

# Anticipated acquisition by TFL Ledertechnik GmbH of the leather chemicals business of LANXESS Deutschland GmbH

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

**ME/6901/20**

The CMA's decision on reference under section 33(1) of the Enterprise Act 2002 given on 4 December 2020. Full text of the decision published on 24 December 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. TFL Ledertechnik GmbH (**TFL**) has agreed to acquire the leather chemicals business of LANXESS Deutschland GmbH (**LANXESS**) (the **Target Business**) (the **Merger**). TFL is controlled by Black Diamond Capital Management L.L.C. (**BDCM**). TFL and the Target Business are together referred to as the **Parties** and, for statements referring to the future, the **Merged Entity**.
2. The Competition and Markets Authority (**CMA**) believes that it is or may be the case that each of TFL and the Target Business is an enterprise; that these enterprises will cease to be distinct as a result of the Merger; and that the share of supply 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 manufacture and supply of beamhouse, wet-end<sup>1</sup> and finishing leather chemicals in Europe<sup>2</sup> to customers that manufacture and supply leather to a range of industries, including footwear, automotive and upholstery, among others.<sup>3</sup>
4. Based on the evidence received in its investigation, the CMA has assessed the impact of the Merger in the supply of each of (i) beamhouse, (ii) wet-end and (iii) finishing leather chemicals in Europe. The CMA considered any differences in the Parties' offerings depending on the industries supplied by customers, including those mentioned in paragraph 3 above, as part of its competitive assessment.
5. In assessing the competitive effects of the Merger in each of these frames of reference, the CMA considered a range of evidence, including shares of supply, the Parties' internal documents and third-party views. In respect of each frame of reference, the CMA found that post-Merger there will remain sufficient competitive constraints from a number of alternative suppliers.
6. 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 effects.
7. The Merger will also create a vertical relationship between the Parties with regard to the supply of finishing leather chemicals by virtue of BDCM's control of GST Auto Leather, Inc. (**GST**), active downstream in the manufacture and supply of leather to the automotive industry.<sup>4</sup> The CMA has therefore assessed the impact of the Merger on the Merged Entity's ability to foreclose GST's competitors from access to finishing leather chemicals. The evidence available to the CMA indicates that the Merged Entity would not have the ability or incentive to foreclose GST's competitors post-Merger, as there are a number of alternative suppliers of finishing leather chemicals that GST's downstream competitors could switch to. The evidence available also indicates that GST has a significant number of competitors downstream, indicating that any customer switching to GST as a result of the foreclosure of

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<sup>1</sup> Including dyes.

<sup>2</sup> For the purposes of this Decision, Europe refers to the EEA and the UK. The relevant data used for the purposes of this Decision is based on 2019 figures, when the UK was part of the EEA.

<sup>3</sup> The Parties also re-sell some leather chemicals produced by other manufacturers. In 2019, TFL had minimal revenues from re-selling certain leather chemicals produced by the Target Business.

<sup>4</sup> While the Merger will also create a vertical relationship between the Parties with regard to the supply of beamhouse and wet-end leather chemicals, the Parties' internal documents and third-party views indicate that the Target Business is particularly strong in the supply of finishing leather chemicals to leather manufacturers serving the automotive industry. The CMA received no evidence to suggest that this applies equally to beamhouse or wet-end leather chemicals. Therefore, the focus of the CMA's assessment of the vertical theory of harm is on the supply of finishing leather chemicals.

any one competitor would be limited. Moreover, the evidence indicates that GST would not be able to increase its supply of leather to the automotive industry to capture the respective pre-Merger downstream supply by its competitors. The CMA therefore believes that the Merger does not give rise to a realistic prospect of an SLC as a result of vertical effects.

8. The Merger will therefore **not be referred** under section 33(1) of the Enterprise Act 2002 (the **Act**).

## **ASSESSMENT**

### **Parties**

9. TFL is incorporated and headquartered in Germany and is controlled by BDCM. TFL is active in the manufacture and supply of leather chemicals. TFL's UK turnover in 2019 was approximately £[].
10. The Target Business is also incorporated in Germany and is active in the manufacture and supply of leather chemicals. The Target Business's UK turnover in 2019 was approximately £[].

