

GREIF INC/BLAGDEN PACKAGING MERGER INQUIRY

Provisional findings report

Published: 19 June 2007

The Competition Commission has excluded from this published version of the provisional findings report information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by ✂.

Acquisition by Greif Inc of the steel drum and closures business of Blagden Packaging Group

Contents

	<i>Page</i>
Summary.....	4
Provisional findings	9
1. The reference.....	9
2. The companies.....	9
Greif Inc.....	9
Blagden.....	10
3. The merger and the relevant merger situation	11
Outline of merger situation	11
The rationale for the merger.....	12
Interim measures	13
Jurisdiction	13
4. The industry	14
Suppliers of industrial packaging	14
Industrial packaging	16
Closures.....	20
5. Market definition.....	21
Product market.....	22
Demand-side substitution	23
Alternative industrial packaging products	23
Factors affecting customers' choice of packaging	24
Previous switching behaviour	27
Supply-side substitution.....	31
Small steel drums and pails	31
Other packaging products.....	31
Conclusion on product market	32
Geographic market.....	33
Great Britain	33
Northern Ireland.....	33
Europe	34
Factors affecting switching to imported drums.....	35
Prices.....	36
Transport costs	37
Assessment	37
6. Counterfactual.....	40
7. Competition in the market	41
Market concentration.....	41
Features of the market.....	42
Reconditioned large steel drums	42
New large steel drums.....	43
History of switching.....	44
Pre-merger competition between Greif and Blagden	44
Competition for customers by Metal Drum, Ramsden and Whale and AW Stokes	46
Pricing.....	47
Suppliers' costs	49
8. Assessment of the competitive effects of the merger	52
Removal of Blagden.....	52
Other competitive constraints.....	53
Entry or expansion.....	53
Independent entry	53

Independent expansion	54
Sponsored entry or expansion	56
Countervailing buyer power	58
9. Provisional conclusions on the SLC test	59

Appendices

- A: Terms of reference and conduct of the inquiry
- B: Industrial packaging products
- C: Switching from new steel drums to alternatives
- D: Factors determining the alternatives to new large steel drums
- E: Evidence of transport costs and prices of new large steel drums produced in Continental Europe
- F: Competition in the market

Glossary

Summary

1. On 20 February 2007, the Office of Fair Trading (OFT) referred to the Competition Commission (CC), for investigation and report, the completed acquisition by Greif Inc (Greif) of the steel drum and closures business of Blagden Packaging Group. Our terms of reference are set out in Appendix A. We are required to publish our final report by 6 August 2007.
2. Greif is a listed company, with headquarters in the USA. Its UK subsidiary, Greif UK Limited (Greif UK), is the largest manufacturer of new large steel drums in the UK. Prior to the merger, the acquired businesses were owned by Belgium-based Blagden Group NV (Blagden Group), a leading producer of new and reconditioned drums in Europe. Blagden Group's UK new steel drum operation (Blagden) was the second-largest producer of new large steel drums in the UK.
3. On 30 November 2006, Greif acquired the new steel drums and closures businesses of Blagden Group for approximately €210 million. As a result of the transaction, Greif and the acquired businesses ceased to be distinct enterprises. The parties' combined share of supply of new large steel drums in the UK is 85 per cent, an increment of 32 per cent¹. We concluded that a relevant merger situation had been created.
4. The parties overlap in the supply of new large steel drums and closures. New large steel drums are the most popular form of rigid large industrial packaging. They are used in a range of industry sectors to package, transport and store a variety of substances. Other forms of large industrial packaging include reconditioned large steel drums, large plastic drums and intermediate bulk containers (IBCs).

¹The share of supply test is different from the identification of market shares undertaken as part of the analysis of the competition in the relevant economic market (see paragraph 10).

5. Demand for new large steel drums in the UK has been declining for many years. We estimated that total UK sales had fallen by 13 per cent in the last five years, to 3.7 million in 2006. We heard that the decline was attributable partly to a decline in the demand for packaging overall and partly to switching to other packaging, particularly plastic drums and IBCs.
6. Closure systems are the mechanism by which the content of a drum can be pumped or poured in or out, and the drum resealed. We did not expect any competition concerns to arise in relation to the supply of closures. The market for closures appears to be global and the increment from the merger is small. We found no evidence that the merger would affect UK closure customers or the viability in the UK of other closure manufacturers. For these reasons, we did not consider closures further.
7. In relation to new large steel drums, we concluded that the product market was new and reconditioned large steel drums. We found evidence of both some past switching and some switching costs to other alternatives such as large plastic drums, IBCs and bulk transport. Different customers (and, indeed, individual customers in relation to the different uses they made of new large steel drums) had different propensities to switch. We noted that significant increases in the price differentials between large steel drums and plastic packaging products in the past had not resulted in the level of switching that we might expect of close substitutes, even when taking into account the fact that these increases may be viewed by customers as transitory. These indicators led us to the view that a hypothetical monopolist of large steel drum products could rely on the 'stickiness' of enough of its customers (and indeed the existence of some customers who would have no alternative at all) to make a small but significant price increase profitable.

8. We concluded that the geographic market primarily affected by the merger was Great Britain. We did not consider in detail how to define the market for the supply to customers in Northern Ireland, as the effect of the merger in Northern Ireland will be linked to the effect in Great Britain. We excluded imports from neighbouring countries because, despite lower prices for steel drums in Continental Europe, higher transport costs meant that imports were not a close enough substitute for Great-Britain-produced drums. We calculated that prices in Continental Europe would have to be at least 9 per cent cheaper than in Great Britain, but did not find evidence of such a wide price differential.
9. We assessed the competitive effects of the merger on the basis that Blagden and Greif would have continued in competition with each other in similar conditions to those that existed prior to the merger. Although we accepted that, in the absence of the acquisition by Greif, it may be that Blagden would have changed ownership anyway, we did not think that any existing UK manufacturer of new large steel drums would have acquired it. Having excluded that possibility, we found no evidence that indicated to us that either party would have altered its strategy over the next two or three years.
10. We considered rivalry in the relevant market prior to the merger and found that the market was highly concentrated. We considered the merging parties' own information on their customers' switching behaviour. For each of Greif and Blagden, we found that more custom was lost to the other than to any other single alternative (either another type of packaging or another supplier of new large steel drums).
11. We found evidence that reconditioned drum suppliers exerted only a limited constraint on behaviour because there were shortages in the supply of their raw materials and they would not be able to increase their share of the market. Although

we found that all manufacturers of new large steel drums had spare capacity, the evidence indicated that the merged parties had lower variable costs, in particular as a result of lower steel costs per unit than those of their rivals. In light of the evidence on rivalry, we considered that Blagden was the main constraint on Greif's pricing prior to the merger.

12. We considered that the merger would result in the loss of Greif's strongest competitor, who had imposed the greatest constraint on Greif pre-merger. The merged company would account for between 50 and 60 per cent of the market for new and reconditioned large steel drums in Great Britain. In order to decide whether this would result in a substantial lessening of competition, we considered whether there were other possible constraints that would mitigate the loss of Blagden and prevent the merged entity exercising market power by, for example, raising prices to some or all customers. We considered whether the loss might be offset by entry or expansion in the market, and/or buyer power.

13. With regard to entry or expansion, we considered three possible scenarios:
 - (a) *Independent entry* was unlikely as we found that there would be significant costs for any new entrant, including those companies with a UK manufacturing base in other industrial packaging products and new steel drum production overseas, and uncertain returns in a declining market.
 - (b) *Independent expansion* by one or more of the smaller suppliers of new large steel drums could occur. However, we found that increased use of existing plant (by incremental improvements or additional shifts) would not mitigate the loss of Blagden. The smaller suppliers produce on a higher cost-per-drum basis, and therefore this additional capacity would only constrain Greif's ability to raise prices above those of the remaining small suppliers. In light of the costs and risk associated with such a strategy, we did not consider that any of the smaller

suppliers was likely to undertake a transformation of its business to operate on a similar cost-per-drum basis to that enjoyed by Blagden.

(c) *Sponsored entry or expansion* was not a credible threat because very few customers accounted for a sufficient amount of sales to consider such a strategy, and Greif could easily identify and offer lower prices to these customers, thus removing any incentive to follow such a strategy.

14. We considered whether there was sufficient buyer power to countervail the loss of Blagden as a competitor. We were not persuaded that larger buyers would be able to exert power because we do not believe that threats to sponsor entry or expansion, or to take away business from Greif in other parts of the world, would constrain Greif's behaviour towards all UK customers.
15. For these reasons, we provisionally concluded that the merger may be expected to lead to a substantial lessening of competition in the market for new and reconditioned large steel drums in Great Britain.

Provisional findings

1. The reference

- 1.1 On 20 February 2007, the OFT referred the completed acquisition of the steel drum and closures business of Blagden Packaging Group, comprising various subsidiaries of Blagden Group NV,² by various subsidiaries³ of Greif Inc (Greif), to the CC for investigation and report. The reference was made under section 22 of the Enterprise Act 2002 (the Act). Our terms of reference are contained in Appendix A. We are required to publish our final report by 6 August 2007.
- 1.2 This report constitutes our provisional findings which we are required to notify to the main parties under the CC's Rules of Procedure.⁴ Further information, including non-confidential versions of main party and third party evidence, and details of a survey of the main parties' customers conducted by the CC (the customer survey), can be found on our website.⁵

2. The companies

Greif Inc

- 2.1 Greif is incorporated in Delaware, USA, and its shares are listed on the New York Stock Exchange. Its turnover for the year to 31 October 2006 was \$2.6 billion.
- 2.2 Greif was founded in Ohio in 1877, originally as a barrel maker. During the 20th century, it expanded and diversified into various other forms of industrial packaging. It is organized into three divisions: Industrial Packaging and Services (including steel, plastic and fibre drums, closures and IBCs); Paper, Packaging and Services (containerboard, corrugated sheets and multiwall bags); and Timber Properties (ie

²Blagden France Holdings SAS, Blagden Packaging NV, Blagden Packaging Tournai NV, Blagden Packaging Femba Ibérica SL, Blagden Packaging Singapore Pte Ltd, Bipol Sib Co Ltd and certain assets of Blagden Packaging Bederland BV.

³Greif Belgium BVBA, Greif Bros Canada Inc, Greif France Holdings SAS, Greif International Holding BV, Greif Nederland BV and Paauw Holdings BV.

⁴CC: *Rules of Procedure*, CC1. Paragraph 10.3.

⁵www.competition-commission.org.uk.

forests). It now has manufacturing facilities in over 40 countries. In the UK it produces a range of industrial packaging products, including large, intermediate and special new steel drums, small blow-moulded plastic drums and polycarbonate water bottles.

