established its own central research laboratories to cover the whole field of the group's interests. This facility was complemented in 1967 by a larger unit—The Lord Rank Research Centre. In addition the group is a major supporter of the work of the Flour Milling and Baking Research Association and also employs, as occasion requires, outside consultancies (universities, research institutes and research associations). In the five years 1968–69 to 1972–73 the group's expenditure at its Research Centre and elsewhere on research and development amounted to approximately £6·1m.

176. The development of milling techniques to enable a higher proportion of soft wheat to be incorporated in breadmaking flour grists has brought about cost savings which the group estimated for 1975 at £4.25m and which, it told us, has been wholly passed on to all its baker customers in lower flour prices.

Spillers Limited (The Group/Spillers)

Growth and present structure

177. Spillers Limited is a quoted public company comprising a number of subsidiary companies principally concerned in the manufacture and distribution of food products in the United Kingdom where it is a leading supplier of flour and bread. Its milling and baking interests are vested in Spillers-French Holdings Limited which is owned as to 75·1 per cent by Spillers Limited and as to 24·9 per cent by J W French (Milling and Baking) Holdings Limited. The latter company is, in turn, jointly owned by the Co-operative Wholesale Society Limited and J Lyons and Company Limited.

178. In 1927, the group—then known as Spillers Milling and Associated Industries Limited and comprising principally flour milling, animal feedingstuffs and pet food interests—was reorganised under the name of Spillers Limited. By 1939 the re-formed company had grown substantially and had acquired new businesses in Scotland, closed down several old flour mills, opened new mills at Cardiff, Avonmouth and Newcastle upon Tyne and expanded its pet foods and animal feedingstuffs activities. It had also acquired a controlling interest in a large plant bakery in 1937.

179. As noted in Chapter 2, following decontrol of the flour milling industry in 1953, Spillers decided to acquire bakeries of its own. As with RHM this decision recognised the changing structure of the baking industry and especially the fast growing importance of Allied Bakeries Limited. Between 1954 and 1969 Spillers bought 70 plant baking firms in Great Britain.

180. By the mid-1960s Spillers' share of the bread market was about 11 per cent but, as a supplier of bread mainly to the wholesale grocery market, it was encountering increasing pressure from multiple groups for higher levels of discounts on their purchases. It thus felt itself to be in a trading position relatively

weaker than the other two main bread suppliers (Ranks and Allied Bakeries) each of whom had a substantially higher market share and was not so largely dependent on selling bread to wholesale grocers. Another bakery organisation, J W French (Milling and Baking) Holdings Limited, was in a somewhat similar position to Spillers. In 1972 the companies merged their milling and baking interests.

181. The group's flour milling and breadmaking activities are, respectively, conducted by Spillers-French Milling Limited and Spillers-French Baking Limited. A wholly-owned Spillers-French subsidiary, Federal Bakeries Limited, holds 50 per cent of the issued ordinary share capital in 10 bakery companies of which 7 at present operate plant bakeries under the name of Associated Family Bakers. That subsidiary acts as agent for Spillers-French Milling Limited in the supply of flour to those bakeries. The group has no mills or bakeries in Northern Ireland.

Milling

182. Changes in the group's structure and in the scale of its activities since 1956 have necessarily involved substantial rationalisation of its milling operations. Accordingly, several mills have been closed down, more than a dozen have been re-modelled and re-equipped and new mills have been built at Hull, London, Gainsborough and Glasgow. The cost to the group of modernising, rationalising and re-equipping its flour mills during the four years ended 31 January 1976 amounted to approximately £7m.

183. Wheat supplies for the group's mills are obtained through a subsidiary company, Spillers Grain and Feed Limited.

184. At October 1976 the group owned and operated 17 flour mills of which 16 were in England and Wales and one was in Scotland.

185. The group supplies a wide range of flours for use in all forms of baking as well as in food production generally, including the manufacture of pet foods. Its total output in the years 1975 and 1976 was at the rate of approximately 1m tons a year. About 39 per cent of that output is supplied to its baking subsidiaries and Federal Bakeries Limited whilst some 20 per cent is supplied to other non-baking group subsidiaries. The group is a leading supplier of flour to independent bakers as well as of pre-packed flour for domestic use. Pre-packed flour is supplied by the group to Spillers Foods Limited for packaging and marketing. About 60 per cent of the group's flour output is delivered to customers by bulk tankers.

186. Except as regards certain speciality flours, group policy is that its bakeries shall obtain their requirements of flour from the group's mills.

187. It is estimated that the group's share of the free market (see paragraphs 236 to 238) for flour was about 25 per cent in 1975. Flour supplied to Associated Family Bakers (see paragraph 181) has not been regarded as free trade for the purposes of the estimation in this paragraph.

188. Group production of household flour (mostly branded) in 1975 was about 95,000 tons. This is estimated to have represented about 28 per cent of the market for that product.

Milling productivity, capacity and capacity utilisation

189. Since 1972, although 4 of its mills have been closed, the volume of the group's production of flour has remained virtually unchanged. During that period the average nominal rated capacity utilisation of its mills has been raised from 87·9 per cent to 101·2 per cent. Productivity per milling employee was raised by over 21 per cent from the level of 2,186 sacks in 1972 to 2,650 sacks in 1975.

190. The group has supplied the following information about the rated capacities of its mills.

TABLE 3.9

Number of flour mills and their rated capacities as at 2 October 1976

Spillers

Rated capacity	*Number of mills*	*Percentage of total installed rated capacity*
100 sacks per hour and over	4	35·5
80–99 sacks per hour	5	32·6
60–79 sacks per hour	2	11·4
40–59 sacks per hour	4	15·7
Less than 40 sacks per hour	2	4·8
	17	100·0

191. In calculating mill capacity utilisation Spillers determines a standard output in sacks per week for each mill. For this purpose a mill working 4 shifts is deemed to operate for 152 hours per week and 3-shift working represents 112 hours per week. By multiplying the rated or nominal capacity of each mill by the appropriate number of hours worked a figure is obtained which represents 100 per cent capacity utilisation. Figures in excess of 100 per cent reflect overtime working. On this basis the figures in the following table have been provided by the group.

TABLE 3.10

Capacity utilisation of flour mills as at 2 October 1976

Spillers

Rate of capacity utilisation	*Number of mills*
100 per cent and over	6
95–99 per cent	5
90–94 per cent	4
85–89 per cent	1
80–84 per cent	–
Less than 80 per cent	1
	17

Milling industry associations: membership

192. The group is a member of the Millers' Mutual Association and of the Incorporated National Association of British and Irish Millers Limited.

Baking

Nature and extent of operations

193. At October 1976 the group owned and operated 36 bread bakeries of which 34 were in England and Wales and 2 in Scotland. In addition to producing reference bread many of these bakeries also produced non-reference products (eg flour confectionery). The group supplies the main bulk of its total bakery products to the grocery trade, catering outlets, institutions and master bakers. Door-to-door deliveries, principally by franchisemen, account for almost all of the balance.

194. The group spent approximately £4·8m in modernising, rationalising and re-equipping its bakeries during the four years ended 31 January 1976.

Baking productivity, capacity and capacity utilisation

195. The group said that it continually appraises and adjusts its baking capacity and that this has resulted in the closure of 15 bread bakeries between January 1972 and August 1976. In the 3 years 1973-75, during which its share of the total bread market fell by less than one per cent, the group said that it reduced the number of employees engaged in the production and distribution of its bakery products from 22,644 to 17,338. During the same period the average nominal capacity of its bakeries was substantially raised as was the rate of utilisation of that capacity.

196. The information in the following table has been provided by the group regarding its bakeries and their nominal capacity ranges.

TABLE 3.11

Number of bread bakeries* and percentages of total nominal capacity represented by bakeries of various scales as at 2 October 1976

Spillers

Nominal capacity	*Number of bakeries*	*Percentage of total nominal capacity*
36 sacks per hour and over	1	7·4
31–35 sacks per hour	1	6·2
25–30 sacks per hour	1	5·3
19–24 sacks per hour	5	19·2
15–18 sacks per hour	15	42·4
12–14 sacks per hour	3	6·3
7–11 sacks per hour	5	7·9
6 sacks per hour and under	5	5·3
	36	100·0

*Some bakeries are multi-plant. For the purposes of this table the nominal capacity of a bakery is the aggregated capacity of its plants.

197. A note by the group explaining its method of determining the capacity utilisation of its bakeries is at Appendix 5. Using that method the particulars in the subjoined table have been supplied by the group.

TABLE 3.12

Capacity utilisation of bread bakeries as at 2 October 1976

Spillers

Rate of capacity utilisation	*Number of bread bakeries*
100 per cent and over	23
90–99 per cent	5
80–89 per cent	4
70–79 per cent	2
Under 70 per cent	2
	36

198. The group said that it intended to continue to modernise its baking facilities, confining future installations to plants of at least 12 sacks per hour, and told us in 1976 that it envisaged that, subject to availability of the necessary capital, some 90 per cent of total output would within five years be from modern plants mainly of 9 sacks capacity or over per hour.

Baking industry associations: membership

199. The group is a member of the Federation of Bakers and of the Scottish Association of Master Bakers.

Research

200. The group maintains its own Research and Technology Centre which concerns itself not only with new bread products and techniques of baking, but also with new methods for assessing wheat and flour which are devised and tested in liaison with commercial plant breeders and other research organisations. Basic research to enable a higher proportion of soft wheats to be used in bread produced by the Chorleywood Bread Process; microbiological studies aimed at reducing the bacterial content of flours; development of the air-classification process in making special flours and studies in wheat damping and conditioning in milling bread flours are among matters on which work has been done by the Centre. In addition, the group is a major supporter of the Flour Milling and Baking Research Association (FMBRA). The group considers it commercially necessary to carry out some basic research work strictly within its own organisation, but in order to avoid duplication of effort it makes maximum use of FMBRA data. It collaborates with FMBRA provided that this does not involve the loss of any short-term competitive advantage arising from the group's own work in basic areas of technology and engineering.

CHAPTER 4

An outline of the principal regulatory controls affecting flour and bread supply since 1939

201. In the preceding chapters we have given some of the general background to milling and baking and have traced the major changes which have taken place in the structures of those industries in recent years. We now briefly outline the principal legislative and related official constraints and influences which have constituted the general environment in which the industries have operated since 1939. The effect which some of these have had on flour and bread supply is commented on in more detail in subsequent chapters.

Flour and Bread

The period from 1939 to 1956

202. At the outbreak of war in 1939 the Government introduced controls relating to extraction rates to be achieved by flour millers and the prices which they could charge for their products. In 1940 a baking subsidy was introduced and in 1941 price controls were extended to bread. The purpose of the subsidy was to stabilise the costs and profits of bakers from the time of purchasing flour to the time bread was sold. The rate of subsidy was determined principally by the price of flour and by baking costs. Hence, as the maximum rate of bakers' profits was fixed, any change in the price of flour was reflected either in the price of bread or in the rate of the baking subsidy. An additional graduated subsidy was later introduced with the purpose of achieving, for smaller bakers, a greater degree of equality with the larger bakers whose unit costs were lower. The rate of this subsidy varied from time to time and the subsidy ceased in 1945. The flat rate of basic subsidy had been calculated so as to achieve an average profit of five shillings (25p) per 280lb sack of flour used. After 1945 the smaller bakers became increasingly discontented with this margin and sought a return of the graduated additional subsidy.

203. In April 1953 the subsidy on flour was removed and the whole increase in the resulting price of flour was transferred to the baking subsidy. It was then recognised that the smaller bakers were, on that account, placed at a disadvantage because, chiefly in the purchase of flour, the larger bakers could negotiate better terms with their suppliers. As all bakers were required to charge the same retail prices for bread, the Government introduced an additional subsidy of four shillings (20p) per sack payable to all bakers on the first 25 sacks of weekly flour usage. In October 1954 the permitted profit margin was raised from five shillings to seven shillings and sixpence (37½p) a sack equivalent. This increase was designed to service the additional capital necessarily employed in baking since the inception of price control and to offset inflation since then. Price control on bread and the baking subsidy were removed in September 1956.

204. During the period from 1942 to 1956 the number of bakers claiming subsidy fell by over 40 per cent. Among the factors regarded as contributing to that decline were the fact that the controlled price levels of bread were too low to permit an adequate return on capital employed, labour shortages and the effect of the subsidy arrangements.

Flour

The period since 1956

205. Between the years 1956 and 1964 there was no statutory price control on flour. Nevertheless as flour (and hence bread) was regarded as a politically sensitive commodity the industry was encouraged to notify intended price changes to the Ministry of Agriculture. Two price reductions were made during the period (in June 1960 and October 1962) and three increases were made (in 1963) in order to maintain a gross margin of 32s 6d (162½p) per sack.

206. The Government took powers in 1964 to control prices and incomes generally. These powers initially took the form of a voluntary scheme, later replaced by statutory provisions, under which early warning of intended increases in the price of flour was to be given by millers. The National Board for Prices and Incomes (NBPI) examined proposed increases in flour prices during this period and a liaison committee was established in August 1966 to ensure close and regular contacts between Government and the flour milling industry.

207. As discussions in the flour liaison committee were on an industry-wide basis the Minister of Agriculture informed the trade representatives that concerted action resulting from such discussions would not be regarded as involving any breach of the Restrictive Trade Practices Act 1956.

208. On a change of administration in June 1970, the early warning system was replaced by a system of voluntary notifications of intended price increases for certain products, including flour. In November 1970 an increase was made under these arrangements to offset increased material, production and distribution costs. The voluntary notification system was, in practice, modified in response to the CBI initiative of August 1971 under which unavoidable price rises were limited to 5 per cent subject to the effect of increased costs of imported materials. By mid-1972 flour prices were increased on account of significant increases in both material and production costs. These had risen over a period but had not been immediately or fully reflected in increased prices, partly, we were told, at Ministerial request. By October 1972 increasing world wheat prices resulted in a further flour price increase.

209. World prices of wheat were rising dramatically by the end of 1972, partly on account of a Russian crop failure. The industry, however, having purchased forward supplies of wheat in substantial quantities, had some immediate measure of protection against their effects.

210. Legislation was introduced in November 1972 to freeze prices at existing levels. This standstill, which was known as Stage 1 of the counter-inflation provisions, lasted until April 1973. The milling industry, on account of the situation referred to in paragraph 209, sought to be exempted from this prices standstill but its request was rejected.

211. A Price Commission was established on 2 April 1973 under the Counter-Inflation Act 1973. Its primary function is to ensure that the provisions of the Price Code relating to prices are implemented. A common provision of each Stage of Price Code arrangements has enabled manufacturers to recover in their prices allowable increases in their costs. Millers have generally sought to do so in so far as the overall constraints of the market have permitted.

Bread

The period since 1956

212. After the bread industry was freed from statutory control in September 1956, the Federation of Wholesale and Multiple Bakers (FWMB) recommended to its members the minimum retail price levels for bread on the basis of certain costings provided by members. That arrangement, which is said to have had the support of the Minister of Agriculture, was changed in April 1958 to one whereby FWMB recommended not minimum, but maximum, price levels for bread. The Restrictive Practices Court ruled that this was in breach of the restrictive trade practices legislation and the arrangement ceased in November 1959.

213. As in the case of flour, although statutory control of bread prices had ceased in 1956, government continued to take a keen interest in the industry. In this connection major bakers prepared cost statements which sought to justify, by reference to increased costs incurred, any increases they proposed to make in bread prices. These proposals were discussed with the Ministry and agreements were reached as to the timing and, presumably, the amount of increases. This practice obtained from about the end of 1959 until 1965.

214. In November 1964, in continuation of the voluntary arrangements referred to in paragraph 206, the price of the standard loaf rose by 1d. In May 1965 the matter of this increase in the price of bread was referred to the NBPI for investigation. That body was also asked to examine the justification for the level of bread prices generally. It reported[1] in September 1965 that the November 1964 increase had been justified but recommended a standstill on bread prices for six months (ie until the end of February 1966) during which time the industry should examine its productivity and discuss with government whether the long-term needs of the industry warranted an adjustment in prices. The industry found this recommendation unacceptable and, after discussion with government, the major bakery groups undertook to review the position after three months.

215. In December 1965 the levels of bakery workers' wages had been referred to NBPI. The bakers, having been pressing for increases in bread prices, were reluctant to await the Board's report. In the event one of them acted unilaterally and, with effect from 17 January 1966, increased the price of its standard loaf by 1d to 1s 4½d. The other major bakers awaited the Board's findings[2] which were published on 18 January 1966. These were to the effect that an increase of 1d above the November 1964 level was justified and all bakers raised their prices by this amount within two weeks.

[1] NBPI: *Prices of Bread and Flour: Report No 3* (Cmnd 2760) HMSO, 1965.
[2] NBPI: *Wages in the Bakery Industry: Report No 9* (Interim) (Cmnd 2878) HMSO, 1966.

216. In June 1966 the NBPI report[1] on bakery wages was published and in July the Government announced a standstill on prices and incomes until the end of 1966 to be followed by a period of severe restraint until the end of June 1967. Meanwhile in August 1966 a bread industry liaison committee had been formed and we are informed that the Minister suggested in that forum that bread prices might be increased by 1d per large loaf in February 1967 provided this was followed by a price standstill of 12 months. This suggestion was rejected by the industry. Instead, a price increase of 1d was allowed as from 16 January 1967, accompanied by a statement that the industry did not intend making any further increase before 30 June 1967.

217. In December 1967 one of the Big Three groups gave early warning of its intention to increase the price of its standard loaf by 1d in order to offset cost increases and to provide a better return on capital employed. Later in the same month the flour millers gave early warning of proposed flour price increases on account of devaluation of the pound in November. An increase of 1½d per loaf was authorised with effect from 12 February 1968 to allow for devaluation (½d), other cost increases (½d) and to provide a better return on investment (½d). On 3 February 1969 a further increase of 1d was authorised on account of cost increases, including a wage settlement in the industry.

218. By 1969 it had become clear that existing procedures for dealing with applications for bread price increases were defective in that, under price control legislation, individual companies were required to submit accounting information in support of their proposed price increases whereas, in the liaison committee, negotiations with Government were conducted on an industry basis. Additionally, the industry felt that the restriction of price increases, in general, to a level sufficient only to recoup additional costs, had adversely affected its profitability for several years. The Ministry therefore invited the major bakery groups in July 1969 to prepare and submit a memorandum suggesting a new procedure to govern future bread price changes. This was done in October 1969 in a document proposing that profit levels in the industry, rather than the examination of costs in arrears, should be the main consideration and that the problems of under-recovery of costs and the level of return on assets employed, should be dealt with under new arrangements. The text of this document is reproduced at Appendix 6.

219. In December 1969 the major groups all notified proposed increases in bread prices aimed at restoring profit margins to a more acceptable level. The Minister agreed to an interim increase and referred to NBPI the matters of the adequacy of return on capital and the proposed new price review arrangements. NBPI produced two reports[2] in relation to this reference.

220. The first NBPI report, made in April 1970, recommended a further increase of 1d in the retail price for large loaves in order to provide funds for investment in bakery plant. In that report it noted that the average return on

[1] NBPI: *Wages in the Bakery Industry: Report No 17* (Cmnd 3019) HMSO, 1966.

[2] NBPI: *Bread Prices and Pay in the Baking Industry: First Report: No 144* (Cmnd 4329) HMSO, 1970.
NBPI: *Bread Prices and Pay in the Baking Industry: Second Report: No 151* (Cmnd 4428) HMSO, 1970.

capital employed in the industry was lower than it had been in 1965; that the return of the most profitable of the five main bakery companies examined was lower than the average for industry as a whole; that two of the five largest companies were making losses and that 'the capital needs of the major plant bakers have, therefore, continued to be met in part from the milling and other interests of the groups concerned'.

221. In the second of its reports, published in July 1970, NBPI said, regarding the proposed revised arrangements referred to in paragraph 218, as follows:

> 'We consider that the procedure proposed by the bakers would be an improvement on present arrangements subject, however, to important qualifications. Initially information about the rate of return will need to be based on assets depreciated on a historic basis, but a move to valuations based on depreciated replacement cost should be made as soon as possible and in order to ensure consistency in making comparisons. It will still be for individual firms to submit proposals for a price increase when they think one justified. According to the Board of Trade, the average rate of return earned by the food industry over the last three years for which figures are available (1966–68) was 13·4 per cent; a somewhat lower figure might be appropriate for bread at the present time. However, the use of any particular figures must be subject to important qualifications relating to the return obtainable on new investment, the return obtained by the groups to which the major plant bakers belong on related activities, and the need to contain costs through higher efficiency and in particular to avoid any assurance that the cost of negotiated wage increases can automatically be passed on in the form of higher prices.'

Meanwhile a change of government had taken place (in June 1970) and the proposed new system for reviewing bread prices appears not to have been pursued.

222. The new administration terminated the early warning arrangements shortly after taking office in June 1970 and substituted a system of voluntary notification of intended price changes for certain products, including bread. An increase of 1d per loaf was made under these arrangements in November 1970. From mid-July 1971 to November 1972 bread pricing decisions were influenced by undertakings given by producers to the CBI and by increasing government concern about the amount and timing of food price increases generally.

223. In May 1972 the Minister of Agriculture, Fisheries and Food was informed that it was the intention of the major producers to raise the prices of all loaves by ½d from about the end of that month. As a result of discussion with the Minister the industry agreed to defer the increase until 26 June and not to apply it to 14 oz loaves. The Minister also obtained an assurance from the major groups that the exact timing of future price increases would be discussed with his Department before implementation.

224. Although flour prices had been increased in October 1972 bakers were precluded from increasing bread prices because of the prices standstill imposed in November 1972 under Stage 1 of the Counter-Inflation legislation. In March

1973 the major suppliers pressed the Minister to permit an increase in bread prices. Their representations were not successful but they did secure consent for a 10 per cent increase in the price of certain products other than bread (eg cakes, buns and flour confectionery).

225. Stages 2 and 3 of the Price Code arrangements (which covered the period up to 19 December 1974) were regarded by the major bread suppliers as particularly onerous because of the time-lag involved between notification to the Price Commission of price increases and their implementation and also because of the provision whereby successive increases were required to be separated by at least a three months' interval. (The former of these provisions applied only during Stage 2 which ended on 31 October 1973 and the latter provision did not come into effect until 15 May 1974.) In addition, the major bakers felt that the non-allowance for price increase purposes of 50 per cent of wage increases was particularly harsh in their industry which was both labour-intensive and declining in size. A change in the base date in Stage 3 (for the purpose of establishing the relationship of unit costs to prices) was also unfavourably regarded. Although the relevant provisions were modified in Stage 4, which operated from 20 December 1974 until 31 July 1976, the plant bakers did not cease to regard operation of the Price Code as preventing them from making adequate profits although the Stage 4 Code made additional provisions designed to safeguard profits and to facilitate capital investment. The revised Price Code which has operated since 1 August 1976, provides for further relaxations including enhanced rates of profit safeguards and an increase in the rate of investment relief.

226. Early in 1974 the Price Commission, under the provisions of paragraph 80 of the Code then in operation, required a reduction of 10 per cent to be made in the gross margin reference levels of food distributors, including the large multiple retailers in respect of their food activities. This action was superseded five weeks later by a Code Amendment which applied the cut in margin to virtually all distribution activities. The effect of this on bread supply had significant consequences for the plant bakers (see paragraph 296).

Household flour subsidy

227. For household flour supplied in retail packages of prescribed maximum weights, a subsidy of 0·9p per lb was introduced under the Household Flour Subsidy Scheme 1974 with effect from 2 September 1974. The subsidy is paid to the miller or packer and the Scheme requires that its amount shall be fully reflected in the suppliers' selling prices and trading discounts neither of which may be changed without the consent of the Minister. The maximum price at which subsidised household flour may be sold (as at February 1977) is prescribed in The Household Flour Prices (Amendment) Order 1977[1].

The bread subsidy

228. In March 1974 the Bread Subsidy Scheme 1974 was introduced whereby a subsidy became payable to bakers in respect of flour used in producing all standard and speciality loaves of over 10 oz. From May 1974 the coverage was

[1] Statutory Instrument 1977 No 192.

extended to include all tin-baked loaves of 8 oz to 10 oz. The objective of the subsidy was to leave the industry neither better nor worse off than it would otherwise have been. In practice the rate of subsidy corresponded to the amount which the Big Three plant bakers would otherwise have been able to recover from the market by price increases on subsidised bread in the light of the Price Commission's determinations on their pre-notifications and of commercial constraints on prices. As DPCP has told us: 'The price parallelism which exists on standard bread means that in practice the major baking companies will only be able to take the lowest increase proposed by any of them—the so-called "back marker" principle.' Where the rate of subsidy, as so determined, fell short of a producer's entitlements under the Price Code it was open to him to seek to recover the difference on speciality loaves (see also paragraph 230). The rates of subsidy which have been payable from time to time are as shown below.

TABLE 4.1

Bread subsidy rates

As at	*Rate of subsidy per sack of flour used*
24 March 1974	£1·21
12 May 1974	£3·81
13 August 1974	£4·65
29 September 1974	£5·16
12 January 1975	£6·22
16 February 1975	£5·16
30 November 1975	£4·06
8 April 1976	£2·98
2 January 1977	£1·90

Supplementary subsidy for master bakers

229. The higher unit costs of the master baker's operations were, prior to introduction of the bread subsidy, generally reflected in the higher prices of his bread products. As, however, the differential which existed at the base date between his prices and those of plant bakers for subsidised bread had since widened, on account of the operation of the back marker principle referred to in paragraph 228, it was deemed equitable to take action to restore the previous relationship. This was done by means of supplementary subsidy which was introduced in August 1974. It was then at the rate of 25p per sack on the first 40 sacks of flour used, provided total weekly usage in the production of eligible types of bread (ie bread qualifying for the basic subsidy referred to in paragraph 228) did not exceed 200 sacks. The rate was increased to 90p in September 1974, reduced to 60p in November 1975 and further reduced to 30p in January 1977 when the 200 sacks weekly limit was reduced to 150 sacks.

Pricing of non-standard bread

230. For the purposes of the Price Code the size of the enterprise is material and only large enterprises are required to pre-notify price increases to the Price Commission. The effect of this has been that most master bakers have been able to adjust the prices of many of their non-subsidised products as they have deemed to be appropriate within the constraints of the market. The large pre-notifying enterprises (which include the Big Three bakery groups) have, from time to time, been able within the terms of the Price Code to increase the prices of many of their bread products, other than standard loaves, by amounts sufficient to offset allowable cost increases on bread baking generally.

