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***Case No IV/M.1127 - NESTLE / DALGETY***

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**REGULATION (EEC) No 4064/89**
**MERGER PROCEDURE**

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Article 6(1)(b) NON-OPPOSITION
Date: 002/04/1998

*Also available in the CELEX database*
*Document No 398M1127*

Office for Official Publications of the European Communities
L-2985 Luxembourg

COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 2.04.1998

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

**To the notifying party**

Dear Sirs,

**Subject: Case No IV/M.1127 - Nestlé/Dalgety**

Notification of 27.02.1998 pursuant to Article 4 of Council Regulation N°4064/89

1. On 27.02.1998 the Commission received a notification of a proposed concentration pursuant to Article 4 of Council Regulation (EEC) No 4064/89 ("the Merger Regulation") by which Nestlé SA. ("Nestlé") of Switzerland acquires within the meaning of Article 3(1)(b) of the Merger Regulation control of the Spillers pet food business ("Spillers") of Dalgety PLC ("Dalgety") of the UK.

## I THE PARTIES AND THE OPERATION

2. Nestlé is a large multinational company. Nestlé is and has traditionally been involved primarily in the production, marketing and sale of a large variety of nutrition products, including pet food.

3. Dalgety is a British food manufacturer including pet food manufacture, food distribution and agribusiness.

4. The operation consists of Nestlé acquiring the Spillers pet food business from Dalgety by way of purchase of shares and assets.

## II THE CONCENTRATION

5. The operation will give Nestlé sole control over the Spillers business of Dalgety. The operation thus constitutes a concentration within the meaning of Article 3 (1)(b) of the Merger Regulation.

Rue de la Loi 200, B-1049 Bruxelles/Wetstraat 200, B-1049 Brussel - Belgium
Telephone: exchange 299.11.11
Telex: COMEU B 21877. Telegraphic address: COMEUR Brussels.

## III COMMUNITY DIMENSION

6. The undertakings concerned have a combined aggregate world-wide turnover of more than 5000 million ECU. Each of the undertakings has a Community-wide turnover in excess of 250 million ECU and they do not achieve more than two-thirds of their aggregate Community-wide turnover within one and the same Member State. The notified operation therefore has a Community dimension according to Article 1(2) of the Merger Regulation. It does not constitute a cooperation case under the EEA Agreement.

## IV. RELEVANT MARKETS

### A. Relevant product markets

7. The principal categories of pet food affected by the operation are industrial dog and cat food sold through grocery stores and specialist (non-grocery) stores. In addition, as a supplement to their cat and dog food business, Nestlé and Spillers both sell pet food accessories. This category includes a wide variety of products such as cat litter, cat and dog snacks, cat and dog hygiene products, cat and dog toys and leatherware, bird care, fish care etc. Whether the pet food accessory category constitutes one or several separate relevant product markets can be left open, since even on the narrowest possible market definition the concentration does not create or strengthen a dominant position as a result of which effective competition would be significantly impeded in the EEA or any substantial part of that area. In the following the focus is, therefore, exclusively on dog and cat food.

8. Concerning the distribution channels, it cannot be excluded that specialist stores are a separate relevant product market from grocery stores. However, this question does not finally need to be decided for the purpose of the present case, since it does not change the assessment of the competitive impact of the case, whether grocery and non-grocery stores are considered together or separately.

9. The parties have argued that there is one overall market for dog and cat food, which includes both home prepared (often scraps) as well as industrial dog and cat food. The Commission has already examined the pet food sector in case IV/M.554 - Dalgety PLC/The Quaker Oats Company. In that case the Commission found that industrial dog and cat food and home prepared pet food are not part of the same relevant product market. Furthermore, in that case there were indications that dog and cat food are separate relevant product markets and that even dry dog, wet dog, dry cat and wet cat could each be separate relevant product markets. However, in that case it was finally not necessary to decide in detail on the relevant product market definition, and the product market definition was left open.

<u>A.1. Demand-side substitutability</u>

10. It is recognised by the parties as well as competitors and customers that dog and cat food are not substitutes from a demand side point of view, because dogs and cats have different nutritional requirements.