- 2.3 Greif expanded into Europe in 2001 with the purchase of the industrial packaging business of Royal Packaging Industries Van Leer NV, which was renamed Greif International Holding BV. Greif's UK operations are managed by Greif UK Ltd (Greif UK), a subsidiary of Greif International Holding BV. Greif UK is the largest manufacturer of new large steel drums (typically 210l capacity) in the UK. In 2003, Greif acquired the third-largest UK producer of new large steel drums, T&D Packaging Ltd (T&D). Greif absorbed the additional volume on its existing UK manufacturing lines and closed the T&D facility. Greif UK currently operates sites at Ellesmere Port, Hull and Burton-on-Trent. In the year to 31 October 2006, Greif UK sold [x] new large steel drums with a sales value of £[x].

Blagden

- 2.4 Blagden Group NV (Blagden Group), a company registered in Belgium, was a leading producer of new and reconditioned steel drums in Europe. It started reconditioning drums in the 1920s and commenced new steel drum production in 1948.
- 2.5 Following restructuring in 1998, Blagden Group was sold to a management team led by the CEO, Marc Verstraete. After further restructuring in February 2004, the ownership was split between Alchemy Investment Partners (Alchemy) (75 per cent) and Blagden Group management (25 per cent).

- 2.6 Since 1998, Blagden Group has pursued a strategy of expansion by acquisition throughout Europe, acquiring reconditioning companies in Germany, France and Spain and a new drum company in Belgium. In March 2006, it purchased the container and closure business of the Hong Leong Group, which has operations in China, Malaysia and Singapore.
- 2.7 Greif acquired the new steel drums and closures businesses of Blagden Group, which produced new steel drums and closure systems in Europe and Asia. The acquisition included the UK new steel drum operations (Blagden) which were part of the business of a UK branch of a Belgian subsidiary, Blagden Packaging NV. Prior to the merger, Blagden was the second-largest producer of new large steel drums in the UK, operating from a site at Trafford Park, Manchester. In the 11 months ended 30 November 2006, Blagden produced [X] large steel drums with a sales value of £[X].

3. The merger and the relevant merger situation

Outline of merger situation

- 3.1 On 30 November 2006, Greif acquired shares and assets of parts of the Blagden Packaging Group. The transaction involved various subsidiaries of Greif located in Continental Europe and Canada acquiring the entire issued share capitals of five Blagden Packaging Group companies,⁶ together with their respective subsidiaries. Greif also acquired Blagden Packaging Group's interests in two Russian joint ventures⁷ and assets relating to certain drum operations of Blagden Packaging Nederland BV.

⁶Blagden France Holdings SAS, Blagden Packaging NV, Blagden Packaging Tournai NV, Blagden Packaging Femba Iberica SL, and Blagden Packaging Singapore Pte.

⁷Bipol Co Ltd and Bipol Sib Co Ltd.

- 3.2 Consideration for the deal was approximately €210 million. The consideration was apportioned between the acquired businesses; the consideration for Blagden Packaging NV (which includes the UK branch) was €[REDACTED]. At the time of the merger, the net assets of the new steel drums business of the UK branch of Blagden Packaging NV were approximately £[REDACTED], including £[REDACTED] of goodwill.
- 3.3 The transaction described above was the second stage of a ‘back-to-back’ deal. An initial offer by Greif was rejected because it was for only the new steel drum and closures business and not the whole Blagden Packaging Group. The Blagden Group management later approached Alchemy with the ‘back-to-back’ deal (which involved a management buyout of Blagden Packaging NV followed by an immediate sale of the new steel drum and closures business to Greif), which was accepted. The remaining reconditioning and recycling businesses are now owned by a new Netherlands-registered company, pack2pack Group NV (pack2pack).
- 3.4 The share and assets sale agreement contains a number of non-compete clauses. In addition, Greif and pack2pack have entered into a preferred partnership agreement which involves development of a joint marketing plan, cross-promotion of each other’s businesses, and [REDACTED] from each other’s customers.

The rationale for the merger

- 3.5 Greif said that its rationale for the merger was to reduce costs, through efficiencies and synergies such as reducing overheads and increasing its purchasing power in the procurement of steel; and to enable it to improve steel drum technology. It said that these steps were necessary to enable steel drums to continue to compete effectively with other forms of industrial packaging, particularly plastic drums and IBCs. Greif told us that the production and supply of new steel drums in the UK was

characterized by significant excess capacity, declining demand, low margins and competition from plastic drums, IBCs and potentially from imports.

Interim measures

3.6 On 28 December 2006, the OFT accepted interim undertakings under section 71(2) of the Act from Greif International Holding BV and Greif UK to prevent Greif from taking any action which might prejudice any investigation. When the merger was referred in February 2007, the CC adopted those interim undertakings. We considered requests from Greif for variation of those undertakings as well as whether other changes to the undertakings were necessary to prevent pre-emptive action (as defined by section 80(10) of the Act) by the parties. As a result, on 30 April 2007, the CC accepted revised undertakings given by Greif, and its subsidiaries Greif International Holding BV and Greif UK, in accordance with section 80(2) of the Act.

Jurisdiction

3.7 Under section 22 of the Act, the CC is required to decide whether a relevant merger situation has been created. A relevant merger situation is created where two or more enterprises have ceased to be distinct and either the share of supply test or the turnover test specified in the Act is satisfied.

3.8 The transaction described in paragraph 3.1 has resulted in Greif and the acquired businesses ceasing to be distinct, as defined in section 26 of the Act. The share of supply test in section 23(b) of the Act is satisfied as a result of the addition of Blagden's 32 per cent share to Greif's 53 per cent share of supply of new large steel

drums in the UK.⁸ We therefore conclude that there is a relevant merger situation.

This was not disputed by any party during the course of our inquiry.

4. The industry

Suppliers of industrial packaging

4.1 Several companies supply industrial packaging products in the UK. Table 1 lists UK manufacturers of new large steel drums, as well as examples of other suppliers of large rigid packaging in the UK (both UK produced and imported).

TABLE 1 **Selected suppliers of large rigid industrial packaging in the UK**

<i>Company</i>	<i>UK manufacturer of large steel drums*</i>	<i>UK reconditioner of large steel drums</i>	<i>UK manufacturer of large plastic drums†</i>	<i>UK manufacturer of IBCs</i>	<i>UK distributor of large rigid industrial packaging‡</i>
AW Stokes and Son (Drums) Ltd	✓	x	x	x	x
Blagden	✓	x	x	x	x
Greif UK	✓	x	x	x	✓
Harcostar Drums Ltd	x	x	✓	x	x
H W Stockley & Sons Ltd	x	✓	x	x	✓
James G Carrick & Co Ltd	x	x	x	x	✓
Mauser UK Ltd	x	x	✓	✓	x
The Metal Drum Company Ltd	✓	x	x	x	x
pack2pack	x	✓	x	x	x
Ramsden & Whale Ltd	✓	✓	x	x	x
Schütz (UK) Ltd	x	x	✓§	✓	x
Sulo	x	x	x	x	✓
Tycon Containers (Services) Ltd	x	x	x	x	✓

Source: Industrial Packaging Association (IPA) website and the companies.

*Steel drums with a typical capacity of 210 litres and a maximum capacity of 250 litres.

†Plastic drums with a typical capacity of 210 litres and a maximum capacity of 250 litres.

‡In this column, we show whether the company distributes products other than those produced in-house in the UK—ie by distributing products manufactured by others in the UK or importing their own or others' products from manufacturing facilities outside the UK.

§Schutz told us that manufacture in the UK of plastic drums was imminent (see paragraph 4.4).

4.2 In addition to Greif and Blagden, there are three other significant producers of new large steel drums, which all manufacture a range of new large steel drums: AW Stokes and Son (Drums) Ltd (AW Stokes), The Metal Drum Company Ltd (Metal Drum) and Ramsden and Whale Ltd (Ramsden and Whale). These are private

⁸The share of supply test is different from the identification of market shares undertaken as part of the analysis of the competition in the relevant economic market (in section 7 of this report). See *Merger References: Competition Commission Guidelines*, CC2, paragraphs 1.17 and 1.18.

companies, typically selling to smaller customers, and with no operations outside the UK.

- 4.3 pack2pack is a privately-owned company comprising the reconditioning operations of the Blagden Group. pack2pack (see paragraph 3.3) is the largest steel drum reconditioner in the UK. Ramsden and Whale also reconditions drums.
- 4.4 Plastic drums and IBCs are also manufactured in the UK. Harcostar Drums Ltd (Harcostar), a manufacturer of large plastic drums, is part of the Dutch company Bulk Packaging Group BV. Mauser UK Ltd (Mauser) is part of Mauser AG (Mauser Group), a private-equity-owned producer of industrial packaging with headquarters in Germany and operations in various countries around the world producing steel drums, IBCs and plastic drums. In the UK, Mauser manufactures IBCs and large plastic drums. Schütz (UK) Ltd (Schütz) is part of Schütz GmbH und Co. (Schütz Group), a private German company operating in various industries including industrial packaging (producing steel drums, plastic drums and IBCs). In the UK, Schütz produces IBCs and the company told us that the production of large plastic drums was imminent.
- 4.5 Large steel drums manufactured outside the UK are available direct from the manufacturer or through agents or distributors. Sulo Emballagen GmbH & Co KG, a German manufacturer of new large steel drums (part of the Sulo Group), for example, has a UK agent. Various companies, such as Tycon Containers (Services) Ltd and H W Stockley & Sons Ltd, stock and distribute steel drums, plastic drums and IBCs. James G Carrick & Co Ltd, a private company that distributes drums and other packaging, told us that it had the ability to manufacture large steel drums in small quantities (up to [X] per year), [X].

Industrial packaging

- 4.6 Industrial packaging is used in a range of industry sectors, including chemicals, petrochemicals, pharmaceuticals, food, coatings and resins. Many new large steel drum customers also use a range of other industrial packaging products, including reconditioned large steel drums, large plastic drums and IBCs⁹ as well as less close alternatives such as fibre drums. Bulk transport is also used. A description of various different types of industrial packaging products is at Appendix B.
- 4.7 We were told by the parties that there had been an overall fall in the demand for rigid large industrial packaging (large steel, plastic and fibre drums and IBCs), and for steel drums in particular, because of an ongoing decline in the manufacturing base in the UK. This trend of declining demand for steel drums and large industrial packaging in general was confirmed by many sources in the industry.
- 4.8 The parties told us that this trend reduced the customer base in the UK and that it was likely to continue. Greif told us that the products which were most likely to be packed in a steel container tended to be of the hydrocarbon-based solvent type and the chlorinated hydrocarbons. It initially told us that demand for these types of chemicals was declining because of wider environmental considerations. Subsequently, Greif said that the decline in the UK chemicals industry may have been overstated and suggested that declining UK demand for large industrial packaging indicated movement to bulk transport. It said that there was a trend for chemical companies to ship product by tanker to a preferred location (eg low labour cost regions) where it would then be filled into drums and distributed, rather than filled into drums at the site of manufacture, although it did not quantify this trend towards increasing use of bulk transport.

