Buyer power and market entry

Introduction

1. This appendix sets out our assessment of factors relating to buyer power and market entry in the retail ketchup market and the food service sector. It does not specifically cover the retail barbecue sauce market, the retail baked beans market or the retailed tinned pasta products market for the following reasons:

- In the case of the retail barbecue sauce market, the extent of buyer power and barriers to entry were important to our assessment of the effect of the merger on competition. We therefore addressed these issues in the main text.

- In the case of the retail baked beans market and the retail tinned pasta products market, our analysis of buyer power and market entry was similar to that for the retail ketchup. To the extent that we considered any additional issues in these two markets, these are noted in the main text.

Buyer power in the retail ketchup market

2. In support of its case for the presence of buyer power, Heinz noted that the top four retailers accounted for nearly [✄] per cent of Heinz ketchup sales. According to Heinz, while Heinz and retailers cooperated so as to stimulate consumer interest and demand, Heinz was subject to competitive constraints imposed by each of its major retail customers as follows:

- Heinz considered that, as the customer, retailers could and did exert control over its prices. Heinz submitted that price increases were infrequent and required justification on grounds of raw material cost increases or product innovation.

- As ‘gatekeeper’ over access to the consumer, Heinz considered that the retailer could affect the competitive success of the manufacturer in a variety of ways, including through the allocation of retail selling space, merchandising and promotional opportunities and through setting the retail price.

- As competitors to Heinz, Heinz submitted that the retailer could and did take decisions regarding the relative weight it gave to its competing own-label products, and over relative pricing between own-label and branded products.

- Heinz considered that the effects of these aspects of the vertical relationship between a branded manufacturer such as Heinz and retailers were reinforced by what Heinz saw as the intense competition between retailers.

3. In relation to ketchup, we did not receive evidence from any retailers that suggested that they used Daddies ketchup in their negotiations with Heinz, nor that [✄] However, retailers indicated they would *(a)* seek justification from Heinz and *(b)* attempt to negotiate lower price increases. Retailers did not suggest that they would remove Heinz ketchup from their shelves as part of their response to an attempted price increase. Rather, they told us that Heinz ketchup was a ‘must stock’ item; if the retailer did not stock it, then consumers would switch to other retailers.

4. We saw data that indicated that retailers' margins on Heinz products were smaller than on other branded and own-label products in the same market, and we saw little evidence that retailers were able to resist price increases proposed by Heinz in the past.[1] IRI data submitted to us by Heinz indicated that there had been a 21 per cent increase in the retail price per kg for its ketchup from 2003 to 2005, which Heinz explained as being principally linked to the introduction of top-down packaging. [✂] although one retailer did tell us it regarded Daddies as a competing brand to Heinz for shelf space, if not for consumers.

5. We had no reason to believe that any buyer power that existed would extend from the larger retail customers such as the major supermarkets to the smaller retail customers purchasing directly from the manufacturers. However, we noted that, in relation to other brands of ketchup such as Daddies, the brand-strength factors that served to counterbalance buyer power in the case of Heinz ketchup might not be so pronounced.

Market entry in the retail ketchup market

6. We considered that there were no significant technical, legal or regulatory barriers to entry into the production of ketchup. We were told by manufacturers that the ingredients for ketchup were commodities and that production involved standard food processing techniques. Whilst recipes might be regarded as confidential trade secrets, there did not appear to be any reason why manufacturers could not develop successful recipes for themselves.

7. However, whilst we considered that entry into production of ketchup would be technically feasible, we considered that there were high commercial barriers to branded entry into the retail ketchup market. Well-established brands such as Heinz that are actively promoted and have high levels of consumer recognition may themselves act as a barrier to market entry by serving to increase the amount of marketing and promotional activity required to establish a new brand.

8. We heard evidence from Premier that the cost of launching nationally the Branston brand of baked beans and tinned pasta products was £[✂] million in [✂], and that further costs might be incurred beyond this.[2] We noted that, as an existing manufacturer of own-label beans and tinned pasta, Premier was able take advantage of its production capability, distribution arrangements and established contacts with retailers in launching Branston beans and pasta. A completely new entrant to the retail ketchup market would not have such pre-existing arrangements, and its costs for launching a brand able to compete with Heinz might be even higher than Premier's were in the case of Branston beans and pasta. An entrant would need the financial resources to incur these costs which would not be recoverable on exit. It would also need brand management expertise.

9. For branded entry, access to retailers' shelf space would also be critical and could not be guaranteed. Retailers told us that allocating shelf space to new products depended on their views as to the likely success of the product in terms of it winning a sufficient market share. We considered that the Heinz brand in ketchup would make it difficult for a new branded entrant to achieve the required market share threshold. We did, however, note that there were some major food manufacturers with established brands in adjacent product and/or geographic markets (such as

[1]See paragraphs 3.58 and 3.59, on countervailing buyer power, in the CC merger guidelines.
[2]As set out at paragraph 5.91, Premier told us that, absent the merger between Heinz and HP, it would not have launched Branston beans and tinned pasta.

Unilever, Kraft and Premier) that were credible potential entrants to this market. We saw that branded entry to the retail ketchup market had recently occurred, in that Premier launched Branston-branded ketchup in early 2006.

10. Overall, we considered that the chances of sustainable branded entry into the retail ketchup market would be small. We obtained data from AC Nielsen across various grocery categories regarding the number of new brands launched in 2003 that remained on the shelves at the end of 2005. This data is set out in Table 1.

Table 1 **Current status of new brands launched in 2003 in selected grocery categories**

Grocery category	*Number of new brand launches in 2003*	*Number of new brand launches in 2003 now discontinued*	*Number of new brand launches in 2003 still on the market*	*Percentage of new brand launches in 2003 still on the market*
Baked beans	3	2	1	33
Tinned pasta products	10	5	5	50
Condiments	7	6	1	14
Canned vegetables	12	11	1	8
Smoothies	7	6	1	14

Source: AC Nielsen.

