Easy as Pie? Assessing inter-brand mergers

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BIICL 10th Annual Merger Conference

Three levels of competition: 1

Competition for consumers

Market framework
Three levels of competition: 2

- Competition for shelf space
- Competition for consumers
- Bargaining framework
- Market framework

Three levels of competition: 3

- Competition to be the 'label' supplier
- Competition for shelf space
- Competition for consumers
- Bidding framework
- Bargaining framework
- Market framework
Retail versus wholesale merger assessment

UPPR/IPR increasingly used in assessing mergers in differentiated retail markets. Uses retail diversion ratios and retail margins. But what about wholesale mergers between branded goods?

Wholesaler incentives are related to retailer incentives...

- Retailers may apply a standard mark-up on wholesale prices, or at least pass through to some extent.
- Switching by customers downstream will reduce sales at the wholesale level.
- So, retail preferences should reflect downstream preferences to some extent.

...But different

- Wholesalers and retailers have different margins.
- If the wholesaler raises its price the retailer may not pass this fully through – this depends on retail competition.
- If the wholesaler raises its price the retailer also has the incentive to change the retail prices of other competing products.
- Retailers may have bargaining power from source shelf space and wholesaler options not to stock a product (bargaining framework is relevant).

Implications of bargaining: An extreme

Retailers with bargaining power can make suppliers compete for limited shelf space

- If retailers choose not to stock products then customers find it more difficult to switch between them downstream.
- This means downstream measures of competition may not directly apply and the bargaining framework should be considered directly.

Market with three products (A, B, C): A is a 'must stock' brand and retailer chooses only one of brands B or C.

Upstream diversion: A ← 0% → B ← 100% → C

Downstream diversion: A ← 100% → B ← 0% → C

Consider a merger between A & B
- Downstream diversion overstates upstream competition between A&B.

Consider a merger between B & C
- Downstream diversion understates upstream competition between B&C.
OFT cases: Using downstream data to assess upstream competition

Unilever/Alberto Culver (OFT, 2011)
- Evidence of downstream customer switching from Kantar survey
- Retailers say their behaviour driven by and not market behaviour
- Parties argued that retailer switching overstates wholesale switching:
  - If wholesale price of FRM raised, retailers would raise price of other soups
  - Competition for shelf space means retailers have wider range of products to switch to, so there is more diversion to an out of stock option
- OFT accepted these points, but emphasised that other arguments could go either way. Overall, considered retail level switching data is a reasonable proxy for wholesale, but mindful of limitations.

Princes/Premier Foods (OFT, 2011)
- Formative analysis of retail scanner data to quit diversion estimates
- Used both for Critical loss analysis and for GUPPI analysis
- OFT view that, since parties do not compete directly downstream in all retailers, there may be more diversion at wholesale level than is apparent from retail level diversion. And thus GUPPI is if anything lower bound

Competition to be the own label supplier:
Kerry/Headland (CC 2011)

- Market shares
  - [50-60]% at tender stage
  - [40-50]% at wholesale stage

- Tender analysis
  - 25 tenders
  - In 11, Kerry was second to Headland
  - In 9, Headland was second to Kerry

- Switching analysis
  - Post-merger price rises!
  - But some switching, and potential for more.
  - CC concluded that customers would be able to find alternative FRM suppliers, and thus the price increase was temporary
Easy as Pie? Questions/views?

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