⁹In this report, generally we use the term IBC to refer to composite IBCs.

- 4.9 Greif told us that the large steel drum had been in use for over 80 years and was now approaching the end of its life cycle. It said that alternative types of industrial packaging products had been developed in recent years which offered similar performance but with advantages such as more efficient supply chain management and lower transportation costs. [✂]
- 4.10 Greif provided us with its estimates of UK sales for IBCs, new large steel drums, fibre drums, reconditioned large steel drums and large plastic drums in 2001 and in 2006.¹⁰ These suggest that sales of IBCs and large plastic drums have increased, whilst the volumes of fibre drums and of new and reconditioned large steel drums have declined, and that the overall demand for large packaging has declined by [✂] between 2001 and 2006.
- 4.11 However, we have some reservations about Greif's estimates. Greif's estimates of the growth in sales of large plastic drums are higher than those of Harcostar (the leading plastic drum manufacturer in the UK) and the IPA. Our concerns about the data lead us to interpret it with caution: the decline in volumes of large steel drums relative to large plastic drums may be less than shown.
- 4.12 There are no authoritative industry figures for the full range of industrial packaging products.¹¹ We obtained estimates of sales of large industrial packaging for recent years (2003 to 2006) through the IPA. These estimates are shown in Table 2.

¹⁰Greif's estimates are presented in Appendix C, Figure 6.

¹¹The IPA compiles some data on UK sales of steel drums, reconditioned drums, plastic drums and IBCs. This does not always include all manufacturers, and the data on plastic drum sales covers the period until the end of 2004 only.

TABLE 2 Annual sales of large packaging, 2003 to 2006

	'000 drums sold			
	2003	2004	2005	2006
New large steel drums				
Reconditioned steel drums				
IBCs*		✂		
Large plastic drums			†	†
Total				

Source: CC, based on data provided by steel drum manufacturers and the IPA.

*The unit for IBC sales is [Number of IBCs sold *5].

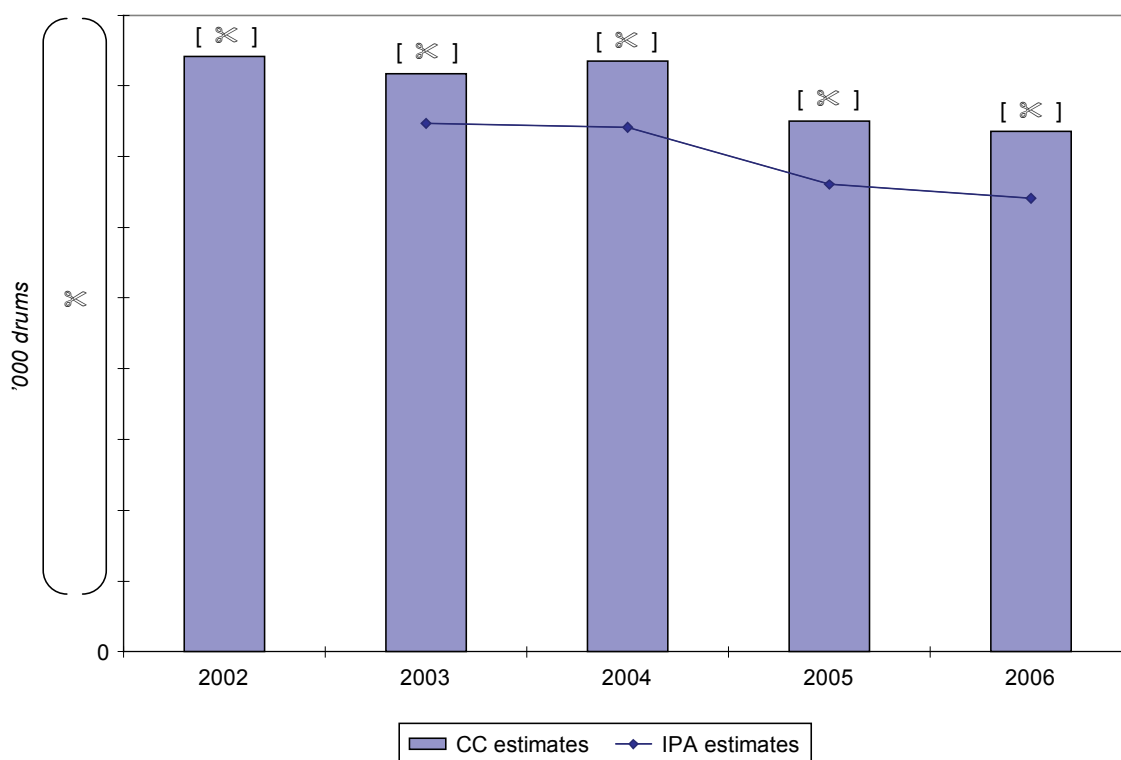
†The IPA did not compile data on sales of large plastic drums in 2005 and 2006; these figures are based on what we were told by the IPA and Harcostar of a flat market and by Greif of sales of around [✂] in 2006.

4.13 These estimates show a 7 per cent decline in total sales of rigid large industrial packaging between 2003 and 2006, attributable to a fall in new and reconditioned drum sales, whilst IBC and plastic drums sales have increased slowly.

4.14 In relation to large steel drums, figures for UK sales from the European Association of Steel Drum Manufacturers show a significant decline over a 12-year period (1994 to 2005). This is shown in Appendix C, Figure 4. We compiled our own estimates of sales of new large steel drums in the UK for the past five years, by asking each manufacturer for its annual sales of large steel drums (see Figure 1). We believe that our estimates are the most reliable, as these include sales by all UK manufacturers, whereas the data that we also obtained from the IPA does not include sales by Ramsden and Whale and AW Stokes. Our calculations show that total UK sales of new large steel drums were [✂] million drums in 2006. Between 2002 and 2006, total sales of new large steel drums fell by [✂] per cent. Most of the decline in sales took place in 2005. The IPA data shows similar trends, although its estimate of total market size is lower.

FIGURE 1

UK sales of new large steel drums, 2002 to 2006



Source: CC, based on data from UK manufacturers of steel drums and from the IPA.

4.15 Prices of steel drums have been increasing since the beginning of 2002, driven by large increases in the price of steel which is the main input to the production of steel drums. The largest increases in steel prices and in steel drum prices occurred in 2004, and these were followed by a decline in steel drum sales in 2005.

4.16 Large steel drums remain the most popular form of rigid large industrial packaging. According to the estimates provided by Greif, large steel drums (including re-conditioned drums) account for [%] of total volumes sold of large industrial packaging; IBCs account for about [%] of volumes sold (in terms of drum-equivalent volumes). Large plastic and fibre drum sales are small compared with sales of large steel drums and IBCs: large plastic drums account for [%] of volumes sold and fibre drums account for [%] of volumes sold.

- 4.17 The evidence is unclear on whether the move to IBCs and plastic drums is continuing or whether it has stabilized. The recent entry by Mauser Group into UK production of large plastic drums and IBCs, and by Schütz Group into UK production of large plastic drums, might imply potential for growth in these types of packaging, perhaps from customers switching from new large steel drums.¹²
- 4.18 Overall, it is clear that there has been a decline in sales of steel drums in the past ten years, partly attributable to an overall decline in the demand for rigid large industrial packaging and partly to switching to other packaging, notably plastic drums and IBCs. The evidence on switching is further discussed in Appendix C.

Closures

- 4.19 Closure systems are the mechanism by which the contents of a drum can be manageably pumped or poured in and out, and the drum resealed. Greif owns the Tri-Sure group of companies, which manufactures closures in Europe, Asia and South America and has a minority interest in two other companies that produce closures in India. It estimated that its pre-merger share of total worldwide production was 50-60 per cent. The acquired businesses include Rex, which manufactures closures in China. Greif estimated that Rex had approximately 0-10 per cent of the world market share. Neither party manufactures closures in the UK, although Greif supplies Tri-Sure closures in the UK.
- 4.20 The market for closures appears to be global. Transport and storage costs are low relative to the value of closures and the UK is supplied by manufacturers from around the world. The increment from the merger is small and we did not receive any evidence which suggested that UK customers would be affected by the change. We

¹²Mauser told us that its entry was at least partly motivated by a need to replace current imports of IBCs (although this would use only around 40 per cent of its new capacity). Schütz indicated that, while it had been planning to establish production in the UK for some time, the timing of its launch now had been prompted by Mauser's move.

also considered whether there was a risk of foreclosure of the UK to independent closure manufacturers if Blagden switched to sourcing its closures in-house following the merger. However, the costs associated with supplying closures in the UK are not dependent on Blagden's volumes. We would not expect any action by Blagden to affect the viability of other closure manufacturers.

5. Market definition

5.1 For the remainder of this report, we consider only the supply of new steel drums in the UK. In defining the market, we identify the relevant product market and then the geographic market. We seek to identify the extent to which customers would switch between substitute products (demand-side substitution), or suppliers would switch their facilities between the supply of alternative products (supply-side substitution) in response to a small but significant price increase by a hypothetical monopolist. The approach is described in the CC's guidance.¹³

5.2 Generally, a product or a group of products will constitute a market if a hypothetical monopolist could profitably raise prices by 5 per cent or more. The profitability of a price rise is related to the costs of production and to margins: the higher the marginal cost of production, the higher the savings in costs for any given loss of volumes. In the case of steel drums, variable costs are relatively high. The cost of steel alone accounts for 35-50 per cent of the price of steel drums. Therefore, we expect that the critical level of lost sales that would render a price rise unprofitable would also be relatively high. Based on its cost structure at current production levels, Greif estimated that a 5 per cent increase in price would be unprofitable if it lost around [X] per cent of units sold. Our analysis of Greif's 2006 costs confirmed that this figure was reasonable. We estimate that the critical loss is around [X] to [X] per cent of volumes.

¹³Merger References: Competition Commission Guidelines, CC2.

Product market

- 5.3 Greif submitted that the relevant product market was wider than new large steel drums, and extended to industrial packaging more generally, including at least new and reconditioned large steel drums, large plastic drums and IBCs. Greif said that other forms of industrial packaging such as fibre drums and bulk packaging, whilst not close enough substitutes to form part of the same relevant market, were a substitute for some customers and so acted as a constraint on steel drum prices.
- 5.4 We first considered whether the relevant market is smaller than new large steel drums. The different types and specifications of steel drums are described in Appendix B. Plain tight-head drums are by far the most common type of drum, accounting for more than half of the large steel drums sold by Greif and Blagden in the UK. There does not appear to be any potential for demand-side substitution between open-head and tight-head drums, or between lacquered and plain drums, as the type of drum used will be determined by the nature of the substance being packaged in the drum.
- 5.5 There is, however, strong evidence of supply-side substitution between the four main types of large steel drums. The product range of all UK manufacturers of large steel drums spans the four main types, and the different types are produced on the same production lines, using the same core processes. In view of the evidence of supply-side substitution, we conclude that the product market is not narrower than new large steel drums. Nonetheless, we note that, because of limited demand-side substitution between types of drums, manufacturers could price discriminate between the different types. This means that, if a competitive constraint applied to one type of drum but not to another, manufacturers may still be able to increase prices for certain types of drums profitably. Price discrimination is discussed further in paragraphs 7.20 to 7.24.