Pricing of subsidised bread

231. In January 1975 the Bread Subsidy Scheme 1975 superseded the 1974 Scheme (see paragraph 228). Its principal objective was to limit the amount of discount which could be given by claimants on subsidised bread loaves supplied by them. The 1975 Scheme was replaced, in March 1976, by a slightly amended Scheme which, in turn, was superseded by the Bread Subsidy Scheme 1977 (see paragraph 234).

232. To ensure that the benefit of the bread subsidy was passed on to the consumer, Orders[1] were made (the first of them having effect from 28 October 1974) under the Prices Act 1974 fixing the maximum retail prices of subsidised bread loaves.

233. Under the foregoing arrangements, which obtained until early in 1977, there was thus control over the amount of discount which bakers could give on subsidised bread loaves supplied to retailers and over the maximum price at which such loaves could be sold to the public.

234. On 2 January 1977 the Bread Subsidy Scheme 1977 came into force. It differed from previous Schemes in that it made no provision for discount limitation on the sale of subsidised loaves as a condition of eligibility for bread subsidy. And, with effect from 4 January 1977, a new Bread Prices Order[2] extended price control to most categories of bread loaves irrespective of subsidy. It also provided for reductions in the prescribed maximum retail prices of such bread by amounts related to the effective level of discounts received by retailers from their suppliers.

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[1] Among the 11 Orders made were:
The Bread Prices Order 1974 No 1711;
The Bread Prices Order 1975 No 1245;
The Bread Prices Order 1976 No 511.

[2] The Bread Prices (No 2) Order 1976 No 2128.

CHAPTER 5

Competition, market shares, prices and discounts

235. In Chapter 3 we noted in broad outline how the markets in flour and bread are shared as between the Big Three groups and independent suppliers. We now look at the individual shares of the flour and bread markets held by each of the Big Three groups, the general competitive environment and the pricing and discount policies and behaviour of those groups in relation to flour and bread supply in recent years.

Flour

Market distribution: the Big Three and the independent millers

236. From data provided by the Big Three groups we estimate that in 1975 out of a total United Kingdom flour market of some 3·7m tons, those groups supplied over 1·9m tons to their own flour-using subsidiaries and to other users with whom they had some form of preferential trading arrangement, including tied loans. Effectively this portion of the flour market was not open to independent flour suppliers. In addition, RHM and Spillers supplied about 0·2m tons of household flour to subsidiary companies within their own groups. But as that flour was not *used* within those groups (being sold to wholesalers and retailers after packaging) we have regarded it as having been supplied on the free market. On this basis the free market is estimated, for 1975, at somewhat less than 1·8m tons. The overall position therefore is that millers outside the Big Three groups were excluded from over 51 per cent of the total flour market and that those groups, together with independent millers, were in competition to supply the remainder of that market.

237. In using the term 'free market' we recognise that some independent millers, too, have tied outlets for some of their flour. And in using the term 'independent' we also recognise that some such millers are themselves part of larger organisations which include baking amongst their activities. We are informed, for instance, that a large biscuit manufacturer has a substantial holding in certain independent milling companies. Similarly we are also aware of a minority holding which one of the Big Three groups has in two independent milling companies. For all these reasons it is clear that the genuinely free market in flour was well under 1·8m tons in 1975 and that the independent millers seeking to supply it were not wholly independent either of the Big Three groups or of other enterprises. However to use the terms 'free' and 'independent', in their broad sense, is sufficiently accurate in the present context.

238. Taking the nominally free market in flour as 1·8m tons and noting the estimate in table 2.2 of the amount of flour supplied by independent millers, that market would appear to have been divided in 1975 approximately as follows:

Big Three milling groups	1·07m tons (59 per cent)
Independent millers	0·73m tons (41 per cent)

We are not aware of any circumstances likely significantly to have varied this division of the market during the year 1976.

239. The approximate percentages of the total market represented by bakers', household and other flour are shown in paragraph 35 whilst table 2.2 indicates the approximate division of the market as between the Big Three groups and the independent millers for each product classification.

240. As shown in Appendix 1 the independent millers are generally located in proximity to their sources of home-grown wheat. As such wheats are used to a substantial extent in the production of, for example, household, cake and biscuit flours, independent millers, as might be expected, supply a significant part of those markets (see table 2.2 and paragraph 74). One witness, himself an independent miller, estimated that 80 per cent of biscuit flour is supplied by independent millers. We were informed that profitability in biscuit flour is low, a fact which witnesses have told us is accounted for by the strong buying power of the biscuit manufacturers.

Market shares held by each of the Big Three groups

241. Each of the Big Three groups has estimated its individual percentage share of the total market for flour in the United Kingdom for each of the years 1965 to 1975 as shown below. It will be noted that on the basis of these estimates their aggregate share of the market in 1975 was 78·8 per cent. The marginal difference between this figure and that estimated in table 2.2 may largely be accounted for, *inter alia*, by the fact that a different 'year' has been used by each of the three groups both for assessing the volume of its own sales and the total volume of flour supplied annually. In considering the market shares held by ABF and Spillers, in particular, it should be noted that in 1972 each of these groups increased its milling activities by acquisition or merger (see paragraphs 124 and 180).

TABLE 5.1

Estimated percentage shares of the United Kingdom market in flour supplied individually and collectively by the Big Three milling groups: 1965–1975

Year	*ABF*	*RHM*	*Spillers*	*Big Three Total Share*
1965	10·9	30·5	18·9	60·3
1966	11·5	30·9	19·4	61·8
1967	12·5	31·7	19·3	63·5
1968	14·5	31·7	19·5	65·7
1969	15·8	31·0	19·8	66·6
1970	17·3	30·8	20·0	68·1
1971	17·5	31·0	19·9	68·4
1972	17·1	31·3	26·8	75·2
1973	19·5	31·6	27·3	78·4
1974	21·1	31·3	26·6	79·0
1975	21·7	30·7	26·4	78·8

Flour pricing by the Big Three groups

242. Each of the Big Three groups told us that its main flour products are substantially the same, type for type and grade for grade, as those of its competitors. This similarity has been confirmed to us by independent plant bakers who, like bakers generally, obtain supplies of flour from more than one supplier. One of them told us that, whilst he occasionally blended the separate flours before use, he often used them unblended without any discernible variation in product quality. Further evidence in support of the substitutability

of different suppliers' products is implicit in what RHM said to us in regard to its pricing policy. It observed '. . . (we operate in a market) in which a number of suppliers are competing for the business of individual customers by supplying products (flour and bread) which in composition and performance can vary only by a little and which to a large extent are therefore directly substitutable for the products of other suppliers'. In another context the same group wrote 'The principal types of bread flour are in the nature of standard commodities, homogeneous in type and known to users to be such . . .'. ABF and Spillers expressed similar views.

243. In considering the pricing policies adopted by millers it is relevant, therefore, to note that they are competing to supply similar products in a market which is, overall, static in volume but which has been in decline, in respect of the bakers' flour and household flour sectors, for several years (see paragraph 58).

244. As is the practice of the flour trade, the Big Three millers do not publish list prices for flour other than household flour, though ABF told us that its price lists were freely available to its customers. The groups told us that price lists served merely as a guide to sales staff, the prices shown on them providing no more than datum or reference points from which actual net prices are determined. Where a particular type or grade of flour is required to meet the needs of a particular customer no list price is produced even for internal use. Instead the price for that product was said to be determined on the basis of grist and production costs.

245. A feature of the (pre-metrication) list price is that it relates to the supply of 280 lb (a sack) of flour in bagged form, the weight of individual bags generally being 70 lb or 112 lb. Where an order consists of less than a stipulated minimum quantity, the price list generally provides for a surcharge on the listed price.

246. The objective pursued in setting its flour prices was stated by ABF to be 'to seek any improvement in operating margins which can be achieved within the external constraints imposed by government and in the general context of declining demand and some degree of excess production capacity in the industry as a whole'. Spillers said that its policy was 'to set prices at as high a level as is practicable in the prevailing circumstances'. RHM told us that its milling division was 'expected to stand on its own feet and make the best profits that it can in the current economic trading conditions in the milling industry'.

247. In determining list prices for their products all the groups said that they had to have regard primarily to grist and production costs as well as to the price realised for wheatfeed. In addition, RHM said that, in pricing its bakers' flour, it sought to meet the requirements of its flour-consuming subsidiaries as economically as possible and at the same time to secure as much external trade as possible in 'highly competitive conditions to the extent necessary to keep its mills operating economically'. ABF and Spillers said substantially the same. All the groups pointed to the high proportion of total flour costs which is represented by the cost of wheat (see paragraph 25).

248. As regards pre-packed flour Spillers said that in setting list prices it sought to secure a return of 30 per cent gross on sales, to remain competitive

with Ranks' brands and maintain existing levels of price differentials between its branded products and own label products. RHM also said that it had to have regard to the prices charged by retailers of own label flours and by those charged by Spillers for its competing branded products.

Grist composition and flour prices

249. Each of the groups told us about the impact which grist costs have on total flour production costs and, therefore, on flour prices generally. Each of them indicated that grist costs were materially influenced by their hard wheat content. Thus ABF, in reply to a question whether a variation of 10 per cent in the hard wheat content of grist would produce any difference in the price of flour replied 'That would show up on the price list, because the types of flour vary in price depending basically upon the grist they are made from'. Spillers said 'To a large degree the difference in price (of flour) is influenced by the Canadian and North American wheats which we use, because the price of that is higher'. RHM said 'The factor which underlies differences in the group's list prices (for flour) is differences in the price of the wheat used for blending in the grist'.

250. We asked each of the groups to provide us with details showing the hard wheat content of its chief brand of CBP flour as supplied to external customers and the list price of that flour as at particular dates over a 12 month period. The results are as shown below. (For this purpose the groups are not referred to by name.)

TABLE 5.2

Flour grists and flour prices: the Big Three groups
Details for the period April 1974 to March 1975

Date	*Percentage hard wheat content of grist used in making comparable grades of bakers' flour as supplied to external customers*			*List price per 280 lb sack of comparable grades of bakers' flour as supplied to external customers*		
1974	X	Y	Z	X	Y	Z
1 April	39	45	40	£14·81	£14·75	£14·86
1 May	40	45	40	14·81	14·75	14·86
1 June	40	45	40	16·70	16·75	16·78
1 July	41	45	40	16·70	16·75	16·78
1 August	43	45	40	16·70	16·75	16·78
1 September	42	50	40	16·70	16·75	16·78
1 October	42	52½	40	16·70	16·75	16·78
1 November	41	52½	44½	16·49	16·45	16·48
1 December	33	52½	44½	16·33	16·45	16·48
1975						
1 January	40	52½	44½	16·33	16·45	16·48
1 February	48	57½	44½	16·33	16·45	16·18
1 March	46	55	44½	16·21	16·45	16·18
Average	41·3	49·8	41·9	16·23	16·29	16·28

Note:

In relation to the above table both ABF and RHM have emphasised that it might be misleading to draw firm conclusions solely from the data contained in it. Among the qualifications which ABF said should be borne in mind in evaluating the table are the following:

1. The hard wheat contents of the grist shown in the table are the averages as used at a particular date; are only part of the total grist, and grist compositions can and do change from day to day or week to week.
2. The figures take no account of the grade or quality of the wheat.
3. List prices of flour reflect a number of considerations of which the strong wheat content is only one, and certain of those considerations may be such, in practice, as to modify (if not override) the influence of the hard wheat element.
4. The protein content of hard wheat can vary according to type from 11 per cent to 15 per cent.
5. List prices, since Price Commission control, will have changed more in relation to the weighted average grist cost of *all bread flours* than to the grist composition or part grist composition of any *one* bread flour.

On the basis of this evidence we can only conclude that the price of flour does not appear necessarily to have been directly related to the proportion of hard wheat used in the grist.

Transfer prices for flour within the Big Three groups

251. The substantial amount of the Big Three intra-group trade in flour has been indicated at paragraph 236. The levels of prices for flour so supplied are important to any assessment of the profitability of those groups' milling and baking activities. They are also important in connection with statutory price control arrangements for subsidised standard bread loaves, since under those arrangements it is essentially the costs of the Big Three bakers (or, more accurately, the lowest costs of any of them) which are taken into account. Flour represents about 36 per cent of bread production costs.

252. We consider, first, the groups' pricing policies in relation to flour supplied to their subsidiaries.

253. ABF said that its prices for flour supplied to its bakery division were set out in inter-company correspondence and that its pricing policy sought to achieve broad parity of treatment as between flour sold to Allied Bakeries and to independent bakers where equivalent quantities of comparable products were concerned. It added that in practice the quantities supplied to independent bakers were usually smaller than those supplied to individual bakeries within the group.

254. RHM told us that it did not have separate price lists for flour supplied within the group. It said it was group policy that where flour is sold for further processing by group companies the price is normally an arm's length price[1] and that group companies paid RHM Flour Mill's list price less the appropriate load allowance for large bag and bulk delivery (though in the case of speciality flour the load allowance is received regardless of the quantity supplied).

255. Spillers, like RHM, said that its policy was to charge arm's length prices for flour supplied to its own subsidiaries except as regards household flour which is transferred to its subsidiary, Spillers Foods Limited, for sale and distribution to retailers. In the latter instance the transfer price is, as with RHM, said to be determined on the basis of grist cost plus manufacturing charges.

The Price Code and flour prices

256. As noted in paragraph 211 the pricing of flour has since April 1973 been influenced by the operation of the Price Code. As to transfer prices generally paragraph 43 of the Stage 4 Price Code (paragraph 56 of the 1976 Code) provides that:

> 'Where the (Price) Commission are satisfied that prices, either of purchases or of sales which an enterprise proposes to regard as a basis for the calculation of allowable cost increases or of net profit margins, differ

[1] The exception is Tenstar which is priced on a formula based on grist cost, the price being paid by Tenstar Products to RHM Flour Mills. Pre-packed flour, which is not sold for further processing but for packing and distribution, is also priced to the group companies on a formula based on grist costs.

from what they would be if the goods . . . had been transferred on an arm's length basis, they may substitute modified cost increases or profit margins which in their judgment fairly reflect what would be appropriate on that basis.'

257. We observed that in their evidence both RHM and Spillers used the term 'arm's length' to describe the prices charged by them for flour supplied to their flour-using subsidiaries. When we asked precisely what it meant a representative of RHM referred to the fact that it was the term used in the Price Code. He said that his group's pricing policy for flour supplied to its subsidiaries was regarded as having been officially approved because 'we had a very long investigation by the Price Commission into this in great detail and they are satisfied as a result of that investigation that (the practice of charging similar prices for the same product when supplied to internal and external customers) is a sound and sensible basis which they themselves would accept as "arm's length".' Spillers and ABF commented similarly. The Price Commission, however, told us that it did not consider that such an assumption of official approval could necessarily be justified and added:

> 'Before the Price Commission could substitute modified cost increases or profit margins under this Code paragraph (ie 56 of the 1976 Code) it would need to have convincing evidence that the transfer prices differed from what they would have been on an arm's length basis. The fact that the (Price) Commission has not exercised that power merely means that it has not had such evidence; this does not lead necessarily to the conclusion that the Price Commission has at all times been satisfied that the transfer prices are what they would have been on an arm's length basis.'

258. We found that none of the Big Three groups gave to its flour-using subsidiaries an overall discount in recognition of the total volume of flour supplied to them though it seemed probable that, if a true arm's length relationship had existed between, say, their milling and baking divisions, the latter would have been able to use their considerable buying power to secure significant price reductions.

259. Our enquiries confirmed that the actual net prices charged by two of the Big Three groups were virtually the same when the same flour was supplied in like quantity to their own subsidiaries and to external customers. But, in the case of the third of the Big Three groups, such identity could not be established because, although prices were about the same for apparently comparable flour supplied internally and externally, the grist composition of CBP and other bakers' flour milled by that group for use in its own bakeries had, on average, a significantly higher percentage hard wheat content than for comparable flours supplied to external customers (cf paragraphs 249 and 250). The other two groups, however, told us that, for example, CBP flour used in their own bakeries was exactly the same as the CBP flour supplied to external customers.

260. Each of the groups referred to the effect of the Price Code on the profitability of flour milling in recent years. In so doing each emphasised the interdependence of its milling and baking operations in relation to the group's overall profit performance. The following are extracts from submissions made

to us by ABF in this connection. They summarise the general view of the groups on the impact of statutory price controls on their flour pricing policy.

> 'The effect of statutory price control on milling and baking and other factors . . . has been to impel the ABF milling companies to raise their list prices (for flour) in this period (since the end of 1973) by the maximum amount permitted by the Price Commission. The basic concept of the Price Code has throughout been essentially control by reference to increases in allowable costs and the revenue needed to recover them. This resulted in different permitted increases for the various Groups. ABF for its part took such maximum permitted increases for flour and it appears that the other Groups did likewise. . . .
>
> '. . . As a matter of principle the Code controls prices by reference to permitted *margins* of profit. The greater the quantum of allowable cost increase, the greater will be the amount, in sterling terms, of the permitted increases in (bread) prices. Thus the increase in wheat prices that have taken place in and since 1972 have increased the *cash* margins resulting from the millers' permitted price increases. The above feature of the Code has created every incentive for ABF to improve the cash profits on the milling side as some compensation for the hammering that bread profits have taken. If the Milling Division had decided to take less than its full permitted price increase for the sake of enabling Allied Bakeries to receive cheaper flour, then:
>
> (i) the mills would be unable on any subsequent price increase to recoup the full amount of the difference; and
>
> (ii) Allied Bakeries would not be permitted to retain the saving under the Code, notwithstanding its undoubted need for improved cash flow. . . .'

The group added:

> '. . . During the years 1973–74 and 1974–75 we were entirely subject to statutory price controls. Those controls introduced distortions, one of which was to remove any incentive for Allied Mills to accept lower percentage profit margins on sales of flour to Allied Bakeries, which would only have reduced the profits of the latter by reducing Allied Bakeries' allowable costs and would have caused Allied Mills to lose *permanently* a part of any permissible price increase not taken up. . . . Since Allied Bakeries has been the "back-marker" in the industry under price control, profitability in the (baking) industry as a whole would have been even more depressed than it has been, if Allied Mills had passed on the full benefit of cost savings.'

261. Specifically ABF attributed the high return on its milling activities in its financial years 1974 and 1975 (see table 7.5) entirely to operation of price control. Its representative added:

> 'We do not apologise for the fact that we used it for improving our bakeries rather than for adjusting the prices of our flour. Had we passed it on to independent bakers in the form of lower prices for flour this would have prevented them from applying for increased bread prices because they would not have had the necessary allowable cost increases to justify

them. On the other hand, had we passed on the profit to our own bakeries alone, because of their position as the back-marker in baking, the effect would have been to force all the independent bakers out of business.'

262. We were told that many independent millers, because they had low profit reference levels under the Price Code, were prevented by the Code from raising flour prices to more profitable levels even if market conditions should permit them to do so.

263. Spillers said that, as regards pre-packed flour, increases in retail prices of the major brands were effectively limited to the lowest increase allowed by the Price Commission to any of the major suppliers and that, as brand sales within the market were extremely elastic, it endeavoured to ascertain from its chief competitors what increases they had applied for and been permitted. This action was necessary to ensure that it did not over-price its own brands. Also, to ensure that pressures from large customers did not delay implementation of price increases, the group said that it sought to obtain information as to the timing of price increases by its competitors.

264. The maximum price at which subsidised household flour may be sold by retail is prescribed by Order (see paragraph 227).

Discounts on flour sales

265. Each of the groups allows off its list prices for flour the same settlement discount. That discount amounts to 2 per cent for settlement within 10 days or 1 per cent for settlement within 20 days of the invoice date. Bulk tanker delivery and load allowances are also earned, where appropriate, on the scale shown below. RHM's load allowance applies to its bakers' flours excluding Hovis.

Bulk tanker delivery allowance

ABF	10p to 15p per sack (280 lb)
RHM	15p per sack
Spillers	15p to 45p per sack for 8 to 18-ton deliveries

Load allowance

ABF	1 ton and over	6p per sack (280 lb)
	2 tons and over	10p per sack
	5 tons and over	22p per sack
RHM	1 ton and over	5p per sack
	2 tons and over	10p per sack
	5 tons and over	15p per sack
	10 tons and over	22½p per sack
Spillers	1 ton and over	5p per sack
	2 tons and over	10p per sack
	5 tons and over	15p per sack
	10 tons and over	22½p per sack

266. In addition to the standard, freely available discounts referred to above, each of the groups said that, in negotiating actual prices charged to external customers, it would, if deemed to be commercially prudent to do so, grant an

additional or special discount. In deciding whether to grant such discount each group said that it would have regard to a variety of circumstances including the terms likely to be offered by competitors, the value and importance of the business on offer, the workload on the mill likely to be concerned in the transaction and the contribution to extra profit that the trade would provide.

267. The groups all said that in the flour trade what counted was the actual net price and that the process of arriving at that price often ignored the mathematical calculations implicit in list prices and allowances and discounts off the list prices whether those allowances and discounts were for settlement, quantity, bulk delivery or special reasons. As regards speciality flours, however, we were told that the price actually charged was generally the list price less any freely available discount earned (ie the question of a special discount did not arise in relation to such flour).

268. Spillers summed up the general position in oral evidence to us in the following terms in reply to a question about the practice of allowing 'standard discounts for bulk delivery and prompt payment'. Its representative said: 'We do not have discounts in that sense of the word in the flour milling industry. The only discounts are for payment. Otherwise we negotiate with each customer individually the price we can get. There are no standard discounts. . . .' The same group referred to the highly competitive situation which exists in the biscuit flour market which may result in prices being charged which are not wholly related to costs.

269. One of the Big Three groups told us that out of its total customers for bakers' flour the number who from time to time obtain a special discount element in the net flour prices paid by them fluctuated between about 6 per cent and 12 per cent.

Big Three flour price changes for bakers' flour compared[1]

270. The following table shows the changes in list prices made by each of the major groups in the period from February 1960 to October 1976 for its main brand of bakers' flour. The list prices quoted by RHM and Spillers for their equivalent products were identical, or almost identical, immediately prior to 1 February 1960 and those of all three groups were identical, or almost identical, when ABF began supplying bakers' flour in 1963.

TABLE 5.3

Date	*RHM* £	*Spillers* £	*ABF* £
1/2/60		+0·15	*(Milling division not formed until 1963)*
25/4/60	+0·15		
27/6/60	−0·05		
1/7/60		−0·05	
10/3/61	+0·15		
11/4/61		+0·15	
28/8/61	+0·15		
1/11/61		+0·15	
13/11/61	+0·10		
20/11/61		+0·10	
15/10/62	−0·10	−0·10	

[1]Price changes up to and including those of May 1976 relate to a sack of 280 lb. Thereafter they relate to a sack of 100 kg (approximately 220 lb).

Table 5.3 (*contd*)

Date	*RHM* £	*Spillers* £	*ABF* £
20/5/63	+0·10		
27/5/63		+0·10	
11/11/63	+0·15	+0·15	
25/11/63			+0·15
30/12/63	+0·15	+0·15	+0·15
5/3/65		−0·10	
8/3/65	−0·10		−0·10
13/6/66	+0·15	+0·15	
4/7/66			+0·15
1/1/67	+0·40	+0·40	
2/1/67			+0·40
12/2/68	+0·40	+0·40	+0·40
16/11/70	+0·40	+0·40	+0·40
21/6/72	+0·70	+0·70	+0·70
16/10/72	+0·40	+0·40	+0·40
4/6/73			+0·40
11/6/73	+0·40	+0·40	
26/9/73			+0·69
29/9/73	+0·65		
1/10/73		+0·65	
15/11/73			+2·14
16/11/73		+1·70	
17/11/73	+1·82		
31/12/73	+0·05		
4/1/74			+1·46
7/1/74	+1·91	+1·95	
11/2/74	+1·03	+1·30	
14/2/74			+1·11
21/3/74	+1·25	+0·95	+1·29
4/5/74	+2·27		
6/5/74		+2·00	+2·25
28/10/74			−0·21
18/11/74			−0·16
25/11/74	−0·30	−0·30	
6/1/75	−0·30		
17/2/75			−0·12
28/4/75	+0·40		+0·36
5/5/75		+0·35	
8/9/75		−0·18	
15/9/75	−0·39	−0·16	
23/2/76	+0·41		+0·34
8/3/76		+0·35	
5/4/76			+0·41
26/4/76	+0·56		
3/5/76		+0·42	
10/5/76			−0·03
2/8/76		+0·59	
7/8/76			+0·54
9/8/76	+0·58		
4/10/76		+0·81	
9/10/76			+0·84
11/10/76	+0·84		

Bread

The market and its suppliers

271. In Chapter 2 we have given an outline of the structure of the bread-making industry and have indicated the positions occupied by the three classes of suppliers, namely, the Big Three plant bakers, the independent plant bakers and the master bakers. In this connection we would explain that the term 'independent' is here used by us to differentiate between those plant bakers who are members of the Big Three groups and those who are not. Some bakers

who, in our terms, are independent, are known to be subsidiaries of larger groupings and hence probably have access to wider financial resources.

272. It can reasonably be deduced from the estimates given in table 2.4 that, whilst some 5,500 master bakers account for 27 per cent of all reference bread supplied in the United Kingdom, they are unlikely to be in a position to influence the price of standard bread of which their aggregate share of that market is estimated at only about one per cent. Nor can there be any real probability that less than 45 independent plant bakers having an aggregate share of the standard bread market of only 15 per cent could, either individually or collectively, exercise price leadership nationally in regard to that commodity.

273. About two-thirds of the total bread market is accounted for by standard bread produced by the Big Three and independent plant bakers. It is produced in automated plants from bakers' flour which has been tailored to a close specification requiring, among other qualities, precisely determined levels of protein and absorptive capacity. Hence, as several witnesses pointed out, standard bread has many of the attributes of traded commodities.

274. Millers, and others, were said to engage continuously in intensive research into wheat properties, optimum gristing mixes, milling techniques, baking processes and bakery equipment with the aim of producing a flour precisely suited to the production of standard bread by the Chorleywood Bread Process at the lowest possible cost. There was said to be close technical collaboration between millers and plant bakers, both within the groups and outside them.