11. The parties have argued that dry and wet cat food are substitutable and dry and wet dog food are substitutable. In particular they argue that:

- wet and dry are nutritionally equivalent
- most brands are available in both wet and dry formats
- consumers use both wet and dry in various proportions
- movements in the relative price per serving leads to shifts between wet and dry

The Commission questioning of customers and competitors showed a range of divergent views on this question. Therefore, it cannot be excluded from the evidence available, that dry cat and wet cat food and dry dog and wet dog food are separate relevant product markets from the point of view of the demand-side. However, it is not necessary to finally decide this issue, since it would not affect the assessment of the competitive impact of the operation.

A.2. Supply-side substitutability

12. The parties have argued that wet cat food and wet dog food are substitutable and dry cat and dry dog are part of the same relevant product market because of a high degree of supply-side substitutability. According to the parties the supply-side substitutability is due to the following factors:

- production, packaging, and raw materials are similar
- recipes and production processes are similar
- distribution channels are identical
- most producers who produce wet cat food also produce wet dog food
- most producers who produce dry cat food also produce dry dog food
- manufacturing lines can be shifted easily

However, similarity in terms of raw materials, packaging, production processes, distribution channels as well as the fact that the same machines are often used to produce both dry cat and dry dog food or wet cat and wet dog food respectively, are insufficient to create a single relevant product market for dog and cat food for the purpose of assessing the notified operation. The need to create and position a new product, to advertise and promote a new product or a new brand, and to obtain access to distribution outlets for the product means that the mere physical capability of production equipment to produce a number of different products is not sufficient for the conclusion to be drawn that wet cat food and wet dog food are part of the same relevant product market neither that dry cat food and dry dog food are part of the same relevant product market.

A.3. Conclusion

13. Dog food and cat food are not part of the same relevant product market.It cannot be excluded from the evidence available that dry cat food, wet cat food, dry dog food and wet dog food each constitute separate relevant product markets. However, for the purpose of the present case it is not necessary to finally decide this issue, since the competitive assessment of the case would not change, even if dry cat food, wet cat food, dry dog food and wet dog food were each to be separate relevant product markets.

**B. Relevant geographic markets**

14. According to the parties the geographic market for dog and cat food is the EEA. This concurs with the finding of the Commission in case IV/M.554 - Dalgety PLC/The Quaker Oats Company. In the present case the Commission notes that there are considerable trade flows between the EEA countries, and that several customers have stated that they source pet food on a European scale. Furthermore, the same brands are basically present in all EEA countries, and the market structure is broadly the same for all EEA countries. The operation is, therefore, assessed on an EEA level.

## V COMPATIBILITY WITH THE COMMON MARKET

**A. Market shares**

15. The market shares of the producers of industrialised dog and cat food are set out in the table below. In terms of the importance of the individual categories cat food and dog food each account for about 50% of total sales of pet food. Within cat food wet cat food accounts for about 80% of sales, and dry cat food only for 20%. Within dog food wet dog and dry dog food each account for about 50% of the total sales value.

**Market shares, value basis, 1996**

| | Dry cat | Wet cat | Tot. cat | Dry dog | Wet dog | Tot. dog | Total pet |
|---|---|---|---|---|---|---|---|
| Nestlé | [...][1] | [...][2] | [...][3] | [...][4] | [...][4] | [...][4] | [...][2] |
| Spillers | [...][3] | [...][5] | [...][5] | [...][2] | [...][3] | [...][3] | [...][3] |
| Tot. part. | [...][6] | [...][1] | [...][1] | [...][3] | [...][3] | [...][3] | [...][7] |
| Mars | [...][1] | [...][8] | [...][9] | [...][7] | [...][10] | [...][6] | [...][11] |

1 Deleted for publication : between 25 and 30 %
2 Deleted for publication : between 05 and 10 %
3 Deleted for publication : between 10 and 15 %
4 Deleted for publication : between 00 and 05 %
5 Deleted for publication : between 15 and 20 %
6 Deleted for publication : between 35 and 40 %
7 Deleted for publication : between 20 and 25 %
8 Deleted for publication : between 45 and 50 %
9 Deleted for publication : between 40 and 45 %
10 Deleted for publication : between 50 and 55 %
11 Deleted for publication : between 40 and 45 %

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Royal C. | [...][4] | 0 | [...][4] | [...][5] | 0 | [...][3] | [...][2] |
| Purina | [...][4] | 0 | [...][4] | [...][2] | 0 | [...][4] | [...][4] |
| Others | [...][3] | [...][2] | [...][3] | [...][1] | [...][5] | [...][7] | [...][5] |
| Priv. lab. | [...][5] | [...][5] | [...][5] | [...][3] | [...][7] | [...][5] | [...][5] |
| Total | 100 | 100 | 100 | 100 | 100 | 100 | 100 |

Note: Spillers is the second largest producer of private label in the EEA. It accounts for about [...][4] percentage points of the [...][5] % share of private label pet food in the EEA in the table.

