Procter & Gamble/Gillette: the role of economic analysis in Phase I cases

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In July 2005, the European Commission has approved, subject to conditions, the acquisition of Gillette by Procter & Gamble. The merger creates one of the world’s biggest consumer goods producers with a combined turnover of roughly €50 billion. Although the companies are active in many markets, the Commission’s investigation showed that their activities overlap to a limited extent, mainly in the oral care sector. However, since the merger combines two leading global producers of branded consumer goods, the Commission examined carefully potential anticompetitive effects arising from the parties’ large combined products portfolio. The market investigation has, however, shown in this particular case that even after the transaction the parties would not be in a position to dictate conditions on retailers to the detriment of the consumers. The only remaining competition concern in the sector of battery toothbrushes could be solved by the parties’ commitment to divest of Procter & Gamble’s battery toothbrushes business. The case is a good illustration of the importance of economic analysis in conglomerate mergers and discusses for the first time the notion of category captainship/management.

1. Introduction

Procter & Gamble (‘P&G’) is well-known for its branded products, in particular in the field of household, beauty, baby and family care products. P&G’s brands include ‘Ariel’, ‘Pringles’, ‘Oil of Olay’, ‘Tampax’, ‘Always’, ‘Pampers’, ‘Fairy’, ‘Head & Shoulders’ or ‘Pantene’. Gillette is a multinational manufacturer of consumer products, offering blades and razors, oral care products and batteries, under brand names such as ‘Gillette’, ‘Oral B’ or ‘Duracell’. After the merger the combined entity would own 21 brands with a turnover of more than one billion dollars.

After the transaction, Gillette will become a wholly-owned subsidiary of P&G.

2. Possible dominance?: The investigation of horizontal concerns

Although both companies are active on a large number of markets, their activities overlap only on a relatively limited number of product markets. The overlaps concerned the oral care sector (markets for toothbrushes, toothpaste, dental floss, mouthwashes, whitening preparations), the personal care sector (antiperspirants/deodorants, shaving formulations, male fragrances, shower gels) and small household appliances. However, the only significant overlap appears in the markets for toothbrushes.

a) From simple manual to High Tech: Toothbrush market definitions

The product market definition for toothbrushes has been subject to an extensive market investigation. The Commission has previously considered the relevant product market for manual toothbrushes as separate from powered brushes (i.e. rechargeable and battery driven toothbrushes), however left the exact product market definition open. According to the parties the market for toothbrushes should be divided into two different product markets: on the one hand the market for manual and battery toothbrushes and on the other hand the market for rechargeable toothbrushes.

The Commission’s investigation showed, however, that manual toothbrushes exert only negligible competitive constraints on the other toothbrushes markets. Manual toothbrushes were therefore assessed separately from battery and rechargeable toothbrushes. Regarding the market(s) for battery and rechargeable toothbrushes, a number of arguments militate in favour of two separate relevant markets. Most customers said that they would not switch to stocking rechargeable toothbrushes if prices of battery toothbrushes were increased significantly. Furthermore, brushing efficiency of rechargeable brushes seems to be superior to battery brushes (mainly because battery brushes lose power over their lifetime).

However, since the rechargeable market is split between low end and high end (premium) products, the separation between battery and rechargeable toothbrushes markets is blurred. On the demand side there is no difference between the low end rechargeable and the battery toothbrushes as prices are similar. Gillette (being rather on the premium battery market) has an average price for battery toothbrushes at €10 (varying between
5 and 20 according to the quality and the Member States). The low end rechargeable toothbrushes are priced from € 20 whilst the top end rechargeable are priced between € 100 and 150. This continuum of prices between high end batteries and low end rechargeable is reinforced by the fact that these toothbrushes are sold together in the same category product mainly on the same shelves, and are difficult to distinguish for the end consumers (similar appearance, both types having replaceable head-ends).