275. Each of the major bakers has sought by brand advertising to secure primacy for its standard bread product, but we have been told that brand loyalty is, in practice, virtually non-existent in that field.

276. Our reference includes in its scope types of bread in addition to standard bread. Some of these other products are often regarded as specialities and, as the demand for them is not on a scale which always warrants mass production methods, they are not a large part of the Big Three and the independent plant bakers' total output. The data in table 2.6 would appear to confirm this.

277. As we have noted in paragraph 39, there has been a tendency for some of the larger retailers to bake bread on their own premises. Supermarket and hypermarket operators having in-store bakeries are thus in competition with plant bakers in that they supply part of the bread requirements of what might otherwise be some of the plant bakers' largest customers. Reference has also been made in paragraphs 40 and 111 to the advent of hot bread shops.

278. The attraction which hot bread shops and in-store bakeries offer to customers is the freshness of their products, a fact which is visually evident and also implicit in the aroma of baking bread. The method of production employed, whether CBP or ADD (see paragraphs 44 and 47), can convert raw materials into baked products in between 1½ and 2½ hours. And, if low levels of yeast are used, output from the oven can be extended over a long period although the actual dough-making operation has taken place early in the day.

Market shares held by each of the Big Three bakery groups

279. In view of the wide range and diverse nature of products which comprise reference bread it is not possible readily to establish the precise size of the market in terms of any common basis of measurement (eg quartern).

280. Each of the Big Three bakers estimated its share of the total market for reference bread in the United Kingdom for each of the years 1965 to 1975 as shown below. (As noted in paragraph 241 in the case of flour, different 'years' have been used by each of the three groups and somewhat different means of assessing the non-domestic element in the total bread market volume have been adopted.) In considering the market shares held by ABF and Spillers, in particular, the timing of the acquisitions referred to in paragraphs 124 and 180 should be borne in mind.

TABLE 5.3

Percentage shares of the United Kingdom market in bread supplied individually and collectively by the Big Three baking groups: 1965–1975

Year	*ABF*	*RHM*	*Spillers*	*Big Three Total Share*
1965	19·4	21·1	10·7	51·2
1966	19·0	21·6	11·0	51·6
1967	16·9	23·3	11·1	50·3
1968	17·0	23·5	10·3	50·8
1969	17·9	23·7	11·0	52·6
1970	17·1	24·4	10·8	52·3
1971	17·0	23·9	11·1	52·0
1972	19·5	24·8	11·1	55·4
1973	20·6	25·2	17·2	53·0
1974	20·7	23·8	16·4	60·9
1975	21·7	23·3	16·5	61·5

Bread pricing by the Big Three groups

281. Each of the groups told us that in setting prices for bread it endeavoured to attain objectives similar to those which it sought to achieve in pricing its flour (see paragraph 246).

282. The pricing policies of each of the Big Three groups were described to us in much the same terms. Spillers' policy, as quoted below, is typical of them all. That group said:

> 'The pricing policy relating to bread and rolls is subject to the Counter-Inflation Price Code as well as to commercial considerations. In normal times prices are determined on the basis of the costs of the product, the degree of competition expected,[1] the price normally obtained within the product group as a whole and the profit contribution expected to be made by other members of the same product group. Products with distinctive characteristics such as taste, texture or packaging, and containing higher cost ingredients, sometimes command a higher price (though not always a higher unit profit) than otherwise comparable products without such distinctive characteristics, and are marketed in order to increase overall sales and therefore market share. At the present time, pricing policy is simply to recover costs so far as is possible within the limits of the Price Code and to the extent allowed by competition.'[1]

[1] In the case of standard bread, it is not possible to charge higher prices than those of the Company's competitors.

283. As regards reference bread of types other than standard bread the Big Three groups and the other plant bakers are in competition with the master bakers. Collectively the master bakers would appear to have the larger share of this sector of the bread market (see table 2.6). Although there are no certain means of determining the position for the United Kingdom as a whole, the weight of the opinions expressed to us was that the general level of non-standard bread prices was not set by the Big Three but by master bakers. Representatives of the Scottish Association of Master Bakers, however, said that one of the difficulties encountered by that Association's members arose from the relationship which existed between the price of standard bread and that for rolls and baps. So, to that extent, the pricing policies on which standard bread prices are determined appear to have an influence on the prices which most master bakers can set for at least some of their products. But, even so, this hardly disturbs the view that the influence of master bakers on this sector of the market is, on the whole, significant, if not decisive.

284. RHM said that for speciality or fancy breads, normally commanding a higher price than standard bread, it moved its prices generally by the same amount and at the same time as for standard bread 'so as to maintain the differentials which have become established in the light of commercial experience'. This suggests that the prices of non-standard bread generally would appear to bear a close relationship to those of standard bread.

Bread prices, allowances and discounts

285. It is the accepted practice of the plant bakery trade to sell bread to retailers at a published retail list price less a basic allowance of 12½ per cent off that price. This is the means whereby a wholesale price is established. In addition, a discount may be given. The level of discount above the 12½ per cent allowance is negotiated with individual retailers. The chief factors governing its quantum (when this is not limited by law) concerned, we were told, the competitive situation, the volume of sales involved or likely to be involved, savings in distribution costs and the necessity to keep bakery production capacity employed to the greatest extent economically possible. (Reference is made in paragraphs 298 *et seq* to statutory limitation of discounts on subsidised bread loaves supplied by bakers.)

The competitive position

286. Before proceeding to look in detail at how list prices for bread are determined and the circumstances which, in practice, influence discount behaviour, it is appropriate to consider some of the factors which are said to govern the supply position generally.

287. Each of the Big Three groups, as well as representatives of bakers generally, argued that, principally for the reason given at paragraph 273, none of them could sell the standard loaf at a price higher than could any other plant baker. They said that the producer with the lowest costs—who they emphasised need not necessarily be the most efficient producer—sets the price. Such a producer is, in the language of the trade, the back-marker (see also paragraph 228).

288. As has already been explained, RHM entered baking in 1954. In 1966 its then Chairman decided not to await the outcome of a reference to NBPI (see paragraph 215) and on 17 January increased the price of the standard loaf by 1d two weeks or so before the rest of the trade (see also paragraph 308). The effect was the immediate loss of trade equivalent to 2,000 sacks a week which the group took a long time to recapture. In recounting this experience the present Chairman of RHM told us 'We were then inexperienced in the trade. We thought we could stand it but we could not'. We were told, too, that when one producer reduces his price (as only rarely happens) the others must inevitably do so simultaneously and to the same extent. A price reduction of ½p for a standard loaf was made by one of the groups in October 1975 (see paragraph 304) and, although, as is shown in Chapter 7, that was a time when most plant bakers were making very low profits, the other groups nevertheless considered themselves compelled to make the same reduction.

289. In noting that the plant baking industry is dominated by the Big Three groups it should be recognised that one of them (ABF) had its origins in baking whilst the other two (RHM and Spillers) were founded in milling. Thus ABF has had over 40 years' experience in baking in the United Kingdom whereas the other groups, for the most part, have been baking for only about half that time (since 1954). This is not to imply that those groups are technically any less accomplished on that account. But it does mean that they have been in the industry during a period when it has experienced almost continuous official controls. And during that time all the Big Three groups have been heavily engaged in endeavouring to establish, mainly by acquisitions, rationalisation and modernisation programmes, their bread production and distribution operations. Thus, on account of their relatively late entry into baking, RHM and Spillers have had, if anything, a somewhat greater task than ABF in this connection because ABF already had earlier momentum in its process of reorganisation whereas the others had to acquire it from a standing start in 1954. ABF is the acknowledged lowest cost bread producer and the back-marker. Neither RHM nor Spillers can ignore it in considering bread pricing.

290. A longer term difficulty for the industry has been the steady decline in the overall demand for bread for several decades. Demand has fallen by over a third since 1956. A second substantial factor which became acute in recent years has been the growing buying power of the multiple grocery groups who retail bread (see paragraph 116). They have been able to exercise that power the more effectively because of the volume-sensitive nature of the plant baking industry. This sensitivity has been accentuated by the existence within the industry of a significant amount of spare, excess, under-utilised or otherwise marginally profitable production capacity. And although in any circumstances the loss to a plant baker of a national multiple grocery retailer's business can be a serious matter, it is even more serious when that baker is also a miller whose mill output is directly related to his bakeries' bread sales. Furthermore, we were told that multiple retailers obtain their supplies at any one time, not from one, but from two or three, major bakers. Such buyers are thus in a position to 'drop' a supplier who is not prepared to do business on terms which are at least as favourable as those conceded by any of his co-suppliers. Given these circumstances the market is essentially one of strong buyers and weak sellers.

291. In an attempt to curb the pressures on them by retailers for progressively more attractive terms, the major groups sought, before 1974, to take some form of concerted action to limit the scale of discounts and related concessions and advantages. The attempt was not notably successful because, we were told, of the mutual distrust which existed between the major bakery groups in a weak market. There was, too, the restrictive trade practices legislation which proscribed concerted action of this character (see paragraph 310).

292. Concurrently with these events, the delivery of bread by directly employed bakery roundsmen was becoming less profitable. Some of the groups have sought to overcome this by entering into distribution arrangements with milk suppliers (cf paragraph 144).

293. There has been, too, the essentially local competitive influence of the independent plant bakers, none of whom operates nationally. Independent bakers are said to enjoy certain cost advantages which are denied to the large national groups. First, the nature of the independent's business is generally the supply of bread from a single bakery. Geographically his market is restricted by the cost of distribution to within a radius of about 40 miles. Independent plant bakers appear to be at no cost disadvantage as regards the supply of flour. We were told that some of them may even obtain flour at a marginally lower price than the Big Three's own bakeries. Nor does the independent baker incur national advertising costs or costs associated with what one of the Big Three referred to as 'fancy executives'. He is able to keep costs down and exercise personal supervision over every aspect of his operations. Furthermore, not all grocery supermarkets are in the national chains. Hence independent bakers are often able to secure substantial amounts of local supermarket business through their ability to offer exceptionally attractive terms. These the Big Three suppliers have to match if they seek to be joint suppliers to such outlets. We were also told that independent bakers often have an effect on bread prices outside their own supply areas. Thus Spillers said that it was not unusual for an independent baker to secure some of the local business of a national retail chain on highly competitive terms which that chain then expected to be matched nationally by the Big Three. ABF confirmed that independent plant bakers in their own localities were frequently more aggressive competitors than the big groups.

294. Finally, the competitive position of the Big Three bakers has been influenced by the extent to which there are outlets for their products within their own organisations. In this connection it is sufficient to note that ABF has shop outlets within its own organisation for a significant proportion of its bread output (cf paragraph 139). At the other extreme is Spillers with virtually no such outlets. Occupying a middle position is RHM with its own shops and expanding catering interests.

The effect of statutory controls on bread prices, discounts and baking generally

295. In addition to the general competitive considerations referred to in paragraphs 286 to 294 there has been, as set out in Chapter 4, strict government control over the baking industry for many years. Some of the effects of that control, as represented to us by the Big Three groups as well as other plant bakers, are referred to below.

296. The Counter-Inflation legislation which came into operation in November 1972 (see paragraphs 224 *et seq*) caused, we were told, a number of independent plant bakers to leave the industry. However this may be, the Price Commission requirement early in 1974 that the gross margin reference levels of food distributors be reduced by 10 per cent (see paragraph 226) had a direct effect on the levels of discounts given by the major bakers. This arose because, in applying the 10 per cent reduction in gross margin reference levels, the multiple food retailers are understood to have concentrated it largely on bread thus enabling them to reduce bread retail prices. Those retailers then exerted increased pressure on their bread suppliers for increased discounts. Also the smaller grocers, who hitherto had not been able to obtain discounts of the magnitude enjoyed by the multiple retailers, then renewed pressure on the plant bakers for comparable terms. They did so through the voluntary or symbol groups (see paragraph 115) and, in September 1974, Spillers yielded to this pressure with RHM following shortly afterwards. The discount war which had hitherto been sporadic now intensified although its effect was bound to result in increased unprofitability for the whole plant baking industry.

297. As has been noted at paragraph 228 a bread subsidy had been introduced in March 1974. It was apparent that, unless restrained in some fashion, the increased discount levels being granted by bakers would in due course have to be paid for by the Exchequer. This would be bound to arise because, under Price Code arrangements, increased discounts would be allowable costs and the subsidy would have to be increased if bread price increases were to be avoided. Statutory controls were therefore applied to the maximum discounts which suppliers could grant on subsidised bread loaves and to the maximum retail prices at which such loaves could be sold (see paragraphs 231 to 234).

298. The Bread Subsidy Scheme 1975 which came into effect on 13 January 1975 provided *inter alia* that, with minor exceptions, no discount on the sale of subsidised bread loaves by a subsidy claimant (ie a baker) might, save with consent of the Secretary of State, exceed 22½ per cent. Any discounts which were then being allowed which exceeded that level were required to be reduced to it.

299. RHM in its submissions to us was particularly conscious of what it regarded as the penalty which had been inflicted on it in this connection solely on account of its responsible behaviour. It said that in compliance with repeated official entreaties to the trade generally to behave responsibly in the matter of discounts, it had kept its discounts to a level lower than those of its main competitors. Thus the windfall which accrued to it when, in 1975, discounts were required to be rolled back to the 22½ per cent level was smaller than that enjoyed by those competitors who had behaved less responsibly (see table 7.4).

300. Some independent plant bakers sought permission to grant discounts in excess of those statutorily prescribed on the ground that they needed to do so in order to counterbalance the greater advertising power of the Big Three groups. At the suggestion of Government, this led to a voluntary agreement whereby the Big Three undertook to refrain from national advertising of their major brands of 28 oz standard bread for a period.

301. The composite effect of revisions of the Price Code, the Bread Subsidy Scheme and the Bread Price Orders (see Chapter 4) was to improve the profit-

ability of the baking industry, though they created new difficulties of their own. Notwithstanding these difficulties both RHM and Spillers emphasised to us in mid-1976 the importance which they attached to the continued statutory control of discounts on bread sales.

302. Concurrent operation of the several controls referred to in paragraph 301 undoubtedly did lead to anomalies and some distortion of competition in bread supply. ABF pointed, for example, to the fact that the method of computing the rate of subsidy tended to produce price alignment of bread at the level of the lowest-cost producer whilst the Subsidy Scheme also produced rigidity because competition in discounts had been eliminated. That group also referred to the fact that prior official approval was required for any reduction (as well as for any increase) in the retail list prices for subsidised bread loaves and to the fact that the Bread Prices Orders were officially regarded (in the absence of specific dispensation) as requiring uniformity in the retail price for the same product when supplied by different bakers.

303. By way of illustrating some of the anomalies which arose during operation of the various forms of control we mention one particular instance which was brought to our attention. It concerned a plant baker who, on account of the operation of the Price Code was unable to raise his price for standard bread to the level allowed by government and as laid down in the Bread Price Order. The reason for his inability to do so was, we were told, that the Bread Subsidy Scheme 1975 had required him (and all other plant bakers) to roll back the level of discounts on wholesale bread sales to the 22½ per cent maximum prescribed in that Scheme. The baker in question had been giving discounts of 35 per cent or so hence, in turning these back to 22½ per cent, he found himself trading more profitably than he could have even imagined to be possible. This, of course, affected his position under the Price Code in that he could not apply a price increase to his products—even if it were approved by government as being generally justified for subsidised bread—because his profit reference level related to a much less prosperous trading position. This baker was, therefore, allowed by the DPCP to continue to sell his subsidised bread at a lower price than any other supplier on condition that he would not seek to exploit his advantage by increasing his share of the market.

304. ABF told us that, that in October 1975, because of Allied Bakeries' profit margin reference level position under the Price Code, it had to seek the approval of DPCP for making a ½p reduction in the price of its standard loaf and that in consequence the whole industry had to follow suit. It is a matter of record that after less than two months ABF, like all other plant bakers, found it necessary to increase the price of bread on account of circumstances which were foreseen in October.

305. RHM made the general comment (in October 1975) that:

> 'The great complexity created by the interaction of the Price Code, the regulation of discounts and the subsidy mechanism remains. It is probably inevitable that unforeseen eventualities will continue to appear for so long as the fundamentally differing concepts of control on an industry-wide basis (embodied in the regulation of discounts) and of control by enterprise (embodied in the Price Code) are operated side by side.'

306. In all these circumstances it is clear that since November 1972 the major bakers have not been free to fix their own bread prices and between January 1975 and December 1976 were unable to compete in discounts on subsidised bread sales. Thus it would be somewhat unrealistic to expect the list prices of bread, particularly subsidised standard bread loaves, to have shown any variation as between different suppliers in recent years. The nature of the product, the structure of the market and government action have all contributed to price similarity. In their report[1] on bread (and flour) prices in September 1965 NBPI wrote:

> 'In our view there are special factors in the bread industry which militate against price competition. The demand for bread is inelastic; a reduction in the price does not enlarge the market, nor does any practicable reduction significantly enlarge the market share of one competitor against another. A price reduction, in order to be effective in attracting new customers, should be at least one (old) penny per loaf; but such a cut would have a disproportionate effect on profits since it would represent some 7 per cent of the selling price of bread.'

307. Since NBPI made that comment there would not appear to have existed much opportunity for assessing how the 'special factors' have militated against price competition since, as ABF writing in May 1976 has remarked, 'in the last 10 years there has been only one bread price change by ABF which was made in circumstances where it was free to make and announce its own decision, unfettered by any discussion with or notification to MAFF or any other (official) body'. Each of the groups, as well as the Federation of Bakers, has emphasised the effect which the several government controls and constraints referred to in Chapter 4 have had on both the level of bread prices and the timing of bread price changes over many years. They have argued that, in so far as there has been parallel pricing in bread supply, this has been not only accepted by government but has been required by it as an instrument of policy.

Standard bread price changes compared

308. The following table shows the changes in the recommended retail sale price of a 28 oz wrapped and sliced loaf of standard bread supplied by each of the Big Three bakers in the period from December 1960 to October 1976. (The price of such a loaf was 12d at the former date and 20p at the latter date in most areas.)

TABLE 5.4

Date	*RHM*	*Spillers*	*ABF*
12/12/60	+½d	+½d	+½d
12/6/61			+½d
19/6/61	+½d	+½d	
5/2/62	+½d	+½d	+½d
27/5/63			+½d
17/6/63	+½d	+½d	
9/12/63	+½d	+½d	+½d
2/11/64	+1d	+1d	+1d
17/1/66	+1d		
25/1/66		+1d	
31/1/66			+1d
16/1/67	+1d	+1d	+1d
12/2/68	+1½d	+1½d	+1½d

[1] NBPI: *Prices of Bread and Flour: Report No 3* (Cmnd 2760), HMSO, 1965.

TABLE 5.4 (*cont.*)

Date	*RHM*	*Spillers*	*ABF*
3/2/69	+1d	+1d	+1d
5/1/70	+1d	+1d	+1d
20/4/70	+1d	+1d	+1d
30/11/70	+1d	+1d	+1d
15/2/71	(price rounded down from 1/11d to 9½p on decimalisation)		
6/12/71	+½p	+½p	+½p
26/6/72	+½p	+½p	+½p
4/6/73	+½p	+½p	+½p
1/10/73	+½p	+½p	+½p
19/11/73	+1p	+1p	+1p
7/1/74	+1p	+1p	+1p
18/2/74	+1p	+1p	+1p
18/2/75	+1½p	+1½p	+1½p
5/5/75	+½p	+½p	+½p
20/10/75	−½p	−½p	−½p
1/12/75	+1p	+1p	+1p
5/4/76	+1p	+1p	+1p
9/8/76	+1p	+1p	+1p
10/10/76	+1p	+1p	+1p

Profitability of bread retailing

309. Selling bread by retail is said to be a relatively profitable activity for large food shops. We were told of a trade survey carried out in 1973–74 by United Biscuits (UK) Limited which showed that wrapped bread and packaged cakes then accounted for 14 per cent of the total gross profit contribution from 7 per cent of the shelf space in grocery retail outlets. The next best profit earner produced 9·2 per cent of total gross profit contribution from 9 per cent of shelf space. Apart from this, retail business in bread is conducted for cash; there are no bad debts and settlement with suppliers is made in arrears, often monthly. Bread is a perishable commodity which has to be bought regularly. If sold at a reduced price it can thus be relied on to attract customers regularly.

Registration of restrictive agreements

310. Each of the groups informed the Commission of arrangements or agreements made from time to time to secure some limitation of the level of discounts and other inducements to retail customers (see paragraph 291). Most of these were of limited and local effect only. During the currency of this inquiry the groups furnished to the Office of Fair Trading in this connection details of some 77 such agreements to all, or some, of which they had at some time been party.

CHAPTER 6

The evidence of other parties

311. In the course of our investigation we sought the views of those associations of employers and of employees principally engaged in the supply of flour and bread. In addition, we invited a number of individual suppliers to comment on those aspects of supply of which they might be expected to have knowledge particularly in relation to the nature and extent of competition in the milling and baking industries. We also, by press notice, notified the public at large about our investigation and invited their comments. The evidence given to us by associations of employers and of employees, respectively, is summarised in sections (A) and (B). Evidence from other sources is summarised in section (C). In Chapter 8 we give an account of the views of the Big Three groups in relation to those portions of the evidence in sections (A), (B) and (C) which appeared to them to have implied some criticism of their activities.

(A) Trade Associations

The Millers' Mutual Association (MMA)

312. We have referred in paragraph 71 to the part which the MMA has played since 1929 in the rationalisation of the milling industry in England and Wales. The Association has a current membership of 31 all of whom are also members of the National Association of British and Irish Millers Limited (see paragraph 317 *et seq*). It collects from its members, on behalf of the latter body, the levy referred to at paragraph 319 which it remits in full to the National Association. There is no annual levy made on MMA members solely on account of their membership of that organisation.

313. As noted in paragraph 71, MMA has from time to time raised funds to finance the purchase of goodwill, plant and machinery of flour milling businesses whose owners wish to leave the industry. It has done so by capital levies on its members. The last occasion when a capital levy was made was in the year ended June 1973. From time to time certain non-members have been asked by MMA to contribute to its funds where the proposed purchase has related to a mill in close geographical proximity to them. Millers in Scotland and Northern Ireland are also said occasionally to have made voluntary contributions to MMA levy funds.

314. When its representatives appeared before us we asked them why it was deemed appropriate to circulate to all its members weekly[1] information in such detail as is indicated by the document at Appendix 3. We did so because we felt it to be of such a character as might be potentially detrimental to a miller whose performance was seen to be in decline. MMA agreed that the information as circulated represented an unusual degree of disclosure but said that this had long been so and that in practice it had not been found to be of either commercial advantage or disadvantage to recipients.

[1] MMA stated that as from 1 January 1977 the information would be circulated to members monthly.

315. We also drew attention to certain of the Rules in MMA's constitution which seemed to us to imply a measure of discrimination against millers who were not members. We were told that the Rules in question (reproduced in Appendix 4) were not enforced, the Chairman adding that:

> '. . . when they were made they were possibly used . . . certainly they have not been used in recent years and I would very much doubt if they ever would be used. In fact I am sure they would not be. It is a question of what you can do and what you cannot do. You cannot operate these sort of rules. . . . We really ought to have got rid of them, I think.'

316. As the avowed aim of the MMA is to assist in the removal of excess milling capacity in England and Wales, we enquired whether there was now any excess and, if so, how much and whether it would, in MMA's view, be in the public interest that it should be removed. The MMA's representatives told us (in October 1976) that, whilst there were undoubtedly some mills which could produce a greater quantity of flour by operating for a greater number of hours per week, this did not necessarily mean that there was excess capacity; the management of the companies concerned might be running their mills in the way they thought most appropriate. Nevertheless it was their view that there was some excess capacity. The chairman of the Association said that he thought that, provided the industry was profitable, it was in the public interest that there should be some spare capacity. He thought that the then current position was about right.

The Incorporated National Association of British and Irish Millers Limited (NABIM)

317. NABIM includes in its membership practically all flour millers in the United Kingdom. Although membership at October 1976 comprised the Big Three groups and 39 independent millers its representatives told us that the Association did not concern itself with such matters as the policy of the Big Three groups in requiring their subsidiaries to purchase flour solely from group mills or with the pricing of flour.

318. The Association, however, agreed that it did commission and circulate to its members periodically a report prepared by its accountants giving information about milling costs. A copy of the report for the year ended March 1975 is at Appendix 7. Although one of the NABIM members told us that he found this information to be useful in his business, the President of the Association was of the opinion that this was not universally so. We were told that NABIM had not considered whether further diminution of the number of independent millers would be desirable. The Association, however, expressed its interest in a number of developments likely to affect the industry, many of which had no direct bearing on our investigation.

319. The Association said that it obtained its revenue from a levy at the rate of 1·6p per 100 kg (2p per sack) of members' production. Nearly 80 per cent of its total revenue was said to be derived from the Big Three milling groups. This was the position at October 1976.

The Federation of Bakers

320. The Federation of Bakers told us that it represents between 90 and 95 per cent of all plant bakers in the United Kingdom. At 1 March 1976 its member-

ship was 204 of whom 45 were independent bakers in so far as they were 'neither owned nor controlled' by the Big Three groups. However, according to information given to us by the Big Three groups themselves, it would appear that 9 of what, in the Federation's terms, were independent members, had a financial relationship with those groups. In our terms this would not entitle them to the description 'independent'. The Federation's membership at 1 March 1976 may, therefore, properly be regarded as having comprised 36 independent bakers and 168 group and associated bakers.

321. Federation representatives who gave evidence to us in September 1976 expressed the view that, in so far as concerned the supply of flour to its independent members, there appeared to be a substantial degree of competition among millers but it observed that plant bakers generally showed some reluctance to change their suppliers. The Federation felt unable to express a view in relation to any matter concerning competition in the supply by the Big Three integrated groups of flour to their own bakeries.

322. The representatives said that the restrictive trade practices legislation inhibited the activities both of the Federation itself and of its individual members to an extent exceeding the requirements of the public interest. Thus the Federation could not exchange information or devise a policy to prevent a new discount war except in so far as Ministers might exceptionally be prepared to give it immunity from the penalties provided by that legislation. Its individual members were likewise unable, for example, to verify the claims made by particular customers as to the terms on which members were said to be prepared to do business with them. In the absence of statutory control of discounts on bread sales (which was in force at the time the Federation gave its evidence) the Federation felt that such inhibitions would create the circumstances for a discount or price war with consequences which would be detrimental to all concerned and in particular to the consumer.

