

## Anticipated acquisition by PepsiCo Inc. of Pioneer Food Group Limited

### Decision on relevant merger situation and substantial lessening of competition

ME/6872/19

The CMA's decision on reference under section 33(1) of the Enterprise Act 2002 given on 18 March 2020. Full text of the decision published on 7 April 2020.

Please note that [X] indicates figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

#### SUMMARY

1. PepsiCo, Inc. (**PepsiCo**) has agreed to acquire all outstanding shares in Pioneer Food Group Limited (**Pioneer Group**) (the **Merger**). Pioneer Group owns Pioneer Foods (UK) Limited (**Pioneer**). PepsiCo and Pioneer are together referred to as the **Parties** (and for statements referring to the future, as the **Merged Entity**).
2. The Competition and Markets Authority (**CMA**) believes that it is or may be the case that each of PepsiCo and Pioneer Group is an enterprise; that these enterprises will cease to be distinct as a result of the Merger; and that the turnover test is met. Accordingly, arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.
3. The Parties overlap in the production and supply of breakfast cereals in the United Kingdom (**UK**). Principally, the Parties overlap in the supply of granola and porridge. The CMA has, on a cautious basis considered granola and porridge separately and distinct from other types of cereal, and has considered the upstream market for contract manufacturing of cereal as

distinct from downstream retail supply of cereal by brand owners (retailer and small brand owner).

4. The CMA received evidence that the downstream retail side of the cereal market should be assessed on a national basis. However, upstream cereal manufacturers usually supply various geographic regions in Europe. Several retailers who responded to the CMA's confirmed the presence of alternative suppliers in Europe. However, the CMA has, on a cautious basis, considered the markets for cereal to be UK-wide. Nevertheless, the CMA has considered any competitive constraint from EU-based manufacturers in its competitive assessment.
5. The CMA therefore assessed the impact of the Merger in the following frames of reference:
  - (a) the upstream market for contract manufacturing of granola and porridge in the UK; and
  - (b) the downstream retail market of granola and porridge in the UK.
6. With regard to the horizontal effects of the Merger on the retail market for granola, the CMA has found that the estimated combined shares of supply of the Parties are moderate to low, the Parties are not close competitors, and there are other private label and branded suppliers that will constrain the Merged Entity.
7. With regards to conglomerate effects, the CMA has found that the Merged Entity will not have the ability to bundle its private label and branded offerings, nor the ability to negotiate more shelf space. This is because:
  - (a) retailers have told the CMA that negotiations over stocking branded products and contract manufacturing of private label products take place separately;
  - (b) there are several alternative competitors of both contract manufacturers and brand owners of granola and porridge;
  - (c) large retailers that procure own label cereals have significant buyer power and could therefore easily push back on any demands that the Merged Entity places on them.
8. With regards to vertical effects, the CMA has found that the Merged Entity will not be able to use its position in the upstream contract manufacturing market to foreclose rivals in the downstream retail market. This is because:
  - (a) the Parties are not actual or potential customers of one another;

- (b) the barriers to switching manufacturers are low; and
- (c) the Parties face strong competition from both UK and European suppliers.
9. The evidence available to the CMA from shares of supply, the Parties' internal documents, and third parties indicate that the Parties were not competing particularly closely pre-Merger and will continue to face sufficient competition post-Merger across all of the areas in which they overlap.
10. The CMA believes that these constraints, taken together, are sufficient to ensure that the Merger does not give rise to a realistic prospect of a substantial lessening of competition (**SLC**) as a result of horizontal unilateral/vertical/etc effects.
11. The Merger will therefore **not be referred** under section 33(1) of the Enterprise Act 2002 (the **Act**).

## ASSESSMENT

### Parties

12. PepsiCo is a US-based global food and beverage manufacturer whose UK portfolio mainly consists of beverages, snacks and breakfast cereals. It produces traditional rolled oats, porridge sachets, porridge pots, granola and muesli under the Quaker Oats and Scott's Porage Oats brands. In 2018, PepsiCo had a UK turnover of [REDACTED] and worldwide turnover of £48.4 billion.
13. Pioneer Group is a South Africa-based company, which produces and distributes a range of branded food and beverage products, mainly in South Africa. In the UK, Pioneer is a self-standing subsidiary of Pioneer Group that manufactures and supplies private label breakfast cereals to retailers and small branded suppliers, as well as branded granola (under the Lizi's brand). [REDACTED]. In 2018, Pioneer had a UK turnover of [REDACTED] and worldwide turnover of £750 million.