- 5.6 We now consider whether the market is wider than new large steel drums, looking at the potential for demand-side substitution and for supply-side substitution.

Demand-side substitution

- 5.7 In order to assess (within the hypothetical monopolist framework) the amount of business that would switch from new large steel drums in response to a price rise, we first assess the *potential* for switching by considering evidence of the alternatives available to customers. We then assess the *likelihood* of switching by considering the factors which might influence a decision to switch to these alternatives, and the evidence on previous switching.

Alternative industrial packaging products

- 5.8 Greif told us initially that it considered that all customers for new large steel drums could use some alternative packaging; the majority could use various types of plastic drums or IBCs and technical advances for plastic drums meant that the percentage of customers for whom this was an option was increasing. Further, customers who required steel packaging could use reconditioned steel drums or steel IBCs.
- 5.9 Customers and suppliers suggested that the range of industrial containers that was available for packaging a particular product depended on two factors: the regulations on the transport of dangerous goods, and the compatibility of the substance to be packaged with different packaging materials. These issues are discussed further in Appendix D.
- 5.10 The evidence we received indicates that there are some substances currently packed in new large steel drums for which there is no alternative packaging available. There is no easy way to quantify the extent to which this is due purely to packaging

regulations but it is clear that only a small number of customers will be entirely constrained by the rules. The more frequent determinant appears to be compatibility.

5.11 We have considered various analyses and estimates of the extent to which substances are tied to large steel drums. These show a range of results. Greif told us that [X] per cent of its 40 largest customers were able to use alternative packaging for at least some of their requirements and that alternative packaging was available for [X] per cent of Greif's sales to its top 40 customers. The customer survey suggested that around one-third of users were unable to switch from new large steel drums. It is clear from the evidence taken as a whole that regulation and chemical compatibility do not, on their own, prevent the majority of customers from switching to other packaging. Even where customers cannot switch for certain applications, the ability of those or other customers to switch for other applications could in principle constrain a supplier from raising prices of large steel drums for any application.

5.12 The key issue for market definition is how much marginal custom would switch to alternative packaging products in response to a small but sustained rise in the price of steel drums. To make this assessment, we need to consider both the factors affecting customers' decisions to switch where alternatives are available, and the evidence on past switching.

Factors affecting customers' choice of packaging

5.13 Even when there are practical alternatives to new large steel drums, a number of factors may affect a customer's decision whether to switch in response to a price rise. We have heard from a range of customers and others that the considerations include:

- the cost of adapting or changing their own handling and filling equipment;

- the perception of customers that steel drums are safer and structurally stronger for stacking during storage and transport, and any related costs (such as insurance premiums or special storage requirements);
- end-user preferences for a specific type of industrial packaging, which in part depends on the facilities available to the end-user for handling and storing containers, but also on the quantity of the packed products required by end-users;
- the importance to the customer and end-user of labelling and appearance; and
- the cost of holding stocks of packaging, which depends on delivery lead times and on the reliability of supply.

5.14 We discuss the factors affecting the decision to switch from large steel drums for different customers for each of the most likely substitutes to new large steel drums (reconditioned drums, large plastic drums, IBCs) in paragraphs 43 to 68 of Appendix C. We summarize the points raised below.

5.15 The majority of respondents to the customer survey identified some barriers to switching to alternative materials. The main barriers (ie issues that would affect their propensity to switch) identified were product requirements and end-user specifications and requirements.

5.16 Around 35 per cent of customers said that they could currently switch some of their orders to alternative packaging. By weighting each response by the respondent's reported expenditure, we estimated that around 15 per cent of annual expenditure could currently be switched to alternative packaging.

5.17 We heard that costs associated with filling and handling equipment would be a consideration in a switch to plastic drums or IBCs. Customers were likely to be influenced by their own costs and those of their customers. When compared with

switching to plastic drums, the one-off costs to customers of switching from steel drums to IBCs will be higher, but so too may be the longer-run savings. We did not hear of any one-off costs of switching in relation to reconditioned drums.

- 5.18 We heard that some customers with strong brand images preferred new large steel drums to any of the alternatives, and that this preference was often driven by the end-users' preferences.
- 5.19 Some concerns were relevant to only one alternative. For example, customers were concerned about the reliability of supply of reconditioned drums. Some additional safety concerns may arise in relation to IBCs, due to the increased risks associated with storing larger volumes of some dangerous substances.
- 5.20 Greif also told us that fibre drums and bulk packaging may be an alternative to new large steel drums for some customers. Indeed, the customer survey showed that between 11 and 20 per cent of respondents identified bulk as an alternative to steel drums, and between 0 and 7 per cent of customers identified fibre drums as an alternative to steel drums. Greif also provided a number of examples of customers who had chosen to switch to bulk packaging where possible and if volumes allowed.
- 5.21 However, the CC survey found that only one customer had switched to bulk and one to fibre at their latest switch, and we received little evidence from third parties to suggest that fibre drums and bulk were a substitute to large steel drums. Fibre drums are generally used for solids, powders, pastes and semi-liquid products rather than liquids (see Appendix B), which makes them unsuitable for most products which are packaged in steel drums.

5.22 A switch to bulk transport, when possible and where volumes allow it, would depend on a range of considerations, including volumes transported, costs of storage, the cost of labour at the end destination, and the location of end-users. The price of steel drums would be unlikely to be a major factor. We do not, therefore, think that a switch to bulk transport is likely to be prompted by small changes in the prices of steel drums relative to the price of shipping in bulk and filling drums at the destination.

Previous switching behaviour

5.23 Simply trying to quantify each of the switching costs identified or aggregate them across customers is not useful because the costs clearly vary from customer to customer. The issue we need to consider is how much custom would switch in response to a price rise. To make this assessment we need to consider what we heard on switching costs alongside the evidence on past switching.

5.24 The analysis of how customers have reacted in response to previous price changes is presented in Appendix C (paragraphs 10 to 48). We summarize here the main results from this analysis.

5.25 The customer survey found that new steel drum customers were price sensitive: there was some evidence of past switching to alternatives. 28 per cent of customers had replaced some steel drum orders with alternatives in the past 12 months. We also asked for estimates of the proportions of requirements switched to alternatives in the previous 12 months, for both each alternative and all alternatives. Combining these answers with reported annual expenditure of each respondent implied that, in the previous 12 months, 6 per cent of total order value was switched to alternatives. The main alternatives switched to were IBCs and reconditioned steel drums. Price was repeatedly mentioned as the main reason for switching.

- 5.26 The parties provided data on their customers switching to alternative packaging. The data provided by Greif showed losses to other types of packaging of between 0 and 10 per cent a year from 2003 to 2006. Greif's losses to other types of materials were lower than Greif's total losses to other new large steel drum manufacturers for the period 2004 to 2006. The data provided by Blagden showed that gains and losses to other materials were limited and most business was lost to, or gained from, competing steel drum suppliers.
- 5.27 Greif submitted an economic analysis on volumes of sales of steel drums in Europe. This analysis suggested that EU steel drum volumes tended to vary inversely with the relative price of steel and plastic. The paper attempted the same analysis for the UK. However, there was no clear relationship between changes in UK volumes and changes in the relative price of steel and plastic, although large increases in raw material prices sometimes coincided with periods of steeper decline in steel drum sales. Greif suggested that the lack of relationship may be due to an overall decline in the demand for packaging in the UK.
- 5.28 As discussed in Appendix C, Greif's analysis was limited by a lack of data on steel and plastic drum prices, and on volumes of plastic drums. In addition, there were limitations on the reliability of the data provided by SEFA on EU volumes of steel drums. For this reason, we undertook our own analysis of UK steel drum volumes.
- 5.29 We analysed the relationship between changes in new steel drum volumes in the UK between 2002 and 2006 and changes in the relative price of new steel drums, plastic drums, reconditioned drums and IBCs. This analysis is in paragraphs 10 to 32 of Appendix C. We found an inverse relationship between the change in the price of steel drums relative to plastic and changes in UK volumes of steel drums, with a one-year lag. The one-year lag is consistent with the existence of switching costs for

switching to alternative materials. However, it was not clear to what extent customers had switched to large plastic drums in response to price changes: the evidence we received suggested that large plastic drum sales had remained stable during the period when new large steel drum sales had decreased.

- 5.30 The relationship between changes in prices of IBCs and changes in prices of steel drums was less clear. Steel drum prices have increased relative to IBC prices throughout the period, but the estimates on the total growth of IBC sales suggest that only a small proportion of the steel drum sales lost were switched to IBCs.
- 5.31 We did not find a relationship between changes in the prices of new drums relative to the prices of reconditioned drums and the change in the relative volumes of new and reconditioned drums. We were told that the supply of reconditioned drums had been limited in recent years because of shortages in the availability of steel drums to be reconditioned (see also Appendix B, paragraph 11). This may explain why new steel drum volumes could not switch to reconditioned drums.
- 5.32 Overall, our analysis of UK steel drum volumes in Appendix C suggests that new steel drum sales have decreased following increases in new steel drum prices relative to plastic drum prices. However, the data also suggests that the substitution to plastic drums and to IBCs in response to past changes in relative prices has been lower than the critical loss level (which was calculated as [X] to [X] per cent loss in volume in response to a 5 per cent price increase). In 2004, new steel drum prices increased by 10 to 13 per cent relative to plastic, and this was followed by a 10 per cent fall in new steel drum volumes in 2005.
- 5.33 Part of this fall in volumes is likely to be due to a fall in overall UK demand for large packaging and a migration to less direct substitutes such as bulk packaging, rather

than to substitution to plastic drums and IBCs. The evidence suggests that the increase in IBC sales in 2005 was moderate compared with the fall in large steel drum volumes. Also the information we gathered from plastic manufacturers and from the IPA suggests that plastic drum sales have been broadly stable in the recent years. See further Appendix C.¹⁴

5.34 We also analysed the current differential between steel drum and plastic drum prices and how this compared with the differential in 2004, when it appeared to have caused a relatively large proportion of customers to switch away from large steel drums. Because of recent increases in plastic (HDPE) prices relative to steel, the gap between steel and plastic drum prices is currently at its lowest in four years. We found that, given current plastic and steel drum prices, steel drum prices could increase by more than 5 per cent before reaching the level of differential of 2004.