### **Transaction**

11. The Merger relates to the acquisition by TFL of the Target Business pursuant to a Share Purchase Agreement signed on 12 August 2020.

### **Jurisdiction**

12. Each of TFL and the Target Business is an enterprise. As a result of the Merger, these enterprises will cease to be distinct.
13. The Parties overlap in the supply of finishing leather chemicals, with a combined share of supply of [20-30]% by value (with an increment of [10-20]% brought about by the Merger), as shown in Table 1 below. The CMA therefore believes that the share of supply test in section 23 of the Act is met.
14. 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.
15. The initial period for consideration of the Merger under section 34ZA(3) of the Act started on 21 October 2020 and the statutory 40 working day deadline for a decision is therefore 15 December 2020.

## Counterfactual

16. 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>5</sup>
17. In this case, the available evidence indicates that there is a realistic prospect that, absent the Merger, the Target Business would either have been sold to an alternative purchaser active in the supply of leather chemicals (Stahl) or retained by LANXESS. There is no evidence to suggest that either scenario would have resulted in a counterfactual that is more competitive than the prevailing conditions of competition. Therefore, the CMA believes the prevailing conditions of competition to be the relevant counterfactual.

## Frame of reference

18. 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>6</sup>
19. The Parties overlap in the supply of beamhouse, wet-end and finishing leather chemicals in Europe.

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<sup>5</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).

<sup>6</sup> [Merger Assessment Guidelines](#), paragraph 5.2.2.

## ***Product scope***

### *Supply of leather chemicals*

20. At the start of the leather production process, slaughterhouses produce hides originating from cattle. The raw hides are then transported to tanneries where they undergo various chemical and/or mechanical processes to achieve the finished leather product. In broad terms the leather production process can be separated into three sequential stages: beamhouse; wet-end and finishing. The Parties supply leather chemicals for all three stages.
21. The CMA's starting point for the product frame of reference was the narrowest overlaps between the Parties, ie the supply of (i) beamhouse, (ii) wet-end and (iii) finishing leather chemicals.
22. The CMA considered whether it is appropriate to widen the product frame of reference to include the supply of leather chemicals for all leather production stages.
23. The CMA also considered whether the supply of leather chemicals should be segmented by the industry in which the customer is active (eg, upholstery, footwear, automotive).

### *Segmentation by leather production stage*

24. The Parties<sup>7</sup> submitted that the narrowest product frame of reference should be all leather chemicals on the basis that:
  - (a) Some customers prefer to purchase chemicals for different leather production stages from the same supplier to ensure compatibility;
  - (b) Major leather chemical customers are generally active in each of the three leather production stages;
  - (c) Suppliers sometimes sell products manufactured by other suppliers to offer customers a wider range of leather chemicals; and
  - (d) It is relatively easy for manufactures to shift production between leather chemicals used at different leather production stages.<sup>8</sup>

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<sup>7</sup> The CMA notes that while the Merger Notice (**MN**) was submitted by TFL, the statements in the MN are made in the name of both Parties, which is the approach the CMA applies in this Decision.

<sup>8</sup> MN, paragraphs 13.4 and 15.72.

25. However, the evidence received by the CMA in its investigation indicates that, on the demand side, there are differences based on the production stage. In particular:
- (a) The Parties' internal documents indicate that beamhouse, wet-end and finishing leather chemicals serve different purposes and are not substitutable;
  - (b) A significant share of each of the Parties' revenues in 2019 was generated from sales to customers sourcing leather chemicals for only one or two leather production stages; and
  - (c) Third-party views indicate that customers can and do mix-and-match leather chemicals supplied by different manufacturers for different leather production stages.<sup>9</sup>
26. While the boundaries of the relevant product market are generally determined by reference to demand-side substitution alone,<sup>10</sup> the CMA may widen the scope of the market where there is evidence of supply-side substitution. The CMA may do so where there is evidence that suppliers have the ability and incentive to shift capacity quickly (generally within a year) between different products depending on demand for each; and the same suppliers compete to supply these different products and the conditions of competition between the suppliers are the same for each product.
27. The evidence received by the CMA does not indicate that any of these conditions are met such that the product scope should be widened to include all leather chemicals, irrespective of the leather production stage. In particular:
- (a) As evidenced by the variation in suppliers' shares of supply of leather chemicals (shown in Table 1 below), suppliers' competitive strengths differ depending on the leather production stage;
  - (b) The Parties' internal documents indicate that the Parties discuss their performance (eg [X]) in the supply of leather chemicals separately for each leather production stage; and
  - (c) The majority of the Parties' competitors that responded to the CMA's investigation identified significant barriers to shifting their production

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<sup>9</sup> One customer told the CMA that leather chemicals manufactured by different suppliers can be compatible with each other.