### Transaction

14. The Parties entered into an Implementation Agreement on 18 July 2019. PepsiCo will acquire all outstanding shares of Pioneer Group for approximately £1.36 billion.
15. The Parties informed the CMA that the Merger is also the subject of review by competition authorities in Botswana, COMESA, Cyprus, Germany, Kenya, Namibia, Nigeria, South Africa, and Taiwan.

## Procedure

16. The CMA's mergers intelligence function identified this transaction as warranting an investigation.<sup>1</sup>

## Jurisdiction

17. Each of PepsiCo and Pioneer Group is an enterprise. As a result of the Merger, these enterprises will cease to be distinct.
18. The UK turnover of Pioneer Group exceeds £70 million (see paragraph 13), so the turnover test in section 23(1)(b) of the Act is satisfied.
19. The CMA therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.
20. The initial period for consideration of the Merger under section 34ZA(3) of the Act started on 30 January 2020 and the statutory 40 working day deadline for a decision is therefore 26 March 2020.

## Counterfactual

21. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). For anticipated mergers the CMA generally adopts the prevailing conditions of competition as the counterfactual against which to assess the impact of the merger. However, the CMA will assess the merger against an alternative counterfactual where, based on the evidence available to it, it believes that, in the absence of the merger, the prospect of these conditions continuing is not realistic, or there is a realistic prospect of a counterfactual that is more competitive than these conditions.<sup>2</sup>
22. In this case, there is no evidence supporting a different counterfactual, and the Parties and third parties have not put forward arguments in this respect. Therefore, the CMA believes the conditions of competition to be the relevant counterfactual.

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<sup>1</sup> See [Mergers: Guidance on the CMA's jurisdiction and procedure](#) (CMA2), January 2014, paragraphs 6.9-6.19 and 6.59-60.

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

## Background

23. The Parties overlap in the production and supply of cereals in the UK, known as 'ready-to-eat cereals' (**RTEC**). Within the cereal category, both Parties produce granola, muesli, and porridge.
24. The Parties submitted that the manufacture of muesli and granola essentially consists of mixing oats and other cereals, dried fruits and nuts and packing the mixture in bags and/or boxes ready for sale. The manufacture of granola includes the additional steps of mixing the dry ingredients with honey and baking them in an oven.

### *Branded suppliers and private label/contract manufacturers*

25. The CMA understands that there are two levels in this industry:
  - (a) Upstream contract manufacturers are companies that manufacture cereals as per the instructions of a downstream brand owner (ie retailers and branded suppliers), and which are marketed under the brand owner's label. Upstream contract manufacturers are selected through a tender process and contracts are reviewed on a regular basis from annually to once every 3-4 years.
  - (b) Downstream brand owners (ie retailers and branded suppliers) are companies active in the retail market. These brand owners can either manufacture the product themselves or contract an upstream contract manufacturer to do it for them. They provide quality specifications to the manufacturer and make all pricing, branding and marketing decisions.
26. PepsiCo is a vertically integrated company encompassing both levels of the industry. However, PepsiCo does not manufacture cereals for third-party brand owners, ie it manufactures cereal exclusively for itself. PepsiCo solely competes in the downstream retail market through its supply of Quaker Oats porridge, granola, and muesli and through its Scott's Porage Oats brand.
27. Pioneer is predominantly active in the upstream contract manufacturing market. It manufactures porridge, granola, and muesli for third party downstream brand owners, including retailers and other brands. Pioneer is also active in the downstream retail market for granola through its Lizi's brand. This is the only area where the Parties horizontally overlap since Lizi's granola competes with Quaker Oats granola.

## Frame of reference

28. Market definition provides a framework for assessing the competitive effects of a merger and involves an element of judgement. The boundaries of the market do not determine the outcome of the analysis of the competitive effects of the merger, as it is recognised that there can be constraints on merging parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others. The CMA will take these factors into account in its competitive assessment.<sup>3</sup>
29. In general terms, the Parties overlap in the production and supply of breakfast cereals in the UK, in particular in relation to granola, muesli, and porridge.