323. The Federation said that, if statutory control of discounts on bread sales were to cease, in its view one consequence would be a fierce scramble by powerful buyers for substantially higher levels of discount and that this would result in the elimination from the industry of 'quite a number' of producers of whom the first to suffer would be its independent plant bakery members.

324. The Federation reminded us that although the large national multiple grocery retail groups exercised strong buying pressure on plant bakers there were many individual supermarkets, not being members of such groups, who were also strongly competitive. Before statutory control of discounts was introduced in 1975 some of the highest levels of discounts had, according to the Federation, been given by independent plant bakers.

325. In the opinion of the Federation there was excess capacity in the plant baking industry throughout the United Kingdom. Because of the long productive life of bakery plant, excess capacity could not be disposed of quickly without seriously affecting the economics of bread production. This made plant bakers highly volume-sensitive and thus likely to succumb to pressures from retailers for additional discount rather than face loss of sackage. Whilst it was likely that the existence of excess capacity would in any event lead to plant closures, the process would be hastened if a discount war were to be resumed. Plant

closures involving loss in overall capacity might well result in the supply of stale bread or perhaps in a shortage of bread in the areas immediately affected.

326. We asked the representatives whether a form of pricing could not be adopted for bread which would avoid the complexities of the present discounting arrangements. The Federation said the present basis on which bread is supplied by bakers (ie a published retail price less discount) is traditional, that bakers and retailers understand it and therefore that any change in that basis would not be of advantage. In any event the adoption, say, of a net wholesale price for bread would not prevent practices which would produce results similar to those produced by discount competition.

327. They also made the point that a new bread discount war would result in the adoption by bakers of higher published prices. Consequently, whilst supermarket customers in the United Kingdom generally might often be protected against paying the whole of the actual increase reflected in such high published prices (although there would be no guarantee to that effect) because supermarkets could negotiate higher discounts on their purchases, the rural housewife would have no such possibility of protection. It would be clear, the Federation said, that this form of 'protection' of some consumers as against others would, where it occurred, be made possible only at the expense of the small retail traders and their customers who would not benefit from the higher discounts obtainable by the large retailer. The Federation said that in effect the smaller retailer would be giving a form of hidden subsidy to the large retailer.

328. In referring to Northern Ireland the Federation said that bakers in that province were conditioned to a five-day working week. For this and other reasons the cost of producing a 28 oz loaf of standard bread had been estimated by the Price Commission in December 1975 to be 0·93p higher than elsewhere in the United Kingdom. Selling and distribution costs of such a loaf were 3p higher than in Great Britain, reflecting the relatively high proportion of bread which was delivered by roundsmen to customers in rural areas in Northern Ireland (see also paragraph 62).

329. The Federation said that it sought not to bring pressure to bear on its members on matters regarding their trading practices except when acting as 'an agent of one or other of the government departments . . . (and that) the Federation has tried very hard to keep this separate from the commercial activities of its members and really it has been the degree of government intervention and the degree of government control that has made that part of the Federation activities very much greater than it was in the years when controls were less stringent'.

330. In a reference to one non-member of the Federation who had been permitted to sell bread at a price lower than that adopted by other suppliers (see paragraph 303), the Federation agreed that it had suggested to its members that they should not seek to match that lower price. The Federation said that in doing so it had in mind the very low level of profitability (and indeed the not uncommon net trading losses) of the plant baking industry. The Federation said that it also had in mind the distortion of the market which would arise over a wide area if other bakers did in fact match the lower price since they would be permitted by DPCP to do so in their dealings with customers supplied

jointly by themselves and the lower price supplier but not in their dealings with other customers. The Federation's suggestion in this respect had, it said, never amounted to a recommendation, but was more in the nature of a commentary on the implications for the industry. The Federation was unable to say whether any of its members did, nevertheless, reduce prices to meet this competition but observed that 'in the course of general conversation on other matters people have indicated that in general the situation has been contained'. Its representatives said that the course which the Federation would adopt in any future similar circumstances would depend on the magnitude of the price discrepancy and the size of the area in which it would be likely to operate.

The National Association of Master Bakers, Confectioners and Caterers (NAMBCC)

331. NAMBCC gave evidence to us both orally and in writing. It represents master bakers in England and Wales. The average weekly turnover of its members was estimated by its representatives in September 1976 to be not more than £750. About 40 to 45 per cent of that turnover was accounted for by the sale of reference bread, some of which (standard loaves, for example) its members bought in from the plant bakers.

332. NAMBCC representatives told us that its members generally showed reluctance to change their flour suppliers. Except in the more remote areas where its members found difficulty in negotiating competitive prices for their flour, there was a reasonable amount of competition among millers (both independent and Big Three groups) to supply master bakers' requirements. It was generally felt that, other things being equal, master bakers tended to favour independent millers. However, they said that it was fairly common for master bakers to be tied to particular millers for flour supplies as a condition of having loan facilities accorded to them.

333. Hot bread shops and in-store bakeries were said to represent additional competition but NAMBCC thought it was still too early to judge what their long-term effect would be.

334. Master bakers in England and Wales were in general thought not to be losing trade. Witnesses felt, however, that, if proper provision were made at the appropriate rate for hours worked, probably at least half of the master bakers would be found to be not making a profit on their businesses. In many instances the businesses were in effect being subsidised by old leaseholds or freeholds. Bread price-cutting was a matter of concern to NAMBCC members as the prices which they were able to realise for their products necessarily bore some relation to those charged for bread sold in supermarkets. The Association felt that the Bread Subsidy Scheme had distorted competition and might have aggravated price-cutting in bread supply. It felt that if the bread subsidy were to be discontinued price control of bread should also cease.

The Scottish Association of Master Bakers (SAMB)

335. SAMB told us that it saw no evidence of keen competition between millers to supply flour to master bakers in Scotland. All millers except one, who supply bakers' flour in Scotland, were said to be members of one or other of the Big Three groups. Given the fact that they all produced products which

were much the same in quality and price, it was only in the field of service that competition could take place. Scottish master bakers were said not readily to change their flour suppliers.

336. Its representatives said that in Scotland master bakers' net profits were low; that many such bakers were losing money and that a number were going out of business. This decline they expected to accelerate for a number of reasons. Among them was the basic one that small businesses generally were being inundated with legislation involving the expenditure of an undue amount of time and resources on form-filling, compliance with regulations and so on. Other reasons were that few young people are prepared to work the long and anti-social hours required for success in an industry which is showing signs of low profitability and increasing frustration. An added disincentive was that the major bakery groups had penetrated into every town of, say, 5,000 population in Scotland. In addition, supermarkets were taking an increasing share of the retail trade, often supplying bread at discounted prices and indeed often as a loss leader. Independent bakers in Scotland had, therefore, to face bread price-cutting on a wide scale.

337. SAMB said that it would not like to see either flour milling or bread-making fall into fewer hands than at present, though it said that this view did not reflect any inherent antipathy towards the major groups as such. Indeed the relationship which existed between plant bakers and master bakers in Scotland was said to be generally good. But, particularly in the case of flour supply, SAMB would wish to have some assurance that the large national, integrated groups so conduct their milling and their baking activities that no net price advantage is secured by their bakeries solely on account of their membership of such groups. As regards the baking industry itself, although SAMB did not regard the current situation as a good one it considered that if there were to be any reduction in the number of the national bakery groups (which is three) the position would then be even worse.

338. We were told that the chief interest that SAMB independent bakery members had in regard to discounts on bread sales was in respect of their purchases of standard bread from the plant bakers. The Association's view was that if the statutory limitation on discounts were removed the overall effect would be likely to be adverse to all interests, including those of the consumer.

339. SAMB said that it would like to see price controls on bread removed. One probable result of such removal would be to reduce the differential which existed between the price of the standard loaf on the one hand and of rolls, baps and tea bread on the other. The latter products were said to represent a major portion of Scottish master bakers' production.

(B) Trade Unions

The Bakers' Union

340. The Bakers' Union said in written evidence that the major bakery groups agreed on bread price increases after consultation with the appropriate government bodies and that such increases determined the retail price fixed for standard bread throughout the entire industry. The high levels of discounts granted by bakers, however, enabled certain large retailers to sell bread to the public below that price. Competition in discounts granted by the large bakers was

said to lead to the transfer of business to the supplier prepared to grant the most advantageous terms. Given the present economic situation of the industry this must tend to a total monopoly in baking and the trend in that direction had not been arrested by the bread subsidy arrangements. There was thus a possibility that one of the major baking groups might be forced out of business. This was not regarded by the Bakers' Union as a healthy state for the industry.

The Scottish Union of Bakers and Allied Workers (SUBAW)

341. SUBAW in written evidence referred to the bargaining power of the large bread retailers, particularly supermarkets, who on account of the volume of their business, were in the position to secure discounts at levels described as 'unrealistic' on purchase of bread from bakers. In many cases these retailers were said to sell bread to the public at prices below those recommended by the producers.

342. SUBAW said that the effect of these circumstances was to impair the quality of bread and the choice of bread available to the consumer, as producers sought to make products at a price which they estimated the market could stand. This situation had not been remedied by the Bread Subsidy Scheme.

343. SUBAW held the view that 'Governments have not, either under complete price freedom with removal of retail price maintenance or by control through prices and subsidies, appreciated that our (the baking) industry can improve its contribution to consumer choice by removal of the inhibitions which arise from indiscriminate price-cutting'. It said that price-cutting, in addition to resulting in bread of poor quality and low food value was bound to create an industry with low wages and no career structure. In SUBAW's view the increasing strength of the large retailing groups tended to cause bakers to merge and to concentrate production. This inevitably not only reduced consumer choice but resulted in the loss of employment.

The North of Ireland Bakers, Confectioners and Allied Workers Union (NIBCAWU)

344. NIBCAWU wrote to us in November 1976 confirming its earlier concern at the quality of flour used in breadmaking. In particular it referred to the quality of flour used in producing standard bread baked in tins. It said that such flour absorbed more water than did stronger flour and that this resulted in a soft spongy loaf. In its view the public accepted standard bread 'more as a matter of convenience than of taste' and believed that if it became known 'that better bakery goods could be produced by the use of better flour, there would be an outcry (in support of such use) from the many consumer associations here (Northern Ireland)'. NIBCAWU attributed the low quality of much of the bread now being produced to government price control and said that bakery research was primarily directed towards maximising bakers' profits within the constraints imposed by such control.

345. NIBCAWU said that the smaller bakeries (ie home, or master, bakers) in Northern Ireland used better quality ingredients than did the large plant bakers and that this was reflected in the superior quality of their products and in the increasingly larger share of the market which they supply. It distin-

guished between these separate classes of producers by saying 'In the larger plant bakeries it is a question of quantity and not quality with the use of more water increasingly in mind, to increase the yield . . . Most master bakers give the public what they want'. This Union felt that its members' interests were directly related to the quality and range of bakery products which were made available to consumers and for this reason said that 'the quality of flour used in the making of bakery products should conform to a certain high and agreed standard'.

The United Road Transport Union

346. The United Road Transport Union made its views known to the Commission in writing directly, and also indirectly through the Department of Prices and Consumer Protection, on trading practices alleged to be indulged in by the large bakery groups. It was concerned about the high level of discounts and other inducements granted by such suppliers to large retailers even when discount levels were limited by the provisions of the Bread Subsidy Scheme. The Union expressed the view that the price of bread might, on account of such practices, be higher than would otherwise be justifiable. It wished to see the discount limitation provisions of the Bread Subsidy Scheme more rigidly enforced.

(C) Other witnesses

347. Twenty-five correspondents submitted their comments to us as a result either of individual invitations or of the press notice referred to in paragraph 311. Of those comments, 7 concerned matters dealt with in sections (A) and (B). Of the other 18 correspondents a number of them were concerned about, for example, the identity in the timing and amount of price changes in flour and bread. Only 2 of those who wrote to us appeared to have no direct financial connection with milling, baking or food distribution. We set out below a summary of the comments made by all these 18 correspondents. For ease of reference, we have grouped them under headings to indicate their particular interests.

Independent millers

348. One independent miller said 'It is perhaps worth stating that . . . the major companies, with their diverse interests produce only composite balance sheets covering all their activities. Thus the true trading facts of their flour milling activities are not known . . .'.

349. Another independent flour miller, in referring to the 'intense competition' between the main group millers and the independents and to the incidence of Price Commission controls, observed that 'We as a Category III company, must live in hope rather than on good commercial planning while the reporting companies parley with those who decide when prices can be adjusted and we believe that even now (December 1973) the industry leaders are looking to their other activities to subsidise the flour milling section'.

350. The following comment on competition as between group and independent millers was made by one of the latter when reviewing developments in the industry in recent years. 'The (flour milling) industry has been split between

those companies manufacturing bakers' flour and those manufacturing soft flours from all English wheats. Generally the bakers' flour margin has been very adequate, and the soft flour margin very inadequate. The reason for this is thought to be that the larger groups sold most of their bakers' flour to their own bakeries, on a very economical basis, but at full price. Thus they were able to compete with independent millers selling soft flours at prices often less than cost. In addition to this, the poor margins on soft flours reflected the intense competition prevailing in the industry and this has been borne out by the regular closure of smaller independent units which were traditionally soft flour millers . . .'

351. Another miller referred in 1974 to the effect on independent millers of 'the massive increase in the price of wheats which have not been compensated by adequate rises in the price of flour . . . The result of this has been that many private bakers have turned now to the Combines for their supplies of flour and naturally the Combines are able to weather the current storm . . . The net result is to encourage a monopoly of the trade between the three Combines and this state of affairs has naturally caused great despair amongst the Independents'.

Master bakers

352. One master baker said that the large baking groups have interests in flour milling which have enabled them to fix the prices of flour supplied to independent bakers at levels higher than necessary and that even before price control 'these higher prices were offset in their own baking establishments by discounts which were passed on monthly, quarterly or annually, although invoice prices (for flour) were the same as to the outside trade . . . The result of this was that they were able to underprice the goods (ie bread products) which were in direct competition within the independent and family trade'. He also complained that the date of implementation of increases in prices for flour supplied by the major groups to independent bakers was often from 3 to 6 months earlier than the date of implementation to outlets within the groups' own organisations.

353. Another master baker urged that the milling activities of the large groups 'must be controlled in some way to ensure that their position is not used to liquidate the independent sector . . .'. He complained that extension of the interests of the large groups enabled them to 'dominate numerically and financially Trade Associations' and that they 'can develop, patent or restrict the sale of packaging materials to independents . . . dominate the market place by owning supermarkets or hotel chains who then are instructed to close their doors to the independent bakers'. This complainant regarded it as vital 'that all Government Departments should take the time and trouble to consult the independent trade and not just the three groups before implementing decisions affecting the whole trade' and suggested that 'products sold under a brand name should show in equally large letters the name of the Group'.

354. A master baker pointed to the fact that the large baking groups continue 'to trade under independent names' and said that 'this results in the public and the catering trades being frequently deliberately misled in dealing with several different companies which in practice are one and the same'. He also referred to

'the centralised buying policies of the large groups which discriminate against local and independent bakers . . .'. The same correspondent at a later date amplified the foregoing remarks by observing that 'frequently bakery companies appear with a new name or new vehicle livery all with heavy emphasis on local names deliberately misleading local purchasers . . .'. This lack of knowledge was said to extend to local government and reference was made to a supermarket having been granted planning permission although the planning officials were apparently not aware that this would result in the exclusion from the supermarket of bread other than that produced by the national baking group of which the applicant company was a part. Our correspondent suggested that 'some increase in awareness would result if the Group's name was prominently displayed on the product and on the invoices etc . . .'.

355. One master baker, in commenting on the quality of standard bread, said 'we are for instance still using very satisfactorily and to our customers' satisfaction, the traditional method of fermentation, which takes between 5–6 hours to produce a loaf of bread. The Chorleywood process used by most factory bakers does of course produce the standard spongy sliced loaf, which takes only 1½ hours from dough mix to the slicer. This I find is a very important point as we find our customers more than willing to pay an extra penny or so for a traditional type loaf'.

Bread retailers

356. A large supermarket chain retailing bread said that 'there appears to be very little difference between the three major plant bakers in terms of product range, service, discounts . . .'.

357. One supermarket executive reported, on the basis of long experience of the bread trade, that he was forced to say that 'frankly there is no doubt in my mind that through all of these years there has been agreement between the major suppliers. Virtually the only competition has been in the degree of service they have given us at van sales level'. He added that 'A major problem of the bread industry is the sameness of the ranges on offer. This has been brought about by the decline of the small baker . . . and there is no doubt on the whole they have been forced out by the major bakers . . .'.

358. A small retailer of bread, in referring to competition from a local Co-operative store, said that he received only 12½ per cent discount off the recommended selling price whereas large retailers such as the Co-operatives were given discounts of as much as 33⅓ per cent. He felt this to be unfair and argued that the large bakers had no right to spend a government subsidy in such a discriminatory fashion.

Members of the public

359. One correspondent claimed that, from a study of the timing of bread price increases during a period of 20 years in the industry, he could now forecast which of the Big Three groups would take the initiative in announcing the increase on any occasion. He also made general references to unsocial hours of working in the baking industry and to the low wages paid by employers in it.

360. A housewife asked in November 1974 whether it was appreciated 'that as a result of the large holdings that Rank-Hovis McDougall own, and their gross takeover activities in the West Country, consumers in an area from Bristol to possibly Cornwall have no choice from bakers' shops, supermarkets, etc, of subsidised bread. For example in the town where I live we have three supermarkets, two bakers' shops and one grocers' shop of the International chain, all selling "Mother's Pride", a product of the Rank monopoly. Surely one should not be forced into a state where, because of a local bakery closing down (owned by Sunblest Ltd) one can only obtain one brand of bread . . .'.

361. Another housewife referred to her 'personal vexation at the withholding of Hovis flour from retail sale while at the same time the quality of the Hovis loaf on sale to the public is generally very inferior to that of the Hovis loaf as we first knew it'.

CHAPTER 7

Sales, costs and profits in milling and baking

The Independent Suppliers

362. In our investigation of sales, costs and profits in the milling and baking industries we have been principally concerned with the major suppliers, ie the Big Three integrated milling and baking groups. However, we also obtained information from a small sample of non-group participants in each of these industries. Whilst that information has assisted us in forming some appreciation of the general position, it did not provide us, in the case of either industry, with a sufficiently firm basis for more detailed analysis. This was due to a number of causes including the fact that some independent millers, for example, specialise in producing one particular product (eg biscuit flour) whilst many non-group bakers produce a widely varied mix of reference and non-reference products thus making it difficult to isolate the position in respect of the supply by them of reference bread only.

363. As a generalisation, however, the results obtained from our sample, taken together with their published accounts, indicated that non-group millers on average earned a return on capital employed which was lower than that earned by the Big Three groups on their milling operations (see paragraph 396) but reasonably in line with the average for United Kingdom manufacturing industry.

364. The information which we received from non-group bakers showed such wide disparity in profitability that it would not be useful to attempt to calculate an average figure. It was clear, however, that they have not been consistently profitable and 7 of the 18 companies in our sample made either losses or an inadequate return on capital employed during the years 1971 to 1973.

The Big Three Suppliers

General

365. The information in the following paragraphs relates to the Big Three integrated milling and baking groups. Whilst those groups are all organised in a broadly similar fashion there are nevertheless variations in their respective procedures which are significant in the context of this chapter. We refer to those variations in paragraphs 367 to 371.

366. In this chapter we use the term return on capital employed, on a historic cost basis, as meaning profit, before interest, taxation and extraordinary items, expressed as a percentage of the average of opening and closing capital employed, comprising share capital and reserves, dividends payable, minority interests, loan capital and borrowed money, deferred and non-current taxation, and intra-group financing (as opposed to trading) accounts. Goodwill, investments and surplus cash balances are deducted from capital employed, in accordance with our usual practice, but we illustrate the effect of not deducting goodwill (see paragraph 398). Return on capital employed, on an inflation adjusted basis,

has been calculated by adjusting profits and capital employed in accordance with the methods outlined in the report of the Sandilands Committee on *Inflation Accounting*[1].

367. The Big Three groups make up their annual financial accounts to different dates—RHM to 31 August, Spillers to 31 January and ABF to 31 March (or, in each case, to the Saturday nearest to that date). All the accounting data in this chapter and in Appendix 9 are based on group financial accounts and references to, for example, the year 1975 denote the accounting period ending nearest to 31 December 1975—ie RHM's year to 30 August 1975, Spillers' year to 31 January 1976 and ABF's year to 3 April 1976.

Milling

368. Sales of flour by each of the Big Three groups are made principally by the milling division of that group. These divisions' sales are of three types. First there are sales of flour as defined in the reference—both to their own flour-using subsidiaries (principally bakeries) and to other customers. Second there are sales of wheatfeed. Third, in some cases, there are sales of other products, such as tapioca, which are not covered by the reference. In this chapter the term 'flour milling', in relation to the business of the Big Three, means the supply by their milling divisions of reference flour and wheatfeed, the costs of production of which two products cannot be separately determined. The relatively small amount of other, non-reference, products supplied by the milling divisions are excluded.

369. Household flour is regarded, for the purposes of this chapter, as having been sold when, as in the cases of RHM and Spillers it is supplied by the milling divisions of these groups to subsidiary companies for packaging and sale to retailers and, in the case of ABF, when it is supplied directly to retailers by its milling division.

Baking

370. The terms 'breadmaking' and 'bread baking', in relation to the business of the Big Three, mean, with two exceptions, the supply by their bakery divisions of reference bread. One exception is that both RHM and Spillers treat sales of rolls and baps as confectionery and have been unable to extract data for these two products to enable them to be included with bread, as would be required under the terms of the reference. RHM estimated that rolls and baps accounted for approximately 6 per cent (by value) of its bakery division's sales in 1973. The other exception is that ABF treats fruit loaf, which is a non-reference product, as bread and is unable to extract information regarding the profitability of this product separately. ABF's sales of fruit loaves in 1974 were less than 1 per cent of its total bread sales.

371. Organisationally the bakery division of each of the Big Three groups includes its own bread retail and catering outlets. Additionally ABF has supermarket subsidiaries outside its bakery division (see paragraphs 139 and 437) to which that division supplies bread on an arm's length basis. The bakery

[1] *Inflation Accounting: Report of the Inflation Accounting Committee* (Cmnd 6225) HMSO 1975.

division of each group, besides selling reference bread, also sells through its retail and catering outlets non-reference bakery products such as cakes and buns and also some articles which do not originate in the group's bakeries.

Flour sales

372. Sales of flour and wheatfeed by each of the Big Three groups for the five years 1971 to 1975 are shown in table 7·1. Flour sales are analysed as between sales to divisions or companies within the groups and sales to external customers.

TABLE 7.1

Sales of flour and wheatfeed

£ million

	Flour Internal	Flour External	Flour Total	*Wheatfeed*	*Total*
ABF					
1971	24·0	7·9	31·9	6·1	38·0
1972	27·5	9·0	36·5	7·4	43·9
1973	40·1	18·1	58·2	13·3	71·5
1974	68·7	33·0	101·7	15·1	116·8
1975	74·5	31·5	106·0	15·0	121·0
RHM					
1971	38·2	19·3	57·5	10·9	68·4
1972	39·1	20·5	59·6	10·2	69·8
1973	45·5	23·2	68·7	13·5	82·2
1974	74·7	40·5	115·2	22·4	137·6
1975	89·6	48·2	137·8	20·5	158·3
Spillers					
1971*	31·8	21·2	53·0	10·2	63·2
1972	31·2	20·9	52·1	9·4	61·5
1973	39·4	26·7	66·1	15·2	81·3
1974	65·6	47·3	112·9	18·7	131·6
1975	66·3	50·5	116·8	17·7	134·5

* Spillers' 1971 figures include sales of the French group with which it merged in January 1972 (see paragraph 180).

373. In each case the major part of flour sales, by value, has been to other divisions or companies within the group; in 1975, 70 per cent of ABF's flour sales were intra-group, as compared with 65 per cent for RHM and 57 per cent for Spillers. Such sales are principally to the bakery divisions for use in bread and confectionery products, but flour is also sold to other divisions for use in, for example, cake mixes and pet foods.

374. RHM and Spillers sell wheatfeed mainly to their own animal feeds divisions, the transfers being made at market price. ABF, having no animal feeds interests within the group since 1970, sells wheatfeed on the open market.

375. The substantial increases in the value of flour sales by the Big Three between 1971 and 1975 were largely due to increased flour prices following rises in wheat prices. In terms of volume, RHM's and Spillers' sales remained practically constant during those years. ABF's sales rose by 29 per cent in the same period but a major part of that increase was due to the acquisition of the Cranfield group in 1972 (see paragraph 124).

Bread sales

376. Table 7.2 shows the sales of bread[1] by each of the Big Three groups in the United Kingdom for the five years 1971 to 1975—except for Spillers for whom only four years' figures are available.

[1] See paragraph 370.

TABLE 7.2

Sales* of bread: 1971 to 1975

	ABF	*RHM*	£ million *Spillers*
1971	76·5	79·6	N/A
1972	81·7	84·4	57·4
1973	100·6	90·1	59·3
1974	138·8	111·5	81·8
1975	168·0	134·6	95·6

* Sales, for the purpose of this table, are sales at retail list prices plus the bread subsidy but less trade discounts allowed to wholesale and contract customers.

377. As in the case of flour, the increase in the value of bread sales was due largely to higher prices. The volume of RHM's bread sales fell between 1971 and 1975 by 9 per cent and Spillers between 1972 and 1975 by 7 per cent. ABF's bread sales increased in volume between 1971 and 1975 by 21 per cent; part of this increase was due to the acquisition of the Cranfield group in 1972, but sales also increased (by some 7 per cent) in 1975 at a time when the other two groups' sales were static or declining.

Reference goods in relation to total group sales

378. We have outlined in Chapter 3 the range of activities of each of the Big Three groups. The make-up of each group's total United Kingdom sales in 1975 is shown in the following table.