<sup>10</sup> [Merger Assessment Guidelines](#), paragraph 5.2.17.

capacity between leather chemicals used at different leather production stages.<sup>11</sup>

28. Based on the evidence set out above, the CMA believes that it is not appropriate to widen the product frame of reference to include the supply of leather chemicals for all leather production stages. The CMA has therefore assessed the impact of the Merger on the supply of (i) beamhouse, (ii) wet-end, and (iii) finishing leather chemicals separately.

*Segmentation by customer industry*

29. The Parties' customers manufacture and supply leather to a range of industries (eg footwear, automotive and upholstery). The CMA considered whether it is appropriate to narrow the product frame of reference by the industries served by the Parties' customers (leather manufacturers).
30. The Parties submitted that broadly all leather chemicals can be used in all leather applications (including upholstery, footwear, automotive etc), and that while the overall leather manufacturing process may need to be adapted to ensure that the leather meets any industry-specific requirements, this requires no significant changes to the leather chemicals production process.<sup>12</sup>
31. The evidence received by the CMA indicates that, on the demand side, there may be certain differences in the conditions of competition based on the industry served by the customer.
32. One TFL document<sup>13</sup> indicates that leather manufacturers serving the automotive industry 'need a [redacted]' for beamhouse chemicals, and that there are '[redacted] players who can service OEMs [ie the automotive industry] effectively.'
33. The CMA has also received evidence that, on the supply-side, conditions of competition may vary by the industry served by customers.

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<sup>11</sup> In particular, four competitors told the CMA that they would face significant barriers to switching production between leather chemicals used at different leather production stages (including technological, environmental and legal barriers, the need for specific expertise and significant investment and time to adjust production). One competitor told the CMA that entry was easier in the supply of beamhouse and wet-end leather chemicals, compared to the supply of finishing leather chemicals.

<sup>12</sup> MN, paragraphs 15.5 and 15.7.

<sup>13</sup> [redacted].

34. Several of the Parties' internal documents also indicate that they consider themselves particularly strong in the supply of leather chemicals to customers that serve specific industries.<sup>14</sup>
35. Third-party views indicate that the number of suppliers offering finishing leather chemicals to manufacturers of leather for the automotive industry is smaller compared to other industries.<sup>15</sup> Some third parties told the CMA that leather chemicals suppliers' relative strengths vary depending on the downstream industry served by their customers – for example, the Target Business is relatively strong in the supply of finishing chemicals to customers serving the automotive industry.<sup>16</sup> Competitors' views were mixed as regards the ease of starting to supply leather chemicals to customers active in a different downstream industry.<sup>17</sup>
36. The CMA notes that most of the evidence of the Parties' respective strengths tended to relate to different industries,<sup>18</sup> indicating that further segmentation by industry served by customers will not lead to greater competition concerns in relation to the horizontal overlaps between the Parties. The CMA therefore believes that it is not necessary to conclude on whether the product frame of reference should be segmented based on the industry served by customers for the purposes of its assessment of horizontal unilateral effects, as no competition concerns arise on any plausible basis.
37. In relation to potential vertical effects arising from the vertical relationship between the Parties in the supply of finishing leather chemicals (in which the Parties overlap upstream) and the manufacture and supply of leather to customers in the automotive industry, in which GST, a company controlled by BDCM, is active (downstream), the CMA has considered whether GST's rivals will have sufficient credible alternative suppliers of leather chemicals suitable for the automotive industry post-Merger in assessing the risk of foreclosure. It

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<sup>14</sup> For example, one TFL document ([REDACTED]) states that '[Target Business] is a [REDACTED] in Automotive leather finishing' (and that TFL was the '[REDACTED] in Finishing for shoe and leather goods'). A Target Business document indicates that it considers itself to have the '[REDACTED] position in automotive finishing', that 'automotive [was the] [REDACTED] industry sector for [the Target Business] due to [REDACTED]', and that it has a '[REDACTED] market position of [REDACTED] in automotive' (see [REDACTED]).