16. As can be seen from the table, Mars is the market leader in all categories. Nestlé and Spillers are either number two or three in all categories with the exception of dry dog food, where Royal Canin is number two. The merged entity will be the leader in dry cat food and a clear number two in the overall pet food sector.

17. On a European scale the principal remaining competitors supplying branded products in competition with Mars and Nestlé/Spillers will be Royal Canin and Purina. Both of these companies specialise in premium dry pet food products mainly sold through specialist stores. Royal Canin is a French medium-sized company. It was listed on the stock exchange in 1997, but is ultimately controlled by Paribas via the Guyomarc'h Group. Purina is a subsidiary of the US company Ralston Purina, which main businesses are pet food and batteries. The remainder of the market is mainly made up of a number of smaller producers, who produce private label and in some cases also have their own regional or national brands.

**B. The market for dog food**

18. As can be seen from the table above, the new entity will be the number two operator with a market share of about [...][3] %. Mars will continue to be the market leader by a wide margin. It can also be seen that the operation is likely to have only a small impact on competition, since it will only lead to limited market share additions in the dog food market, where Nestlé is currently not very strong. In conclusion, the operation will not lead to the creation or strengthening of a dominant position in the dog food market.

**C. The market for cat food**

C.1. Current competition in the cat food market

19. Mars is the market leader with a market share of [...][9] % in 1996. Spillers is number two with [...][5] % and Nestlé number three with a market share of [...][3] %. Private label acounts for [...][5] %. The balance of [...][3] % is distributed between a number of specialist producers, national and regional brands. It should also be noted that Mars has its strength in wet cat food, whereas Nestlé is almost as strong as Mars in dry cat food. The new entity will be the future leader in dry cat food.

20. An examination of the development of prices, volumes and market shares over the last three years on the EEA level shows that the total market has been growing both in terms of volume and value, whereas prices have declined. The

BSE crisis may partly explain the decrease in prices, but it is only part of the reason.

21. The development of the market shares of the main competitors shows that Mars has lost market shares in the cat food market. Spillers has seen a marginal deterioration, whereas Nestlé and private label have increased their market share. There are also indications that Mars and Spillers have seen a relatively higher decrease in prices than their competitors. The development in market shares and prices in a growing market are indications of competition in the market.

22. The competition in the market has been driven by a number of factors. First, Nestlé has attempted to increase its market shares and have undertaken a number of promotional and product development efforts, which have challenged, among others, Mars. Second, private label has increased its market share from [...][4] % to almost [...][5] % within the last 5-10 years. The retail trade has been the driving force behind this development, and is expected to continue to develop the private label business in competition with the branded products of the main producers. It is estimated by the industry that there is room for private label products to capture further market share, and that it will, therefore, continue to provide competition to established brands.

C.2. Barriers to entry and potential competition

23. From the point of view of production, cat food is a relatively simple product. The technology is not particularly complicated, and the investment is modest. From this perspective barriers to entry would, therefore, not seem to be very high. This was indirectly confirmed in the Commission questioning of customers, who almost unanimously said that it would be relatively easy to find new producers of private label, if there were to be a decrease in the current capacity available for private label production.

24. Barriers to entry are, therefore, more likely to be present on the level of marketing and distribution. Branding is an important feature of the cat food market. To enter the market with a branded product would require large scale investments in advertising and distribution in order to get access to shelf space in stores. A large part of this investment would be sunk costs, and is, therefore, likely to constitute a barrier to entry. The large brands are in the possession of Mars, Nestlé and Dalgety. A new entrant with a branded product would not be able to enter by purchasing an existing brand, but would have to develop its own brand.

25. In conclusion it would be relatively easy for an entrant to supply private label. However, it would be much more difficult to enter with a branded product. Probably only a major international corporation with an existing brand would in reality have the possibility to do so. Royal Canin and Purina are basically not present in the cat food market at present. However, as major suppliers of branded dry dog food suppliers they would have the means and know-how to develop a presence as a supplier of branded products in the cat food market. Furthermore, the parties have mentioned in the notification that Heinz of the United States is a potential entrant to the market. Heinz has supplied pet food in the United States for many years. It bought the US pet food business of the Quaker Oats Company in 1995, and it is a leading supplier of pet food in the United States. Heinz is also already present in the EEA as a supplier of various types of other food products. Therefore, Heinz is considered a potential entrantto the EEA market for pet food.