TABLE 7.3

Analysis of total United Kingdom sales—1975

	ABF		*RHM*		£ million *Spillers*	
Reference flour	106		138		117	
Wheatfeed	15		20		18	
		121		158		135
Reference bread		168		135		96
Other activities		760		543		317
Total UK sales		1,049		836		548
Less: Intra-group sales		186		136		64
External UK sales		863		700		484

Flour milling costs

379. We have obtained information as to the flour milling costs and profits of the three groups for each of the five financial years 1971 to 1975. During that period the cost of wheat and other materials increased from about 19p per 10 pounds of flour in 1971 to about 47p in 1975, but there were corresponding increases in flour prices and in each case the percentage net profit margin in 1975 was approximately the same as in 1971.

380. The cost structures of the three groups are similar. The costs of wheat and other raw materials in 1975 accounted for between 75 per cent and 77 per cent of total sales (flour plus wheatfeed); after charging manufacturing and other costs, the net profit margin as a percentage of total sales ranged from 8·6 per cent (Spillers) to 12·1 per cent (ABF).

Bread baking costs

381. We also obtained information as to the bread baking costs and profits of ABF and RHM for the five years 1971 to 1975 and for Spillers for the four years 1972 to 1975.

382. As well as reference bread each group sells in its bakery division a substantial volume of non-reference products, principally cake, buns and other flour confectionery, which are distributed through the same outlets as bread. ABF and to a lesser extent RHM also have substantial catering business within their bakery divisions. The Big Three groups' turnover on non-reference activities in 1975 was between 40 per cent and 60 per cent of the value of their bread sales. The costs of selling, distribution and administration common to bread sales and other sales amounted to some 30 per cent of bakery division net sales revenue in 1975. Two of the three groups do not attempt to allocate these common costs for their own purposes between bread and other sales so as to calculate separately the net profit or loss on the two categories of sales. One group does do so, but not as part of its regular management accounting system.

383. In preparing information concerning the costs and profitability of bread baking for the purposes of our inquiry, the three groups have, with our agreement, applied a formula for cost apportionment which has been established in the industry for many years. It was originally developed by the Ministry of Food during the second world war and has subsequently been used for the purpose of inquiries affecting prices. Since the formula has been so long and so widely used we have adhered to it for the purposes of our inquiry.

384. As in the case of flour milling, there is substantial similarity between the structures of the Big Three groups' bread baking costs. The cost of materials in 1975 was approximately 50 per cent of net sales revenue (sales at retail list prices, plus bread subsidy, less trade discounts). Bakery manufacturing costs were about 20 per cent and costs of selling, delivery and administration about 30 per cent of net sales revenue. The groups had net losses of between 0·5 per cent and 1·5 per cent of net sales revenue. ABF has approximately 2,000 retail and catering outlets within its bakery division and sells a larger proportion of its bread by retail than either RHM or Spillers. This tends to increase ABF's net sales revenue, gross margin and selling and delivery costs in comparison with the other two groups.

385. Discounts given to wholesale and contract customers increased from 1971 to 1974, but declined following introduction of The Bread Subsidy Scheme 1975 (see paragraph 231). Table 7·4 shows each group's average discount, expressed as a proportion of the retail list price of wholesale and contract[1] sales, for each of the years 1971 to 1975.

TABLE 7.4

Average discounts off retail list price for wholesale and contract sales of bread

per cent

	ABF	*RHM*	*Spillers*
1971	21·4	17·8	N/A
1972	23·0	18·6	20·6
1973	23·8	19·1	21·1
1974	24·7	20·2	22·7
1975	22·9	20·8	22·1

The differences between the three groups are due to some extent to the different periods covered—ABF's figures relate to a period some seven months later than RHM's and two months later than Spillers'—as well as to differing

[1] eg to hospitals and prisons.

proportions of wholesale sales being made to the larger, more powerful, retailing concerns, and to differences in marketing policy.

Profitability: flour milling

386. A summary of the sales, profits and capital employed by each of the Big Three groups in flour milling and in bread baking for the five years 1971 to 1975 is given in Appendix 9.

387. For flour milling, the profit margin on total sales (including wheatfeed), the ratio of sales to capital employed (on a historic cost basis) and the return on capital employed for each group for the five years are tabulated below.

TABLE 7.5
Profitability: flour milling
Historic cost basis: 1971 to 1975

	ABF			*RHM*		
	Profit/sales	*Ratio of sales/capital employed*	*Return on capital employed*	*Profit/sales*	*Ratio of sales/capital employed*	*Return on capital employed*
	%		%	%		%
1971	12·1	3·0	36·9	8·5	2·1	17·6
1972	11·3	3·4	38·2	6·8	2·1	14·4
1973	7·4	4·0	29·7	9·9	2·4	23·8
1974	10·5	5·1	53·0	7·7	3·3	26·0
1975	12·1	4·6	56·3	9·5	3·4	32·4

	Spillers		
	Profit/sales	*Ratio of sales/capital employed*	*Return on capital employed*
	%		%
1971	9·0	N/A	N/A
1972	5·9	2·2	13·0
1973	6·4	2·8	18·1
1974	6·8	4·1	27·8
1975	8·6	3·8	32·2

It is evident from table 7·5 that the improvement in each group's return on capital employed over the five years 1971 to 1975 has largely been accounted for by increased ratios of sales to capital employed, rather than by increased profit margins on sales. In each case the largest contributory factor has been the relative fall in the book value of fixed assets, based on historic costs, in comparison with sales values which have increased principally as the result of increases in the world price of wheat.

388. In one respect ABF's figures are not comparable with those of the other two groups. This is because part of ABF's wheat stocks are held by a subsidiary company (Mardorf, Peach and Company Limited) which purchases wheat and receives a commission which is charged in arriving at the milling division's profits (see also paragraph 127). It has not been possible to segregate the profits and capital of Mardorf, Peach's wheat procurement activities from the remainder of the business so as to obtain a consolidated result of the flour milling activity on a basis comparable to the other two groups.

389. The profit and return on capital employed in milling cannot be analysed as between flour supplied to the groups' own subsidiaries and to external customers. The evidence which we have seen regarding the comparison of

gross margins on internal and external flour supplies indicated that the former were generally close to, or slightly above, the latter for similar types of flour. There are, however, differences between the margins earned on different types of flour. In part, these differences are accounted for by the fact that price increases for the various types of bakers' flour over the past three years have not reflected precisely the increases in the cost of the different constituent wheats in the grists. The Big Three's prices during this period have tended to be increased either by equal sums or by nearly equal percentages for all types of bakers' flour, notwithstanding that the cost of soft wheats, which form a larger part of the grist of Chorleywood flours, has increased by considerably less than the cost of hard wheats. Moreover each of the Big Three has succeeded in reducing the hard wheat content of Chorleywood flours. This would tend to increase the relative profitability of sales of Chorleywood flours. One of the groups has provided figures showing that its gross margin on standard Chorleywood flours at a recent date was 33 per cent as compared with 27 per cent for other standard bread flours. Since Chorleywood flours account for a much larger proportion of internal than of external supplies of bakers' flour by each group, the trends noted above have tended to increase the relative profitability of internal supplies.

390. As regards indirect costs, we consider that there must be economies on internal supplies in respect of selling and delivery costs. On the other hand one of the groups claimed that the allocation of manufacturing costs to internal supplies should be greater than to external sales because the strict specifications of the group's own bakeries demand elaborate quality control procedures.

391. We asked each group to calculate its profits and capital employed in flour milling in 1974 and 1975 on an inflation adjusted basis, applying as best it could the methods outlined in the report of the Sandilands Committee on *Inflation Accounting*. Inevitably there were some differences in the methods adopted by the three groups, reflecting in part differences in their circumstances and in part uncertainty regarding the precise form of current cost accounting. Whilst the three groups' calculations may not, therefore, be on a fully comparable basis they each represent a reasonable interpretation of the principles of current cost accounting as formulated at the time of our investigation. On that basis, the returns on capital employed in 1974 and 1975 were substantially lower than on a historic cost basis as is shown below.

TABLE 7.6
Return on capital employed—flour milling
Inflation adjusted basis

£'000

	ABF		*RHM*		*Spillers*	
	Historic cost	*Inflation adjusted**	*Historic cost*	*Inflation adjusted**	*Historic cost*	*Inflation adjusted**
1974						
Capital employed	23,041	42,700	41,066	61,261	32,431	48,285
Profit	12,208	9,744	10,657	1,879	9,007	7,293
Return on capital employed (%)	53·0	22·8	26·0	3·1	27·8	15·1
1975						
Capital employed	26,053	54,146	46,457	64,548	35,846	54,057
Profit	14,657	10,452	15,046	13,719	11,542	9,736
Return on capital employed (%)	56·3	19·3	32·4	21·3	32·2	18·0

* Based on capital employed at the year end.

The substantial difference between RHM's profit for 1974, when calculated on the two bases, was due to a large 'cost of sales adjustment' because that group's 1974 accounting period (the year to 31 August 1974) covered a period of exceptionally rapid increases in wheat costs. Inclusion of ABF's wheat stocks held by Mardorf, Peach and Company Limited (see paragraph 388) would probably be reflected by a reduction in the inflation adjusted return on capital shown in the table.

Profitability: bread baking

393. The profit margin on reference bread sales, the ratio of sales to capital employed (on a historic cost basis) and the return on capital employed for each group for the five years 1971 to 1975 are summarised below.

TABLE 7.7
Profitability—bread baking
Historic cost basis: 1971 to 1975

	ABF			*RHM*		
	Profit or (loss)/ sales	*Ratio of sales/ capital employed*	*Return on capital employed*	*Profit or (loss)/ sales*	*Ratio of sales/ capital employed*	*Return on capital employed*
	%		%	%		%
1971	3·0	3·4	10·0	5·5	2·8	15·7
1972	2·1	3·3	6·9	5·5	3·0	16·7
1973	(2·4)	3·2	loss	1·9	3·2	6·2
1974	(3·8)	3·5	loss	(2·3)	3·8	loss
1975	(0·5)	3·8	loss	(1·4)	4·5	loss

	Spillers		
	Profit or (loss)/sales	*Ratio of sales/ capital employed*	*Return on capital employed*
	%		%
1971	N/A	N/A	N/A
1972	(2·6)	2·3	loss
1973	(8·0)	2·3	loss
1974	(6·4)	3·1	loss
1975	(0·6)	3·9	loss

The deterioration in profitability from 1971 to 1974 and the small improvement in 1975 is apparent. In contrast to flour milling, where of the order of half of the capital employed is in the form of stocks and other current assets, the capital employed in bread baking in each group is almost entirely in the form of fixed assets, with the comparatively small stocks and the debtors largely offset by creditors.

394. The relative stability of ABF's ratio of sales to capital employed, when compared with those of the other two groups, is due to its heavy investment in fixed assets during the period. Whereas ABF's net book value (on a historic cost basis) of fixed assets used in bread baking rose by some 90 per cent between 1971 and 1975, RHM's rose by only 3 per cent and Spillers' (1972 to 1975) fell by 10 per cent.

395. On an inflation adjusted basis, both the losses and the capital employed in bread baking in 1974 and 1975 would have been substantially higher than on a historical cost basis, as is shown in the subjoined table.

TABLE 7.8

Return on capital employed—bread baking

Inflation adjusted basis: 1974 and 1975

£'000

	ABF		*RHM*		*Spillers*	
	Historic cost	*Inflation adjusted**	*Historic cost*	*Inflation adjusted**	*Historic cost*	*Inflation adjusted**
1974						
Capital employed	39,414	93,339	29,082	47,854	26,557	42,183
Profit/(loss)	(5,214)	(10,106)	(2,559)	(4,553)	(5,229)	(8,289)
Return on capital employed	loss	loss	loss	loss	loss	loss
1975						
Capital employed	43,879	110,366	29,644	48,735	24,314	45,804
Profit/(loss)	(763)	(7,821)	(1,946)	(4,984)	(621)	(2,931)
Return on capital employed	loss	loss	loss	loss	loss	loss

*Based on capital employed at the year end.

Profitability: flour milling and bread baking

396. The following table contains a summary of the return on capital employed by each of the groups in flour milling and in bread baking, and a comparison of those returns with the returns earned by United Kingdom manufacturing industry.

TABLE 7.9

Summary of return on capital employed—flour milling and bread baking

per cent

	1971	*1972*	*1973*	*1974*	*1975*
Historic cost basis					
ABF					
Flour milling	36·9	38·2	29·7	53·0	56·3
Bread baking	10·0	6·9	loss	loss	loss
Flour milling and bread baking	19·5	17·6	5·9	11·2	19·9
RHM					
Flour milling	17·6	14·4	23·8	26·0	32·4
Bread baking	15·7	16·7	6·2	loss	loss
Flour milling and bread baking	16·7	15·5	15·8	11·5	17·2
Spillers					
Flour milling	Not available	13·0	18·1	27·8	32·2
Bread baking		loss	loss	loss	loss
Flour milling and bread baking		4·0	0·9	6·4	18·2
UK Manufacturing Industry*	12·5	15·0	17·4	17·0	15·2†
Inflation adjusted basis					
ABF					
Flour milling	Not available	Not available	Not available	22·8	19·3
Bread baking				loss	loss
Flour milling and bread baking				loss	1·6
RHM					
Flour milling	Not available	Not available	Not available	3·1	21·3
Bread baking				loss	loss
Flour milling and bread baking				loss	7·7

TABLE 7.9 (*contd*)

	1971	*1972*	*1973*	*1974*	*per cent* *1975*
Spillers					
Flour milling	Not	Not	Not	15·1	18·0
Bread baking	available	available	available	loss	loss
Flour milling and bread baking				loss	6·8
UK manufacturing industry*				2·0	2·1†

* The returns on capital employed by United Kingdom manufacturing industry have been calculated by the Commission on the basis of information provided by the Department of Industry.
† Preliminary estimates.

397. When the results of flour milling and bread baking for the years 1971 to 1975 are taken together, RHM and ABF have each had an overall return from flour milling and bread baking on a historic cost basis which, taking the period 1971 to 1975 as a whole, is closely in line with that of United Kingdom manufacturing industry. Spillers has consistently earned a lower return on capital up to and including 1974, but there was a substantial improvement in 1975.

398. As noted in paragraph 366 and in accordance with our usual practice, goodwill has been excluded from our capital employed calculations. If goodwill were to be included, as the three groups maintain that it should be, the returns on capital employed would be reduced. For example, the returns for 1975 on a historic cost basis would then be as shown below.

TABLE 7.10
Return on capital employed including goodwill: 1975
Historic cost basis

	ABF	*RHM*	*per cent* *Spillers*
Flour milling	49·3	31·7	32·0
Bread baking	loss	loss	loss
Flour milling and bread baking	17·7	14·9	16·1

399. As has also been noted in paragraph 366, the returns shown in table 7.9 have been calculated using profits excluding extraordinary gains and losses. RHM had an extraordinary loss of £1·8m in bread baking in 1975 relating to rationalisation costs. Spillers had similar losses, mainly in 1975, of £1·6m (£0·7m from milling and £0·9m from bread baking). That group charged most of its rationalisation costs prior to 1975 against a provision set up at the time of the merger with the French group (see paragraph 180). ABF had extraordinary profits of £2·1m from property sales over the five years 1971 to 1975. These related almost entirely to bread baking.

Profitability of milling and bakery divisions

400. We referred earlier in this chapter to the fact that in the case of each of the Big Three the bakery division has a substantial volume of sales other than sales of reference bread. We also referred in paragraphs 382 and 383 to the difficulty of measuring separately the profitability of reference bread and other sales in view of the need to make an apportionment of the substantial common costs of selling, delivery and administration. The formula to which

we have referred in paragraph 383 is essentially arbitrary, as is any formula for apportioning costs, and its effect on the relative profitability of bread sales and other bakery division sales could be more than negligible. We have therefore thought it useful to consider also the profitability of the whole bakery divisions of the three groups, and we accordingly set out below a summary of the returns on capital employed in each group's milling and bakery divisions. The figures include, in addition to bread baking, the substantial volume of non-reference goods supplied by the bakery divisions.

TABLE 7.11

Summary of return on capital employed in total milling and baking operations

per cent

	1971	*1972*	*1973*	*1974*	*1975*
Historic cost basis					
ABF					
Milling division	36·4	37·4	29·8	52·0	55·0
Bakery division	18·3	20·1	8·6	loss	7·7
Milling and bakery divisions	23·3	24·8	14·8	14·8	23·2
RHM					
Milling division	17·6	14·4	23·8	26·0	32·4
Bakery division	17·9	21·3	16·7	0·8	0·1
Milling and bakery divisions	17·7	18·3	19·8	12·8	16·4
Spillers					
Milling division	Not	13·0	18·1	27·8	32·2
Bakery division	available	loss	loss	loss	loss
Milling and bakery divisions	Not available	5·4	1·8	3·1	14·4
Inflation adjusted basis					
ABF					
Milling division	Not	Not	Not	22·9	19·2
Bakery division	available	available	available	loss	loss
Milling and bakery divisions	Not available	Not available	Not available	1·6	3·0
RHM					
Milling division	Not	Not	Not	3·1	21·3
Bakery division	available	available	available	loss	loss
Milling and bakery divisions	Not available	Not available	Not available	loss	6·4
Spillers					
Milling division	Not	Not	Not	15·1	18·0
Bakery division	available	available	available	loss	loss
Milling and bakery divisions	Not available	Not available	Not available	loss	4·1

Cash flow

401. A summary of the cash flow from flour milling and bread baking for ABF and RHM during the years 1971 to 1975 and for Spillers during the years 1972 to 1975 is given below. The summary shows how the cash flow from profits has been applied to meet group charges for interest, tax and dividends and extraordinary items, and to finance increases in fixed assets and in net current assets.

TABLE 7.12

Summary of cash flow—flour milling and bread baking: 1971 to 1975

£million

	ABF 1971–75	*RHM 1971–75*	*Spillers 1972–75*
Profit, before interest, tax, dividends and extraordinary items	37·4	50·7	17·3
Less/(add): apportionment of interest	7·3	10·7	8·1
tax	4·6	16·0	1·8
dividends	5·2	10·8	4·6
extraordinary items	(2·1)	1·8	1·6
	15·0	39·3	16·1
Profit after interest, tax, dividends and extraordinary items	22·4	11·4	1·2
Less: increase/(decrease) in:			
fixed assets—			
new investment (net)	54·6	18·9	5·8
depreciation	(22·3)	(19·7)	(12·0)
	32·3	(0·8)	(6·2)
goodwill	2·5	0·2	1·5
net current assets	5·5	16·5	10·9
	40·3	15·9	6·2
Contribution to/(reduction in) group liquid resources	(17·9)	(4·5)	(5·0)
Analysed as follows:			
Flour milling	11·8	7·6	10·8
Bread baking	(29·7)	(12·1)	(15·8)
	(17·9)	(4·5)	(5·0)

402. Table 7.12 shows that during the period referred to each of the Big Three groups had to rely for additional finance from its other activities in order to support its flour milling and bread baking operations. For ABF this additional finance in the period 1971 to 1975 amounted to £17·9m, which was more than accounted for by the net increase in fixed assets (excluding goodwill) of £32·3m. Only in the case of ABF did net new investment in fixed assets exceed depreciation charges based on historic cost during that period. Each group had a positive net cash flow from flour milling, which was more than offset by a negative cash flow from bread baking.

CHAPTER 8

The views of the Big Three groups

403. We sought the views of each of the Big Three groups on a number of matters which, it appeared to us, might have particular relevance to the possible existence of monopoly 'conditions' in flour or bread supply. We also afforded them an opportunity to comment on the criticisms and complaints made to us by some of those witnesses whose evidence is set out in Chapter 6. The views and comments of the groups on these matters are summarised in this chapter.

Similarity of flour prices and bread prices: general

404. The groups argued that uniformity, or near uniformity, of flour and bread list prices did not constitute any restriction of competition, but was the result of competition. ABF and RHM made the preliminary factual point that, for flour, list prices had not in fact been uniform since about the end of 1973 (see paragraph 270), but all three groups argued that, in so far as list prices were uniform, this was only to be expected and did not amount to restriction of competition and was not evidence of such restriction.

405. RHM argued (in relation to bread, though the argument is equally valid for flour) that before it could be held that the conditions of the Act prevail it must be established that there is 'deliberate mutual abstention' from competition and not a mere 'response to what competition itself enforces'. The group said that 'unless what is observed to occur is a result different from what competition might be expected to produce, it cannot be characterised as conduct which is restrictive of competition', and it claimed that there must be 'something which, in all the circumstances, would not have been produced by response to the impersonal forces of the market'. The group submitted that the similarity of list prices was consistent with response to market forces and that no inference of 'deliberate mutual abstention' from price competition was justifiable. According to the group there was no absence of price competition and net prices for flour could and did differ, though they might be the same (especially for shared accounts) because of competition, while net prices for bread were 'entirely fluid, as is to be expected in a very competitive industry'.

406. ABF said that the same, or nearly the same, prices for flour resulted from competition and from the bargaining strength of independent bakers. The group summed up the position as follows:

(i) list prices, looked at in isolation, are no more than a starting point for competition on price between suppliers of flour, since competition takes place on the net price, and they operate as the maximum that could be asked for or achieved;

(ii) in so far as prices (ie net prices) charged to the same customer(s) or to customers in a similar situation by different suppliers are 'the same, or nearly the same', this is the result of competition, and is not evidence that they restrict competition.

407. Having posed the question 'What is the competition that would or might take place, or would or might have taken place, in the absence of the conduct said to be restrictive of competition?', ABF said that the answer was that one would not expect to find any lesser similarity or closeness of prices than in fact existed. The group stated that 'it is a travesty of the facts to say that the sameness of the suppliers' prices is some evidence that they restrict competition'. As regards bread, it argued that 'in the absence of any co-ordination between the companies resulting from Government-inspired or sponsored discussion', the most that could have been expected if there had been a free market (ie one not subject to various kinds of Government control) would have been price differentials which, because of competition, could not possibly have lasted more than a few days. Concerning the most recent years the group remarked that 'since the advent of statutory price control at the end of 1972, competition in regard to list prices has not been a practical possibility'. Allied Bakeries has been the lowest cost producer and has consistently been the 'back-marker'; because of cost pressures the other major groups 'have had no practical alternative but to raise their prices for standard products to the limits set by those of Allied Bakeries', and 'since competition on list prices has not been a practical possibility over the last $3\frac{1}{2}$ years, it cannot be said that the three major bakery groups have acted in a manner restrictive of such competition'.

408. Spillers said that 'competition ensures that the net prices charged . . . to any individual do not differ significantly for any substantial period. The company does not accept that uniform prices constitute restriction of competition'. It said that they represent the effect of competition.

Pricing of flour

409. We drew attention to the admitted practice of Spillers and RHM on certain occasions of discussing the timing and amount of proposed flour price increases and enquired whether that might account for the observed similarity of price movements. They said that this was in no way restrictive because any miller must give his customers advance notice of a price increase and therefore the intention to raise prices became publicly known. RHM said that the similarity of flour pricing between itself and Spillers was 'significantly due more to government discussion or control than any other one factor. . . . Over the last decade on each occasion of price movement, the government finally agreed the amount'. ABF said that before 1972 it had never raised its prices until RHM's decision to do so had become generally known and that, since 1972, it had in general limited its price increases to the lowest permitted under the Price Code to its chief competitors.

410. RHM told us that the level of prices for bakers' flour, including transfer prices within the groups, was determined by what happened in the free trade. The group was in no doubt that, if its prices were at 'artificial levels' it would not be able to retain its free trade. Spillers said that when considering price changes it regarded the likely reactions of the other two major groups as 'much more important' than that of the independent millers. Spillers said that it did not think that the independent millers had any decisive influence on the level of prices nationally though they did have an impact regionally.

411. As regards speciality flour, RHM said that whilst it was not the practice to advertise ordinary bakers' flour it was necessary to advertise Hovis bread and thus, indirectly promote the sale of Hovis flour, because 'what we are trying to do there is to sell a brand, which is quite different from selling raw material'. The cost of advertising Hovis bread was about £650,000 per annum and Hovis accounted for about 35 per cent of the brown bread market. Hovis was in competition with, in particular, VitBe and also with numerous wheatmeals, wholemeals and other varieties, and in pricing it, regard had to be had to that competition. Additionally there was a close relationship between the price of Hovis flour and that of bakers' flour. The differential (in favour of Hovis) was nearly £3 per sack and this had remained constant for many years.

412. Speaking of household flour, RHM and Spillers said that although they set recommended retail prices for their brands the wholesale price at which they supplied it to retailers reflected the competitive situation generally. A significant factor in that situation was the competition offered by own brand household flours which had in recent years increased their share of the market. Independent millers were said to supply a large part of the own brand household flour market.

413. We asked each of the groups whether there was any justification for flour prices being uniform throughout the country. Spillers replied that prices were governed by competition and that it was not possible for one supplier to vary his prices from place to place to reflect local manufacturing costs or delivery costs regardless of the competition. ABF made the point that the rationalisation which had taken place in its milling business would make it wholly inappropriate to revert to the position as it was in the early 1960s, with each mill quoting its own list prices. Different mills now specialised in producing different flours and thus achieved the lowest average costs within the milling division. It added that any suggestion of regional variation of flour prices was academic since, in response to competition, it would always match its competitors' net prices whatever its list prices might be. RHM said that the uniformity of prices in England and Wales was the product of competitive forces which had eroded the zone price differentials which existed in the late 1960s and early 1970s. It added that it was a national flour milling business and, having regard to its rationalisation achievements, it attained the most competitive position by adopting flexibility in its supply arrangements. Accordingly it said that it would be very difficult to operate on the basis of different prices from different mills, or to justify doing so.

The policy of requiring subsidiary companies to purchase flour from group sources

414. The extent to which the Big Three groups supply flour to their own subsidiaries is referred to in paragraph 236.

415. Each of the groups confirmed its practice of requiring its flour-using subsidiaries to purchase flour solely from within the group except in so far as concerns speciality products which are not obtainable from that source. Each of them argued that it would be unrealistic to hold that vertical integration in this case necessarily amounted to a restriction of competition in flour supply.

416. In explaining the circumstances in which it would review its practice in this matter, ABF said that if an independent miller made a sufficiently

attractive offer, in terms of price, quality, consistency and quantity, so that it would be in the interests of ABF group's milling and baking activities as a whole to take advantage of it, ABF would give that offer serious consideration. The group said that it would be unrealistic to expect purchasing decisions in a vertically integrated enterprise to be made on any other basis, since otherwise the achievement of true integration of the sort achieved by Allied Mills and Allied Bakeries would be pointless.

