

# 6 Views of the main parties

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## Introduction

6.1. This chapter summarizes the views of Cargill and Cerestar (the main parties) provided in written submissions and at hearings. The main parties provided joint views throughout, except at one brief hearing for each company separately.

## Background and rationale

6.2. Cargill explained that the demerger of the EBS group in June 2001 had been perceived as a signal that Montedison wished to dispose of its majority stake in Cerestar. The following month Cargill approached Montedison about a possible acquisition of its shareholding. The proposed transaction was unusual for Cargill's European food processing business, which in the past had tended to purchase assets rather than shares in whole companies. Although other companies were thought to be interested in parts of the Cerestar business, Cargill secured exclusive negotiating rights for 30 days on the basis of its interest in the whole global operation. Cargill emphasized that the glucose syrups and blends business in the UK represented only a small part of Cerestar's total business and was not a driver in Cargill's decision to acquire Cerestar. The share purchase agreement with Montedison was conditional on EC and US clearance (both achieved by early April); Cargill was therefore required to proceed with completion of the acquisition irrespective of clearance by the UK authorities. After acquiring Montedison's majority interest, Cargill was required under French securities law and the terms of the share purchase agreement to make a follow-on offer for the remaining Cerestar shares listed on the Euronext Stock Exchange.

6.3. The main parties emphasized the benefits they saw flowing from the merger:

(a) Cargill would gain access to global manufacturing capabilities for a broad range of higher-value products, together with associated research and development facilities and customer service operations. This would fit with the company's aspirations, in response to customer demands, to move further into the production of specialty starch derivatives such as polyols and modified starches. While the company would remain committed to producing bulk commodities as efficiently as possible, the merger strategy was based on moving into higher-value production.

(b) [ *Details omitted. See note on page iv.* ]

(c) Cerestar believed it would benefit from becoming part once again of a global agro-industry group, rather than remaining a European constituent of a diversified multinational group no longer committed to the agri-food sector.

(d) Although the UK had not been a driving force for the merger, [

*Details omitted. See note on page iv.*

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## Wider market context

6.4. Although the reference to the UK competition authorities was limited to one product area (glucose syrups and blends) and restricted to one geographic area (the UK), the main parties urged us to appraise the merger in a wider context. In this respect, in addition to issues related to the geographic market, pricing and transport (discussed below), in their view it was necessary to take account of:

(a) *The wide range of products resulting from the industrial wet-milling of agricultural products.* Outside the glucose syrups and blends sector, there was little overlap between Cargill's products and the high-value products Cerestar produced, including dextrose, isoglucose, polyols, modified starches and caramels.

- (b) *The supply-chain for food and drink retail products using glucose syrups and blends often criss-crossed the English Channel.* Most raw materials used in the production of glucose syrups and blends consumed in the UK was sourced from Continental Europe, including all those inputs used by the Cargill and Cerestar facilities at Tilbury and Manchester and all those inputs used to produce imported glucose syrups and blends sold to UK customers; some of the UK-produced glucose syrups and blends were exported to the Continent to be incorporated into food and drinks; all UK-produced food and drink using glucose syrups and blends (whether from imported or domestic product) competed on supermarket shelves with food and drink produced on the Continent. The main parties said that they were operating in a much broader and competitive environment than simply the supply of glucose syrups and blends in the UK.

## **Product market**

6.5. The main parties saw considerable overlap between the different sectors of the sweeteners' market. Although recognizing that sugar was generally a separate market, because of the EC regime, they pointed out that there were certain applications, for example in some fermentation processes, in which sugar (and other carbohydrate sources such as molasses) competed with high DE glucose syrups; glucose syrups and blends were technically substitutable for sugar (and other natural and artificial sweeteners) in many other processes; many companies produced both sugar and starch-based sweeteners, reflecting a shared customer base for the two products. The main parties said that, while fructose was formerly a separate market from that for glucose, the development of fructose/glucose blending had resulted in a single blends and syrups market comprising a wide spectrum of products.