## Product scope

30. The CMA's approach to market definition is to begin with the overlapping products of the Parties, taking this as the narrowest plausible candidate product market and then assess if this can be widened on the basis of demand-side substitution.
31. The CMA notes that PepsiCo has no presence in the upstream market for the manufacture of muesli for third party brand owners in the retail market, and Pioneer has no presence in the retail market for muesli, [REDACTED]. Pepsi's share of supply in the retail market for muesli was [0-5]% in 2018.<sup>4</sup>
32. The CMA does not believe that any competition concerns will arise in the upstream manufacturing or downstream retail market for muesli as a result of the Merger.
33. Similarly, the CMA notes that PepsiCo has no presence in the market for the manufacture of porridge for private label and branded suppliers, and Pioneer has no presence in the retail market for porridge.<sup>5</sup>
34. The CMA does not believe that any competition concerns will arise in the upstream contract manufacturing or downstream retail market for porridge as a result of the Merger.
35. Therefore, the CMA has considered:

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<sup>3</sup> See [Merger Assessment Guidelines](#), para. 5.2.2.

<sup>4</sup> Kantar data. [REDACTED]

<sup>5</sup> [REDACTED]

- (a) whether upstream contract manufacturers and downstream brand owners should be considered under the same frame of reference; and
- (b) whether granola, muesli, and porridge should be considered within the same frame of reference;

*Competitive constraint on downstream brand owners in the retail market from upstream contract manufacturers*

*The Parties' submissions*

36. The Parties submitted that upstream contract manufacturers and downstream brand owners in the retail market are not competitors, and therefore that there is no competitive interaction between PepsiCo and Pioneer (with the exception of the retail market for granola). The Parties submitted that in the downstream retail market, the competition is between brand owners. In particular, the Parties explained that:
- (a) In the downstream retail market, retailers and branded suppliers are brand owners competing with one another because these are the parties that make decisions in relation to the competitive offerings (eg including pricing, marketing, branding) to target downstream end-consumers.
  - (b) Upstream contract manufacturers, such as Pioneer, do not have any role in marketing or advertising in relation to the brand owners' products in the downstream retail market. The manufacturers' role is to manufacture and supply the brand owner with a product that is marketed under its own label as a competitive alternative to other branded products.

*Third party evidence*

37. Respondents to the CMA's investigation confirmed that upstream contract manufacturers of granola do not compete with downstream brand owners in the retail market.
38. A downstream supplier of branded granola in the retail market told the CMA that it considered its competitors to be the retailers rather than the upstream contract manufacturers of these products. This is because retailers make all the strategic decisions around these products.
39. Some upstream contract manufacturers also told the CMA that cereals are always manufactured in line with the downstream brand owner's specifications. Upstream contract manufacturers share their expertise, give feedback, and advise on recipes. However, brand owners have ultimate

control over the products to the extent that brand owners give instructions to the contract manufacturers. In addition, upstream contract manufacturers of granola told the CMA that they considered their main competitors to be other manufacturers of granola rather than downstream brand owners in the retail sector.

40. All the retailers (brand owners) that responded to the CMA' investigation confirmed that upstream contract manufacturers have little influence over the products. In particular, upstream contract manufacturers do not make any decisions in regard to retail pricing, branding or marketing, and they manufacture the products under the brand owner's instructions. A few retailers acknowledged that the development of recipes was a collaborative process. However, the brand owners make the ultimate decisions around the final product.
41. On the basis of the above, the CMA understands from third parties that downstream retail brand owners compete between each other in the retail market and do not compete with upstream contract manufacturers.

#### *Internal documents*

42. The CMA received evidence that suggest that Pioneer views retailers as its customers rather than end consumers and [REDACTED].<sup>6</sup> [REDACTED].<sup>7</sup>
43. The CMA also considered PepsiCo's internal documents, which indicate that PepsiCo compares its Quaker Oats business to [REDACTED].<sup>8</sup> Some internal documents indicate that PepsiCo takes account of [REDACTED].
44. On the basis of above, the CMA considers that the internal documents provided by the Parties support their submission that downstream retail brand owners should not be considered within the same frame of reference as upstream contract manufacturers. PepsiCo and Pioneer do not seem to compete with one another, except in the retail market for granola where Pioneer provides limited competitive constraint to PepsiCo.

#### *Granola, muesli and porridge*

45. The Parties submitted that in the cereal market, both hot cereal and RTEC products compete for the same consumers of breakfast cereal. The Parties further submitted that consumers are not confined to one particular type of

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<sup>6</sup> [REDACTED]

<sup>7</sup> [REDACTED]

<sup>8</sup> [REDACTED]



cereal and regularly switch their breakfast choices based on factors such as variety, price, and taste.