5.35 However, we note that the conditions post-merger are different from those where we have observed previous switching. First, customers' responses to price changes will not be the same at different levels of prices. As shown in Appendix C, the differential between steel and plastic drum prices increased in 2004, and decreased in 2006. Currently, the gap between steel and plastic drum prices is at its lowest in four years. The reaction of customers to small price rises above the current level may therefore be less than those observed after 2004 when steel drum prices were at their highest compared with plastic drum prices. Second, customers may react more to an increase in price that they perceive to be permanent (because it was driven by the exercise of market power) than to an increase that they may perceive to be temporary (because it was driven by increased input costs).

¹⁴The analysis covers a five-year period. Although no robust conclusion can be drawn from this analysis in terms of elasticities, the analysis does indicate the reaction of customers to past price increases.

5.36 In addition, we have heard from some third parties that many of the customers who could most easily and cheaply switch away from steel drums may have already done so. If this is correct, then the bulk of remaining customers of new large steel drums are likely to be less sensitive to small increases in price. However, developments in product range (eg improved suitability of plastic drums and IBCs for certain substances) may, in time, also alter switching behaviour.

Supply-side substitution

Small steel drums and pails

5.37 Greif told us that there was a high degree of similarity in the manufacturing process and the technical know-how used in the production of small steel drums and large steel drums, and noted that it produced both large and small steel drums. However, it acknowledged that a switch from the production of small drums to large drums would still require significant investment (upwards of £[REDACTED]). We do not, therefore, consider the production of small steel drums to be a close supply-side substitute.

Other packaging products

5.38 There does not appear to be any potential for supply-side substitution from the production of plastic drums, IBCs or any other packaging products to steel drums, since these are each produced using quite different manufacturing processes. Greif suggested that the examples of Ramsden and Whale and AW Stokes illustrated the potential for supply-side substitution from reconditioning drums to new steel drum production. However, there are few overlaps in the production processes for producing new drums and reconditioned drums. Ramsden and Whale said that although in terms of technical know-how there was some overlap, it had to purchase a separate production line when it started manufacturing new drums. Some parts of the production line were shared (eg painting), but most were separate. Ramsden and Whale told us that a switch from production of reconditioned drums to new drums

would require significant investment. We agree with this view and conclude that production of reconditioned drums is not a supply-side substitute.

Conclusion on product market

5.39 Reconditioned drums are a potential substitute for a wide range of new steel drum uses. For all but a few substances where contamination from residues might be a concern, the barriers to switching to reconditioned drums are low. There are no barriers linked to the handling of the drums.¹⁵

5.40 Regarding other alternative packaging, we found that:

(a) Large plastic drums and IBCs are alternatives to new steel drums for a number of customers, and developments in technology will over time increase the number of applications for which plastic drums are an alternative to steel drums.

(b) Some customers and third parties told us that a switch from steel drums to plastic drums or IBCs was costly and difficult; one of the main difficulties identified was end-user resistance to a change in packaging.

(c) Many customers in our survey identified some costs to switching to alternatives. We estimated from the survey that around 15 per cent of orders could currently be switched to alternative containers.

(d) There has been large-scale switching from steel drums to plastic drums and IBCs in the past ten years. However, the fall in steel drum volumes in response to large increases in the price of steel drums relative to plastic drums and IBCs was not as large as the critical loss level as assessed in paragraph 5.2.

(e) The differential between steel and plastic drum prices is currently at its lowest level in four years because of large increases in plastic drum prices in the past

¹⁵We note that fewer customers identified reconditioned drums as an alternative to new large steel drums in response to the customer survey than identified IBCs or large plastic drums. The reasons for this are not clear and may reflect concerns about availability of supply—see paragraph 7.3.

year, and steel drum prices could increase by more than 5 per cent before reaching the differentials observed in 2004.

(f) Fibre drums and bulk packaging were identified as alternatives to steel drums by a number of customers in our survey. However, there is very little evidence of past switching from large steel drums to fibre drums or bulk (from the customer survey or the other evidence submitted by the parties or third parties).

5.41 Overall, we believe that this evidence taken together indicates that if prices of new and reconditioned large steel drums were to increase by 5 per cent above their current levels, some switching would occur, but that this would be below the critical level of lost sales of [X] to [X] per cent, and therefore would not be sufficient to make the price increase unprofitable.

5.42 Therefore, we conclude that the relevant market is the supply of new large steel drums and reconditioned large steel drums.

Geographic market

Great Britain

5.43 In considering the geographic dimension of the market, we first consider whether the market is smaller than Great Britain. We note that, although transport costs are high relative to the value of drums, all steel drum manufacturers serve the whole of Great Britain from each of their plants. This suggests that the relevant market is not narrower than Great Britain.

Northern Ireland

5.44 We next consider whether the market should include Northern Ireland. The evidence we have received shows that there is no production of new large steel drums in Northern Ireland and that all supplies of steel drums in Northern Ireland are imported,

either from Continental Europe or from Great Britain. In light of this, the prices of steel drums in Northern Ireland (or, indeed, the Republic of Ireland, since there is no production there either) are unlikely to be a constraint on Great Britain prices. This suggests that Northern Ireland does not form part of the relevant market for supply in Great Britain.

- 5.45 Of course, the fact that Northern Ireland is served only by imports from Great Britain and other countries means prices in Northern Ireland may be constrained by Great Britain prices for steel drums. Although this implies a separate relevant market for supply to customers in Northern Ireland (from producers based elsewhere, including Great Britain and other countries), we do not consider this market further. This is because the question of whether there could be a substantial lessening of competition in Northern Ireland will be linked to the impact of the merger on the competitive effects in Great Britain. There will be no substantial lessening of competition in Northern Ireland if there is none in Great Britain. Alternatively, addressing any substantial lessening of competition in the Great Britain market would also address competition concerns in Northern Ireland.

Europe

- 5.46 We consider next whether imports from neighbouring European countries are part of the relevant market. Greif told us that there was evidence that current Great Britain prices were constrained by imports, and that any increase in Great Britain prices above current levels would see significant imports into Great Britain. However, several third parties told us that it was not economic to import steel drums from Continental Europe to Great Britain.
- 5.47 We again used the framework of the hypothetical monopolist. A 5 per cent price increase by a hypothetical monopoly supplier in Great Britain would not be profitable

if customers could switch away from Great Britain suppliers with relative ease. The factors that appear to determine the constraint from imports on Great Britain producers are:

- prices in Great Britain and elsewhere;
- transport costs; and
- concerns about lead times and security of supply.

Factors affecting switching to imported drums

5.48 In the customer survey, customers were asked what price differential between the UK prices of local and imported new large steel drums would make them choose imported drums. 43 per cent of customers said that they would purchase imported drums if the UK price of local drums was up to 5 per cent higher than the UK price of imported drums. This suggests that customers would be willing to switch to imported drums for small savings on price.

5.49 Customers were also asked whether there were any factors which would inhibit switching to imported steel drums and the majority said that there were. Respondents were concerned about longer delivery times, additional transport costs and warehousing. Some customers we spoke to were also concerned about increased lead times and reliability of supplies.

5.50 Greif told us that many of its customers sourced other inputs from Continental Europe and therefore security of supply concerns about steel drums were not likely to be substantial. We received differing evidence on the time it would take a customer to receive an order placed with a non-UK producer. Sulo¹⁶ told us that average lead times (order to delivery) were [redacted] days. We note that this is substantially longer than the average lead time (order to delivery) for Great Britain manufacturers (three to four

¹⁶Sulo currently imports around [redacted] large steel drums per year into the UK from Germany.

days). This is possibly because Sulo delivers to its UK warehouse before dispatching to UK customers. Greif showed us delivery notes showing a two-day delivery time (dispatch to delivery) from northern France or Germany to north-west England.

Prices

- 5.51 The parties told us that there were generally higher operating costs in Great Britain and that this was reflected in higher sales prices. Our analysis of the evidence on price differences is set out in Appendix E. We looked in particular at the prices in four countries—Belgium, the Netherlands, France and Germany—as these are the closest countries in which there are large steel drum production facilities.
- 5.52 Greif's prices in neighbouring countries (Belgium, the Netherlands, France) were [REDACTED] per cent cheaper than Greif's Great Britain prices. Blagden's prices in Belgium and the Netherlands were [REDACTED] per cent respectively cheaper than in Great Britain, although its prices in France were about the same as in Great Britain. Greif's prices in Germany were [REDACTED] per cent cheaper than its Great Britain prices. Another supplier estimated that prices in Continental Europe were approximately 5 per cent lower than in Great Britain.
- 5.53 However, the pricing data that we have from the parties are average prices for all the drums produced in each country. The differences may reflect the fact that different combinations of drums are produced in each country. For example, the parties noted that Blagden's operations in Belgium made mostly higher-priced internally-coated drums and its French operation made mostly higher-priced open-head drums.

Transport costs

5.54 We obtained invoice data and estimates of transport costs of importing steel drums from the parties and from other suppliers, and this is shown in Table 3. Our analysis of transport costs is set out in Appendix E.

TABLE 3 **Transport costs from Continental Europe to Great Britain**

<i>From</i>	<i>Cost/drum £</i>
Belgium/Netherlands France Germany	([X])

Source: CC, based on data supplied by the parties and other steel drum manufacturers.

5.55 We found that transport costs increase with distance from Great Britain, with costs from Belgium and the Netherlands (between £[X] and £[X] per drum) being lower than from France and Germany (between £[X] and £[X] per drum). For its 2006 financial year, Greif UK's average transport cost was £[X] per drum.¹⁷

5.56 We note that currently Greif faces only limited competition in the Netherlands and Belgium, but faces competition from large producers based in northern France and Germany (see also paragraph 5.60).

Assessment

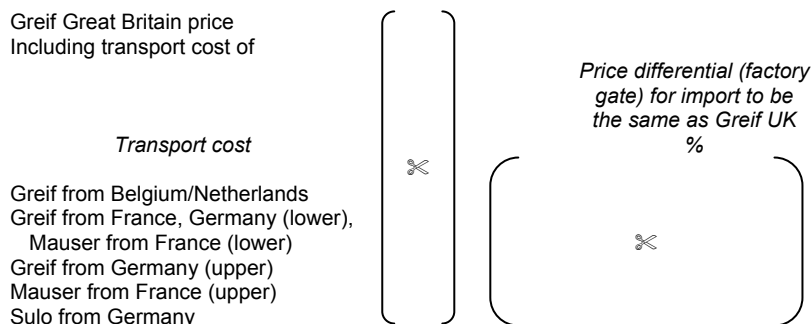
5.57 From the evidence available to us, it appears that the main limit on imports is the high cost of transport relative to the price of drums, although this is offset to some degree by lower prices in Continental Europe.

5.58 We calculated the differential between Great Britain and Continental European prices that would be necessary to compensate for the additional transport costs. We

¹⁷Based on annual transport costs of [X] million and sales of [X] million drums. Source: Greif management accounts.

compared the transport costs submitted by the main and third parties with Greif's sales price and transport costs in the Great Britain (see Table 4).