<sup>15</sup> One competitor told the CMA that 'Barriers [for customer switching] are rather limited apart from end customer approval. This is [sic] in Automotive a substantial barrier [sic].'

<sup>16</sup> For example, one customer told the CMA that the Parties are relatively strong in the supply of leather chemicals used in leather production for the automotive, shoes and fashion industries, noting that Stahl is another alternative. One re-seller of [REDACTED] told the CMA that the Target Business is relatively strong in the supply of finishing chemicals used to manufacture automotive leather (and solvent-based paint), while also listing Stahl, Smit & Zoon, Trumpler and certain regional suppliers as alternatives.

<sup>17</sup> Four competitors identified environmental or legal barriers and specific know-how, as well as time required to adjust production. Two other competitors told the CMA that they would not face any barriers to enter the supply of leather chemicals for a different downstream industry.

<sup>18</sup> For example, both Parties' internal documents indicate that the Target Business is strong in the supply of finishing leather chemicals for the automotive industry. By contrast, one TFL document ([REDACTED]) indicates that it considers itself to be 'number 1 in Finishing for [REDACTED].'



has therefore not been necessary to conclude on the relevant frame of reference for this assessment.

#### *Conclusion on product scope in the supply of leather chemicals*

38. For the reasons set out above, the CMA has considered the impact of the Merger in the following product frames of reference for the purposes of the horizontal unilateral effects assessment:
- (a) The supply of beamhouse leather chemicals;
  - (b) The supply of wet-end leather chemicals; and
  - (c) The supply of finishing leather chemicals.
39. The CMA has considered the impact of the Merger in the supply of finishing leather chemicals to customers serving the automotive industry for the purposes of the vertical effects assessment.

#### **Geographic scope**

40. The Parties submitted that the narrowest candidate geographic frame of reference is global on the basis that leather chemicals are procured and shipped globally, suppliers have limited need for local operations and local customers' preferences do not vary significantly by geography.<sup>19</sup>
41. The CMA has assessed the frame of reference starting from the narrowest overlap between the Parties, ie the UK, and considered whether it could be expanded to include global suppliers.
42. When considering the geographic frame of reference, the CMA analysed the levels of imports of leather chemicals into the UK and Europe.
43. Neither of the Parties have leather chemicals production facilities in the UK. Similarly, none of the competitors that supply leather chemicals to customers in the UK that responded to the CMA's market investigation have production facilities in the UK. In addition, one customer told the CMA that only [X]% of the leather chemicals used in its UK leather manufacturing facilities was manufactured in the UK (the remaining [X]% was manufactured in the rest of Europe). This evidence indicates that the frame of reference is wider than national.

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<sup>19</sup> MN, paragraph 13.24.

44. The Parties estimated that more than [70-80]% of overall demand for leather chemicals in Europe is satisfied by leather chemicals manufactured in Europe.<sup>20</sup>
45. Similarly, customers that responded to the CMA's investigation said that in 2019 between 60% and 90% of the leather chemicals they used in their European production facilities were manufactured in Europe. The vast majority of competitors that responded to the CMA's investigation said that most of their sales to European customers in 2019 were accounted for by leather chemicals produced in Europe (ie between 63% and 100%).
46. While some customers told the CMA that they are able to source leather chemicals from suppliers on a global basis, the evidence discussed at paragraphs 44 and 45 above indicates that the majority of customer demand in Europe is satisfied by leather chemicals manufactured and supplied in Europe.
47. For the reasons set out above, and on a cautious basis, the CMA has considered the impact of the Merger in Europe. The CMA has taken any evidence of competitive constraints from suppliers outside of Europe in its competitive assessment.
48. However, it was not necessary for the CMA to reach a conclusion on the geographic frame of reference, since, as set out below, no competition concerns arise on any plausible basis.

