

Part II

Background and evidence

3 Background to the reference and the reference practice

Introduction

3.1. The reference made under section 5 of the Competition Act 1980 (see Appendix 1.1) required the MMC to investigate the granting of discounts to UK wholesalers or retailers on condition that they stock the whole or part of the range of Tambrands' tampons.

MMC reports on the supply of tampons

3.2. The MMC investigated the supply of tampons in the UK on two previous occasions in 1980 and 1986.

3.3. The 1980 report concluded that the determination of tampon prices by both Tambrands and Southalls (now trading as Smith & Nephew) was against the public interest, in that tampon prices were higher than would otherwise be expected. There was, however, prospect of new entry (from Playtex Ltd (Playtex)), no evidence of anti-competitive practices in the industry nor any insuperable barriers to the entry of new competitors. The MMC could not therefore recommend any steps with a view to bringing about more active competition in the industry. Given also a significant decline in rates of return over the previous five years, the majority of the Group believed it inappropriate to recommend any price restraint, but recommended only that the DGFT should follow closely developments in the market for a period of two years.

3.4. By the time of the 1986 report, Playtex's entry had proved unsuccessful although there had been other limited market entry. The 1986 report referred to changes in actual and prospective competitive conditions, notably the marked improvement and reduction in prices of external sanpro products; the increasing importance of retailers' own-label tampons; and the increased probability of effective competition from new entrants to the tampon market, particularly in the light of the decision to allow television advertising of sanpro products. The 1986 report again found therefore that the prices of tampons were higher than would be the case if market power were less, but there were no insuperable barriers to entry nor any evidence of restrictive or anti-competitive practices. The 1986 report therefore accepted that 'in these circumstances high profits may be attributable to superior entrepreneurial ability, successful innovation, and more efficient techniques of production and organisation'. There was therefore no adverse public interest finding.

Background to the current reference

3.5. In 1993, following consumer complaints about prices, the OFT conducted a comprehensive review of the UK tampon market. It concluded that while the market continued to be dominated by Tambrands and Smith & Nephew, there were signs that the trends pointed to in the 1986 report were occurring. Profitability, while still high, was declining, the only entry barriers were the strong brand images of the dominant brands, and there was evidence of stronger competition from other forms of sanpro products. The OFT therefore decided that a general monopoly inquiry was not merited.

3.6. However, in 1994 Somerfield complained to the OFT about the special contract terms and conditions on which it was supplied by Tambrands, which included a requirement to stock the full range of Tambrands' products to qualify for the maximum discount. The OFT passed its complaint to Tambrands and learnt for the first time that the special contract terms under which nine retailers

(including Somerfield) purchased and the chemist wholesaler terms included a requirement that Tambrands' full range must be stocked.

3.7. The MMC's 1981 report on full-line forcing and tie-in sales concluded that the effect of full-line forcing or tie-in sales on the public interest 'is not consistently harmful, beneficial or neutral, but depends on the circumstances'. Among the guidelines the MMC advanced to be borne in mind in the process of identifying line forcing and in deciding when to initiate action against it in particular cases were the following: tie-in sales and line forcing were unlikely to be found or unlikely to persist except when the supplier has some degree of market power in supply of the tying goods or service, and any adverse effect on the public interest was likely to depend on the extent of market power. Where a supplier has substantial market power in the tying goods or service, the exclusionary effect on competitors was likely to be against the public interest, but how far this was so in practice would depend on the structure of the market for the tied good or service, and the extent to which it might be changing.

3.8. Against the background of that report and bearing in mind the market power which Tambrands had already been judged to possess, the OFT identified two possible effects of Tambrands' range-stocking provision. First, it might restrict the availability of scarce retail shelf space to competing brands, and secondly, it might act as a barrier to new entrants which might want to enter the UK tampon market.

3.9. Following Tambrands' refusal to offer an undertaking to delete the range-stocking requirement from its terms and conditions, the OFT referred the practice to the MMC for investigation.

Tambrands' terms and conditions

3.10. Table 3.1 shows the current terms and conditions offered by Tambrands. In 1994 over 60 per cent of Tambrands' sales by volume were made under its special contract terms and a further 12 per cent under its chemist wholesaler terms, both of which contain a full range-stocking requirement.

TABLE 3.1 Tambrands' terms and conditions, 1994

<i>Terms</i>	<i>Conditions</i>	<i>% discount on standard retail terms (Rate 1)</i>	<i>% 1994 sales</i>	
			<i>Volume</i>	<i>Value</i>
Standard retail terms				
(Rate 1)	At least 7 cases per order	0	0.04	0.04
(Rate 2)	20-39 cases per order	10	0.47	0.52
(Rate 3)	40 cases per order	13	6.59	6.91
Standard wholesale terms	At least 7 cases per order	13	19.36	20.33
Chemist wholesale terms	At least 7 cases Full range to be stocked	15	11.31	11.57
Special contract terms	At least 150 cases per order in full pallet quantities. Full range to be stocked	15-21*	60.43	59.02
Other trading terms	-	-	<u>1.81</u> 100.00	<u>1.61</u> 100.00

Source: Tambrands.

*[*Details omitted. See note on page iv.*]

3.11. Both special contract terms and chemist wholesaler terms derive from the 1980s. At the time of the MMC's 1980 report Tambrands had a standard rate which required each order to be of at least three cases. However, 99 per cent of customers purchased at a 7.5 per cent discount off the standard rate. This discount was available to retailers which ordered a minimum of five cases and to wholesalers which ordered a minimum of six cases. In addition, Tambrands offered two 'general deals' per year, generally

lasting for four weeks each, during which a further 7.5 per cent discount was offered to all customers. As a result, retailers and wholesalers purchased the vast majority of their stock twice a year in order to take advantage of the additional discount.