46. However, in *ABF/Dorset*, the CMA considered the RTEC market, in particular whether muesli and granola should be considered as two distinct frames of reference. The CMA, on a cautious basis, considered both the supply of muesli and the supply of granola as distinct from other types of cereal, and as distinct from each other.<sup>9</sup>
47. In addition, third parties have not supported the Parties' submission, even though one third party recognised that consumers do switch between different types of cereal. However, it did make a distinction between granola and porridge.
48. On the basis of the above, the CMA has considered granola, muesli, and porridge to be separate frames of reference for the purposes of its competitive assessment.

#### *Conclusion on product scope*

49. Overall, the CMA has considered that there are two separate frames of reference relevant to this Merger. First, there is an upstream frame of reference for contract manufacturing of cereal on behalf of downstream brand owners. In this frame of reference, the customer is the retailer or a branded supplier which owns the cereal brand. Second, there is a retail frame of reference where different brands (including retailers' own-label brands) compete with one another. In this frame of reference, the customers are end consumers of cereal. The CMA has also, on a cautious basis, considered the granola, muesli, and porridge segments as separate frames of reference.

#### ***Geographic scope***

##### *Retail market*

50. In line with *OEP/MSP-Stiftung*, the Parties submitted that the geographic market for retail the supply of all cereals is at the UK, if not Europe-wide. The Parties further submitted that they are aware that consumer preferences can be influenced by national preferences.
51. In *OEP/MSP-Stiftung*, the European Commission considered the RTEC segments. The merging parties in this case submitted that, in line with the European Commission's previous practice, at the retail level, the RTEC

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<sup>9</sup> [X]

market is still national in scope because (i) retail chains have a strong national focus regarding the marketing and the presentation of their goods; and (ii) consumers' interests generally vary according to the nutrition habits and background of different countries. The European Commission left the market definition open but noted that there are differences in consumption patterns among different countries.<sup>10</sup>

52. On a cautious basis, and in light of the aforementioned previous case, the CMA has concluded that the geographic frame of reference for the retail supply of granola and porridge is national, ie the UK. The CMA has considered any constraint exerted by retailers in Europe in its competitive assessment.

#### *Contract manufacturing market*

53. The Parties submitted that the frame of reference for the upstream manufacture of cereals is likely to be broader than the UK and is likely to be Europe-wide.
54. In *OEP/MSP-Stiftung*, the merging parties submitted that at wholesale level (upstream manufacture) competition may occur both at European and national level. The European Commission noted that (i) even if some customers do not consider location as an aspect when assessing tenders, some competitors focus their sales to one or a limited number of countries; (ii) international retail chains have different suppliers in different countries; and (iii) there are different consumption patterns among different countries. However, the European Commission left the market definition open.<sup>11</sup>
55. In *ABF/Dorset*, the CMA considered the wholesale supply of private label muesli and granola (upstream manufacture). The CMA noted that (i) contracts with retailers were negotiated on a national basis; (ii) retailers only source from brands active in the UK and would not consider importing brands from outside of the UK, and (iii) no evidence supported the existence of a significant international constraint. The CMA believed that the relevant frames of reference should be UK-wide.<sup>12</sup>
56. During this investigation, retailers provided mixed responses as to whether they would consider using contract manufacturers outside the UK to produce their private label cereal. For example, while one retailer said it was happy to use EEA-based contract manufacturers such as Mulder, another said it would not consider this and would only want to use UK-based contract

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<sup>10</sup> See case [COMP/M.4738 OEP / MSP-STIFTUNG / DVG / DAILYCER GROUP](#).

<sup>11</sup> See case [COMP/M.4738 OEP / MSP-STIFTUNG / DVG / DAILYCER GROUP](#).

<sup>12</sup> See case [ME/6452/14 Associated British Foods Plc / Dorset Cereals Limited](#), paragraphs 56 to 60.

manufacturers. Some contract manufacturers outside the UK who responded to the CMA's investigation confirmed that they currently supply cereals to UK-based supermarkets. Therefore, there do not appear to be significant barriers for retailers to use non-UK-based contract manufacturers. rather the choice to solely use UK-based contract manufacturers is a commercial preference.

57. On a cautious basis, the CMA has assessed the contract manufacturing frame of reference on a UK-wide basis but has taken into account competitive constraints from EU-based manufacturers in its competitive assessment.

#### *Conclusion on geographic scope*

58. For the purposes of the competitive assessment, the CMA has considered the following geographic frames of reference on a cautious basis:

- (a) the downstream retail market for granola in the UK; and
- (b) the upstream contract manufacturing market for downstream brand owners of granola and porridge in the UK.