TABLE 4 Price differentials of imports required for parity with UK prices



Source: CC, based on data supplied by the parties and other steel drum manufacturers.

5.59 Table 4 shows that for there to be parity between Great Britain and imported drums, the price (excluding delivery) of the imported drums must be at least 10 per cent cheaper than the price excluding delivery of Great Britain drums. However, as we noted above, Greif faces only limited competition in Belgium and the Netherlands.

5.60 Shortly before we published these provisional findings, we received evidence of possible additional capacity for new large steel drum production in Belgium and the Netherlands. We did not have the opportunity to verify this information, and therefore to determine its impact, before we reached our provisional findings. We will consider this aspect further before finalizing our decision.

5.61 We consider whether drums imported from France or Germany can exert a constraint. We looked at the factory gate prices that would result in parity between the Great Britain prices of Great-Britain-produced and imported drums. If we take the transport costs provided by two other suppliers in Continental Europe (Sulo and Mauser), the Continental European drums would have to be 15 to 20 per cent (from France) or 26 per cent (from Germany) cheaper, on an excluding delivery basis, than

Greif's Great Britain price. Using the transport costs provided by Greif would give equivalent figures of 15 per cent (France) and 15 to 17 per cent (Germany).

5.62 We have been told that delivered sales prices in France and Germany are lower than in Great Britain by approximately [X] per cent. Although our analysis is concerned with prices excluding delivery, we consider the differences in delivered price to be reasonable proxies for the differences in prices excluding delivery. Even allowing for lower prices in Continental Europe, we do not consider that these differences could be large enough for these companies to match Greif's average Great Britain price on a delivered to the customer basis.

5.63 For our assessment of geographic market definition we considered whether a rise of 5 per cent in Great Britain delivered prices (equivalent to a 5.5 per cent rise in Great Britain factory gate prices) would be unprofitable for a hypothetical monopolist owing to customers switching to drums produced by non-Great-Britain manufacturers. In order to achieve parity with Great Britain delivered prices, we calculated that Continental European manufacturers' factory gate prices would have to be 15 to 26 per cent cheaper than Greif's average current Great Britain factory gate price.

5.64 If prices in Great Britain were to increase, then non-Great-Britain-produced drums would become more competitive. On this basis, in order for Continental European manufacturers to achieve price parity with an increased price there would need to be a difference of 9 to 20 per cent compared with Greif's average Great Britain factory gate price before the increase. We have been told that sales prices are up to 8 per cent lower in France and Germany (where Greif's larger Continental European competitors are located) than in Great Britain.

5.65 Comparing the lower bound (9 per cent) of the price differential needed to achieve parity with an increase in delivered price of 5 per cent in Great Britain, with the upper bound (8 per cent) by which prices are already cheaper, we found that even at a Great Britain price 5 per cent higher than that currently charged by Greif, a switch to non-Great-Britain-produced drums would be unlikely. Therefore, we consider the geographic market to be Great Britain.

6. Counterfactual

6.1 In order to assess the effect of the merger on competition in the relevant market, we need to identify what was likely to happen in the absence of the merger.

6.2 Alchemy told us that there was limited interest in the businesses when they were put up for sale in the second quarter of 2006. Only a few parties requested an information memorandum and the only offer initially was from Greif for the new steel drums business, and not the whole group. This was rejected by Alchemy. Subsequently, an offer was accepted for the whole Blagden group from its management. This was dependent on the back-to-back sale of the new drums business to Greif.

6.3 Alchemy said that if no satisfactory offer had been received for the businesses, it would have withdrawn the offer for sale and continued to work with the management to build the business. This might have included further acquisitions, although it was unlikely that these would have been in Western Europe. Alchemy said that it would probably have attempted to sell the businesses six months to two years after the initial attempt, subject to favourable market conditions.

6.4 We explored the question of who might have purchased the Blagden businesses in the absence of the merger with Greif with a range of third parties. Given the size of

the relevant businesses and the views expressed, we do not think any alternative purchaser would have been an existing manufacturer of new steel drums in the UK. We think that in the absence of the merger, there are three likely scenarios for the ownership of the Blagden businesses over the next couple of years: it is retained by Alchemy; it is sold to another private equity business; or it is bought by an industry buyer without any existing new steel drum operations in the UK. We think that the nature of the Blagden businesses as a competitive force in the UK is likely to be similar for each of these scenarios, because Blagden's ability to cut its costs would be unaffected. We therefore do not need to decide which the most likely outcome is.

6.5 In the absence of the merger, we would expect Greif to continue to pursue its stated strategy to become the lowest-cost producer of industrial packaging products.

6.6 For the reasons set out above, we conclude that the counterfactual is the pre-merger conditions for the supply of new steel drums in the UK, ie Greif and Blagden would continue in competition with each other.

7. Competition in the market

Market concentration

7.1 The market was concentrated pre-merger. Table 5 shows shares of UK supply (by volume for calendar year 2006) for new large steel drums and reconditioned drums.

TABLE 5 Volume sales and market shares for new and reconditioned large steel drums, 2006

	Volume sales '000 drums	Share of supply %
Greif		
Blagden		
Metal Drum		
Ramsden and Whale*		
AW Stokes		
Reconditioned drums (aggregate)†		
Total‡		100.0

Source: CC, based on data from Greif, Blagden, MDC, Ramsden and Whale, Stokes and IPA.

*Ramsden and Whale sales of new large steel drums only.

†Source: IPA.

‡Small quantities of new large steel drums are imported in the UK by foreign manufacturers (eg Sulo); these are not included in this table, but account for less than 3 per cent of sales of new large steel drums in the UK.

Features of the market

Reconditioned large steel drums

7.2 Reconditioned drums are either washed or furnaced (see further Appendix B).

Washed drums are the more common of the two. Several third parties told us that there were shortages in the supply of reconditioned drums in the UK. [X].¹⁸

According to the IPA, sales of reconditioned drums in the UK declined from 2.3 million in 2003 to 1.8 million in 2006. We were told that the decline in volumes of reconditioned drums was due to the following factors:

- the decline in the sale of new large steel drums to the UK market;
- many UK-produced steel drums are used for export, which reduces the number available for reconditioning;
- many imported steel drums are too thin a gauge to be suitable for reconditioning; and
- the high price of scrap steel and the rules influencing recycling have increased the incentives for scrapping used drums (see Appendix B).

We were told that the current conditions are likely to persist for the foreseeable future.

¹⁸European steel drum market, KPMG, provided by Greif to the OFT, slide 3.

7.3 pack2pack and Ramsden and Whale told us that they had to concentrate on delivering reliably to existing customers. This evidence suggests that reconditioned drum suppliers are unable to exert a competitive constraint in this market and that the most likely response of reconditioned drum producers to a rise in the price of new large steel drums would be to follow the price increase. Greif told us that, if new steel drum prices rose, creating higher returns for reconditioned drums, it was probable that more reconditioned drums would become available. However, we think that any such increase in volumes would be unlikely to constrain new drum prices because the prices of reconditioned drums would also have increased.

New large steel drums

7.4 Having assessed that suppliers of reconditioned drums cannot operate as a competitive constraint in the market, we look at competition between suppliers of new steel drums. In particular, we assess whether Blagden was Greif's closest competitor pre-merger. If it was, the removal of Blagden as a competitor would make it more likely that the merged entity could exploit its market power.

7.5 We have also considered other relevant features, including non-price factors, that would influence customers' willingness to switch; and whether the suppliers have the capacity to accommodate the demands of would-be switchers. These are set out in Appendix F (paragraphs 1 to 15).

7.6 On the basis of the evidence we have received, we consider that all UK suppliers of new large steel drums produce comparable products, and that switching costs are sufficiently low to enable customers to respond to price changes. We also found evidence of spare capacity in the industry. As set out in Appendix F, at current output levels, Blagden and Greif have spare capacity to take customers from one another. [REDACTED] smaller suppliers [REDACTED] also have spare capacity.

7.7 Given the similarities between suppliers' product range, the low switching costs, and the existence of spare capacity, we need to consider (1) the evidence of past switching and (2) pricing and costs. We look at these two indicators to establish the constraints on Greif's behaviour.

History of switching

7.8 In this section, we analyse the evidence on past switching between suppliers of new large steel drums. The extent of switching between the merging parties, and to other suppliers, is an indicator of the competitive constraint different suppliers exert on each other. We first consider switching between Greif and Blagden, and then consider the extent to which Metal Drum, Ramsden and Whale and AW Stokes had the ability to supply, and were considered by customers as potential alternative suppliers to Greif and Blagden.

Pre-merger competition between Greif and Blagden

7.9 Table 6 shows the yearly sales and shares of supply of new large steel drums by the different UK manufacturers for the period 2002 to 2006. In order to make the figures comparable, we have added T&D's sales to Greif's total sales for 2002 and 2003. At an aggregate level, [✂].

TABLE 6 Sales and shares of supply of new large steel drums

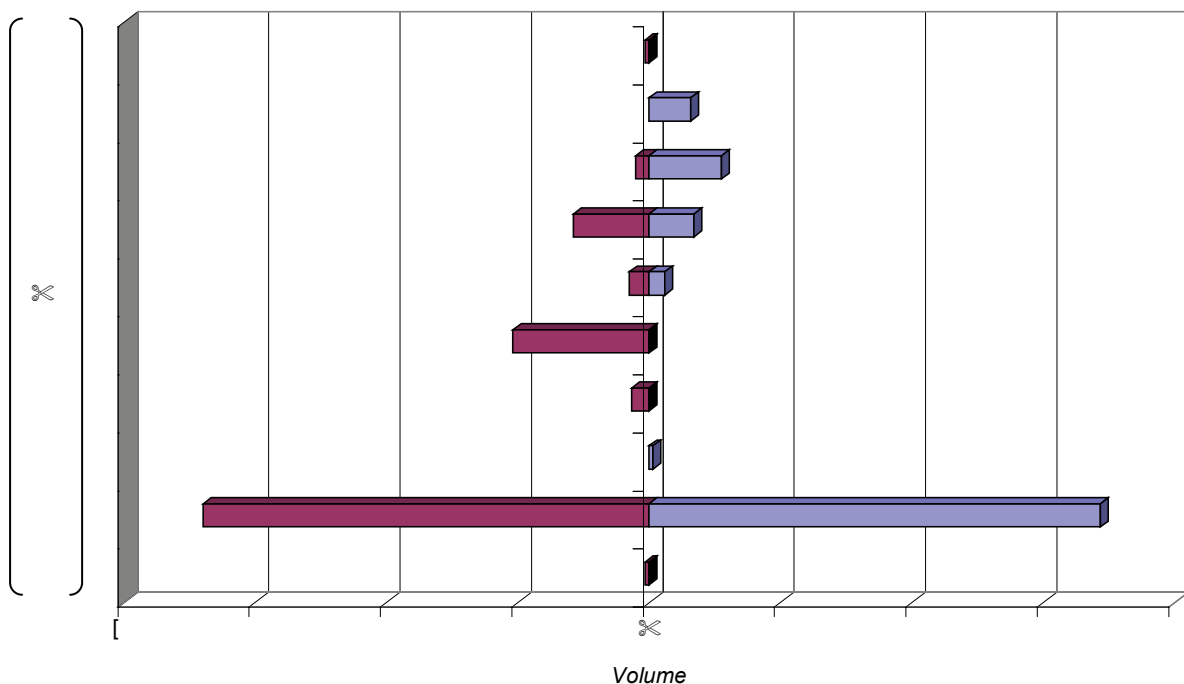
	2002		2003		2004		2005		2006	
	Sales '000 drums sold	Share %	Sales '000 drums sold	Share %	Sales '000 drums sold	Share %	Sales '000 drums sold	Share %	Sales '000 drums sold	Share %
Blagden										
Greif/T&D										
Ramsden and Whale										
Metal Drum										
AW Stokes										
Total		100		100		100		100		100

Source: CC, based on data provided by Greif, Blagden, Ramsden and Whale, Metal Drum and Stokes.