417. RHM told us that its baking subsidiaries were not allowed to get supplies of flour from independent millers, though consideration would be given to any proposition for doing so which would be economically sound in the long term. The group said that there had never in fact been such a case.

418. Spillers told us that it was its policy to require its bakeries to purchase flour, other than speciality flour, from within the group, because the bakeries had been purchased in order to protect its outlets for flour. It said that the question whether the group's bakeries would be prevented from accepting an offer by an independent miller to supply at a lower net price was a hypothetical one; such offers were not in fact made, and no doubt the independent millers were aware of the group's policy.

419. All three groups emphasised the benefits which derived from integrated milling and baking activities. They said that those benefits arose mainly from economies of scale which enabled flour production to be concentrated in large modern mills operated at optimum capacity as well as from product specialisation; close technical liaison between mills and bakeries; reduced purchasing, handling, selling and delivery costs. It was also claimed that integration facilitated research into means whereby the extraction rate could be increased and flour of good quality could be produced from grists comprising reduced amounts of expensive hard wheats. Such economies, it was said, benefited not only the group's own subsidiaries but also all third party customers for flour.

Tied loan agreements concerning flour supply

420. The groups said that their practice of making loans to bakery customers was traditional. (We have confirmed that it is a practice adopted by independent millers also.) Such loans are generally made at rates of interest one or two per cent above the current minimum lending rate. The groups said that they usually reflected situations in which a bakery's bank had regarded the available collateral security as being insufficient for the amount of loan desired or in which the baker had already exhausted his bank facilities. Under the loan agreements the borrower undertakes to obtain his requirements of flour from the lender and the lender undertakes to supply him at the current market price. The groups emphasised that loans might be repaid at any time and that such event broke the tie. RHM said that although 57 of its loans had been cleared between March 1974 and November 1975, the group continued to supply about 80 per cent of the flour requirements of the parties concerned.

421. It was the groups' view that the effect of these loans was in some instances to keep in being bakery businesses which otherwise might have closed down. In other cases the loans enabled the recipients to modernise and re-equip their bakeries. The effect of the facility was, therefore, not in any way restrictive. Rather it enhanced the degree of competition in the supply of bread.

422. But, even if such loan agreements were to be regarded as being in a technical sense restrictive of competition in flour supply, the groups submitted that their effect was *de minimis*. In support of this view each of them provided details of loans in issue at particular dates. These showed that at the end of 1975, ABF had only 67 loans of a total value of £263,316. At June 1976 RHM had 147 loans in force at a time when its customers for flour numbered about 10,300. At November 1975 Spillers had loans then outstanding to the value of £389,839 representing a weekly flour sackage of 2,700. At 2 February 1974 the sum involved was £410,588 and related to a total of 91 loans with an aggregated weekly sackage of 2,344.

Tied flour trade with associated companies

423. RHM had, on account of financial association with them, agreements with certain companies (see paragraph 167) under which those companies were tied to the group for all, or some part, of their flour requirements. The amount involved under these arrangements was said to be about 20,000 tons a year.

424. Spillers likewise had agreements with certain companies with whom it is financially connected (see paragraph 181). These agreements did not entirely preclude those companies from purchasing flour from sources other than Spillers. The amount of flour supplied by Spillers annually under these agreements was said to amount to about 37,000 tons (which is about one per cent of the total United Kingdom market).

425. As with loans agreements (see paragraph 420), the groups concerned pointed to the limited scale of the trade which derives from the agreements with associated companies and contended that those agreements had no practical restrictive effect on flour supply.

Membership of the Millers' Mutual Association (MMA)

426. RHM and Spillers are members of the MMA and, although ABF is not itself a member, it has allowed, exceptionally, its wholly-owned subsidiary, Cranfield Brothers Limited, to remain in membership since its acquisition by the group in 1972. It said that it 'has never been associated with the aims of the MMA, and Cranfield has made no levy payment since coming into the ABF group'.

427. RHM and Spillers said that steps taken by the MMA to assist millers to retire from the industry (see paragraph 313) were in no way restrictive of competition. It had not been part of the Association's role to put pressure on millers to go out of production or to make unreasonably attractive offers in order to induce them to do so. The MMA simply acted as a buyer of the last resort of a miller's goodwill, plant and machinery at a reasonable price, and it was not in the public interest if a miller with no future in the industry was compelled to continue in it until positively driven out because of inability to find a buyer on reasonable terms. The Association had had the effect of facilitating the elimination of excess production capacity in the industry without preventing the industry from remaining highly competitive.

428. MMA representatives explained to us that an independent committee dealt confidentially with applications from millers wishing to leave the industry. If that committee considered 'that it would be right' for the Association to

purchase the goodwill and plant of any applicant, it determined what it considered to be a proper price and advised both the MMA and the applicant accordingly. Since 1973 the MMA has made no levy on its members for the purpose of raising funds to finance the purchase of goodwill, plant and machinery.

429. We have already referred (see paragraph 314) to the MMA's view that there is no restrictive effect in the practice of circulating certain information to members regarding the extent of members' flour production. We have also referred (see paragraph 315) to certain Rules in the MMA's constitution but have been assured that they are not now enforced.

NABIM flour milling cost reports

430. We asked certain of the Big Three groups for their views on the flour milling cost enquiry reports which NABIM circulates to its members (see paragraph 318). They said that such reports in no way influenced them in the pricing of their products. At our request RHM submitted its written comments on the report circulated by NABIM for the year ended March 1975 (see Appendix 7). Those comments are reproduced in Appendix 8.

Relationship between the milling and baking activities of the Big Three groups

431. Each of the groups argued that its milling and baking activities were complementary and formed a single economic unit. In this connection ABF said that its mills and bakeries were considered together for investment purposes and that in recent years its investment in baking had been possible only because of the profits derived from milling. It summed up the position by saying that it decided to spend money on its bakeries 'because that is where the future of the mills lie—in being able to sell bread'.

432. Spillers claimed that, when looking at the profitability of its mills, its milling and baking should be considered together and said that if the group 'did not have its baking business it would run the risk of losing substantial economies of scale in milling upon which the profitability of the milling business depends'. RHM said that, in particular, in 1973–74 it could not look to its bakeries for any significant profit contribution and therefore had had to rely on its milling and other activities to make profits and to generate cash for the group as a whole. In pointing to the significant cost economies which it had achieved in milling, it submitted that this had been possible only because of the integration of its milling and baking operations.

Bread pricing

433. The Big Three groups said that for standard bread the competitive capacity of independent bakers was important and their influence on standard bread prices could have an effect outside their own regions (see paragraph 293). As regards non-standard bread the Big Three groups said that they met keen competition from, in particular, master bakers. Most master bakers could price their products without Price Commission involvement. On the other hand the Big Three required the approval of that body for any price increase. The extent to which they were able to charge premium prices was substantially

governed by the levels set by master bakers and Price Code limitations. These groups also pointed to the increasing number of hot bread shops and in-store bakeries. (ABF has entered the hot bread shop business—see paragraph 111.)

434. The Big Three groups said that evidence of the intensity of competition in bread supply was clear in that prior to the Bread Subsidy Scheme 1975 there had been a discount war between suppliers and this had driven several plant bakers out of business and made baking unprofitable for those who remained. The groups said that in an industry in secular decline, with buyers becoming increasingly powerful, with excess production capacity and with a standard product on offer, it must inevitably follow that (if permitted by law) competition on discounts, service and related inducements would be intense.

435. With regard to the prices at which bread is sold by the Big Three groups in their own retail outlets, they told us that they endeavoured to sell at the full list price whenever possible but that they had to face the realities of competition and it was now their policy to make selective price cuts.

Tied trade in bread

436. ABF said that it had agreements involving 17 small shops, the tenants of which undertook to purchase bread products exclusively from the group but that in practice this involved only standard bread to an annual value of only £120,000. The group said that if these arrangements did not exist the outlets would have been closed. The group did not consider shop franchising to be a satisfactory alternative to closure and said that it might well phase it out in due course. As regards franchise agreements for retail rounds, ABF said these were an alternative to conducting business direct. In any event in May 1976 such agreements existed in respect of only 142 rounds with a total trade of about £1·5m per annum.

437. In addition to its milling and baking divisions, ABF includes within its organisation certain retail grocery subsidiaries. The chief of these in Great Britain is the Fine Fare supermarket chain and, in Northern Ireland, Stewarts Supermarkets Limited. As has been noted in paragraph 139 their requirements of standard bakery products are met either exclusively or substantially from group sources.

438. RHM said that, although certain of the bakers to whom it had loaned money (see paragraph 420) also undertook as part of the agreement to obtain their requirements of standard bread from the group's bakeries, it did not seek to enforce the undertaking. It also said that a 'small number' of shops at which its bakeries division has ceased trading had been let on short term tenancies for a franchise type operation, pending disposal of the freehold or leasehold interest. In such cases the tenancy agreement contained an undertaking that the tenant should purchase his bread requirements from the group. In one case the group had an agreement with a bakery under which, in recognition of a specific financial arrangement, its retail shops covenanted to purchase bread solely from the group.

439. At 1 June 1974, RHM had 1,843 retail round franchisemen. Like ABF, it regarded this method of retailing bread as an alternative to conducting business direct.

440. A mutual understanding was confirmed in 1963 between Spillers Limited and Allied Suppliers Limited—a major grocery chain, now a member of the Cavenham Group—arising out of the purchase of the whole of the issued share capital of Bilsland Brothers Limited by United Bakeries Limited. It provided that Allied Suppliers would give a 'fair wind' throughout its organisation for the sale of products manufactured or merchanted by Spillers Limited or by its subsidiary and associated companies to the extent that such products did not compete with products being manufactured by Allied Suppliers. Similar 'fair wind' understandings were also said to have been entered into with J Lyons & Company Limited and the Co-operative Wholesale Society Limited on the formation of Spillers–French Holdings Limited.

441. Spillers had some 750 to 800 retail round franchise agreements in operation in 1975. As with the other two groups it regarded the sale of bread by franchisemen as an alternative to sale in its own shops.

442. RHM and Spillers said that, as with flour, none of the agreements concerning tied outlets for bread were of any practical significance; in any event the agreements increased rather than restricted competition.

Complaints and criticisms: group replies

443. In the course of the evidence given by those bodies and individuals referred to at paragraphs 340 to 361 a number of complaints and criticisms were made about certain aspects of the conduct of the Big Three groups in regard to their milling and baking activities. Most of those complaints and criticisms were of a general character and have been dealt with by the groups in the course of their evidence as set out in Chapter 5. Others, however, were directed against more specific trading practices and in December 1975 we gave each of the groups the opportunity to comment on them.

444. ABF and Spillers submitted their comments, in May and June 1976 respectively, on each of the complaints and criticisms to which we had drawn their attention. We now summarise those comments in paragraphs 445 to 452.

445. Both ABF and Spillers said that it was quite normal for groups to produce composite balance sheets. ABF said 'it is not the case (nor would it be permitted by the Price Commission) that flour is sold to group bakeries at unduly high prices in order to enable unduly low prices to be charged to external customers'. Spillers remarked that the suggestion that it is the millers of soft flour who have been squeezed out of business is not supported by the facts because 'in the last 10 years, 24 mills with an aggregate nominal capacity of 200 sacks per hour have closed. To our knowledge only six of those mills were predominantly soft flour millers. . . .'

446. Both groups claimed that it was untrue to say that any hidden discounts are given on transactions between their milling and baking companies and that it was also untrue to say that price increases operated earlier for flour supplied to external customers than when supplied to group companies. Spillers said that for commercial reasons its price increases are sometimes applied a week later for flour supplied to external customers.

447. ABF said that it owned no patents over packaging materials and did not restrict the development or acquisition of such materials by other bakers or millers. Spillers commented similarly. As regards influencing trade associations, ABF remarked that it does not seek to do so and referred to the fact that it was not a member of the MMA.

448. Spillers said that the name of the group was included on the packaging of all its packaged products and that all but two of the bakeries in its bakeries' division traded under the name 'Homepride Bakeries'. ABF agreed that some of the bakery companies acquired by it have continued to trade under their original names. However, because of the limited area in which each ABF bakery company trades, in only a few cases did the public have a choice between the bread products of two different ABF companies. ABF said that there was no question of the public being deliberately misled and, referring to the buying power of large groups, said that this was a fact of commercial life with which they must live.

449. Both groups denied the allegation that they were content to take their profits on milling rather than on the consumer bread trade. They said they would like to earn reasonable profits on each of these activities.

450. Each of the groups said that in a free market it was competition which would ensure that there was similarity in the prices of bread charged by them. But with government controls on prices and discounts there was no opportunity to compete in such matters. It would in no circumstances be possible, however, for different prices to be charged for standard bread by bakers supplying a joint account.

451. Bakery research was not, these groups said, directed at reducing the quality of bread. They submitted that 'the standard loaf has no rival in the world in cheapness, nutritional value and keeping quality' whilst the range of other bread products available to the public gave them a wide choice.

452. ABF dealt with the suggestion that the groups take turns to announce bread price increases which have been fixed by them by observing that prices had been determined for many years by Government departments and agencies. Spillers also rejected the allegation saying that the nature of the market was such that standard bread could not be supplied at different prices by different producers.

453. In replying in November 1976 to our invitation to comment on the complaints and criticisms referred to above, RHM said that it deemed it sufficient to deal only with those matters which were specifically directed against the group. It said that it regarded all the other more general complaints and criticisms as having already been dealt with in the course of its written and oral submissions. The group's comments on the complaints made specifically against it are summarised below.

454. RHM pointed to the fact that it acquired from ABF certain shops in Plymouth in its financial year 1974–75. Notwithstanding this it said that in addition to about 10 master bakers, there were in that city a plant bakery owned by Spillers which supplied a significant number of multiple and independent retailers, including, but not limited to, 24 co-operative outlets. It added 'if other plant bakers choose to close down their operations or to

refrain from setting up operations in Plymouth . . . it is hardly a matter for criticism against RHM. . . .'. In commenting on its alleged 'gross takeover activities' RHM said that it had been established in the South West of England since before 1939 and that its bakery serving the Plymouth area and other adjacent areas was, together with certain other bakeries, within the group by 1954. It added that 'the Commission have been made fully aware of RHM's subsequent acquisitions and activities in the South West Area'.

455. Regarding the complaint that supplies of Hovis flour were not available to the general public, RHM said that this flour is a perishable product with a storage life, from production to use, of about three weeks. It added that 'If, within present scientific knowledge, it were practicable to extend commercially the shelf-life of Hovis flour, RHM would have done so as a matter of economy'. Additionally it said that its assessment of the market potential for Hovis flour was between 2 per cent and 3 per cent of the total pre-packed flour market. For this and other reasons, the group thought it 'very unlikely that there will be any significant demand for retail distribution of Hovis flour'.

456. As to the quality of Hovis bread, RHM said that Hovis flour was supplied to more than 300 plant bakeries (including bakeries owned by the ABF and Spillers groups, independent plant bakers and co-operative societies) as well as to over 3,800 master bakers. It informed us of the steps which it takes to ensure maintenance of the quality of Hovis bread and to protect the group's rights in the trade name. It also submitted to us Hovis bread recipes for 1904 and 1956 pointing to their close identity and referred to Hovis National Competitions which it has held since 1962 and the results of which it said 'do not suggest there has been any deterioration (in quality)'.

CHAPTER 9

Conclusions

The conditions

457. The reference was made to us under the Monopolies and Restrictive Practices (Inquiry and Control) Act 1948. Conditions to which the Act applies would prevail as respects flour, or bread, if, under section 3(1) of the Act, at least one-third of all the flour, or bread, which is supplied in the United Kingdom were supplied by or to any one person, or, under section 3(2), at least one-third were supplied by or to two or more persons, who, whether voluntarily or not and whether by agreement or arrangement or not, so conduct their respective affairs as to prevent or restrict competition in connection with the production or supply of flour, or bread (whether or not they themselves are affected by the competition and whether the competition is between persons interested as suppliers or producers or between persons interested as customers of suppliers or producers).

458. The largest suppliers of both flour and bread in the United Kingdom are Associated British Foods Limited, Ranks Hovis McDougall Limited and Spillers Limited; but none of these accounts for as much as one-third of the United Kingdom supply either of flour or of bread. Conditions to which the Act applies do not therefore prevail under section 3(1) as respects either flour or bread.

459. We considered whether any suppliers of flour or bread, and particularly the Big Three groups, which together account for about 80 per cent of the supply of flour and about 60 per cent of the supply of bread, were so conducting their respective affairs as to prevent or restrict competition, and therefore whether the conditions might prevail under section 3(2).

460. Before discussing this point we draw attention to the fact that during the whole period of our investigation, and indeed before that, the flour industry and, even more so, the bread industry have been subject to a substantial degree of statutory control and official pressure. We have given some account of this in Chapter 4 and we have mentioned some of its effects in other chapters. Any consideration of competitive conditions, as well as the existence and effect on the public interest of possibly anti-competitive conduct, must take account of these circumstances.

Flour

461. Each of the three major groups is a vertically integrated organisation whose activities include both milling and baking. Although relatively small quantities of speciality flour are obtained from other millers and none of the groups would necessarily in all circumstances exclude the possibility of buying other flour from other millers, nevertheless it is the practice of each of the major groups to require its flour-using subsidiaries to buy their requirements of flour from its own mills in so far as it is possible to do so.

462. The groups argued that vertical integration of milling and baking did not necessarily imply any restriction of competition in the supply of flour. We accept that the mere fact that the activities of the groups include both milling and baking does not necessarily imply restriction, but a consequence of the practice of the groups, as we have just described it in paragraph 461, is that a proportion of the market for flour, which is significant in respect of each of the three major groups individually and which in total amounts to about 51 per cent of the whole market, is closed to competition from other millers.

463. We conclude, therefore, that ABF, RHM and Spillers, by each requiring its flour-using subsidiaries to buy their requirements of flour from the group's own mills as far as it is possible to do so, are so conducting their respective affairs as to prevent or restrict competition and that conditions to which the Act applies prevail under section 3(2) as regards these three groups in the supply of flour.

464. As far as customers outside the groups are concerned, each of the groups has agreements with a number of independent bakers to whom they have made loans under which those bakers buy their requirements of flour from the group in question as long as the loans remain outstanding (see paragraph 420). The groups argued that these agreements did not involve any restriction of competition in the supply of flour, or that any such restriction was negligible and should not be taken into account for the purposes of section 3(2) of the 1948 Act (see paragraphs 421 and 422). In addition RHM and Spillers have agreements to supply all or part of the flour requirements of a number of bakery companies with which they are financially associated (see paragraphs 423 and 424), but the quantities of flour involved are not large. All these agreements involve restriction of competition since they prevent other millers from competing in the supply of flour to the bakeries concerned, but we consider that the extent of the restriction is negligible.

465. We also considered whether suppliers of flour so conducted their affairs as to prevent or restrict competition in other ways. In particular we considered the implications of the uniformity of list prices for flour (see paragraphs 469 to 476) and the possible effects of the operations of the MMA and the NABIM (see paragraphs 477 to 482).

466. We examine these matters in relation to the supply of bakers' flour, the largest of the three broad categories of flour which we have distinguished in paragraph 35, since (as we explain below) we are satisfied that competitive conditions exist in the supply of the other categories of flour.

467. Household flour is supplied almost entirely to the grocery trade, which is dominated by large buyers such as supermarket chains and buying groups who are able to exert considerable pressure on prices. The groups' branded household flours are sold alongside retailers' own brand household flours produced by millers who are not subject to the same costs as those incurred by millers marketing, selling and distributing branded flours. Own brand household flour is increasing its share of the market. In our view there is no lack of price competition in the supply of household flour.

468. 'Other flour' is mainly soft flour, for example biscuit flour and cake flour. For many types the groups do not publish list prices. The competition from independent millers in this sector of the free market is relatively strong,

and the price of biscuit flour in particular, which represents a substantial proportion of 'other flour', is subject to pressure from large buyers and we were told that its profitability was low. We think therefore that there is effective competition in the supply of 'other flour'.

469. For bakers' flour there has been a substantial degree of uniformity of list prices (albeit less so since 1973) but the list prices themselves are not published by the three major groups and are used by them merely as a starting point for determining actual prices to individual outside customers. It was argued by the groups that, since the actual prices charged are determined by negotiation with individual customers in the light of competitive circumstances, and in view of the function of list prices in this particular industry, the fact that list prices were uniform did not imply any prevention or restriction of competition.

470. However, disregarding allowances for quantity and bulk delivery and discounts for settlements, which are almost uniform between the three groups (see paragraph 265), the negotiated prices actually paid in no case appear to be much below list prices in percentage terms. Moreover, the number of customers who at any particular time are paying negotiated prices below list prices is relatively small, though since they are the larger customers the amount of flour being bought at such prices is proportionately higher. The major groups are undoubtedly supplying bakers' flour in competition with independent millers, and many customers obtain flour from both group and independent millers concurrently. However, the competition of independent millers tends to be somewhat local in its effect and this no doubt contributes to the facts that the majority of customers in the free market are not able to negotiate prices from the major groups below list prices and that for those who can do so the scope is limited.

471. As far as bakers' flour is concerned we do not accept that in considering uniform prices we should regard list prices as irrelevant and look only at the prices actually paid. In the majority of cases list prices (less the standard allowances and discounts mentioned above) are the prices actually paid and their uniformity is relevant to the question whether there is a restriction of competition.

472. The groups argued that in any case uniformity of prices did not amount to a restriction of competition. There were reasons, they said, why flour prices were bound to be uniform or nearly so, and in so far as they were uniform this was the result of competition and was not evidence of any restriction of competition (see paragraphs 404 to 408).

473. It was also argued that, although there have been discussions between RHM and Spillers concerning the amount and timing of flour price changes, these discussions have had no material effect on flour prices (see paragraph 409). We accept that this is so. In any case these discussions have taken place mainly under official sponsorship in the context of the statutory control and official pressure to which we have referred in paragraph 460.

474. In assessing whether the substantial degree of uniformity which exists in the flour prices of the three major suppliers implies a restriction of competition, it is relevant to have regard to the level of those prices as well as

to their uniformity. In this connection we examine whether the level of prices is such as to yield excessive profits.

475. The groups' profit on milling are set out in table 7.5. It is clear from table 7.9 that, particularly in recent years, there has been a marked disparity between the profitability of their milling and that of their reference bread baking, whilst a similar disparity between their milling and their baking activities generally is evident from table 7.11.

476. The relatively high rates of return on a historic cost basis on capital employed in milling suggest, and are consistent with, absence of price competition, or at any rate muted price competition, in the supply of flour. However, as we explain below, in paragraph 496, we do not think that the level of milling profits can reasonably be considered in isolation because these profits, and the flour prices which they reflect, are to a considerable extent the result of the distorting effects of statutory controls. We consider therefore that, while a high level of prices (as reflected in high profits) might generally indicate that uniform prices imply a restriction of competition, in this case the level of prices and profits is attributable to other factors and we do not think that the substantial uniformity of their prices for bakers' flour implies that the groups are so conducting their affairs as to restrict competition in the supply of flour.

477. RHM and Spillers are members of the Millers' Mutual Association and although ABF itself is not a member it has allowed its wholly-owned subsidiary, Cranfield Brothers Limited, to remain in membership since its acquisition by the group in 1972. Any restriction of competition involved in membership of the Millers' Mutual Association would, of course, be a matter concerning all the milling companies in membership and not merely the three major groups.

478. One of the principal objectives of the Millers' Mutual Association has been the rationalisation of the milling industry by means of levies on members for the purpose of purchasing from millers wishing to leave the industry the goodwill, plant and machinery of their milling businesses so that the mills may be closed and their plant and machinery broken up (see paragraphs 71 and 313). It appeared that the members of the Association, in acting collectively to remove milling businesses from the industry, might be so conducting their affairs as to restrict competition.

479. The Association played a significant part in the process of concentration and rationalisation of the milling capacity between the wars and in the early years after the second world war. More recently, with the substantial fall in the number of independent millers, the scale of the Association's activities has been much reduced (see Appendix 2), and the levies, the last of which was made in 1973, have been used to make payments only to milling concerns which would in any case have gone out of business. The Association does not approach any miller with the suggestion that he should dispose of his assets to the MMA. In view of the very small share of the market supplied by those independent millers who have been bought out by the MMA in recent years, we consider that the activities of the MMA do not today involve any significant restriction of competition and do not to any significant extent have the effect of holding up flour prices.

480. The Association circulates to its members detailed information on flour deliveries and mill running hours (see paragraph 314 and Appendix 3), but we are satisfied that this does not have any restrictive effect on competition in the supply of flour.

481. Certain Rules of the Millers' Mutual Association's constitution appeared to us to be possibly restrictive of competition in that they apparently involved some discrimination against millers who are not members (see Appendix 4 and paragraph 315). However, we accept that the Rules in question are not in practice implemented and have not been implemented for some years.

482. We also noted that certain information on milling costs is circulated by NABIM (see paragraph 318 and Appendices 7 and 8), but we do not think that this is likely to have any restrictive effect on competition.

Bread

483. As with flour, we considered whether the uniformity or near uniformity of list prices for bread amounted to, or was evidence of, a restriction of price competition. Retail list prices for bread are published by each of the three major groups. These prices have been uniform or practically uniform for many years (see paragraph 308), but there has also been keen competition in discounts. These discounts have not been in accordance with any fixed scales based on the value or volume of business: they have been determined individually by the competitive situation and the bargaining strength of the customer concerned. For a decade before January 1975 discounts had been rising. During this period a number of agreements were made by the three major groups or their subsidiaries for the purpose of limiting discounts and other incentives. The dates of the majority of these agreements are said to be uncertain, but most of the remainder came into existence between 1970 and 1974; some were earlier, exceptionally as early as 'about 1961'. We regret to find that particulars of these agreements had not been furnished to the Director General of Fair Trading (formerly to the Registrar of Restrictive Trading Agreements). Particulars of them were ultimately furnished in July 1975 and the agreements, which had by then been abandoned, were subsequently registered. We are prevented by section 29(1) of the Restrictive Trade Practices Act 1956 and paragraph 7 of Schedule 11 to the Fair Trading Act 1973 from finding that conditions to which the 1948 Act applies prevail by reason of these agreements.