C.3. Duopolistic dominance

26. The operation will create a supply structure of two large suppliers, which together will account for more than 70% of the market. Mars will continue to be the market leader with a market share of around [...][1] %, whereas Nestlé/Spillers will account for about [...][1] % (including Spillers private label business). Furthermore, the operation will create a new company, which will have a similar position to Mars in terms of its range of brands, production and logistics structure. In this sense Mars and Nestlé/Dalgety will, therefore, be on an equal footing with Mars as future competitors in the cat food market. The operation, therefore, raises the question whether it will lead to the creation of a position of duopolistic dominance in the cat food market.

27. In previous cases (e.g. IV.M/190 - Nestlé/Perrier, IV/M.619 - Gencor/Lonrho) the Commission has examined this issue by analysing such factors as the structural characteristics of the market, past market behaviour, and the impact of the operation on the incentives of the duopolists to compete.

28. The cat food market is a differentiated product market in the sense that there are many different brands, types of products, package sizes and categories of cat food. It is overall a moderately growing market, but with important differences between the two main segments of the market. The wet category is thus relatively mature, whereas the dry cat food category is relatively undeveloped and is expected to show more dynamic growth. According to the Commission investigation and market studies the dry category could grow by up to 6% per year on an EEA level, whereas the wet category is only expected to grow at half that rate. Furthermore, the cat food market is a market characterised by a certain degree innovation in terms of product development and packaging. Finally, the Commission has also found it likely that there is a relatively high degree of transparency in the market, among other things due to publicly available statistics and studies.

29. The Commission has no knowledge of past behaviour which can be characterised as anti-competitive parallel behaviour between Mars and Nestlé in this market. In view of the price and market share developments of the last years, the Commission does not find it likely that anti-competitive parallel behaviour has been a prevalent market feature in the past.

30. The large majority of third parties were either neutral or indicated that the operation would increase competition in the market. It has thus been stated that the operation would allow an alternative to Mars to develop, which would be beneficial for the market. Furthermore, several third parties indicated that private label would continue to develop in an important way, which would put a certain pressure on prices.

31. The Commission considers that a market with the structural features of the pet food market in principle could be subject to duopolistic dominance. However, the present operation will not result in the creation of a duopolistically dominant position. First, there will continue to be incentives for Nestlé/Spillers and Mars to compete. Mars will continue to be the market leader. Nestlé/Spillers will only be about two thirds the size and will have an incentive to catch up with Mars. Second, as mentioned above, Nestlé/Spillers will be stronger than Mars in dry cat food, whereas Mars will be the strongest in wet cat food. Consequently, as dry cat is expected to grow faster than wet cat, Mars will have an incentive to compete for the growth of the dry cat food category, if it wants to keep its leading position in the cat food market. Finally, it has been noted that significant potential competitors exist, notably Royal Canin and Purina in dry cat food, and Heinz for the overall cat food market.

### C.4. Conclusion

32. On balance taking into consideration all the above factors the Commission has come to the conclusion that the factors behind the level of current competition are likely to continue to spur competition in the foreseeable future. Consequently the operation will not lead to the creation or strengtheningof a dominant position.

## V ANCILLARY RESTRAINTS

33. The Sales and Purchase Agreement contains an obligation on Dalgety not to compete with the Spillers pet food business as it is carried out on the date of completion, for a duration of three years. The restriction on the seller only covers the Spillers business as it is carried out on the date of completion. Therefore, it does not prevent Dalgety from entering the pet food business in geographic markets, where Spillers is not currently present. Furthermore, the transfer of Spillers to Nestlé does not only involve goodwill, but also know-how. The duration of three years is, therefore, acceptable. Consequently, the non-compete obligation is directly related and necessary to the implementation of the concentration and thus ancillary pursuant to the Merger Regulation.

## VI CONCLUSION

34. For the above reasons the Commission has decided not to oppose the notified operation and to declare it compatible with the common market and with the functioning of the EEA Agreement. This decision is adopted in application of Article 6(1)(b) of Council Regulation (EEC) No. 4064/89.

For the Commission