6.6. The main parties argued that there was a high degree of demand-side substitutability between different grades of product. As the grades suitable for different applications overlapped, there was, they said, no meaningful way of sub-segmenting within the spectrum of blends from a demand-side perspective.

6.7. On the supply side, the main parties maintained that all the major producers were technically capable of producing the full range of glucose syrups and blends by slightly modifying production settings or varying the proportions of glucose and fructose in blends. The only supply-side constraints related to blends containing 10 per cent or more fructose since the EC quota system for isoglucose and inulin syrups obliged non-quota-holders, such as Cargill, to purchase fructose from quota-holders or to import crystalline fructose under special trade arrangements between the EC and certain third countries. Cerestar did not own an isoglucose production quota in the UK (the only company to own a UK quota being Amylum) and had to import fructose from its plants in the countries where it held quotas, ie Spain, Italy and Germany, or from third parties. (See Appendix 3.2 for further details on the EC regime for sugar and isoglucose.)

6.8. The main parties said that the various processes for the production of glucose syrups and blends (ie based on acid or enzyme conversion methods) were not an issue in relation to the product market. Product grades with equivalent functionality could be produced by different processes, and customers tended to focus on the properties and functionality of different grades rather than the production processes used.

## **Geographic market**

6.9. The main parties maintained that the geographic market for glucose syrups and blends should be regarded as EC-wide. They cited the following as key factors:

- (a) substantial trade flows between the UK/Ireland and Continental Europe;
- (b) evidence of active competition from Continental European producers in parts of the UK and Ireland (and in other 'peripheral' areas of the EC) and of customers in the UK and Ireland looking to Continental Europe for supplies;

- (c) comparable cost positions of UK and Continental producers on a delivered basis (ie including transport costs);
- (d) the absence of specific UK demand characteristics; and
- (e) the absence of technical barriers to transporting glucose syrups and blends across the English Channel and the North Sea.

### ***Trade flows***

6.10. HM Customs and Excise statistics, cited by the main parties, indicated that in 2000 imports had accounted for over 20 per cent of UK consumption of glucose syrups and blends, and exports for around 10 per cent of production. Imports into the UK had increased significantly over the last five years. The main parties pointed out that the level of imports and exports was well above the level normally regarded as evidence for a wider geographic market. Cargill and Cerestar maintained that if prices in the UK were to rise above current levels (relative to prices in Continental Europe), Continental producers would immediately redirect their efforts to competing for more business in the UK and customers would readily switch purchases to these producers.

6.11. While the increase in sterling's strength against European currencies from 1996 had coincided with the increase in imports, the main parties argued that the currency effect had been limited, partly because of the operation of the Common Agricultural Policy (CAP) and partly because prices in the UK had had to be reduced proportionately more than in Continental Europe so as to maintain UK competitiveness. In elaboration, the main parties explained that agricultural inputs—a large component of cost for glucose syrups and blends—were set under the CAP in euros (or earlier in European Currency Units). Moreover, they said, when sterling had appreciated sharply against European currencies, it had been necessary to reduce sterling prices substantially to forestall an influx of imports. This had had to be supported by aggressive cost-cutting at the UK plants. While prices for glucose syrups and blends in both the UK and Continental Europe had been falling over this period as more capacity came on stream and prices for agricultural raw materials had fallen, the main parties pointed out that Cargill's average sterling prices had dropped by almost [§] per cent between 1996 and end-2000, as against a drop in their average Continental prices over the same period of almost [§] per cent.

6.12. Nonetheless, as a research study conducted on behalf of the main parties by the consultancy firm NERA showed, the average price trends concealed wide variations between individual product prices throughout the EC. NERA's analysis of the prices of the 15 product categories sold by Cerestar, both in the UK and at least one other EC member state between 1998 and 2001, revealed differences in the weighted average prices for individual products ranging from a [§] per cent higher price in the UK to a [§] per cent higher price in Continental Europe. According to Cerestar, these differences were related to the volumes and product mix of orders placed by major customers located in particular regions of the EC.