#### *Conclusion on frame of reference*

59. For the reasons set out above, the CMA has considered the impact of the Merger in the following frames of reference:

- (a) the downstream retail market for granola in the UK; and
- (b) the upstream market for contract manufacturing granola and porridge in the UK.

### **Competitive assessment**

60. The CMA has assessed three theories of harm in relation to the Merger:

- (a) Horizontal unilateral effects in the retail market for granola;
- (b) Conglomerate effects in the markets for porridge and granola; and
- (c) Vertical effects in the upstream contract manufacturing market to foreclose rivals in downstream retail markets;

#### *Horizontal unilateral effects in the retail market for granola*

61. Horizontal unilateral effects may arise when one firm merges with a competitor that previously provided a competitive constraint, allowing the Merged Entity profitably to raise prices or to degrade quality on its own and

without needing to coordinate with its rivals.<sup>13</sup> Horizontal unilateral effects are more likely when the merging parties are close competitors. The CMA assessed whether it is or may be the case that the Merger has resulted, or may be expected to result, in an SLC in relation to horizontal unilateral effects in the retail market for granola.

### *Shares of supply*

62. The Parties submitted shares of supply for the retail supply of granola in the UK, which are shown in Table 1 below.

**Table 1: Shares of supply for the retail supply of granola in the UK<sup>14</sup>**

	<b>% Retail Granola (including private label and branded products)</b>	<b>% Branded Granola (branded products only)</b>
<b>PepsiCo (Quaker Oats)</b>	[0-5]%	[5-10]%
<b>Pioneer UK (Lizi's)</b>	[5-10]%	[10-20]%
<b>Combined parties' activities</b>	[10-20]%	[10-20]%
<b>Private Label (includes products supplied by Pioneer)</b>	[40-50]%	N/A
<b>ABF (Dorset Cereals/Jordans)</b>	[20-30]%	[50-60%]
<b>Kellogg's</b>	[10-20]%	[10-20%]
<b>Fresh Marketing (Fuel)</b>	[0-5]%	[0-5%]
<b>Sante.A Kowalski (Sante)</b>	[0-5]%	[0-5%]
<b>Nature's Path</b>	[0-5]%	[0-5%]
<b>Deliciously Ella</b>	[0-5]%	[0-5%]
<b>Morning Foods (Mornflake)</b>	[0-5]%	[0-5%]
<b>Eat Natural</b>	[0-5]%	[0-5%]
<b>Total</b>	100.0%	100%

Source: Kantar data

63. The shares of supply are based on Kantar sales data which is a widely used and recognised data source in the retail industry. The Parties have submitted shares of supply that include all suppliers in the retail market and shares of supply that only include branded suppliers in the retail market (ie they exclude retailers' sales of private label cereal). According to both these measures, the Parties have modest shares of supply with a relatively small increment.
64. PepsiCo and Pioneer have a combined market share in the retail supply of granola of [10-20]% through their respective brands Quaker Oats and Lizi's. The shares of supply show that the Parties face substantial competition from private label granola, ABF (Dorset Cereals, Jordans) and Kellogg's. Other

<sup>13</sup> See [Merger Assessment Guidelines](#), from paragraph 5.4.1.

<sup>14</sup> [X]

competitors include Fresh Marketing (Fuel), Sante.A Kowalski (Sante), Nature's Path, Deliciously Ella, Morning Foods (Mornflake), and Eat Natural.<sup>15</sup>

### *Closeness of competition*

65. The Parties submitted that they are not close competitors in the retail market as their brands are not closely positioned. In particular, the Parties submitted that Pioneer's Lizi's is more of a luxury product than PepsiCo's Quaker Oats, they target different consumers and are generally retailed at very different price points. The CMA found that on average Lizi's is 28% more expensive than Quaker Oats.<sup>16</sup>
66. The Parties submitted internal documents as part of the CMA's investigation. Having reviewed these documents, the CMA found no evidence that the Parties are close competitors in the market for granola. [REDACTED]. On the one hand PepsiCo's internal documents indicate that it monitors and compares itself with [REDACTED]. On the other hand, Pioneer's internal documents show that it considers [REDACTED] as its competitors in the granola segment.
67. The CMA asked retailers who they considered to be PepsiCo's closest competitor in the retail market for granola. Most retailers that responded to the CMA's investigation did not identify Pioneer as a close competitor. Only a small proportion of retailers identified Pioneer's Lizi's brand as a competitor to PepsiCo's Quaker Oats, and these noted that it was seen as a relatively weak competitor compared to Jordans and Morning Foods.
68. The CMA also asked the retailers how closely they consider the Parties to compete regarding the supply of granola. Most of the responses to this question focussed on Pioneer being predominantly an upstream contract manufacturer, while PepsiCo are solely a downstream brand. However, some retailers did address the specific overlap between the Parties in the downstream retail market for granola. One retailer told the CMA that there is some customer switching from Quaker Oats to Lizi's and another said there is a limited degree of overlap between the Parties in granola.