7.10 Blagden's switching data covering 2002 to 2006 shows that Blagden and Greif had competed against one another to supply new large steel drums. Blagden told us that [redacted]. Figure 3 illustrates the total volume of new large steel drum sales won and lost by Blagden. Greif accounted for approximately [redacted] per cent of total sales lost between 2002 and 2006 and represented [redacted] per cent of sales gained.

FIGURE 3

Blagden new drum gains and losses (total, 2002 to 2006), by company



*[redacted] is a distribution agent for a range of industrial packaging products.
 Source: CC based on information from Blagden (Greif totals include T&D).

7.11 Switching data provided by Greif for the last five years indicates that approximately [redacted] per cent of Greif volume that switched to other large steel drum suppliers switched between Greif and Blagden.¹⁹ The remaining [redacted] per cent had switched to Ramsden and Whale.

7.12 Greif told us that Ramsden and Whale had grown in strength as a competitor since it won a significant contract with BP in 2004. For the period 2004 to 2006, Greif told us

¹⁹This dataset applies to large customers only.

that [X] per cent of lost large customer business went to other packaging, [X] per cent to Blagden and [X] per cent to Ramsden and Whale. This is shown in Figure 4 (see also paragraphs 40 and 41 of Appendix C). We note that, even for the period 2004 to 2006 (which was the period during which steel drum prices increased most relative to plastic drum prices), Blagden remained the largest single competitor in terms of the amount of switching.

FIGURE 4

Greif steel drum losses on major contracts, 2004 to 2006

[X]

Source: Greif.

- 7.13 Customers' views on the level of rivalry and switching between Greif and Blagden pre-merger were mixed. Two-thirds of those responding to the customer survey said that promotional activity for both parties had been low. The survey also highlighted different experiences of customers: one-third reported that they had played off Greif against Blagden but half reported that they had not.
- 7.14 There is also evidence of dual sourcing. Blagden listed [X] customers that it shared with Greif. These represent approximately [X] per cent of Blagden's 2006 new steel drum sales. Metal Drum also said that many of its customers dual sourced, with large customers dividing their business 80:20 between the larger and smaller suppliers.
- 7.15 Overall, although customer responses have been mixed, the evidence on switching, on market shares and on changes in market shares suggests that Blagden and Greif were each other's closest competitors.

Competition for customers by Metal Drum, Ramsden and Whale and AW Stokes

- 7.16 In the customer survey, we asked customers for reasons, if any, inhibiting them from switching from Greif or Blagden to other UK manufacturers of new large steel drums.

Price was mentioned, as were service and availability (lead times, innovation, technical capability and support, contingency arrangements and continuity of supply), quality and product specification to meet regulations.

7.17 We also asked customers for estimates of the percentage, by value, of current orders with the parties for new large steel drums that customers could currently switch to alternative UK suppliers. A quarter of those responding could not switch any amount but a third could switch over half their current expenditure with Greif and Blagden. Almost a further quarter did not know the level of expenditure they could switch to other UK suppliers. Based on the answers to this question, we estimated the proportion of the total order volume that could be switched from Greif and Blagden to other UK suppliers²⁰ to be 23 per cent.²¹

Pricing

7.18 All steel drum manufacturers told us that input costs, and particularly the cost of steel, were the main determinant of steel drum prices. We heard that prices varied between customers, depending on the volumes supplied and the location of the customer.

7.19 Blagden told us that it had offered cheap prices at times when it needed volumes to fill its plant. It had mounted an active campaign to improve volumes in 2003/04 and won significant business from Greif on the basis of lower prices. Ramsden and Whale told us that [REDACTED].

7.20 As discussed in paragraphs 5.9 to 5.12, there are substances for which there is no practical alternative to the use of new large steel drums. Some of the customers who

²⁰In order to do this, we weighted each respondent's answer by their reported volumes with Greif and Blagden. In addition, we assumed that those who did not know or could not respond would have acted similarly to those who specified the percentage that they could switch.

²¹Greif suggested that we remove from this the responses from 12 companies that that did not appear to have placed recent orders with the parties; doing so reduces the incidence to 22 per cent of those who did not know.

pack these substances would also pack other substances that could go into alternatives; however, there is a minority of customers who cannot switch any of their requirements away from steel drums. We did not receive any evidence that suggested that customers who were not able to switch away from steel drums paid higher prices than other customers prior to the merger. However, we did consider whether there were characteristics or working practices that would enable suppliers, if unconstrained by competitive forces, to price discriminate by setting different prices between customers unrelated to cost differences. This could occur in different ways, for example:

- setting higher prices (relative to costs) for certain types of new large steel drums (eg tight-head drums) than for others (eg open-head drums), for instance if the prices of open-head drums were more constrained than the prices of tight-head drums; and
- setting higher prices to customers who are known to have a lower propensity to switch than to other customers with a higher propensity to switch.

7.21 Price discrimination can be prevented if arbitrage between customers would occur, ie if customers who pay the lower price were to resell steel drums to customers who pay the higher price. Arbitrage between different types of drums could not occur because of the different uses of these drums: as discussed in paragraph 5.4, different types of drums are not demand-side substitutes. Arbitrage between customers for a similar type of drum is also unlikely to occur. While distributors are active, their current activity is very limited, and we were told that they sold mainly to small customers who required steel drums in smaller quantities than a full truck load. Lead times, the costs of stocking and individual drum identification (painting) mean that arbitrage by customers is unlikely to occur in response to price discrimination.

7.22 The ability to price discriminate by customer also depends on whether suppliers are able to identify some customers or groups of customers with a different propensity to switch in response to price increases. We found that suppliers have detailed information about customer and product requirements, including the drum type, customer classification, the delivery address, and the breakdown of customer volumes, cost and margins.

7.23 [REDACTED]

7.24 Greif told us that its account plans only described customers' products in very general terms, and that larger customers generally had a range of products which would mean that Greif would not know what proportion, if any, of each customer's order for steel drums would have no alternatives to steel. However, we think that the information about its customers accumulated by Greif (which includes [REDACTED]) would enable Greif to form an assessment of the price sensitivity of its customers. In addition, although we acknowledge that the information was compiled into a report for the purposes of submitting evidence to the CC,²² Greif demonstrated considerable knowledge of the products packed by its top 40 customers.

Suppliers' costs

7.25 In order to assess the relative competitiveness of new large steel drum manufacturers, we looked at different manufacturers' costs. Competitors' costs are not identical since the age and reliability of production facilities varies between companies, as do locations of manufacturing plants and hence transport costs. The differences in manufacturing processes also translate into variation in costs, and in particular in variations in marginal costs. Greif and Blagden have highly automated

²²See Appendix D, paragraph 18.

systems. [REDACTED] We would expect this to translate into lower marginal costs, and large economies of scale, for Greif and Blagden compared with other UK manufacturers.

7.26 Greif told us that it would have a more sophisticated business model than its smaller competitors. Its overhead costs per drum included an element of cost related to the [REDACTED]. In addition, maintenance costs on Greif's automated production line would be more expensive than maintenance costs on a less sophisticated, less automated line.

7.27 Another difference between suppliers' variable costs may relate to their input costs of steel. Greif told us that it was able to achieve economies of scale in the bulk purchase of steel. Prior to the merger, Blagden and Greif, due to the size of their global demand for steel, would be able to secure better prices for steel than small UK-only suppliers.

7.28 From the evidence set out above, we would expect that Greif and Blagden would have higher fixed costs than smaller suppliers, but would enjoy lower variable costs (in particular, from their lower steel costs per unit).

7.29 We looked at high-level data on costs from manufacturers.²³ Table 9 compares the costs of suppliers of new large steel drums.²⁴ We note that the data is consistent with the evidence discussed above that indicated that Blagden and Greif operate at lower variable costs per drum (part of which is explained by lower material costs per drum) and higher fixed costs per drum than other UK manufacturers.

²³We requested data for the last completed financial year in respect of production of 210 litre new steel drums, but manufacturers may have used different definitions and allocated costs differently between variable and fixed costs.

²⁴We used average revenue per drum for all drums because some manufacturers were unable to allocate costs between drum types. However, we note that the average revenue per drum is dependent on the product mix, which varies between suppliers and that prices charged vary.

TABLE 9 Comparison of cost by supplier (for all drum types)

	Average revenue per drum	Material cost per drum	Total variable cost (VC) per drum (material + other VC)	Fixed cost per drum	Contribution per drum (price – VC)	Greif – VC	Blagden – VC
Blagden	*		✂				
Greif							
AW Stokes							
R&W							
Metal Drum							

Source: CC analysis of data provided by suppliers.

*For R&W, the average revenue per drum shown is average revenue for tight-head plain steel drums.

Note: The average revenue per drum is different from the selling price for Greif and Blagden because different datasets have been used.

7.30 We also looked at data on prices from manufacturers. Table 7 shows the absolute level of manufacturers' current average prices for the different types of new large steel drums. However, it is difficult to compare prices between manufacturers. Indeed, there are no list prices for new large steel drums, and prices vary (for a given type of drum) depending on the location and size of customers (see paragraph 7.18). In addition, even within a type of drum, there are differences, for instance depending on the gauge and on the type of lacquer applied. For these reasons, price comparisons between manufacturers are indicative at best, although they may be more reliable for plain steel drums than for lacquered drums (because of the different types of lacquers that can be applied).

TABLE 7 Current prices of new large steel drums

	Open-head plain steel	Open-head lacquered	Tight-head plain steel	Tight-head lacquered
Blagden	*		✂	
Greif				
AW Stokes				
R&W				
Metal Drum				

Source: CC analysis of data provided by suppliers.