6.13. The main parties attributed the increase in imports into the UK to the competitive advantages brought about by the new capacity which had come on stream on the EC mainland (for further discussion, see paragraph 6.14), notably the Roquette and Amylum plants in Northern France. More recently this had been supplemented by an intensified sales effort in the UK by Continental manufacturers without plants here, including Roquette (which had no UK production prior to its acquisition of the ABR Corby plant in 2000), Syral and Pfeifer & Langen—the latter two of which had appointed UK agents—and were increasingly targeting customers in the UK. While recognizing that some of the imports were intra-company transactions, the main parties argued that for market definition purposes imports by firms with plants in the UK and imports by firms without such plants were equally important, since both demonstrated that the main parties' competitors competed to supply customers located in the UK from Continental plants. The main parties also argued that the market structure in the rest of the EC showed that it was possible competitively to supply customers on a cross-border basis. Some major producers operating from one large Continental plant supplied customers throughout the EC, as confirmed, in Cargill's case, by an analysis of delivery distances from its plant at Bergen-op-Zoom conducted by the consultancy firm NERA (see Figure 3.4).

### ***Comparative cost positions of UK and Continental plants***

6.14. The main parties argued that the cost elements for glucose and blends should be looked at ‘in the round’, without isolating merely the transport costs. The cost of raw materials was by far the largest cost component, considerably exceeding the costs of other elements such as transport. Since all Cargill’s and Cerestar’s UK production of glucose syrups and blends is based on imported maize (and around 70 per cent of UK consumption is of glucose syrups and blends made from raw materials grown in Continental Europe), the main parties said that there was no significant disadvantage in serving the UK from Continental plants as compared to the main parties’ Tilbury and Manchester plants. In particular, the former enjoyed four competitive advantages in supplying to the UK, more than outweighing the relative cost advantages UK-based plants gained from lower transport costs in delivering glucose syrups and blends to UK customers:

- (a) Many Continental plants processed local wheat, giving a substantial cost advantage over Cargill’s and Cerestar’s maize-processing plants in the UK, because the net cost of wheat was lower than that of maize (ie net of various by-products, including the highly-valued wheat gluten). The main parties calculated that this translated into a cost advantage of around [§] per cent on an average sales price of €350 per tonne. The main parties believed, moreover, that the cost advantage for wheat-based production would be sustained, since the EC would remain structurally in surplus in wheat but moderately in deficit in maize. The chemical compositions of wheat-based glucose syrups and blends were identical to those produced from maize (the GMO-related doubts about maize raised some years ago were no longer a significant concern because of the introduction of traceability systems).
- (b) The major plants on the European mainland were situated close to large wheat- or maize-growing areas. The Tilbury and Manchester plants, in contrast, had to import maize from south-west France via seagoing barges. The main parties calculated that the proximity of Continental producers to their raw material sources gave the latter a cost advantage—taking account of different yields of wheat and maize—ranging from around [§] per cent on an average sales price of €350 per tonne.
- (c) All five UK glucose plants were smaller than the major Continental plants, and consequently suffered significantly reduced economies of scale. Cargill estimated that around [§] per cent of operating costs (ie costs other than raw materials) were fixed costs which gave rise to economies of scale. Cargill also calculated that in 2000 the Amylum plant at Nesle had total costs (excluding depreciation) of around US\$[§] per tonne of grind, whereas Cargill’s equivalent cost at Tilbury was US\$[§] per tonne.
- (d) Operating costs in the UK had increased significantly in relative terms since 1997 as a result of the appreciation of sterling against the euro.