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<sup>15</sup> [REDACTED]

<sup>16</sup> The CMA assessed the price difference between Quaker Oats granola and Lizi's granola. The CMA compared the products sold by three retailers in the UK (Tesco, Sainsbury's, and Morrisons). The CMA found the following products and prices: **(Tesco)** Quaker Oat Granola Raisin 500g and Quaker Oat Granola Golden Crunch 500g both for a price of £2.99 / Lizi's Low Sugar Granola 500g, Lizi's Original Granola 500g, Lizi's High protein granola 350g), all of them for a price of £3.70. **(Sainsbury's)** Quaker Oat Granola Raisin 500g and Quaker oat Granola Golden Crunch 500 for a price of £2.70 and / Lizi's Low Sugar Granola 500g for a price of £3.70. **(Morrisons)** Quaker Oat Granola Raisin 500g for a price of £3 / All of Lizi's products (Lizi's Low Sugar Granola 500g, Lizi's Original Granola 500g, Lizi's High protein granola 350g) for a price of £3.80, discounted to a price of £3. As well as, Lizi's adventurers Banana granola 400g and Lizi's adventurers Strawberry granola 400g for a price each of £3.30.

The CMA notes that Lizi's is, in average, 23% more expensive than Quaker Oats in Tesco, 37% in Sainsbury's, and 26% in Morrisons (discount not counted). In addition, Pioneer sells products in 350g and 400g formats.

69. The CMA also asked rival downstream brand owners in the retail market about the closeness of competition between the Parties. The one respondent which addressed the specific overlap in the downstream retail market for granola told the CMA that both Parties are relatively small in this market.

#### *Competitive constraints*

70. In its assessment, the CMA has also considered whether the Parties face competitive constraints from other suppliers of granola in the retail market.
71. The Parties submitted that there are numerous branded competitors in the granola market, some of which have been growing significantly. In particular, Pioneer considers [X] as key competitors within the granola segment. PepsiCo considers competition in the cereal market as a whole and [X]. Therefore, PepsiCo considers [X] as key competitors.
72. The CMA asked third party suppliers of branded granola in the retail market to state who they considered to be their closest competitors. Some branded granola suppliers in the retail market identified private label as a strong competitor. One of them identified Deliciously Ella and private label granolas as its closest competitors. Another one, indicated that there are a lot of branded granola products available to consumers, suggesting that they have a lot of choice and there is sufficient competition in this market. Similarly, the CMA asked retailers who they consider to be PepsiCo's strongest competitors in the retail market for granola. Those retailers that responded to the CMA's investigation considered Jordans, Morning Foods, and Kellogg's as the strongest competitors to PepsiCo.
73. Overall, the evidence that the CMA received from third parties suggests that the Parties face significant competition from several competitors and face especially strong competition from Jordans, Morning Foods, and Kellogg's in the retail market for granola.

#### *Conclusion on horizontal unilateral effects*

74. For the reasons set out above, the CMA considers that:
- (a) the Parties have a modest combined share of supply with a relatively small increment;
  - (b) most retailers consider that Pioneer's Lizi's brand only provides a limited competitive constraint to PepsiCo in the retail market for granola; and
  - (c) the Parties face strong competition in the retail market for granola, mainly from Jordans, Morning Foods and Kellogg's.

75. Accordingly, the CMA found that the Merger does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in relation to the retail market for granola.

### ***Conglomerate effects***

76. Conglomerate effects may arise in mergers of firms that are active in the supply of goods or services that do not form part of the same markets but which are nevertheless related in some way, either because their products are complements (so that a fall in the price of one good increases the customer's demand for another) or because there are economies of scale in purchasing them (so that customers buy them together).<sup>17</sup>
77. In certain circumstances, a conglomerate merger can result in the Merged Entity foreclosing rivals, including through a tying or bundling strategy.
78. The CMA has considered the following two scenarios:
- (a) Whether the Parties could charge low prices to retailers to manufacture their porridge or granola in exchange for more shelf space for their branded products; and
  - (b) Whether the Parties could stop supplying Quaker Oats to retailers unless they agreed to use them for the manufacture of their private label porridge or granola.
79. The CMA's approach to assessing conglomerate theories of harm is to analyse (i) the ability of the Merged Entity to foreclose competitors, (ii) the incentive of it to do so, and (iii) the overall effect of the strategy on competition.<sup>18</sup> These are discussed below, to the extent relevant.