### ***Conclusion on frame of reference***

49. For the reasons set out above, the CMA has considered the impact of the Merger in the following frames of reference for the purposes of the horizontal unilateral effects assessment:
  - (a) The supply of beamhouse leather chemicals in Europe;
  - (b) The supply of wet-end leather chemicals in Europe; and
  - (c) The supply of finishing leather chemicals in Europe.
50. The CMA has considered the impact of the Merger in the supply of finishing leather chemicals to customers serving the automotive industry in Europe for the purposes of the vertical effects assessment.

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<sup>20</sup> TFL considered that up to [90-100]% of overall demand in Europe is satisfied by leather chemicals manufactured in Europe.

## Competitive assessment

### *Horizontal unilateral effects*

51. Horizontal unilateral effects may arise when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm profitably to raise prices or to degrade quality on its own and without needing to coordinate with its rivals.<sup>21</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 may be expected to result in an SLC in relation to horizontal unilateral effects in the supply of (i) beamhouse leather chemicals, (ii) wet-end leather chemicals and (iii) finishing leather chemicals in Europe.
52. In order to assess the likelihood of the Merger resulting in horizontal unilateral effects, the CMA considered:
- (a) Shares of supply;
  - (b) The closeness of competition between the Parties; and
  - (c) Competitive constraints from other suppliers.

### *Shares of supply*

53. The Parties submitted estimates of shares of supply (by value) in Europe in 2019 for (i) beamhouse leather chemicals, (ii) wet-end leather chemicals and (iii) finishing leather chemicals.<sup>22</sup> The CMA produced its own adjusted estimates based on the data submitted by the Parties and their competitors, as shown in Table 1 below.<sup>23</sup>

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<sup>21</sup> [Merger Assessment Guidelines](#), from paragraph 5.4.1.

<sup>22</sup> The Parties estimated the total market size based on their estimates of total demand, and then attributed shares of supply to competitors based on market intelligence and the management's understanding of the market.

<sup>23</sup> The CMA's adjusted shares were calculated by dividing individual suppliers' self-reported revenues by the total market size (estimated by the Parties), which does not rely on the Parties' estimates of individual suppliers' revenues.

**Table 1: CMA's adjusted share of supply estimates**

Supplier	Beamhouse	Wet-end	Finishing
TFL	[10-20]%	[10-20]%	[10-20]%
Target Business	[0-5]%	[5-10]%	[10-20]%
<b>Combined</b>	<b>[10-20]%</b>	<b>[10-20]%</b>	<b>[20-30]%</b>
Stahl	[10-20]%	[10-20]%	[50-60]%
Schill & Seilacher	[5-10]%	[0-5]%	[0-5]%
Zschimmer & Schwarz	[0-5]%	[5-10]%	[5-10]%
Cromogenia	[5-10]%	[5-10]%	[0-5]%
Trumpler	[0-5]%	[5-10]%	[0-5]%
Silva Team	[0-5]%	n/a*	[0-5]%
Other**	[50-60]%	[40-50]%	[5-10]%

Source: Parties' shares of supply (and market size) estimates and the Parties' competitors' revenue data.

\*'n/a' indicates that the CMA has not been able to estimate a supplier's share of supply with an acceptable degree of precision with the data available. This, however, has no impact on the shares of supply estimated for other suppliers, as these have been computed as individual suppliers' self-reported revenues over the Parties' estimates of total market size, which in turn do not depend on their estimates of individual suppliers' revenues

\*\*'Other' includes suppliers not listed in Table 1.<sup>24</sup> Totals may not amount to 100% due to approximations.

54. The CMA's adjusted estimates show that the Parties have a small or moderate combined share of supply (by value), with a small or moderate increment in the supply of beamhouse leather chemicals ([10-20]% combined, with an increment of [0-5]%), wet-end leather chemicals ([10-20]% combined, with an increment of [0-5]%) and finishing leather chemicals ([20-30]% combined, with an increment of [10-20]%).
55. The Parties' internal documents are broadly consistent with the CMA's adjusted estimates of the Parties' shares of supply.
56. The CMA therefore believes that the shares of supply set out in Table 1 provide a reliable indication of the current market positions of suppliers of (i) beamhouse leather chemicals, (ii) wet-end leather chemicals and (iii) finishing leather chemicals in Europe, and that these shares of supply raise no prima facie competition concerns.
57. The CMA has, nevertheless, considered a range of other evidence relevant to the competitive assessment.