However, the Commission has decided to leave it open whether battery and rechargeable toothbrushes belong to the same product market or if a joint product market for powered toothbrushes has to be defined, since no competition concerns would occur under either market delineation.

b) Geographic market definition: Markets are still national

The market investigation has confirmed that European retailers still negotiate on a national level with the national sales representatives of their respective suppliers. Even bigger retailers do not negotiate with suppliers from another Member State or even on a European-wide basis. The Commission has therefore decided to define national toothbrushes markets. This market delineation is further corroborated by substantially different market shares and significant price differentials between different Member States (e.g. for battery toothbrushes with prices for the same product from € 1.8 to € 8.2 and an average price difference of around 30% between Member States). Similarly, P&G’s and Gillette’s pricing policy is set at a national level. The market investigation has also confirmed that consumer preferences are still diverging between different Member States (e.g. Southern countries being less technology driven than Northern countries). As a result, the main competitors’ sales strategy varies in different Member States, and toothbrushes are sold under many different brand names in different Member States.

c) Competition concerns: Parties dominating power brushing in Europe?

P&G is currently only active in the production of battery toothbrushes sold under the brand name ‘SpinBrush’ and the co-brands ‘Blend-a-Dent’, ‘Blend-a-Med’, ‘Blendi’, ‘Crest’ or ‘AZ’. Gillette produces the full range of powered toothbrushes (battery and rechargeable products) under the ‘Oral B’ brand.

On a combined market for powered toothbrushes (battery and rechargeable toothbrushes) as well as on a separate battery toothbrushes market, the parties would hold high market shares with significant increments in a large number of Member States. In the case of a combined powered toothbrushes market, the merger would combine the clear market leader with the current number 3 in most markets and eliminate a credible competitor to the market leader. In the case of separate markets, the merger would combine the current number 2 and 3 in the battery toothbrushes market, eliminating a potential entrant to the rechargeable toothbrushes market.

From a dynamic point of view, the relative strength of the parties in the market is further corroborated by the fact that the parties have increased substantially their EEA-wide share over the last two years (from [25-35]% in 2002 to [45-55]% in 2004 in a hypothetical battery market and from [45-55] to [65-75]% in a powered toothbrushes market) while their main competitors have lost market shares during this period.

Moreover, competitors have reported that the barriers to enter the market for powered toothbrushes are high compared to other consumer goods. This is not only because Gillette and P&G hold a large number of important patents for powered toothbrushes and have good access to the shelves of the retailers, but also because any new entrant to the oral care market needs to establish a good reputation for its products in order to be successful on the powered toothbrushes market. The market investigation has shown that building a competitive brand image implies not only significant promotion costs, but establishing good relations with European dentists whose recommendation is, according to the market test, a key factor for the success in the powered toothbrushes market.

The competitive concerns are not limited to the horizontal overlaps in the parties’ battery toothbrushes activities. It will also strengthen Gillette’s position on the rechargeable segment/market. Many competitors have explained that the battery segment can be regarded as an ‘entry segment’ to the more profitable rechargeable toothbrush business, since it helps acquiring the necessary knowledge on rechargeable toothbrushes. The parties’ ability to offer the full range of both low-end and high-end powered toothbrushes and to use the ‘Oral B’ brand name for low-end products will strengthen their position on the battery segment. This could deter new entrants to the battery market, which would, subsequently, also deter new entrants to the rechargeable market (since the battery market is seen as entry segment for the rechargeable market which has even higher barriers to entry). Indeed, market entry to both, battery and rechargeable toothbrushes could become more difficult after the
merger, since a new entrant would have to compete with a ‘full-liner’ who offers the full range of products with a well-established brand name.

**d) The solution: SpinBrush divestiture**

In order to solve the competition problems identified above, P&G committed to divest its entire SpinBrush toothbrushes business in the territory of the EEA. P&G committed also to grant a two-year licence for the co-brands used on these toothbrushes (‘Crest’, ‘Blend-a-dent’, ‘Blend-a-Med’, ‘Blendi’ and ‘AZ’) and not to re-introduce the licensed brands in the countries for which the license has been granted within a period of at least four years after the termination of the license agreements. As the commitment covers the whole of Procter & Gamble’s battery toothbrush business, it eliminates the competition problems on the markets for powered toothbrushes (battery and/or rechargeable toothbrushes).