### ***Ability to foreclose by bundling products***

80. The Parties submitted that conglomerate effects will not arise following the Merger. According to the Parties, they do not have such ability because retailers utilise different buying strategies depending on whether they are buying private label or branded goods.
81. The Parties further submitted that retailers have significant buyer power which limits their ability to bundle branded and private label cereal manufacturing for their benefit. In particular, the Parties noted that retailers (i) have a lot of alternative suppliers; (ii) can adopt disciplinary behaviours against a branded

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<sup>17</sup> See [Merger Assessment Guidelines](#), paragraph 5.6.2.

<sup>18</sup> See [Merger Assessment Guidelines](#), paragraph 5.6.6.

supplier (ie delisting or decreasing volume and allocating shelf space), (iii) put pressure on price negotiations despite cost inflation, and (iv) are in position to request reductions in invoice prices. Therefore, even though Pioneer could, theoretically, adopt this strategy, Pioneer submitted that it has not been able to bundle Lizi's granola with the manufacture of private label granola in the past.<sup>19</sup>

82. The CMA received some mixed evidence from third parties. Some respondents raised potential conglomerate concerns:
- (a) A branded supplier of porridge raised concerns that the Merged Entity could offer competitive prices to retailers to manufacture private label porridge in order to get more Quaker Oats products on shelves.
  - (b) Some retailers raised competition concerns about the fact that the Parties are already direct competitors in the retail market for granola and the Merger will mean PepsiCo acquires the largest manufacturer of own-label granola in the market, and they do not consider themselves to have sufficient buyer power to counteract the negotiating power of the Parties. One of them is concerned that the Merged Entity could make the manufacture of own-label granola for retailers conditional on them stocking branded granola, and alternative suppliers, such as Morning Foods, would be less competitive. Another one is concerned that the Merger will create a dominant entity which could leverage its market power against retailers for the benefit of its branded products.
83. However, other respondents supported the Parties' submission:
- (a) Some retailers told the CMA that retailers have sufficient buyer power and negotiations for manufacturing private label cereal and stocking branded cereal are conducted separately. Private label cereal will carry the retailer's brand, the manufacture of private label cereal is therefore closely controlled by retailers and must go through a thorough review, separate from branded products. In addition, the retailers do not foresee a scenario whereby PepsiCo would stop supplying Quaker Oats products to them if they refused to allow Pioneer to manufacture their private label cereal. One of them does not think either of the Parties would use its negotiating power to obtain any benefits. Another retailer told the CMA that no manufacturer has ever offered to produce their private label cereal at low cost in exchange for shelf space for its branded products.
  - (b) All respondents to the CMA's investigation including the retailers that raised concerns around conglomerate effects, confirmed that the

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<sup>19</sup> [ ]



negotiations for manufacturing private label cereal and branded products take place separately.

84. As part of its assessment, the CMA considered internal documents provided by the Parties about Pioneer's communications with retailers over the sale of Lizi's granola and the manufacture of private label granola. [REDACTED].
85. Overall, the CMA considers that the Parties do not have the ability to bundle private label and branded granola and porridge. This is because third parties have told the CMA that negotiations over the manufacture of retailers' private label cereals are conducted separately from those around which brands a retailer will stock. Furthermore, [REDACTED].

### *Conclusion*

86. As outlined above, the CMA considers that:
- (a) Negotiations over stocking branded products and manufacturing private label products take place separately;
  - (b) Pioneer has been unsuccessful in trying to leverage its market position in the manufacture of private label granola in order to get retailers to stock Lizi's granola; and
  - (c) Large retailers that procure own label cereals have significant buyer power and could therefore easily push back on any demands that the Merged Entity places on them.
87. Therefore, the CMA believes that Parties would not have the ability to foreclose rival cereal brands by leveraging its position in contract manufacturing.

### *Ability to foreclose by refusing to supply*

88. The CMA also considered whether the Parties could leverage its strong position in the porridge market into the manufacturing market by stopping supplying Quaker Oats to retailers unless they agreed to use Pioneer for the manufacture of their own-label porridge or granola.
89. The CMA received evidence from third parties that Quaker Oats is a must-stock product and the loss of supply would have an impact on their businesses. As mentioned above (paragraph 81), the Parties submitted that retailers are sophisticated buyers with strong buyer power and sufficient alternative suppliers.