484. In spite of the agreements referred to above discounts escalated particularly in the latter half of 1974, and by the end of 1974 discounts of up to 35 per cent off retail list price were being given to some customers (see paragraphs 299 to 303). In January 1975 the extent of competition in discounts was substantially reduced by a provision of the Bread Subsidy Scheme 1975 (made under the Prices Act 1974) which generally limited discounts to retailers to not more than 22½ per cent (see paragraph 298). Notwithstanding the registered agreements (which we are unable to consider), there has been keen competition in discounts and other inducements, and thus in the net prices charged, when and to the extent that statutory provisions have not prevented this. Because of this we do not consider that the uniformity of the three major groups' list prices for bread is evidence of, or amounts to, their so conducting their affairs as to prevent or restrict competition.

485. We have not overlooked the fact that the Federation of Bakers, of which all the three major groups are members, suggested to its members in mid-1975 that they should not seek to match the lower prices of one particular baker who was not a member of the Federation. The circumstances in which this happened are described in paragraph 330, and we are satisfied these were abnormal circumstances created by the fact that for special reasons the baker concerned had been permitted by the DPCP to reduce his price for standard bread loaves to less than that which other suppliers could charge. We are satisfied also that the Federation of Bakers does not normally concern itself with its members' trading practices or seek to influence their pricing behaviour.

486. As with flour we considered whether the existence of certain agreements under which each of the three major groups has tied outlets for bread involved any material restriction of competition. The extent of these agreements and the groups' arguments concerning them are set out in paragraphs 436 to 442. We accept that no significant restriction of competition is involved.

Conclusion on the 'conditions'

487. Our conclusions concerning the conditions under the Act are:

(*a*) conditions to which the Act applies prevail under section 3(2) in respect of flour because Associated British Foods Limited, Ranks Hovis McDougall Limited and Spillers Limited so conduct their affairs as to restrict competition in the way described in paragraph 463;

(*b*) conditions to which the Act applies do not prevail in respect of bread.

The public interest

488. In Chapter 2 we have described the way in which the flour and bread industries in the United Kingdom came to be dominated by the three major vertically integrated milling and baking groups—ABF, RHM and Spillers. Briefly, the acquisition of bakeries by Allied Bakeries Limited (which subsequently became ABF), together with the decontrol of the flour industry in the mid-1950s and the possibility of once again importing Canadian flour as Allied Bakeries had done before the war, led RHM and Spillers, then the two largest milling concerns, to take steps to protect their flour businesses. Accordingly, they began about this time to acquire bakery businesses on a large scale in order to ensure that they had outlets for their flour.

489. In 1961 ABF, being unwilling to risk having to rely on its principal competitors in baking (RHM and Spillers) for supplies of flour in the event that Canadian flours were no longer economical to import, itself decided to enter the milling industry. We have briefly described in paragraphs 123 to 125 the programme of acquisitions, modernisation, rationalisation and building of new mills on which the group then embarked.

490. Whereas RHM and Spillers integrated forward from milling into baking in order to ensure outlets for their flour, ABF integrated backward into milling in order to ensure supplies of flour as advantageously as possible for its flour-using subsidiaries. An indication of the ways in which productivity has been

increased and economies have been achieved by ABF as a result of modernisation and rationalisation of its milling capacity is given in paragraphs 131 and 132. Indications of similar achievements in productivity by RHM and Spillers are given in paragraphs 163 and 189 respectively.

491. As we have noted in paragraph 419 all three groups emphasised that the benefits of integration of milling and baking lie not only in economies of scale, which enable flour production to be concentrated in large modern mills, but also in the scope for specialisation, liaison between mills and bakeries in production, planning and technical matters and in the facilitation of research leading to increased extraction rates and the use of cheaper grists.

492. We accept that significant cost savings arise from the integration of large-scale milling and baking organisations, and that the achievement of these savings depends on the baking side obtaining all, or virtually all, of its flour from the mills owned by the group[1]. However, the fact that the groups are integrated and have large market shares in both milling and baking could enable them to choose whether or not they pass on the cost savings. It could also enable them to discriminate in price between their own baking subsidiaries and external customers; and it could make possible cross-subsidisation between their milling and baking activities, which could damage either independent millers or independent bakers. Since these are matters which could affect the public interest we think it is relevant to consider the profits being made on flour, the relationship between transfer and external prices, and the possible effects of cross-subsidisation between milling and baking. In considering these points we are concerned particularly with bakers' flour since, as we have explained in paragraphs 467 and 468, we believe that there is adequate competition in the supply of household flour and 'other flour'.

Profits

493. The groups' returns on capital employed in flour milling on an historic cost basis, as set out in table 7·5, show a clear pattern in the last few years of substantial and mainly increasing profits. Particularly high rates of return are shown for ABF in the two latest years for which we have figures (53 per cent in 1974 and 56 per cent in 1975), but it needs to be borne in mind that, as we have explained in paragraph 388, ABF's figures of return on capital employed are in one respect not comparable with those of the other two groups in that part of its stocks of wheat are bought and held by its subsidiary Mardorf, Peach to whom it pays commission on purchases. It is not possible to obtain a consolidated result for ABF's milling activity as a whole including Mardorf, Peach's wheat procurement activities. When adjustment is made for the effects of inflation ABF's return in the two latest years is reduced from 53 per cent to 23 per cent and from 56 per cent to 19 per cent respectively; and the effect of adjusting for Mardorf, Peach's activities would probably be to reduce these inflation-adjusted returns.

[1] In the case of ABF this applies also to the Chancelot mill, which is part-owned by the Scottish Co-operative Wholesale Society (see paragraph 124). This mill supplies flour for use by ABF and the Society, both of which have agreed to maximise their offtake from the mill.

494. We have referred already to the wide apparent disparity between the profitability of milling and that of bread baking. We recognise that because of the problem of apportionment of costs between bread baking and other bakery activities, to which we have referred in paragraphs 383 and 384, the figures of return on capital employed for bread given in table 7·7 must be treated with caution. Nevertheless we think it is clear that for the period for which we have figures returns on bread baking on an historic cost basis have been largely inadequate and, more recently they have been negative. The returns on baking operations as a whole on an historic cost basis have also been generally low since 1974 (see table 7.11).

495. The disparity between milling and baking profits, which goes back for some years, is to some extent due to the power of the Big Three groups and to the fact that, as regards bakers' flour, milling is a less competitive industry than baking. On its present scale the disparity is to a considerable extent the result of distorting effects of statutory controls. These controls appear to have depressed bread prices much more severely than flour prices, and the groups have had to accept very low profits, or losses, on their baking operations in recent years. In their view they have been justified in compensating themselves by making what profits they could on milling. Moreover, as has been noted in paragraph 260, since under the Price Code increases in flour prices have been allowable cost increases for bakers, it has been in the interests of the integrated milling and baking groups to keep the price of bakers' flour as high as possible by taking full advantage of every allowable increase. If they had not done so, not only would there have been less compensation for the low profitability of baking, but the profitability of baking would itself have been still further depressed. Independent bakers would have been adversely affected in the same way.

496. In our view the fact that the three groups are operated as integrated milling and baking organisations, combined with the fact that the disparity of profitability is largely due to the factors we have just mentioned, justifies the claim put forward by the groups that any consideration of whether profits are excessive must have regard to the combined profits of the milling and baking activities of the integrated groups and not to the profits of their milling in isolation.

497. The groups' returns on capital employed on an historic cost basis for flour milling and reference bread baking together in the five years to 1975 have been as follows:

Return on capital employed (historic cost basis)—
Flour milling and reference bread baking (combined)

per cent

	ABF	*RHM*	*Spillers*
1971	19·5	16·7	N/A
1972	17·6	15·5	4·0
1973	5·9	15·8	0·9
1974	11·2	11·5	6·4
1975	19·9	17·2	18·2

As we have said in paragraph 494, the difficulty in apportioning costs between reference bread baking and other bakery activities makes it necessary to treat figures of return on capital employed for bread baking alone with caution. It follows that the above figures in respect of milling and bread baking combined must also be treated with caution. As we have explained in paragraph 400, we obtained the rates of return on capital employed in the whole milling division and the whole baking division, both separately and combined, for each of the groups. The combined rates on an historic cost basis (as set out in table 7.11) are as follows:

Return on capital employed (historic cost basis)—
Total milling division and total baking division (combined)

			per cent
	ABF	*RHM*	*Spillers*
1971	23·3	17·7	N/A
1972	24·8	18·3	5·4
1973	14·8	19·8	1·8
1974	14·8	12·8	3·1
1975	23·2	16·4	14·4

These figures are in most cases slightly higher than those for milling and bread baking, but in our view none of the rates of return in either of the two tables can be regarded as excessive.

498. In any case, given the rate of inflation in recent years, we do not think that profits can satisfactorily be considered solely on an historic cost basis. On an inflation-adjusted basis, the returns on capital employed are substantially reduced. For the two years for which we have information the returns are as follows:

Return on capital employed (inflation-adjusted basis)—
Flour milling and reference bread baking (combined)

			per cent
	ABF	*RHM*	*Spillers*
1974	loss	loss	loss
1975	1·6	7·7	6·8
	Total milling division and total baking division (combined)		
1974	1·6	loss	loss
1975	3·0	6·4	4·1

499. The rates of return on an historic basis have not, as we have said, been excessive; and it is evident that, taking account of inflation, they have been low or even negative.

500. The modest level of profitability, whether of flour milling together with bread baking or of the total milling divisions together with the total bakery divisions, is not surprising since the price of bread is severely limited by statutory controls, and even in the absence of such controls the net price would be effectively restrained by the substantial degree of competition which prevails in the supply of bread and by the existence of large and powerful buyers. The power of large buyers is not confined to supermarkets and large chains of retailers but is also increasingly exercised by small retailers through buying groups. All of these buyers are normally in a position to exert pressure for discounts on the bakers and therefore to retail competitively to the public. The retail price of standard bread also influences the price of non-standard bread; master bakers who bake and retail their own bread are able to charge

higher prices for non-standard bread, but only to the extent that the public is willing to pay the differential. In our view therefore, although apparently high profits have been made on milling, the public is not in general being exploited by high prices for bakers' flour.

Transfer prices

501. The groups claimed that internal transfer prices for flour were on an arm's length basis and therefore comparable to those charged to external customers. Precise comparisons between transfer prices and external prices are difficult to make but such evidence as was available indicates that there is no significant difference (see paragraphs 259 and 390) and we are satisfied that there is no question of independent bakers being put at a competitive disadvantage by the groups discriminating in price in favour of their own baking subsidiaries and against independent bakers.

Cross-subsidisation

502. Although for the reasons we have explained we do not think that the level of milling profits can be considered in isolation and we do not therefore find them to be excessive, we need to consider the effects of the wide disparity in profitability between the milling and baking activities of the three major groups on independent bakers.

503. It has been suggested that it is the policy of the groups to accept low profits on bread so as to make it difficult for independent bakers to compete. It is clear that limited competition in the supply of flour and the dominant position of the three major integrated groups may enable them to compensate themselves for the low profitability of bread by relatively high profits on flour. We are satisfied, however, that the groups are not deliberately depressing the profitability of baking and manipulating the price of flour. They do not willingly accept the low profitability of baking and would indeed prefer to see the disparity reduced and their baking activities making profits which they would regard as adequate.

504. For some years the total number of independent bakers has been declining, as some go out of business and others are taken over; and this has no doubt been due in part to the relative unprofitability of the baking industry. It is difficult to generalise about the profitability of independent bakers because of the wide variety in the types of business. Such evidence as we have suggests that neither plant bakers nor master bakers are on the whole making large profits but that it has been possible, particularly for those master bakers who have a good business in flour confectionery or in special types of bread (for which there is a limited demand but which are not subject to price control), to make satisfactory profits. However, in so far as the bread baking industry is unprofitable this is not attributable to anything done by the three major groups as a result of 'conditions' which we have found to prevail in respect of flour (see paragraph 463). The unprofitability is due largely to the effects of statutory price control and other forms of official intervention. If modification of these

controls leads to the Big Three groups making better profits on baking, but the profitability of their milling activities remains at a high level, the situation may need to be re-examined.

Conclusion

505. We conclude that neither the conditions which we have found to prevail as respect the supply of flour as described in paragraph 463 nor any things done as a result of, or for the purpose of preserving, the conditions operates or may be expected to operate against the public interest.

J G Le Quesne (*Chairman*)

G F Ashford

T Barna

R G Opie

J S Sadler

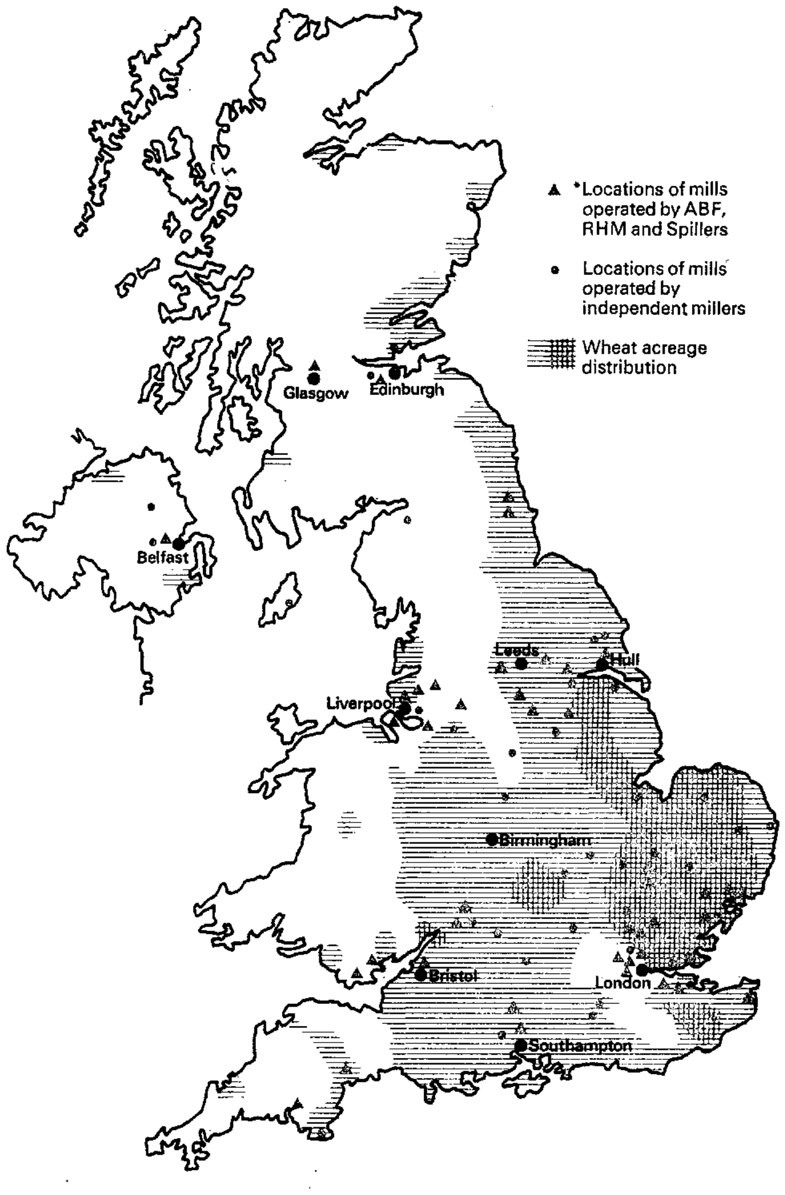
Y Lovat Williams (*Secretary*)

1 April 1977

APPENDIX 1

(referred to in paragraphs 26 and 240)

Locations of flour mills and wheat acreage distribution



**In some instances two or more mills operate at the same location. In Jan 77 ABF, RHM and Spillers operated 57 mills*

APPENDIX 2

(referred to in paragraphs 71 and 479)

The Millers' Mutual Association
Purchase of goodwill and plant and machinery: 1953 to 1976

The following schedule showing the extent of its activities has been prepared by the Association.

(*Note:* Though the heading 'No of Mills' is used below for convenience, it has to be noted that the MMA only purchases the goodwill and plant and machinery relating to the flour milling business carried on in a mill. The MMA never buys the mill itself.)

Year	*No of Mills*	*Price Paid (£)*
1953	12	196,173
1954	None	Nil
1955	1	25,065
1956	1	17,528
1957	5	198,457
1958	9	204,106
1959	13	469,670
1960	11	848,233
1961	6	225,693
1962	4	197,698
1963	2	32,959
1964	None	Nil
1965	4	210,282
1966	3	86,543
1967	4	90,013
1968	None	Nil
1969	4	181,340
1970	4	468,482
1971	2	42,500
1972	3	158,937
1973	3	527,734
1974	None	Nil
1975	2	75,626
1976 (to November)	None	Nil
	93	£4,257,039

APPENDIX 3

(referred to in paragraphs 314 and 480)

The Millers' Mutual Association

Report to Members

For weeks ended Saturday, 197 Period

Member	*Total deliveries (sacks of 280 lb)*						*Average weekly running hours*	*Period*
	Included trade				*Export trade*	*Total trade*		*Total Trade (for weeks)*
	Breadmaking flour	*Biscuit flour*	*Other flours*	*Total included trade*				
First Area								
Allinson Ltd								
Carr's Flour Mills Ltd								
Caudwell E (Rowsley) Ltd								
Croysdale John & Sons Ltd								
Greensmith T C & Sons Ltd								
Nelstrop Wm & Co Ltd								
Smiths Flour Mills Ltd								
Thirsk T S & D Ltd								
Tindall A W Ltd								
Wilson King Ltd								
Area Total								

For weeks ended Saturday, 197

Member	*Total deliveries (sacks of 280 lb)*						*Average weekly running hours*	*Period*
	Included trade				*Export trade*	*Total trade*		*Total Trade (for weeks)*
	Breadmaking flour	*Biscuit flour*	*Other flours*	*Total included trade*				
Second Area								
Baker Edward Ltd								
Clark & Butcher Ltd								
Cranfield Bros Ltd								
Dewing & Kersley Ltd								
Duffield Wm C Ltd								
Green Walter & Sons Ltd								
Heygates Ltd								
Hills & Partridge Ltd								
Paine & Co Ltd								
Read Woodrow Ltd								
Whitworth Bros Ltd								
Area Total								

For weeks ended Saturday, 197

Member	*Total deliveries (sacks of 280 lb)*						*Average weekly running hours*	*Period*
	Included trade				*Export trade*	*Total trade*		*Total Trade (for weeks)*
	Breadmaking flour	*Biscuit flour*	*Other flours*	*Total included trade*				
Third Area								
Botley Flour Milling Co Ltd								
Botting C A & Sons								
Bowman Jas & Sons Ltd								
Clovers Ltd								
Garratt G & Sons								
Marriage W H & Sons Ltd								
Munsey W H Ltd								
Pledge H S & Sons Ltd								
Priday Metford & Co Ltd								
Wright G R & Sons Ltd								
Area Total								
RHM Flour Mills Ltd								
Spillers-French Milling Ltd								
Sub-Total								
Totals for the three areas (Note 1)								
Grand Total								

Note 1: Estimates have been included for Members who have not rendered their Weekly Returns.

APPENDIX 4

(referred to in paragraphs 315 and 481)

The Millers' Mutual Association

The following is an extract from Rule 2 of The Millers' Mutual Association's Constitution and Rules as at October 1976.

'2(*d*) No Member shall retain or acquire any monetary interest in any Flour Mills in England or Wales or such other Areas in which the Association may be operating as determined by the Board if such Mills are owned or controlled by a non-member or non-members unless the owner or controller of such Mills becomes a Member of the Association.

'(*e*) (i) No Member shall, without consent of the Board, sell lease or otherwise dispose of to a non-member any Mills owned or controlled by him save upon an undertaking that the purchaser shall forthwith become a member or that such Mills shall not be used for the production of flour.

(ii) No Member shall, without the consent of the Board, part with control of an Associated Company to a non-member save upon an undertaking that the Mills operated by such Associated Company shall not be used for the production of flour.

(iii) No Member shall without the consent of the Board, sell or otherwise dispose of to a non-member, the whole or any part of the goodwill of any business for the production of flour save upon an undertaking by the transferee forthwith to become a member. Where within this rule the consent of the Board is required, the decision to give or withhold such consent may be taken on behalf of the Board by the Chairman or deputy Chairman.

'(*f*) No Member shall purchase from a non-member the goodwill of any business for the production of flour separate from the Mills used therewith without a covenant from the Vendor that the Mills will not at any future time be used by any person for the purpose of producing flour unless the Vendor obtains from the purchaser his consent thereto which the purchaser may in his absolute discretion refuse. A Member so purchasing goodwill shall not, while he remains a Member, give such consent.'

Appendix 5

(referred to in paragraphs 146, 173 and 197)

Assessment of bakery production capacity

The following are extracts from statements made by the Big Three groups about the method employed for assessing bakery production capacity.

ABF

Definition of production capacity

1. A bakery's bread[1] production capacity is the sum of its individual plant capacities. The weekly production capacity of each plant is taken as

$$((a \times b) - c) \times d$$

where:

(*a*) is the *nominal capacity* in sacks per hour, of the plant;
(*b*) is the number of *production hours* available in the week;
(*c*) is the number of *sack hours not available for bread production* on that plant owing to the need to bake other products;
(*d*) is the *production factor*[2] based on the product mix normally required from the plant in question and on the most efficient scheduling of that product mix.

Each of the above factors involved in the computation of plant capacity is explained below in turn.

Nominal capacity

2. Each plant has a nominal capacity, expressed in sacks of flour per hour, based on the size of the equipment comprised in the plant (mixers, dividers, moulders, ovens, provers, coolers) and its ability to convert a number of sacks of flour per hour into 28 oz standard loaves with no tin changes. A sack of flour is 280 lbs and the yield is of the order of 234 to 236 28 oz standard loaves per sack. Yields for other types of bread will vary according to the weight and type of product. The most common plant sizes are 6, 9, 12, 15 and 18 sacks per hour respectively. . . . Most of the bakeries operate two or more plants, and this provides flexibility of operation in scheduling the product mix.

Production hours

3. The number of hours for which the plant is available for production is the maximum number consistent with freshness of the product and the working of reasonable and not excessive overtime. This number of 'production hours' is taken as 100 hours per week. There is a time-lag of about 1 hour 40 minutes between the commencement of mixing to the completed baking of the first loaf of bread. After baking, a cooling time must be allowed of about two and a half hours. As a result of these factors, 100 hours of production time imply a weekly schedule of broadly 100–112 working hours for production staff. A six-day week is worked from Sunday to Friday inclusive, with two eight-hour shifts a day worked from Sunday to Thursday, two consecutive shifts of twelve hours each on Friday and a total of 6–8 hours of additional

[1] Bread rolls are excluded as they differ so markedly from bread loaves that no meaningful plant utilisation figures could be arrived at by their inclusion. The term 'bread' therefore in this note refers to bread as defined in the Reference but excluding bread rolls.

[2] As this can only be calculated in each case by the bakery in question, there is inevitably some element of imprecision involved even in comparing plant utilisation figures of different bakeries within the Allied Bakeries Group. Any comparison with similar figures for other concerns in the bread industry (if available) would be of doubtful value, because of the impossibility of ensuring comparability of the 'production factor' applied in each case.

overtime, usually on Sunday and Thursday. The above schedule is broadly the pattern of working in the group's bakeries. . . . There are also variances from this normal pattern due to type of plant, product mix and, more especially, the despatch requirements which differ at each bakery.

4. Retail sales of bread peak sharply at the weekend, being heaviest on Saturday but also heavy on Friday. Consumer demand on Saturday is such that it represents more than the average bakery is capable of producing in 24 hours. Production schedules for Friday's deliveries must therefore be advanced sufficiently to allow enough production time for Saturday's requirements.

Sack hours not available for bread production

5. Bread rolls and similar products are baked on the bread plants in many of the group's bakeries, a record is kept of the weekly sack hours unavailable for bread production and an average used for the period in question.

Production factor

6. On the basis of 100 production hours per week a 9-sack plant could produce 900 sacks per week, provided it was producing nothing but 28 oz standard bread with no tin changes. In practice, however, all bakeries have requirements for a variety of breads, and this factor unavoidably reduces the level of production below that which could be obtained on uninterrupted baking of 28 oz standard bread without tin changes.

7. Among the factors affecting the level of production are the following:

(i) the number of different types of loaf being baked affects down time because of changes of tin and mix and the need to alter machinery settings;

(ii) some types of bread can only be produced at a rate slower than (in some cases only half) the rate implied by the nominal sackage of the plant;

(iii) the mix of sales outlets, depots and associated bakeries supplied by the bakery will affect the average length of production runs.

8. As part of its routine production planning each bakery calculates the production of its sales requirements over its lines of plant and over the working day in the most efficient manner possible. For the purpose of the quarterly returns of plant utilisation each bakery calculates for an average week the degree to which the product mix normally allocated to each plant depresses the bread sackage production rate per hour below the nominal figure for that plant. This depressing effect is called the 'production factor' and is expressed as a percentage. This percentage, when applied to the number of nominal sack hours available for bread production, gives the available capacity of each plant for bread production. The average weekly bread sackage produced in the quarter is then expressed as a percentage of the bakery's total available capacity, to give the level of plant utilisation.

Assessment of plant utilisation figures: seasonal influences

9. The main cause of seasonal fluctuations in demand is the effect of holidays. The effect of the annual holiday is felt mainly by bakeries situated in or near the holiday resorts, but also, though to a much less marked extent, by bakeries serving population centres temporarily depleted by the absence of those on holiday. The effects of the national and Bank Holidays are felt by all bakeries.

10. Where a bakery is situated in or near a holiday resort, its trade will normally start to increase in June and fall away again in September. In some cases this affects nearly all the bakery's trade and in others only a part. Where a bakery is normally affected by a peaking of demand in the holiday months, allowance is made for this in assessing its plant utilisation. One aims at an acceptable minimum during the off-peak period of, say, 75–85 per cent utilisation, while expecting a figure of around 100 per cent in the high season.

11. All bakeries throughout the country are affected by national seasonal holidays at Christmas, Easter, and Spring and Summer Bank Holiday weekends. The production required during the week preceding a Bank Holiday can be 20 per cent or more up on a normal week, and as much as 50 per cent up at Christmas time depending on the part of the week in which the holiday falls.