### 3. Foreclosure possible?

**The investigation of non-horizontal concerns (bundling, category management)**

Given the large number of well-known brands both parties are able to offer after the merger, the Commission has also carefully investigated whether anticompetitive ‘conglomerate effects’ can be expected as a result of the merger. It focused, in particular, on the possibility of foreclosure of competitors to the detriment of the end consumer. The market investigation covered i.a. potential competition problems that might occur as a result from offering bundled products, rebates or promotions. The Commission has also examined whether the parties’ involvement in the retailers’ management of shelf allocation decisions (‘category management’) might enable them to obtain control over their customers’ shelves, thereby causing harm to competitors and consumers.

**a) Foreclosure through bundling**

The Commission has examined whether the merger would enable the parties to impose weak brands on their customers, to foreclose competitors from access to the retailers’ limited shelf space or to hinder entry of new products into the market, using bundling practices. In particular, the Commission has investigated whether the parties might be able to oblige their customers to buy ‘weak’ products together with a strong ‘must stock’ product (‘pure bundling’) or if they grant better conditions for the joint purchase of bundled products (‘mixed bundling’). In particular rebates (rebates across-the-board and incentive bonuses) and promotions have been mentioned by complainants as one possibility to enhance the parties’ presence on the shelves.

Regarding in particular pure bundling, anticompetitive conglomerate effects are more likely to arise when the two merging parties offer goods which are highly complementary in demand. The broad range of products offered by the parties cannot be regarded in general as complementary in demand.

In terms of bundling rebates, the parties submitted data demonstrating that rebates granted by them to smaller or larger retailers or even among same size retailers do not vary significantly within the same Member State. The market investigation has shown that P&G grants rebates predominantly based upon concepts such as a ‘mixed truck-load’ rebate scheme (the customer will benefit of the highest rebate only if it purchases from the most productive factory of the parties with the lowest cost of transport). The parties and some retailers reported that incentive bonuses to introduce new products are at present relatively limited compared to the overall rebates granted. Since the parties have already a large portfolio today, this situation is not likely to change in the future. Moreover, the retailers have indicated that even in the case of increased margins for branded products they would not consider to stop selling private label products, with which they can achieve even higher margins than with branded products.

In terms of bundling promotions, the retailers confirmed that cross-promotions are mainly organised in the same product category (for example washing powder plus softener and usually on a ‘buy one get another one’ basis). Indeed, it does not make sense economically to combine promotions between the whole variety of many differentiated products offered by the parties (e.g. between feminine care and male wet shaving). Moreover, the risk of anticompetitive effects is mitigated by both the existence of strong competitors as well as countervailing buyer power of the main customers.

Indeed, there is significant competition between other branded product suppliers having a sufficiently broad product range. Therefore retailers are not dependant on one single company with a broad product portfolio. Furthermore, retailers are able to exercise significant countervailing buyer power.

Retailers can exert pressure on the parties by threatening to change supplier, to start/extend private labels sales or by sponsoring new entry through active in-store promotion. The present case has shown that private-label products are delisted less often than the parties’ branded products.
Since retailers know the prices of the goods offered by the parties, they have the advantage of being in a position to fix the prices for their own private labels in reaction to the producers of branded products. In contrast, these producers are not able to readjust their prices to the retailers’ private label prices. Therefore, the retailer has the capacity to counteract efficiently any significant price change of the leading brands with its own private labels, whilst the parties suffer from an asymmetry of information vis-à-vis prices for private labels.