90. However, third parties were unable to explain what they would do in such scenario, which may be explained by the limited number of concerns expressed by them and the fact that they considered it unlikely to arise. Also, a large number of third parties that responded to the CMA's investigation did not consider that this was a credible threat that PepsiCo could make. This is because this would damage PepsiCo's relationship with retailers, and it would likely lead to a substantial decline in the sales of Quaker Oats.
91. On the basis of the above, the CMA considers that the Parties would not have the ability to leverage its strong position in the porridge market to induce retailers to enter into agreements with the Merged Entity for contract manufacturing by refusing to supply Quaker Oats to retailers.

### *Conclusion*

92. Therefore, the CMA believes that the Parties would not have the ability to leverage their position in porridge to induce retailers to use it for contract manufacturing by refusing to supply Quaker Oats to retailers, as this is not a credible threat.

### *Conclusion on conglomerate effects*

93. For the reasons set out above, the CMA found that the Merger does not give rise to a realistic prospect of an SLC a result of conglomerate effects in relation to the market for porridge.

### ***Vertical effects***

94. Vertical effects may arise when a merger involves firms at different levels of the supply chain, for example a merger between an upstream supplier and a downstream customer or a downstream competitor of the supplier's customers.
95. In this case, the CMA has considered whether the Merger will allow the Parties to use their position in the upstream contract manufacturing market to foreclose rivals in the downstream retail market. In its assessment of vertical effects, the CMA considered whether the Merger could lead to an increase in the price the Parties charge retailers and third-party brands to manufacture their cereal or reduce the quality of the cereal they supply them.
96. The CMA's approach to assessing vertical theories of harm is to analyse (a) the ability of the Merged Entity to foreclose competitors, (b) the incentive of it

to do so, and (c) the overall effect of the strategy on competition.<sup>20</sup> This is discussed below, to the extent relevant.

97. In particular, the CMA assessed the Parties' ability to input foreclose their rivals in the granola market.

*Ability to input foreclose its rivals in the granola market*

98. The Parties submitted that the Merger will not give rise to any vertical effects because neither of the Parties are an actual or potential customer of the other. In regard to raw materials, Pioneer obtains milled oats from other external suppliers while Quaker mills its own oats solely for its own use. However, this does not talk to the possibility of foreclosing rivals at the retail level by raising their costs at the manufacturing level.

99. The CMA considered the upstream contract manufacturing market, the segment where Pioneer has the biggest share is in granola where it manufactures [80-90]% of the private label granola in the UK.<sup>21</sup>

100. Respondents to the CMA's investigation stated that there are alternative manufacturers, such as Morning Foods which is considered to be Pioneer's strongest competitor in the manufacture of private label granola. Respondents also stated that there would be alternative suppliers based outside the UK, such as Mulder which was the only other granola manufacturer to be listed by more than one respondent.<sup>22</sup>

101. In addition, the Parties submitted that, while Pioneer currently manufactures a large proportion of the private label granola sold in the UK, there is a high degree of supply-side substitutability from a manufacturing perspective between muesli and granola since:

(a) both cereals use the same base ingredients (oats, nuts, seeds, and fruits);  
and

(b) the manufacturing process is similar; the only difference being that granola requires the addition of honey and additional baking.

102. On the basis of the above, the CMA considers that the Parties would not have the ability to foreclose its rivals in the granola market. Therefore, the CMA has not further considered the incentive to foreclose.

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<sup>20</sup> See [Merger Assessment Guidelines](#), paragraph 5.6.6.

<sup>21</sup> [REDACTED]

<sup>22</sup> One other supplier that was mentioned is IPL (International Procurement and Logistics), which is an in-house procurer for Asda and therefore not a viable supplier for other retailers.

### *Conclusion*

103. Based on the above, the CMA concludes that the Merger does not give rise to a realistic prospect of an SLC as a result of vertical effects in relation to the market for granola.

### **Third party views**

104. The CMA has received input during its investigation from competitors and customers. Third party comments have been taken into account in the competitive assessment above.

### **Decision**

105. Consequently, the CMA does not believe that it is or may be the case that the Merger may be expected to result in an SLC within a market or markets in the United Kingdom.

106. The Merger will therefore **not be referred** under section 33(1) of the Act.

**Eleni Gouliou**  
**Director**  
**Competition and Markets Authority**  
**18 March 2020**