Evaluation of quarterly performance figures

12. The figures for average utilisation of production capacity provide a broad indication to management of the efficiency of the bakeries' operations. Other things being equal and ignoring factors special to a particular bakery company, a plant utilisation figure of between 80 per cent and 90 per cent is felt to be satisfactory. Anything under 75[1] per cent would give cause for concern and lead to a reappraisal of that company's business (for example by transferring business to it from a nearby but over-worked associated group bakery). A figure in excess of 95 per cent would indicate that assistance would probably be required at holiday times and in emergencies, while a figure over 100 per cent could well mean in addition that excessive overtime was being worked and that high stocks were being carried towards the end of the week.

RHM

1. In assessing the production capacity of bakery plant, it is necessary to take into account the effect of a variety of constraints upon production. These are that:

(i) because bread stales, there is a limit on the period which can, acceptably elapse between its production and its becoming available for sale;

(ii) demand for bread is spread unevenly over the week; it is estimated that on average in any week the demand for bread on Saturday represents about 25 per cent of the total demand for bread in that week. As a consequence of (i) production must follow closely the weekly cycle of demand . . .

(iii) the mix of production affects throughput both in terms of the sackage which can be put through the oven during productive time and in terms of non-productive time occasioned by tin changes;

(iv) limitations may be imposed on the hours available for Friday production by the distribution arrangements of the bakery;

(v) in Scotland only, limitations are imposed by the pattern of Sunday shift working agreed with the unions; and

(vi) in Northern Ireland, a 5-day production week operates. There is no production on Sunday and no distribution on Monday, and plant utilisation is therefore reduced by approximately one-third.

2. Against that background RHM Bakeries calculate the weekly production capacity of each bakery plant (except in Scotland) by (i) ascertaining the maximum potential Friday production of the plant, and (ii) grossing that up to a weekly figure by reference to the proportion which Friday production bears to a total weekly production at the relevant bakery.

3. Maximum potential Friday production is the product of the number of hours available for Friday production and the actual hourly throughput rate of the plant in question (taking account of the mix of production and the non-productive time associated with that mix of production).

4. In Scotland, to assess production capacity by reference to Friday production would overstate the capacity available since it would ignore the limitations on Sunday production imposed by the agreed pattern of Sunday shift working.

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[1] At May 1976 this was raised to 80.

5. Overall demand for bread exhibits a well marked seasonal pattern, following a rising trend from a low point in March until September and then declining over the next six months. Within that pattern, the summer holiday period gives rise to substantial increases in demand, for a period of 8–10 weeks, upon bakeries in the areas of coastal resorts, and peaks of demand occur in the periods immediately preceding statutory public holidays.

6. In general RHM Bakeries aims to provide capacity which will enable it to fulfil average demand.

7. Production requirements for seasonal or Bank Holiday trade may exceed the calculated capacity of a given bakery. Beyond any extent to which those requirements can be met, in the case of seaside bakeries for example, by buying-in from another group bakery, they are provided by working overtime.

Spillers

1. The following factors have been taken into account in assessing capacity:
   (i) Achievable hourly output in relation to the plant available and the particular product mix to be baked. Bread plants have a *nominal* capacity of 6, 9, 12, 15, etc sacks per hour indicating that the plant will process this quantity of flour per hour into standard 28 oz tin loaves. The practical capacity, however, will be less than this according to the product mix. For example, the tonnage output of standard 14 oz tin loaves is some 66 per cent of that for 28 oz tin loaves while in the case of 14 oz Farmhouse and 10 oz Slimcea loaves the figures are 50 per cent, and below 40 per cent, respectively.
   (ii) The acceptable number of hours per week during which a plant can be operated normally and provide reasonable spare capacity to cover Bank Holidays and summer seasonal trade and also non-producing time when maintenance work can be carried out.

2. Ideally, we target for a maximum normal weekly operating time of 110 hours. This means that with Saturday's sales requirements being at least 25 per cent of total weekly needs, production for weekend sale will take up some 28 running hours.

3. An operating period of 110 hours per week fits in with a reasonable two-shift system for operatives of a 5-day 46-hour week (the basic pay week is 40 hours) with 6-day production coming from the use of additional staff. (In practice, because of labour shortage, most operatives in fact work a 6-day week with hours worked in excess of 50.)

4. Certain bakeries need to operate some plants for longer than 110 hours per week in order to meet sales requirements with the capacity available—these are the exception rather than the rule. When operating hours exceed the 120 per week level, three-shift working instead of two becomes economical.

APPENDIX 6

(referred to in paragraph 218)

Major baking groups memorandum to the Ministry of Agriculture, Fisheries and Food on bread price negotiations

Introduction

1. This submission to the Ministry of Agriculture, Fisheries and Food ('the Ministry') is made on behalf of Allied Bakeries Limited, British Bakeries Limited, Co-operative Wholesale Society Limited, J Lyons & Co Limited and United Bakeries Limited ('the Groups').

2. As the Ministry is aware, in accordance with the mechanics established under the 'early warning system' (Cmnd 2808) of HM Government's Prices and Incomes Policy, the Groups' present procedure is to provide at least four weeks' notice to the Ministry of any proposed increase in the retail price of bread and such submissions, which are made individually, are accompanied by such information as is individually considered appropriate to demonstrate the fulfilment of the criteria for price increases set out in HM Government's White Paper—*Productivity, Prices and Incomes Policy in 1968 and 1969* (Cmnd 3590) HMSO.

3. The Groups have been and are now gravely concerned at the effects of the procedures at present in operation and at the bases adopted by the Ministry in determining the fulfilment or otherwise of the criteria for price increases such bases, in their view, giving rise to a continuing diminution of their margins and returns on capital employed. The advent of demonetisation and decimalisation of the currency will severely aggravate the position.

4. The Groups wish therefore to submit, for the Ministry's consideration, alternative procedures for the submission of information in support of proposed price increases and for the assessment by the Ministry of the validity of the cases so submitted; in their view the revised procedures and methods of assessment will serve to significantly reduce the damaging effects upon them of the existing procedures without departing from the principles or reducing the effectiveness of HM Government's Prices and Incomes Policy.

II The present system

5. In general terms the present procedures involve the submission to the Ministry by individual Groups of details of cost increases incurred since the previous price increase expressed in terms of pence per 28 oz loaf or in global terms on an annual basis; the cost increases so submitted are those falling within the criteria imposed by paragraph 16 of Cmnd 3590. Price increases are agreed or otherwise by reference to this information and are of course only effective from a date following that upon which the Ministry's sanction is granted.

6. The principal disadvantages to the Industry stemming from the operation of this system are:

(i) Substantial delays occur between the increased costs being incurred and the submission of an application to the Ministry aggravated by further delays in the amplifications to the Ministry and in general negotiations with them. Thus these factors allied to the Ministry's insistence upon cost increases being expressed at a particular point in time and the effect of agreed price increases only being operative from some future time results in no cognisance being taken of the cumulative 'build-up' of costs which are never recovered in price increases.

(ii) No account is currently taken of the levels of return on capital employed when assessing the validity of claims for price increases; it is submitted that this constitutes an important criterion and it is recognised as such in all other areas in which HM Government attempts to assess or determine relative profitabilities and in the criteria set out in paragraph 16(iv) of Cmnd 3590. The return on capital employed within the Industry was recognised by the National Board for Prices and Incomes in 1965 as being well below the national average.

(iii) Specifically identifiable increases in costs of raw materials, manufacturing expenses and certain administration and selling expenses are, it appears, taken into account by the Ministry but full recognition is not given to general overhead cost increases.

(iv) No account is taken by the Ministry of the continual and gradual contraction in the overall UK market for bread.

III The Proposed System

7. The procedures now proposed by the Groups involve:

(i) The adoption of Industry accounting dates of 30 September and 31 March.

(ii) The submission, at semi-annual intervals, by each of the Groups direct to Peat, Marwick, Mitchell & Co of statements of actual sales, costs and profits on bread for their respective financial half-years ending immediately prior to the Industry accounting date, together with:

(*a*) a further statement adjusting the actual results for their respective financial half-years to reflect changes of a national character (for example—price increases, principal raw material costs, variations in wage rates) occurring during the related Industry half-year period, in order that the results will be shown on a common basis and when aggregated, will represent the Industry's results for the Industry half-year.

(*b*) a further statement showing, in respect of the full year following the relevant Industry date, sales, costs and profits on bread anticipated for that period after incorporating known or definitely predictable selling price and cost changes of a national character in that period.

(iii) The submission annually by each of the Groups of statement of capital employed on bread arrived at on an historic cost basis and by reference to the average of the figures appearing at the opening and closing of the immediately preceding financial year.

(iv) The aggregation and submission by Peat, Marwick, Mitchell & Co of the statements referred to at (ii)(*a*) and (*b*) and (iii) to the Ministry together with calculations of the returns on capital employed.

(v) Price negotiations would thereafter be conducted on an Industry basis.

8. Drafts of the statements which it is envisaged should be sent to the Ministry are attached as Annexes I and II and the following points seem to merit specific reference:

(i) the adjustments introduced into columns (1) and (2) of Annex I of the returns of bread sales and costs will only be those of a national character and general increases in overhead costs will be excluded.

(ii) these statements will exclude all interest charges and all borrowings—regardless of their nature—will be regarded as capital employed.

(iii) depreciation will be charged on the basis of historic cost and assets included in the statement of capital employed will be similarly stated at historic cost values.

(iv) the definition of bread will be agreed both between the Groups and with the Ministry.

IV Conclusions

9. The Industry submits that the information presented in the proposed form to the Ministry would provide a more realistic basis for the negotiation—on an Industry basis—and enable the Ministry to verify the validity of the case for bread price adjustments, and in particular:

(i) it would enable the Ministry to regularly review the Industry returns on capital employed and to assess the extent to which increases in costs and prices affected this return.

(ii) it would enable the Ministry to view retrospectively the effect of price increases and, if thought appropriate, to suggest downward price adjustments, against the background of the Industry's return on capital employed.

(iii) it will substantially reduce the administrative burden on both the Groups and the Ministry.

(iv) from the Industry's standpoint it will enable the more rapid recovery of costs but will ensure that excessive price increases are not sanctioned—or if sanctioned—corrected in due course.

10. It is suggested therefore that the Groups are permitted to consider the above proposals with the Ministry as a matter of urgency. They also accept that they would require to obtain legal advice on the implications of the restrictive trade practices legislation, upon which, it is understood, the Ministry is prepared to assist the Industry.

PEAT, MARWICK, MITCHELL & CO.
27.10.1969.

ANNEX I

Statement of Sales, Costs and Profits on Bread Industry half-year to (30 September 19—/31 March 19—)

	Industry half-year to (30 September/ 31 March) (1) £'000	*Industry Projection year to (30 September/ 31 March)* (2) £'000
Sales of bread		
1. *Production*		
Flour		
Other materials		
Bakery wages		
Fuel and power		
Production overheads		
Depreciation		
2. *Administration*		
Wages and salaries		
Other expenses		
3. *Selling and delivery*		
Wages and salaries		
Other expenses		
4. *Discounts*		
5. *Advertising and promotion*		
Total costs		
Profit before taxation		

Note:
The following adjustments have been made to the figures shown above for changes of a 'national' character.

ANNEX II

Statement of Capital Employed
Industry Year-end—31 March 19—

	Beginning of year £'000		End of year £'000
Fixed assets, at net book value			
1. Land			
2. Buildings			
3. Bakery plant and machinery			
4. Motor vehicles			
5. Other (give broad breakdown)			
6. Goodwill at cost			
Current assets			
7. Stock and work in progress			
8. Debtors and prepayments			
9. Bank and cash balances			
Current liabilities			
10. Trade creditors and accruals			
11. Current taxation			
	( )		( )
12. *Share of Group Head Office capital employed*			
Capital employed			
average			
Aggregate trading profits:		£'000	
Industry half-year to 30 September 19—			
Industry half-year to 31 March 19—			
% on capital employed		%	

APPENDIX 7

(referred to in paragraphs 318, 430 and 482)

Report on flour milling costs

Thomson McLintock & Co, Chartered Accountants

PRIVATE AND CONFIDENTIAL — 6 October 1975

E T J Hurle Esq
Secretary
National Association of British and Irish Millers Ltd
21 Arlington Street
London SW1

Dear Mr Hurle

Cost Enquiry

1. We have previously reported to you upon the results of enquiries we have made into the cost of flour milling. In 1971 and 1972 we performed updating exercises on our 1970 report, and in 1974 we made a further full enquiry into milling costs. This we reported to you on 30 September 1974.

2. The present enquiry is based on the year ended 31 March 1975 although we include 10 millers with other year ends between December 1974 and April 1975. The questionnaire which formed the basis of the enquiry largely followed that used in 1974, although we amended it slightly following comments from members.

3. The response to our questionnaire is still rather disappointing but it is better than in 1974. We sent out questionnaires to 39 millers (three said previously that they did not wish to participate) and to date we have received 22 replies, with two others indicating they did not feel able to participate. The members who replied to the questionnaire are a representative cross-section of the milling industry.

4. We have slightly amended the grouping of returns from our previous reports. We now report as follows:

	Annual production in sacks	*Number of returns*
Group 1	under 100,000	7
Group 2	100,000—200,000	4
Group 3	200,000—300,000	6
Group 4	over 300,000	5
		22

5. We give below a summary of the cost of production per sack for the year ended 31 March 1975, per group:

	Group 1	*Group 2*	*Group 3*	*Group 4*	*All groups*	*Your company*
	p	p	p	p	p	p
Manufacturing costs:						
Wages	56·2	32·2	36·7	38·4	38·4	
Repairs	19·5	16·1	12·1	20·1	19·5	
Depreciation	13·5	12·3	7·3	10·1	10·0	
Power costs	14·7	15·7	13·5	15·1	15·0	
Quality control	1·4	3·3	2·2	2·3	2·3	
Other	36·5	29·1	8·3	9·7	10·5	
	141·8	108·7	80·1	95·7	95·7	
Selling expenses	24·3	8·7	6·1	19·9	18·9	
Delivery expenses	46·2	49·5	31·2	36·7	36·9	
Discounts	27·7	22·3	23·3	18·2	18·8	
Administration	38·0	38·5	18·9	28·6	28·4	
Total before charging MMA levies	278·0	227·7	159·6	199·1	198·7	

6. The general pattern of weighted average results as between groups continues to show the same trend as disclosed in our earlier reports; ie as output gets larger, unit costs fall. In the largest group, costs rise again, largely due to higher selling and delivery expenses and administration costs.

7. The highest and lowest costs in each group are as follows:

	Group 1	*Group 2*	*Group 3*	*Group 4*	*All groups*
	p	p	p	p	p
Highest cost	347·0	303·0	182·0	217·2	347·0
Lowest cost	220·0	144·0	131·0	164·0	131·0
Weighted average	278·0	227·7	159·6	199·1	198·7
Sackage (000's)	367	651	1,500	22,960	25,479*

* *Note by the Commission:*
The 22 millers who participated in this enquiry appear to have accounted for over 85 per cent of total flour production in the year ended 31 March 1975.

8. A more interesting comparison is that of the costs for the year ended 31 March 1975 with those of 1974 and 1973. We give this below:

	Year ended 31 March		
	1973	*1974*	*1975*
Manufacturing costs:			
Wages	27·5	28·2	38·5
Repairs	12·3	12·2	19·5
Depreciation	7·1	7·8	10·0
Power costs			15·0
Quality control	24·2	23·9	2·3
Other			10·5
	71·1	72·1	95·7
Selling expenses	10·9	11·4	18·9
Delivery expenses	27·7	30·1	36·9
Discounts	10·0	13·0	18·8
Administration	21·1	21·7	28·4
Total before charging MMA levies	140·8	148·3	198·7

9. It is clear from this comparison that all costs have increased substantially from 1974 to 1975 (by 34 per cent). It will be seen below (paragraph 11) that the gross margin per sack has increased by more than this proportion.

Gross margin

10. We asked millers to give an analysis of their gross margin per sack. We have summarised these as follows:

	Group 1	*Group 2*	*Group 3*	*Group 4*	*All groups*	*Your company*
	£	£	£	£	£	£
Sales proceeds per sack, before cash discounts	15·11	13·38	13·88	14·88	14·79	
Less material costs including packaging	13·79	12·98	13·56	13·81	13·77	
Deduct net proceeds from sale of wheatfeed	2·58	2·52	2·36	2·38	2·38	
Net cost of materials	11·21	10·46	11·20	11·43	11·39	
Gross margin per sack	£3·90	£2·92	£2·68	£3·45	£3·40	£

11. In order to place in perspective the apparently large increase of 55 per cent in gross margin from 1974 to 1975, we give below a comparison of the gross margins in 1969 and in each year from 1973 to 1975. This table should be viewed with caution, but it shows that increases up to 1974 were relatively small, especially when considered in conjunction with the movement in the retail price index during this period. There was also in 1973 and 1974 some restriction of margins under the prices legislation; this was relaxed in 1974–75.

A comparison of gross margins over the last few years is as follows:

	1969	*1973*	*1974*	*1975*
	£	£	£	£
Group 1	1·63	2·25	2·82	3·90
Group 2	1·47	1·44	1·75	2·92
Group 3	1·41	1·77	1·82	2·68
Group 4	1·78	2·01	2·21	3·45
All groups	1·73	2·00	2·19	3·40
Retail price index (1969 = 100)	100	136	158	186

Analysis of sales

12. We give the proportion of bagged sales to bulk during the year ended 31 March 1975:

	Group 1	*Group 2*	*Group 3*	*Group 4*	*All groups*	*Your company*
Bagged sales	75	61	43	44	45	
Bulk sales	25	39	57	56	55	
	100%	100%	100%	100%	100%	100%

13. We asked members to indicate the level of sales to related companies and we summarise these thus:

Group 1	2·1%
Group 2	nil
Group 3	19·6%
Group 4	62·0%
All groups	57·3%

This is a statistic of relevance only to the biggest millers.

Return on capital employed

14. We lastly consider the question of return on capital employed. We defined capital employed as 'fixed assets plus current assets, less current liabilities including proposed dividends and bank overdrafts. Debentures, long-term loans, bank and other loans and future taxation should not be treated as current liabilities and should be ignored as should goodwill and trade investments'.

15. Notional capital employed is arrived at as above but substituting an estimate of replacement cost for milling buildings and plant and machinery.

16. We set out these figures thus:

	Group 1	*Group 2*	*Group 3*	*Group 4*	*All groups*	*Your company*
Capital employed (£'000s)	1,521	1,606	4,653	90,181	97,961	
Notional capital employed (£'000s)	4,534	5,763	14,221	249,900	274,418	
Profit per sack before tax	113p	68p	108p	146p	142p	
% return on capital employed	27·2	27·5	34·8	37·3	36·8	
% return on notional capital employed	9·1	7·7	11·4	13·5	13·1	

17. In a large number of cases it is clear that the milling business is carried on in conjunction with other activities. In these cases it has sometimes proved difficult for capital employed to be split between the activities carried on. Accordingly we suggest that the foregoing figures of return on capital employed, which take no account of the true effects of inflation on profits, be viewed with caution.

18. We should be glad to discuss this report with you or your members and to let you have any further information you may require.

Yours faithfully

THOMSON MCLINTOCK & CO

APPENDIX 8

(referred to in paragraph 430)

RHM Flour Mills Limited

RHM Centre, PO Box 551, 152 Grosvenor Road, London SW1V 3JL

11 November 1976

W McKeown Esq
Monopolies and Mergers Commission
48 Carey Street
London WC2

Dear Mr McKeown

NABIM Cost Enquiry Reports

After discussion of these reports at the Public Interest Hearing we were invited to submit any further comments that we thought might be useful to you in your consideration of these reports as a means of inter-company cost comparisons.

Our principal comment is that NABIM cost enquiry figures tell one nothing about mill efficiencies or comparative costs for the different types or sizes of mills. Other comments on more detailed matters are given below.

1. Number of Participants

The number of millers who responded to the five most recent reports, listed by annual volume of production size, was:

Date of Report	*Size of Miller* 1	2	3	4	5	*Total*
31/3/75	–	7	4	6	5	22
31/3/74	3	3	3	4	6	19
31/3/72	1	1	1	1	4	8
30/11/70	1	1	1	1	4	8
15/5/69	13	6	6	8	10	43

The difference in the number of participating companies over the period of six years vitiates any attempt to derive sensible economic conclusions.

2. Size Classification

The classification by annual volume is not constant throughout the five enquiries, the various capacity categories being:

Date of Report	*Class size in '000 of Sacks* 1	2	3	4	5
31/3/75		Up to 100	100 200	200 300	Over 300
31/3/74	Up to 60	60 120	120 220	220 320	Over 320
31/3/72	Up to 100	100 200	200 300	300 400	Over 400
30/11/70	Up to 100	100 200	200 300	300 400	Over 400
15/5/69	Up to 60	60 120	120 180	180 300	Over 300

3. Distribution of Minimum Cost

The total comparative costs per 280 lb sack of flour yielded by the enquiries, with the minimum figure given in italics were:

Date of Report	*1*	*2*	*3*	*4*	*5*	*Total*
	Pence	*Pence*	*Pence*	*Pence*	*Pence*	*Pence*
31/3/75	—	278·0	227·7	*159·6*	199·1	198·7
31/3/74	224·4	233·8	*132·1*	137·1	148·2	148·3
31/3/72	200·1	169·9	154·4	*138·5*	145·2	145·5
30/11/70	178·9	*125·3*	131·5	137·3	132·6	132·7
15/9/69	151·2	123·1	110·7	*106·4*	115·5	115·5

The minimum cost figures occurred in the capacity categories having the following annual production in sacks:

1975	200,000 to 300,000
1974	120,000 to 220,000
1972	300,000 to 400,000
1970	100,000 to 200,000
1969	180,000 to 300,000

As you can see the capacity showing minimum cost is significantly different from one year to the next and tells one little about the relative costs of different capacities in general.

4. Discount Costs

We have not been able to interpret the various figures reported in the NABIM reports for discounts.

Our understanding was that the figures should represent only cash discount which is given for prompt payment of flour invoices. The standard terms for this discount are 2 per cent in 10 days or 1 per cent in 20 days.

The report for 1975 gave the figures for discount as follows:

	Flour Sales	*2%*	*Discount cost Reported*
	£ per sack	£	£
TOTAL	14·79	0·29	0·19
Group 4	14·88	0·30	0·18
Group 3	13·88	0·28	0·23
Group 2	13·38	0·27	0·22
Group 1	15·11	0·30	0·28

RHM's average discount was 28·1 pence per sack equal to 1·93 per cent of the sales price. The average of Group 4 figures was 18 pence. The other figures submitted by other companies within this group must therefore be significantly lower than the RHM figures and we do not understand the reason.

Yours sincerely

H W ROBERTS

Director

APPENDIX 9

(*referred to in paragraph 386*)

Sales, profits and capital employed—flour milling and bread baking

	ABF			*RHM*			*Spillers*		
	Flour milling £'000	*Bread baking* £'000	*Total* £'000	*Flour milling* £'000	*Bread baking* £'000	*Total* £'000	*Flour milling* £'000	*Bread baking* £'000	*Total* £'000
	1971 Year ended 1 April 1972			*1971 Year ended 4 September 1971*			*1971 Year ended 29 January 1972*		
Sales	38,050	76,468	114,518	68,390	79,587	147,977			
Profit/(loss) before interest and tax	4,616	2,284	6,900	5,827	4,413	10,240			
Average capital employed	12,505	22,810	35,315	33,139	28,166	61,305		Not available	
Return on sales	12·1%	3·0%	6·0%	8·5%	5·5%	6·9%			
Return on capital employed	36·9%	10·0%	19·5%	17·6%	15·7%	16·7%			
	1972 Year ended 31 March 1973			*1972 Year ended 2 September 1972*			*1972 Year ended 3 February 1973*		
Sales	43,918	81,650	125,568	69,829	84,409	154,238	61,520	57,435	118,955
Profit/(loss) before interest and tax	4,984	1,725	6,709	4,760	4,683	9,443	3,627	(1,491)	2,136
Average capital employed	13,044	25,011	38,055	33,058	28,035	61,093	27,981	24,973	52,954
Return on sales	11·3%	2·1%	5·3%	6·8%	5·5%	6·1%	5·9%	(2·6%)	1·8%
Return on capital employed	38·2%	6·9%	17·6%	14·4%	16·7%	15·5%	13·0%	loss	4·0%
	1973 Year ended 30 March 1974			*1973 Year ended 1 September 1973*			*1973 Year ended 2 February 1974*		
Sales	71,470	100,588	172,058	82,230	90,081	172,311	81,301	59,348	140,649
Profit/(loss) before interest and tax	5,292	(2,389)	2,903	8,102	1,725	9,827	5,214	(4,740)	474
Average capital employed	17,848	31,760	49,608	34,113	27,967	62,080	28,737	25,398	54,135
Return on sales	7·4%	(2·4%)	1·7%	9·9%	1·9%	5·7%	6·4%	(8·0%)	0·3%
Return on capital employed	29·7%	loss	5·9%	23·8%	6·2%	15·8%	18·1%	loss	0·9%
	1974 Year ended 29 March 1975			*1974 Year ended 31 August 1974*			*1974 Year ended 1 February 1975*		
Sales	116,778	138,790	255,568	137,571	111,457	249,028	131,626	81,817	213,443
Profit/(loss) before interest and tax	12,208	(5,214)	6,994	10,657	(2,559)	8,098	9,007	(5,229)	3,778
Average capital employed	23,041	39,414	62,455	41,066	29,082	70,148	32,431	26,557	58,988
Return on sales	10·5%	(3·8%)	2·7%	7·7%	(2·3%)	3·3%	6·8%	(6·4%)	1·8%
Return on capital employed	53·0%	loss	11·2%	26·0%	loss	11·5%	27·8%	loss	6·4%
	1975 Year ended 3 April 1976			*1975 Year ended 30 August 1975*			*1975 Year ended 31 January 1976*		
Sales	121,035	168,041	289,076	158,317	134,556	292,873	134,531	95,625	230,156
Profit/(loss) before interest and tax	14,657	(763)	13,894	15,046	(1,946)	13,100	11,542	(621)	10,921
Average capital employed	26,053	43,879	69,932	46,457	29,644	76,101	35,846	24,314	60,160
Return on sales	12·1%	(0·5%)	4·8%	9·5%	(1·4%)	4·5%	8·6%	(0·6%)	4·7%
Return on capital employed	56·3%	loss	19·9%	32·4%	loss	17·2%	32·2%	loss	18·2%

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