3.12. In response to pressure from retailers, Tambrands revised its discount structure in the early 1980s, offering its largest retail customers an ongoing discount of 5 per cent (on top of the existing 7.5 per cent), with a further 2.5 per cent during the 'general deals'. By the mid-1980s Tambrands' discounts were further divided to include four volume-related 'trade rates' (for minimum orders of 3 to 4, 5 to 9, 10 to 19 and 20+ cases) and a wholesale rate (8 cases). One of the main retailers then suggested that Tambrands introduce a new allowance to reflect the fact that it was purchasing the full Tambrands range and in quantities significantly greater than 20 cases. In response Tambrands put together the special contract terms, which included a condition that retailers should continue to stock the full range. Tambrands told us that the special contract terms were probably formalized at the time of the July 1986 price increases.

3.13. The mid-1980s also saw significant changes in the chemist sector. There was greater concentration between chemist wholesalers which, as a result, offered improved distribution to pharmacies. At the same time, the role of independent chemists in the retailing of toiletries and similar products declined considerably. In 1988 Tambrands decided to move towards trading with the independent sector via pharmaceutical wholesalers, rather than through a direct sales force. In formalizing terms with these pharmaceutical wholesalers, Tambrands offered a standard 15 per cent discount for pharmaceutical wholesaling and included a range-stocking requirement.

Special contract terms

3.14. A copy of the special contract terms and conditions applicable in July 1995 is at Appendix 3.1. The conditions require the retailer to purchase at least 150 cases per order, made up in pallet quantities; to pay within the time period specified in the terms; and to stock the full range of Tambrands tampons.

3.15. A case used to be the standard purchasing unit for retailers and wholesalers. Since each cardboard case at that time contained the same number of tampons (1,440), it was also used as a shorthand unit of measurement. However, with the increase in the number of products, pack sizes and absorbencies offered by Tambrands, as well as developments in packaging, cases no longer come in standard sizes or configurations. The company therefore uses an SU of 1,440 tampons as its standard unit of measurement. Following earlier precedents, the special contract terms include a requirement to purchase at least 150 cases, but in reality this means 150 SUs or at least 216,000 tampons.

3.16. The special contract terms also require retailers to purchase in pallet loads. Each pallet is made up of a single line of product (for example, Tampets regular 16s), but may be arranged in a number of different configurations, depending upon the retailers' preference. The configuration will determine the amount of the product contained in the pallet. A description of pallet configurations possible for each product line is set out in Appendix 3.2. Tambrands told us that in order to meet the 150-case requirement, retailers would normally have to order a minimum of nine pallets. Since standard delivery lorries hold up to a maximum of 22 pallets, this would amount to over one-third of a lorry.

3.17. As far as the range-stocking condition is concerned, it is accepted by Tambrands and retailers that there is no requirement for retailers purchasing under the special contract terms to stock the full Tambrands range in all their retail outlets. Moreover, no single order has to comprise all the different products within the range, nor are there minimum purchasing levels for individual product lines. Tambrands would only be concerned if a retailer failed to stock the full product range-subject to any agreed concessions-in any of its stores.

3.18. Tambrands estimated that the requirement to order 150 cases in pallet quantities saved an estimated 5 per cent in labour (eg picking, labelling and hand-loading trucks) and transport costs as shown in Table 3.2. But it stressed that this would vary from customer to customer and over time. In some cases, the move by retailers from branch delivery to central distribution resulted in a further savings in sales force costs. In addition, the commitment to pay within the time period specified in the terms reduced average days of credit by approximately 20 days.

TABLE 3.2 **Estimated savings to Tambrands of special contract terms**

<i>Saving</i>	<i>% of sales volume</i>	
Pallet quantities (labour)	2.4	
Dedicated truck v general load	0.2	
Payment to terms	0.5	
Improved inventory management	<u>0.2</u>	3.3
Sales force costs (where applicable)		<u>2.0</u>
		5.3

Source: Tambrands.

3.19. Tambrands told us that nine retailers currently purchase from Tambrands under the special contract terms. Boots, Sainsbury's, Tesco, Superdrug Stores plc (Superdrug) and Asda Stores Ltd (Asda) moved to the special terms in 1986. By 1992 they had been joined by Safeway Stores plc (Safeway), Wm Morrison Supermarkets PLC (Morrison's), Somerfield and Waitrose.

3.20. The special contract terms do not offer a unified level of discount on standard retail terms. Appendix 3.3 shows that Boots, Safeway, Sainsbury's, Tesco and Superdrug generally enjoy a higher level of discount [*] than Waitrose, Asda, Morrison's or Somerfield. The range of discounts is greatest for the Tampets lines, [*Details omitted. See note on page iv.*]. Some retailers have negotiated additional discounts for particular deliveries where they assume responsibility for collection. [

Details omitted. See note on page iv.
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3.21. In addition to variations in discounts, all nine retailers have negotiated concessions to the special contract terms shown in Table 3.3. [

Details omitted. See note on page iv.
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TABLE 3.3 **Current concessions on special contract terms**

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Details omitted. See note on page iv.

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*Details omitted. See note on page iv.

Chemist wholesaler terms

3.22. Tambrands' chemist wholesaler terms are open to pharmaceutical wholesalers which order at least seven cases and stock the full range of Tambrands' products. For this they receive a discount of 15 per cent on standard retail terms. These terms currently apply to 30 chemist wholesalers (listed in Appendix 3.4).

3.23. There is no requirement for individual orders to include all Tambrands' product lines, nor is there a minimum order quantity for each product line. However, chemist wholesalers are required to list all Tambrands' product lines in the catalogues they send to individual retail chemists, and meet any order for Tambrands' products they may receive from their customers. Tambrands told us that the cases may be broken down further to meet the individual orders from chemist customers.