11. This data indicated that, even in rapidly developing grocery categories with lots of new product introduction, most manufacturers attempting to enter with new brands failed. The same pattern was repeated in most other grocery categories of relevance to table sauces such as ketchup (and to baked beans), except for tinned pasta, in which category half of the new brands launched in 2003 remained on the shelves at the end of 2005.

12. We considered that entry into the supply of own-label ketchup would be easier than entry into branded supply. Entry would depend on a manufacturer winning a contract with a retailer for the supply of own-label ketchup.[3] We saw evidence that retailers periodically retendered their own label supply contracts and did switch their business between own-label manufacturers. We were told that production could relatively easily be switched between ketchup, brown sauce and barbecue sauce.

Buyer power in the food service sector

13. We noted that a majority of total food service sales were made to large distributors and only 19 per cent of sales were direct to food service end user customers such as restaurants, pubs, hospitals and schools. Heinz told us that its top five food service customers accounted for [✂] per cent of its food service sales. We therefore considered that it was possible that price increases could be resisted. Wholesalers might be able to resist price increases by retendering and direct customers might be able to avoid price increases by switching from direct supply to buying their products from wholesalers, although this would depend on the ease with which they could switch between suppliers (see paragraph 16). We saw some evidence that customers were able to (and did) source directly from one or more suppliers.[4]

14. One manufacturer [✂] told us that it was ceasing the production of tomato sauce and brown sauce for the food service sector as pricing pressure from buyers meant that it was unprofitable for them to continue operating. Heinz told us that prices had been

[3]The periodic retendering of own-label supply contracts by retailers also gives existing own-label manufacturers the opportunity to expand production.
[4]For example, Whitbread told us that it sourced from [✂], and sourced centrally for all its restaurant and pub chains.

falling for the relevant products in the food service sector and that it had to offer lower prices to prevent contracts from being lost to competitors. Although Heinz stated that there was low transparency in the food service market and suppliers were unable to monitor each other's prices, Heinz also told us that its level of pricing was dictated by the pricing of own-label sachet sellers.

15. Another sachet supplier [✂] told us that the price difference between its products and Heinz products had eroded over the last five years. It also submitted that [✂]. The supplier told us that it considered that customers were in a strong enough position to resist attempts by one company to monopolize an area.

16. We examined the importance of branding to food service customers in relation to the relevant products. If brands played an important role, this might reduce the ease with which customers could switch between suppliers and might serve to lessen buyer power. However, we did not think this was the case because:

- brands will not be visible to consumers when products are used back of house (ie in the kitchen) in the food service sector;[5]
- we were told that food service end-user customers often required table sauces for both front of house and back of house usage. They may therefore be prepared to use unbranded products for both front of house and back of house use to simplify their purchasing arrangements;
- we heard evidence that consumers did not choose their eating establishment based on the type of table sauce provided. We therefore considered that consumer preferences for branded sachets and bottles on their own were unlikely to be sufficient to force most end user customers to purchase branded products;
- Heinz told us that only a very small percentage of sales were to customers willing to pay a premium for a brand in food service and that, in its view, all customers were willing to switch between branded and unbranded products;
- 27 per cent of food service sales are to the institutional sector, for example supplying food to prisons, healthcare and educational establishments where the emphasis is likely to be on cost rather than on branding; and
- one food service end user customer [✂] told us that, while Heinz ketchup and beans commanded a price premium of up to 20 per cent over unbranded products, it could switch to own label if price became an issue. Although this customer currently paid more for Heinz beans because of guest feedback and the marketing spend offered by Heinz, it did consider that alternative unbranded options were available.

[5]Using AC Nielsen data, Heinz estimated that 37 per cent of sales to the food service sector were sachets and 63 per cent were in bulk (of which 8 percentage points were table top bottles). We considered that this indicated that a minimum of 45 per cent of sauce sales to the food service sector were front of house sales (ie 37+8 per cent), but noted that it could be higher since bulk sales may also be decanted into other receptacles for front of house use. On the other hand, AC Nielsen data only covers a proportion of wholesalers that collectively cover about 30 per cent of the food service market. It does not cover institutions that may buy directly from suppliers such as prisons and hospitals and which arguably have a lower requirement than commercial food service customers for sauce sachets. This could mean that the AC Nielsen data over-estimates the proportion of sachet sales in the food service sector.

Market entry in the food service sector

17. Heinz submitted that new market entry to the food service sector was frequent as there were low barriers to entry, no need to build brand loyalty and ready access to distribution via wholesaling. Heinz told us that there were low barriers to entry for both front of house and back of house sales and pointed to the large number of manufacturers operating in the food service sector. As an example, Heinz noted that Aimia had no sauce business in the UK five years ago and now supplied to 3663, Coronet (which Heinz claimed was the second largest UK sauce sachet contract), the NHS and the MOD.

18. Evidence from other parties also suggested that market entry would be possible. [✄] told us that entry costs would depend on entry strategy. It said that, to produce half a dozen key products, a company would need to buy three machines at a cost of around £150,000 each, but that at the moment the market was not profitable enough to attract much entry and that branded entry would cost more. It noted that it had the capacity to significantly increase its production if necessary. Another food service supplier told us that it was considering buying and distributing bottles for the food service market and that it currently also had significant spare capacity. It felt that, as the market was in its view so competitive, the capital investment required for market entry might not be worthwhile.

19. A food service customer told us that, in its view, there would be opportunities for entry given that companies could switch between branded and own-label products. It told us that it was constantly contacted by new suppliers and would be happy to place its business with manufacturers outside the UK.