### *Closeness of competition*

58. The Parties submitted that they are neither each other's closest competitors, nor particularly close competitors, as they offer a mostly complementary

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<sup>24</sup> While the 'Other' category appears to account for a substantial share of supply of leather chemicals to European customers for certain leather production stages, this has no impact on the CMA's estimates of the Parties' shares of supply, as these have been calculated by dividing the Parties' revenues by their estimates of the total market size, which, in turn, do not depend on the estimates of the other suppliers' revenues.

portfolio focusing on leather chemicals used at different production stages and target customers active in different industries.<sup>25</sup>

59. When assessing closeness of competition between the Parties, the CMA considered evidence including the Parties' respective revenue split, the Parties' internal documents and third-party views.
60. The Parties submitted that beamhouse and wet-end leather chemicals account for a larger share of TFL's revenue compared to the Target Business, which, by contrast, generates a larger share of revenue from finishing leather chemicals. Nevertheless, the CMA notes that the evidence shows that any difference is limited and both Parties have material activities in all three types of leather chemicals.
61. The Parties' internal documents broadly support the view that, to some extent, the Parties focus on leather chemicals used at different leather production stages, and on supply to customers serving different industries.<sup>26</sup> However, the CMA did not receive specific evidence supporting the significance of this different focus to closeness of competition. In this respect, the CMA notes that competitors can have different focus but nevertheless exert a meaningful competitive constraint on each other.
62. Third-party responses to the CMA's investigation indicate that the Parties are generally not considered to be particularly close competitors. Only a few customers that responded to the CMA's investigation identified TFL as a viable alternative for the leather chemicals they currently source from the Target Business, and vice versa. The large majority of customers also rated alternative suppliers as equally strong or stronger than the Parties for the type of leather chemicals they currently source from the Parties.<sup>27</sup>
63. The CMA believes that evidence on the Parties' closeness of competition is mixed and should, in any event, be considered in the round with the evidence on competitive constraints, which is discussed further below.

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<sup>25</sup> For example, the Parties submitted that within wet-end leather chemicals, TFL focuses on dyestuffs, while the Target Business focuses on dyeing auxiliaries, and within finishing chemicals, TFL focuses on customers serving the footwear and fashion industry, while the Target Business focuses on customers serving the automotive industry. MN, paragraph 15.34.

<sup>26</sup> TFL documents indicate that TFL is strong in finishing for [REDACTED] versus the Target Business in finishing for automotive. While one TFL document ([REDACTED]) indicates that 'TFL and Lund were both recognised for their [REDACTED] products, [REDACTED] and [REDACTED] and to an extent [REDACTED] and [REDACTED]', there is no indication of either Party referring to the other as a close competitor in the supply of leather chemicals.

<sup>27</sup> One competitor told the CMA that the Parties' product offering is differentiated to some extent, but that both Parties are strong in the supply of beamhouse leather chemicals (albeit noting that TFL is active in the manufacture of traditional beamhouse chemicals, whereas the Target Business is active in the manufacture of new eco-friendly beamhouse leather chemicals).

## *Competitive constraints*

64. The Parties submitted that they are and will, post-Merger, continue to be constrained by a large number of leather chemicals competitors, including significant global and regional suppliers.<sup>28</sup>
65. The CMA has assessed competitive constraints by considering customer loss data, the Parties' internal documents and third-party views.
66. The Parties' customer loss data<sup>29</sup> identifies [REDACTED] instances of switching from TFL to the Target Business, and only [REDACTED] of switching from the Target Business to TFL in the last three years.<sup>30, 31</sup> By contrast, the Parties' customer loss data indicates [REDACTED] switching [REDACTED] in the supply of beamhouse leather chemicals, [REDACTED] in the supply of wet-end leather chemicals, and [REDACTED] in the supply of finishing leather chemicals.<sup>32</sup>
67. The Parties' internal documents broadly confirm that there are a range of alternative leather chemical suppliers, including, notably, a competitor ([REDACTED]) which, post-Merger, will have a comparable share of supply to the Merged Entity in the supply of each of (i) beamhouse leather chemicals, (ii) wet-end leather chemicals and (iii) finishing leather chemicals in Europe.<sup>33</sup>
68. Similarly, third-party views indicate that there are a sufficient number of alternative suppliers of leather chemicals used at each leather production stage.<sup>34</sup> A large number of third parties listed one competitor as a very close alternative (and, often, one of the closest alternatives) to each of the Parties that will remain post-Merger. In addition, third-party views indicate that there

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<sup>28</sup> MN, paragraphs 15.54 and 15.55.