6.15. The main parties maintained that transport costs from Continental plants to customers in the UK were outweighed by the countervailing advantages enjoyed by Continental plants and in no way acted as a barrier to trade. Transport costs from Cargill’s Bergen-op-Zoom plant were on average about the same as those from the Tilbury plant, representing about [§] per cent of the average delivered price. Average transportation costs from Bergen-op-Zoom to individual countries ranged from [§] to [§] per cent of the average delivered price. Based on indicative quotations the parties had secured from transport companies to carry glucose syrups and blends from the nearest Continental-based suppliers to various locations in the UK, the transport cost differential between supplying these locations from Tilbury and from the Continent ranged from [§] to [§] per cent of an average sales price of €350 per tonne of glucose. The main parties pointed out that glucose producers in the UK nowadays contracted out transport services to independent logistics companies, which sought to compete for cost-effective transport over long distances; some, for example, were able to exploit opportunities for backhauling of loads.

### ***No specific UK demand characteristics***

6.16. According to the main parties, customer preferences in the UK and the rest of Europe did not differ significantly and no specific grades of glucose syrups and blends were peculiar to the UK. Brands

did not play an important role in either the UK or Continental Europe. Around [redacted] per cent of Cargill's UK sales and around [redacted] per cent of Cerestar's sales were made to customers who formed part of wider groups using glucose syrups and blends both in the UK and in Continental Europe. An increasing number of customers demanded European-wide contracts, sometimes setting a single price for all locations. With increasing consolidation on the demand side, the main parties considered it likely this trend towards pan-European purchasing would continue.

### ***No technical barriers***

6.17. The main parties explained that only high DE products (95 DE and above) containing a high proportion of dry solids required special handling and even then only during long-distance transport in extreme winter conditions, so as to avoid any risk of crystallization. Glucose could easily be transported in unheated tankers for two to three days, covering a wide radius within Europe. Cargill, for example, told us that it sold 95 DE syrups from Bergen-op-Zoom throughout Europe and used transport with heating for less than [redacted] per cent of its EC sales. In all other circumstances, glucose syrups and blends were transported in standard general food tankers. Cargill estimated that, even where the heating facility in a special tanker is switched on, this heating cost amounts to only about €[redacted] per tonne of glucose a day.

6.18. In the main parties' view, just-in-time deliveries, which some customers feared would be difficult for long-distance suppliers to meet, were a misnomer in the context of all industries using glucose syrups and blends. They said that customers were able to predict their requirements in advance and to place orders to ensure that deliveries arrive when required; last-minute ordering could be avoided. Over [redacted] per cent of Cerestar Manchester's customer orders were received on Thursday for delivery during the following week and less than [redacted] per cent of customer orders at both Manchester and Tilbury, and [redacted] per cent at Bergen-op-Zoom, were received within 24 hours of delivery. On this timescale, orders from customers in the UK could be met without difficulty from the Continent. Most of the main parties' customers had invested in sufficient storage facilities to optimize logistical planning, but a few customers, including some large companies, had not done so. Telemetric links installed at customers' plants, with the help of Cargill and Cerestar, monitored stock levels and greatly facilitated timely ordering; [redacted] of Cargill's top 20 customers, with the sites in question accounting for around [redacted] per cent of Cargill's 2001 sales volumes, had such links.

### **Post-merger competition issues**

6.19. The main parties noted that the EC market for glucose syrups and blends was relatively concentrated on both the supply side and (following recent consolidation in the food and pharmaceutical industries) on the demand side also. This reflected the significant economies of scale associated with large production plants and the pressure on margins in the food industry generally. They argued that both demand and supply in the UK would remain healthy following their merger.

6.20. On the supply side, all the major producing companies had recently invested in expanding capacity, including Amylum at Nesle in France, Roquette in Corby in the UK and at Lestrem in France, and Syral in Alsace. Much of the expansion had been to exploit the net cost advantages of wheat as an input, the proportion of total milling production based on wheat having risen from 24 to 36 per cent between 1990 and 1999. The main parties maintained that competition between suppliers became particularly acute at times when capacity was being expanded because their high fixed operating costs obliged them to try to maintain high-capacity utilization. Because demand grows relatively evenly whereas new capacity comes on stream in blocks, the supply and demand balance for glucose syrups and blends tended to be cyclical, for example in the mid to late 1990s when there had been substantial growth in capacity, leading to strong downward pressure on prices and margins. There had been substantial growth in demand for glucose syrups and blends throughout the 1990s, in line with the growth in demand in food and non-food applications. Cerestar estimated that total sales in the EC had increased from around [redacted] million tonnes in 1990 to around [redacted] million in 2000—an average annual growth of [redacted] per cent.