7.31 Tight-head drums account for the large majority of sales of new large steel drums. Tight-head plain steel drums account for around [✂] per cent of Blagden and Greif's sales of new large steel drums, and tight-head lacquered drums account for around

[X] per cent of Greif and Blagden's sales. Open-head plain drums account for [X] per cent of sales, and open-head lacquered drums for [X] per cent of sales. The remaining sales are for specialist drums such as polydrums. Table 7 would suggest that, for tight-head plain steel drums, [X]. For open-head plain steel drums (which account for only [X] per cent of the parties' total sales), [X]. However, as explained above, these price comparisons should be interpreted with caution.

7.32 In light of our assessment that Blagden and Greif are the lowest incremental cost manufacturers and that they are each other's closest competitors in terms of switching and market shares, we think that the main constraint on Greif's pricing pre-merger came from Blagden. This is consistent with the comparison of prices charged by the different suppliers, which would suggest that Greif and Blagden's tight-head plain drums tended to be cheaper than those sold by their competitors.

8. Assessment of the competitive effects of the merger

Removal of Blagden

8.1 The merger has brought under common control the two largest UK producers of large steel drums, with a combined UK market share of approximately [X] per cent (increment of [X] per cent). This results in a highly concentrated market.

8.2 Further, on the basis of our analysis of the market set out in Section 7, the merger has removed the main constraint on Greif's pricing. We do not think that reconditioned drums suppliers are in a position to constrain prices because supply of raw materials is likely to continue to be limited. We note that although the merged company would have the [X] share of residual capacity in the market, there is significant spare capacity outside the merged entity. However, we believe that the three remaining UK competitors in the supply of new large steel drums operate at

higher variable costs than Blagden. Post-merger, we think that the competitive constraint from these firms would be less than that previously exerted by Blagden.

- 8.3 We think that higher prices could manifest in a number of ways: there might be a universal rise, or specific price rises for customers who are least likely to switch away from new large steel drums, or indeed a combination of the two. We therefore need to consider whether there are reasons why this loss of rivalry might not lead to a substantial lessening of competition.

Other competitive constraints

Entry or expansion

Independent entry

- 8.4 Third parties estimated that a new large steel drum factory would cost between £2 million and £4 million, with a lead time of 8 to 15 months. Greif accepted that these estimates might be appropriate for a greenfield site with new equipment, but submitted that entry costs could be drastically reduced by purchasing second-hand equipment, stating that a second-hand production line with a lower speed would cost approximately £1 million. Ramsden and Whale entered the new steel drum market by acquiring second-hand equipment. The production line was purchased about ten years ago for £[REDACTED], but Ramsden and Whale stated that [REDACTED]. There have been no new entrants to the manufacturing of new large steel drums in the UK in the past five years. There were two exits: T&D exited the market in 2003 following acquisition by Greif, and Economic Drums exited the market because of insolvency.
- 8.5 Greif said that the most likely new entry would be for a current UK supplier of alternative industrial packaging to begin supply of new large steel drums alongside existing production processes. It suggested that Mauser and Schütz could transfer a

steel drum production line to their UK operations at low cost because they had underutilized steel drum capacity elsewhere in the world.

- 8.6 Mauser said that the investment needed for a new steel drum operation was considerable. It would not expect a sizeable entry in the UK market, and told us that [REDACTED]. Schütz also told us that entry was expensive and as the market was diminishing year on year it did not believe anyone would set up a new steel drum plant in the UK.
- 8.7 Additional factors that may deter entry include economies of scale, and overcapacity in the market. Further, third parties point to an ongoing process of exit (by both acquisition and liquidation) from the industry, significant examples being Economic Drums and T&D. The potential for Greif's capacity to be utilized aggressively in response to a new entrant may also increase perceived entry risk.
- 8.8 On the basis of this evidence, there seems to be insufficient incentive to attempt entry in the face of the barriers we have identified. We therefore consider that entry would not happen within a timescale that would affect the incentives and decisions of the existing suppliers and that it is unlikely to be of sufficient scale to provide an effective competitive constraint on the merged firm.

Independent expansion

- 8.9 We consider that expansion by an existing UK supplier of new large steel drums could occur with relatively low investment and within a short timescale, by increasing the number of working shifts and/or removing bottlenecks in the production process. Information on the ability of existing suppliers to expand their capacity in this way is set out in paragraphs 18 to 31 of Appendix F. Our assessment suggests that capacity of around 830,000 drums could be added relatively easily.

- 8.10 However, as discussed in paragraphs 7.28 to 7.33, we believe that existing UK suppliers operate at higher variable costs than Greif and Blagden, due to less automated manufacturing processes and the higher material cost arising from their smaller size. Any quick and relatively inexpensive expansion would be unlikely to change this pattern; the variable cost incurred by these suppliers would remain higher than Greif's and Blagden's. We do not consider that creating additional higher-cost excess capacity in the hands of the smaller suppliers would exert as strong a constraint on Greif's prices as Blagden's capacity. Instead, we think that this additional capacity would act only as a constraint on Greif's ability to raise prices above those of the remaining small suppliers.
- 8.11 Expansion could be a stronger constraint on Greif's pricing if the expansion resulted in economies of scale. If one of the smaller suppliers wished to transform its capacity to manufacture new large steel drums in similar volumes at a similar variable cost to Blagden or Greif, it could purchase an entire new production line. This step would be similar to de novo entry in terms of investment and timing.
- 8.12 Metal Drum estimated that a new large drum line would cost £[redacted] and take 12 months to set up. Ramsden and Whale said that [redacted]. Greif provided evidence that a second-hand production line could be purchased for approximately £[redacted] (excluding transport, installation and training costs). It is not clear what level of investment would be needed to achieve a similar level of automation to that operated by Greif or Blagden. However, even an investment at the lower end of these estimates would still be a considerable step for a small company and would involve a substantial financial commitment.
- 8.13 We considered whether any of the smaller suppliers would be likely to undertake such a transformational change to their production capacity. The smaller suppliers

are long-established, owner-managed businesses. One told us that its strategy was to 'stay under the radar'; another said that it tried to avoid low-margin, high-volume business. Any significant capacity expansion and increase in volumes would therefore represent a radical change in strategy. However, we recognize that the merger alters the market significantly.

8.14 In taking a decision whether to expand capacity, suppliers must be sure that they will gain sufficient new customers beyond the short term. If these new customers were liable to switch away, or if the price at which the customer could be supplied was unprofitable, then small suppliers would be less willing to undertake the risks associated with expansion. We noted that the smaller suppliers feared retaliation from Greif if they won business from it.

8.15 In addition, finance for an investment of around £1 million could prove difficult to obtain for a company the size of the three smaller suppliers. Even if it were available, such a debt would increase the smaller suppliers' financial risk substantially. Although newer machinery could be bought and introduced in stages, this would significantly increase the timescales. There could also be disruption to supplies as the newer machinery was brought on-stream.

8.16 Although we recognize that the merger may increase the incentives on each of the smaller suppliers radically to transform its business and become a sizeable alternative to the merged entity, we do not think that this is likely given the high costs and risks involved in such a strategy.

Sponsored entry or expansion

8.17 To the extent that there are barriers associated with entry or expansion, a customer could, in principle, facilitate any necessary new investment by giving assurances over

prices or volumes of business and thereby provide sufficient security for this new investment to be undertaken. Whether this represents a sufficient constraint depends upon the costs, and the credibility, of such a strategy. The credibility would depend, in part, on the proportion of customers' costs accounted for by steel drums, which is unlikely to be high. It would also depend on the size of customers' orders relative to business required in order to make an investment profitable; this is discussed below.

8.18 Greif cited Ramsden and Whale as an example of entry being sponsored by BP. However, Ramsden and Whale told us that it entered the market approximately ten years ago and received BP's order in 2004. [REDACTED] Although we acknowledge that the BP contract may have helped Ramsden and Whale to increase its market share, we do not consider this to be an example of past sponsored entry into the new large steel drum sector.

8.19 Greif also told us that several other large customers were of a sufficient scale to guarantee the financial viability of a new entrant, or to encourage expansion by a smaller competitor. It noted that [REDACTED] had had its own in-house drum manufacturing operations. Table 10 shows the volume of drums purchased in 2006 by Greif's top five customers.

TABLE 10 Drum purchases for top five Greif customers, 2006

<i>Customer</i>	<i>Drum purchase, 2006</i>
[REDACTED]	[REDACTED]

Source: Greif.

Note: These are purchases from Greif alone and so do not include purchases from Blagden or other steel drum suppliers.

8.20 As discussed in paragraphs 8.11 and 8.12, entry or expansion that would constrain the merged entity's pricing would require significant investment and large volumes.

Very few customers in this market purchase more than 100,000 drums per year and would therefore have sufficient size to sponsor entry. And no customer suggested that this was a strategy that they would consider implementing. In addition, if there was a risk that some customers might decide to sponsor entry, Greif could easily identify these customers and charge lower prices to them. These customers might end up incurring the cost of sponsoring entry, without necessarily benefiting from lower prices compared with those available from Greif.

Countervailing buyer power

- 8.21 Countervailing buyer power is the power that ‘buyers, either because of their size or commercial significance to their suppliers, may have the ability to prevent the exercise of market power by suppliers’.²⁵ Buyer power can arise only if buyers have an outside option. This outside option or threat must be credible in the sense that it would be imposed should agreement fail to be reached. The more powerful the buyer’s threat, the closer the price will be to marginal cost.
- 8.22 We have already discussed the possibility of customers sponsoring entry or expansion. Greif also suggested that buyer power could act as a constraint because many large customers had the option to take steel drum manufacture in-house. Customers did not mention this as an option.
- 8.23 For the customer, a threat may be credible if it imposed substantial costs on the supplier. Blagden suggested that customers with multinational accounts could threaten business in other countries. Greif told us of an instance in which Greif had given a price reduction to a customer in the UK and in the Netherlands in order to safeguard their global contract with them. However, it is not apparent to us that the merged entity would necessarily and consistently sacrifice profits *in the UK* to protect

²⁵CC, *Merger References: Competition Commission Guidelines*, CC2, paragraph 3.58.

global business. In addition, Greif noted that a Continental European or international presence was not a determining factor in choice of supplier. This was supported by evidence from Ramsden and Whale that although larger customers tendered on a Europe-wide basis, it had been invited to tender for UK-only business and it had been successful on more than one occasion.

8.24 Even if larger customers could exert sufficient countervailing buyer power to obtain lower prices, it is not clear that smaller customers would have the same ability. Blagden noted that no single customer accounted for more than [X] per cent of its business. Although outside options may be available for some buyers, this would be unlikely to constrain the prices charged to other buyers because contracts are negotiated individually.

8.25 This leads us to conclude that there would not be sufficient buyer power to constrain the merged entity in its dealings with all customers.

9. Provisional conclusions on the SLC test

9.1 For the reasons set out above, we provisionally conclude that the merger may be expected to lead to a substantial lessening of competition in the market for new and reconditioned large steel drums in Great Britain.