<sup>29</sup> Covering EEA and UK losses by TFL in the past 3 years, and by the Target Business in the past 4 years.

<sup>30</sup> The Parties' analysis is subject to a methodological weakness as it does not account for losses of sales arising because of reduced demand, and therefore could mis-attribute such losses to competition from third-party competitors. However, the observation that there [REDACTED] only [REDACTED] between the Parties between 2018 and 2020 is not affected by the Parties' methodology.

<sup>31</sup> The [REDACTED] switching between 2018 and 2020 accounted for a [REDACTED] proportion of the Target Business's losses in the period, but as this was associated with [REDACTED], the CMA could not infer whether [REDACTED] would reflect a typical level of switching between the Parties. The CMA notes that the customers considered that a range of alternative suppliers were available, including in [REDACTED] (eg [REDACTED]).

<sup>32</sup> As the Parties could not always identify the supplier to which the customers switched, the CMA considers that this switching analysis is likely to understate the total number of available alternatives.

<sup>33</sup> For example, one Target Business's document ([REDACTED]) refers to a competitor active in the supply of leather chemicals for all three leather production stages [REDACTED] as 'very strong, pushing hard in all directions', another competitor [REDACTED] as 'increasing share at many customers', another competitor [REDACTED] as 'a revival', and another competitor [REDACTED] as 'active to grow in Automotive', while it says that TFL is 'less visible in the market.' A document prepared for TFL by external advisers [REDACTED] ([REDACTED]) provides that 'A number of smaller players ([REDACTED] and others) are well-considered by the market'.

<sup>34</sup> Based on customers' responses to the CMA's investigation, post-Merger, there will remain between 5 and 11 alternative suppliers of leather chemicals depending on the leather production stage. Based on competitors' responses to the CMA's investigation, post-Merger there will remain between 6 and 8 alternative suppliers depending on the leather production stage.

will remain a number of smaller suppliers that will, post-Merger, be able to exert meaningful competitive constraints on the Merged Entity.<sup>35</sup> While two customers raised concerns regarding the Merger's impact on the number of suppliers, both identified several alternative suppliers as closer competitors to their current suppliers, and neither considered either Party to be the closest competitor to their current suppliers.

69. In light of the above evidence, the CMA believes that there are a sufficient number of competitors that will, post-Merger, continue to exert competitive constraint on the Merged Entity.

#### *Conclusion on horizontal unilateral effects*

70. For the reasons set out above, the CMA believes that there will remain a sufficient number of credible alternative suppliers that will, post-Merger, continue to exert competitive constraint on the Merged Entity. 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 supply of (i) beamhouse leather chemicals, (ii) wet-end leather chemicals and (iii) finishing leather chemicals in Europe.

#### **Vertical effects**

71. 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. Vertical mergers can weaken rivalry, for example when they result in foreclosure of the merged firm's competitors. The CMA only regards such foreclosure to be anticompetitive where it results in an SLC in the foreclosed market(s), not merely where it disadvantages one or more competitors.<sup>36</sup>
72. The Merger will create a vertical relationship between the Parties with regard to the supply of finishing leather chemicals by virtue of BDCM's control of GST, which is active downstream in the manufacture and supply of leather to the automotive industry. Pre-Merger, TFL already supplies some leather chemicals to automotive leather manufacturers, including GST and competitors to GST. The CMA has therefore considered the possible effect on

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<sup>35</sup> One competitor told the CMA that customers are aware of the smaller specialist manufacturers, indicating that smaller manufacturers will be able to provide a meaningful competitive constraint on the Merged Entity. This is consistent with the view of one of the Parties' customers.

<sup>36</sup> In relation to this theory of harm, 'foreclosure' means either foreclosure of a rival or to substantially competitively weaken a rival.

competition of the new vertical relationship between GST and the Target Business.