## ***UK supply and demand***

6.21. The main parties said that the UK was an important area of demand for glucose syrups and blends, currently accounting for around 20 per cent of total EC demand. They considered that customers in the UK were particularly well placed for the supply of glucose syrups and blends, being the only country where Amylum, Roquette, Cerestar and Cargill all had plants, plus an additional local supplier, Grants. UK customers were also close to northern France and Benelux where the recent expansion of EC milling capacity had been concentrated. As in the rest of the EC, surplus capacity and intense competition among suppliers had pushed down UK prices in recent years, compounding the competitive disadvantages the UK plants faced (see paragraph 6.14).

6.22. While their combined share of supply in the UK, extrapolated from 2000 data, would be 49 per cent, the main parties estimated their combined pro-forma share fell to 45 per cent if the data included sales of syrups containing more than 10 per cent fructose by Amylum and importers, as well as sales by Amylum to its sister citric acid company. [

*Details omitted. See note on page iv.*

] In general, the main parties emphasized that changes in market share among the leading glucose-producing companies over time, both in the UK and wider EC, showed that the pattern of supply and demand for glucose syrups and blends was highly competitive and dynamic.

6.23. According to the main parties, buyer power was strong, and customer loyalty weak, in the glucose syrups and blends business. An analysis of ‘customer churn’ carried out on its behalf by NERA, a consulting company, showed that between 1996 and 2001 Cargill lost the whole business of between [ ] and [ ] per cent of its customers in the UK and won between [ ] and [ ] per cent of its customers. Even higher fluctuations were traced in an analysis of partial switching by customers to other suppliers.

6.24. The main parties argued that, against a background of continuing competition from other suppliers, it was implausible to suggest that the merged entity could restrict output in an attempt to increase prices without volumes being taken up by their competitors. They also argued that the market for glucose syrups and blends would not be vulnerable to coordinated action, or tacit collusion, by market players. Among the factors they particularly emphasized were:

- insufficient industry concentration, with other suppliers in a position to destabilize any concerted attempt by the three market leaders to raise prices;
- demand growth, which would allow further new entry or expansion by existing players if there was any attempt by the main suppliers to delay the introduction of new capacity;
- low product homogeneity and low market transparency;
- the high degree of asymmetry in cost structures between different suppliers (resulting from differences in input materials, geographic location and economies of scale);
- the importance of maintaining high capacity utilization rates arising from the high level of fixed costs relative to variable costs which would inhibit attempts to raise prices by restricting production; average unit costs fell significantly with high capacity utilization—Cargill had estimated that in the current financial year loss in volume leading to a fall in capacity utilization from [ ] per cent to [ ] per cent would result in a loss of profit after tax of around [ ] per cent at its Tilbury plant;
- buyer power; and
- the dynamic and competitive nature of the market for glucose syrups and blends.

6.25. Underlining their view that coordinated action or tacit collusion were highly unlikely, the main parties said decisions about capacity utilization and investment involved a number of calculations, ultimately related to profit margins and return on investment. They said new capacity for glucose syrups and blends production was not dedicated to sales in a particular EC member state or area; Continental-based capacity could be directed to serve customers in the UK, just as UK-based capacity could be directed to exports to the Continent. They emphasized that the lack of transparency in the industry would make it extremely difficult for companies to use announcements on capacity issues as a means to coordinate tacitly or to detect non-compliance with a putative tacit understanding; there would be a strong temptation for each company to deviate from any such understanding by optimizing its own capacity utilization or installing new capacity when opportunities arose; the threat that other suppliers would add new capacity in retaliation was not credible, since new refining capacity would be a long-lived asset; meanwhile, the fringe players would undermine any attempt at coordination and increase their market share.