

Note of dissent

by Professor A P L Minford

1. While I accept that Sara Lee's share of the 'self-selection' (ie mainly supermarket) trade is high, at around 70 per cent, after the merger, I can see no competitive detriment from this situation. First, there are many alternative suppliers, both domestically and on the European continent. Secondly, the supermarket buyers have strong bargaining power, and are fully capable of searching out these alternatives and presenting them to the consumer as thoroughly competitive products.

2. I can also see two sources of potential damage to the public interest from the remedy proposed in the majority report (divestment of the Cherry Blossom brand by Sara Lee). First, there is the possibility that Sara Lee's operations will be disrupted in the short term by the upheaval of divesting these fully-integrated products. This disruption could be prejudicial to the quality of service the consumer receives.

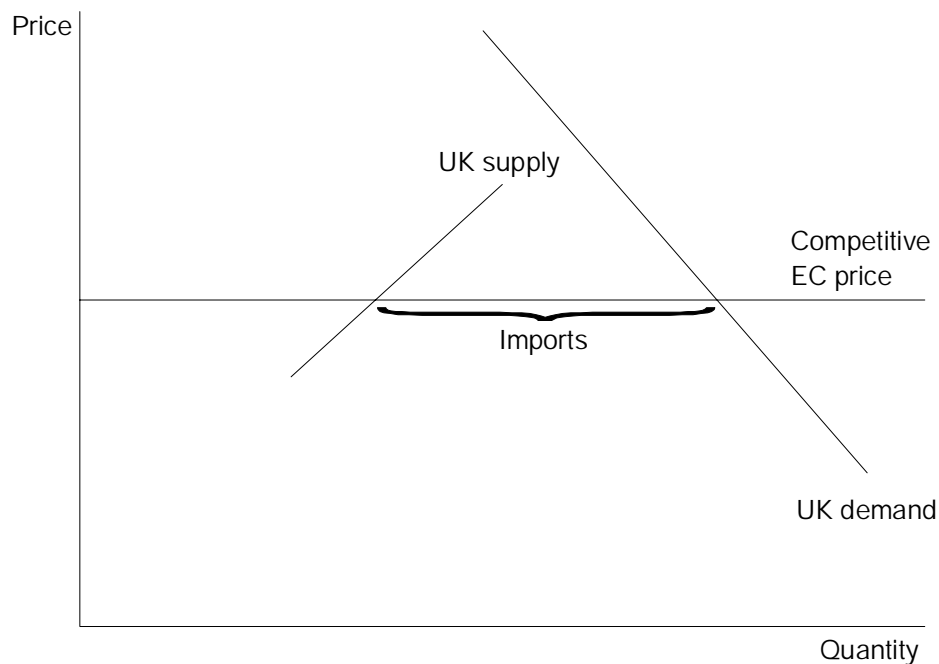
3. Secondly, the future of the Honley plant, never perhaps fully assured, may well be brought into active question by the loss of nearly half its throughput on the paste polish line currently producing both Kiwi and Cherry Blossom. The loss of output and employment in Yorkshire, an area of high unemployment, would clearly be a serious damage to the public interest; while small in absolute terms, it is large relative to any (claimed) competition gains in this small market.

4. In the rest of this short note I develop these arguments in more detail.

5. This market is a normal traded good one, in which there is competition, actual and potential, between domestic and imported brands. Apart from Cherry Blossom and Kiwi, the actual brands are own-label, notably Sainsbury's, and less well-known ones such as Punch, CDM and Dasco, while potential entrants are new own-label, Nugget (after the three years' prohibition on Reckitt & Colman), and a fair number of continental brands (notably those of Salamander, Werner & Mertz, and Salzenbrodt). One must also not forget the large potential capacity from chemical producers and 'contract packers' (see paragraphs 3.66 and 3.67). There are no import barriers apart from transport costs which are agreed to be very low: importing as such is clearly not a problem since one of the major suppliers in the wider market is Punch, an Irish firm. Sara Lee itself is a major European producer, but does not have undue market power, with around 22 per cent of the total EC market for shoe care products (Werner & Mertz has about 20 per cent-see Table 3.15). Within the United Kingdom Sara Lee has only 30 per cent of the shoe care market (see Table 3.14). Its 70 per cent share in the narrow category of self-selection shoe polish is in a sector where there is considerable countervailing power from supermarket chains, with choice from a large array of alternative suppliers at home and abroad.

6. There is a standard model in international trade theory for a market like this. The diagram overleaf illustrates. Prices are set over the medium term by the going international rate. This price level gives an efficient EC producer a reasonable return on capital. The size of the domestic industry is set by the efficiency of local producers. If they can compete with the best in Europe then they may drive imports out altogether and the United Kingdom will become an exporter. If not they will contract until the available capacity is competitive at the going price.

Typical traded goods market within Europe



1. The existence of brands introduces a short-run ability by producers to set price because most consumers will stay loyal to the brand-`imperfect competition'. However, freedom of entry will drive the brand price to the competitive level in the longer run; and in the short run too the knowledge of this will restrain brand price-setting in order to deter entry by new brands. This must be distinguished from `predation' or extreme cuts (actual or threatened) in price aimed to deter entry. In a traded good market such as this one such strategies would be a foolish waste of money: the equilibrium will be immune to it, as there are too many potential entrants.

2. It is argued in the majority report that the two big United Kingdom paste brands, Kiwi and Cherry Blossom, are so strong in the self-selection sector of the United Kingdom market that imports in particular would be effectively deterred from entering. The evidence for such extreme brand strength is weak. There merely appears to be a fairly standard price premium (of 15 to 20 per cent) for these brands over weak or `own' brands. An entrant with a weak brand has not invested as heavily as the brand leader and so carries less financing cost (than, for example, Sara Lee which has paid heavily for its leading brands). There is of course nothing in brands *per se* that confers illegitimate market power; the question is whether there are actual and potential alternatives.

3. The report also argues that the low price elasticity of this product and the small size of its market confer market power on the brand leader. However, the same low price elasticity and small market size applies to many grocery products which are `necessities'. That has not prevented effective competition, since free entry ensures that competing brands of the same product set a competitive price.

4. In this particular market we have limited information about the likely competitive price level. From the facts we have seen, a reasonable interpretation is that prices in the United Kingdom have been lower than this (and specifically lower than actual continental prices) for the recent past, partly perhaps because of the severe United Kingdom recession, partly because of long-term overcapacity (both Honley and Hull factories were operating their paste lines at low utilisation). With or without the merger therefore prices would probably have to rise.

5. As for United Kingdom production at the competitive price this will depend on how much efficient capacity we have in the United Kingdom. The Honley operation is in Sara Lee's words `an efficient little operation': with the merger, it is even conceivable that it could expand production and export to contiguous markets such as Ireland and Scandinavia. Without the merger of Kiwi and Cherry Blossom it is clear that

the Honley factory's paste line will be substantially underutilised-there are modest but definite economies of scale in paste manufacture. (Table 3.16 and paragraphs 2.42 and 2.43 indicate that the withdrawal of the Cherry Blossom lines could reduce the operating surplus of Honley by some £0.25 million to £0.5 million, as against Honley's total operating profits which according to my estimates are in the range of £1 million to £1.5 million.) The rationale for the whole factory, which appears to be critically balanced on the margin of viability, will then quite probably disappear; though distribution (which takes place at Lutterworth) will need to remain in the United Kingdom, manufacturing may be relocated and Honley therefore closed.

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