73. The Merged Entity will, post-Merger, have the second largest combined share of supply of finishing leather chemicals behind the market leader Stahl. As discussed at paragraph 35 above, the evidence also indicates that the Target Business has a relatively strong position in the supply of finishing leather chemicals to customers supplying leather to the automotive industry. Accordingly, the CMA has considered whether the Merged Entity might foreclose GST's competitors, either by withholding supply of finishing leather chemicals from, or by offering less favourable terms to, GST's competitors.
74. The CMA's approach to assessing vertical theories of harm is to analyse (a) the ability of the merged entity to foreclose competitors, (b) its incentive to do so, and (c) the overall effect of the strategy on competition.<sup>37</sup>

### *Ability*

#### *Importance of the input*

75. One customer told the CMA that leather chemicals account for around [20-30%] of its total leather production costs,<sup>38</sup> and that an increase in the cost of leather chemicals would have [X].
76. Moreover, the CMA understands that the leather chemicals used may affect the leather quality. For example, several customers supplying leather to the automotive industry told the CMA that in order to replace their leather chemicals suppliers, they need to undertake quality checks and receive approval of the end-customers in the automotive industry.
77. Therefore, the CMA cannot rule out that the input is sufficiently important to enable the Merged Entity to foreclose GST's competitors.

#### *Market power upstream*

78. While one customer expressed the view that the Merged Entity may change the terms of its supply of finishing leather chemicals post-Merger, this customer told the CMA that there are a number of alternative suppliers (such as [X]) comparable to the Target Business to which it would be able to switch if the Merged Entity was to increase the price of finishing leather chemicals.

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<sup>37</sup> [Merger Assessment Guidelines](#), paragraph 5.6.6.

<sup>38</sup> However, this proportion relates to all leather chemicals, and therefore may not reflect the importance of finishing leather chemicals in isolation.



Evidence received from several other third parties during the CMA's investigation also indicates that customers serving the automotive industry will have a number of credible alternative suppliers of finishing leather chemicals that will remain available post-Merger.

79. No other third parties that responded to the CMA's investigation raised any specific concerns in relation to the Merger's impact on competition in the supply of finishing leather chemicals to customers serving the automotive industry.

### *Incentive*

#### *GST's gains in profits in the supply of automotive leather*

80. Any increase in the Merged Entity's profits as a result of a foreclosure strategy depends on the extent to which customers of GST's competitors would switch to GST. Customer diversion to GST, in turn, depends on the number and strength of other automotive leather manufacturers.
81. The Parties submitted that there are ten competitors to GST, four of which are of a comparable size to GST or larger.<sup>39</sup>
82. One customer told the CMA that there are at least eight manufacturers of automotive leather that compete on an equal footing. This indicates that any customer diversion to GST from the foreclosure of any one competitor would be limited. Moreover, one customer told the CMA that GST is unlikely to have sufficient capacity to supply its competitors' existing customers, limiting the profits that the Merged Entity would be able to generate through any foreclosure. This view is consistent with TFL's submission that GST operated at around [80-90]% of its capacity in 2019.<sup>40</sup>

### *Conclusion on vertical effects*

83. For the reasons set out above, the CMA believes that, in light of the evidence of limited market power on the part of the Merged Entity and the limited extent of possible recapture of sales by GST as a result of foreclosing its competitors, the Merged Entity would not have the ability or incentive to foreclose GST's competitors in the supply of leather to the automotive

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<sup>39</sup> Specifically, four competitors had estimated shares of supply in the supply of automotive leather products exceeding 10% (the largest having [20-30]%) in 2019. GST estimated its share to be around [10-20]%.  
<sup>40</sup> MN, paragraph 19.8.

industry from access to finishing leather chemicals. The CMA has not therefore gone on to consider effect.

84. Accordingly, the CMA found that the Merger does not give rise to a realistic prospect of an SLC as a result of vertical effects in relation to the input foreclosure of finishing leather chemicals to leather manufacturers serving customers in the automotive industry.

## **Decision**

85. 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.

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

**Naomi Burgoyne**  
**Director, Mergers**  
**Competition and Markets Authority**  
**4 December 2020**