Moreover, retailers perform an important ‘gate-keeper’ function for suppliers since they serve as a ‘one-stop-shop’ for the parties’ products. If a retailer refused to carry a brand of the parties, the brand would risk disappearing from the customers’ awareness. As a consequence, it would be detrimental to a leading brand of the parties to be excluded from a major retailer for a longer period, as it would entail significant losses in customer awareness, whilst the costs would be relatively minor for the retailer (whose sales with this brand represent only a small fraction of its turnover). It should also be noted that the parties’ overall sales represent on average not more than 2% of the retailers’ sales, while for the parties certain retailers represent 10% and more of the sales in a given country.

Most retailers protect their bargaining position through a ‘multiple sourcing’ strategy. Such a strategy reduces the risk that the retailer becomes dependent on a particular supplier and allows for more cost-effective switching to other suppliers. Retailers indicated that they will never renounce to a multiple sourcing strategy and to the ownership of own private label products that compete with branded ones. Also, they have largely confirmed that margins they achieve from private labels are higher than in case of branded products. Retailers indicated that they would delist any brand that is not performing well including the parties’ brands. Regardless of the fact that delisting products of important suppliers might entail a risk of losing customers and entail costs, the market investigation has shown that, the retailers’ delisting policy applies also to P&G’s or Gillette’s so called ‘must stock’ brands.

As a conclusion, the transaction is not likely to lead to foreclosure of competitors as a result of bundling non-complementary products. This conclusion is also corroborated by the Commission’s market investigation, which confirmed that the previous merger of P&G and Wella has not resulted in any anticompetitive practices arising from the parties’ enlarged portfolio.

b) Foreclosure through category management

The Commission has examined if the policy of category management or ‘category captainship’, might facilitate anticompetitive behaviour of the parties post-merger.

Category management is a management policy associating suppliers and retailers in order to enhance business results of product categories on a store-by-store basis. The idea of category management was presented to the food industry in mid-1990s and gradually extended to broader category of consumer goods. WalMart was the first retailer introducing a demand driven policy that followed closely customers’ needs and habits. It allowed WalMart to optimise the so called stock-shelves cycle, thereby reducing its capital costs. While grocers had first turned to external consultants, they started soon to ask their suppliers for (free) advice on how to improve the assortment of their products in order to better meet customer demand and to increase sales.

At present, category management focuses on several main pillars, namely efficient assortment (e.g. what products or type of products should be stocked), efficient shelving (e.g. how to lay out the assortment on the shelves and to find the ideal number of brands and quantities of these brands). Sometimes it includes also recommendations on efficient pricing (how to price the assortment in accordance with the profile of the target shopper) and efficient promotion (how frequently to promote the category of products).

A particular form of category management is also generally labelled as ‘category captainship’, since in the beginning of category management (1), retailers determined one so-called ‘category captain’ to offer ‘exclusive’ advice during a given period. Category management is offered by leading suppliers as a free service to retailers. In practice, the task of a category captain is to provide retailers with information on product and shopper habits in relation to a specific category as defined by the retailer. This will be done regularly upon request of the retailer (e.g. every year, two years). A category manager will provide a detailed study (the so-called ‘planogram’) on how to ideally place and assort the products on the shelves. The retailer can then turn to follow the category manager’s advice. He can, however, also follow the advice of other key advisors, such as independent consultants. It is up to the

(1) Today, many retailers do no longer rely on the exclusive advice of one single supplier but engage more than one supplier in their category management strategy, in particular through submitting the proposals of the category manager to other competitors for review.
Some third parties mentioned the possibility that a category manager could favour its own products, either without any knowledge of the retailer or with the agreement of the retailer. This could enable the category manager to better place its products on the shelves thereby increasing its overall output in one category to the detriment of its competitors. The category management position might as well lead to a reduction of brands and therefore of customer choice which could ultimately result in rising prices. Another potential concern with category management for the Commission was that in some cases large retailers with strong private-label presence may share an interest with the parties in excluding other manufacturers of branded goods.

The Commission has investigated whether the transaction could allow P&G and Gillette to increase their involvement as category managers in the oral care sector to the detriment of the consumer. While up to the merger both parties did not offer the full range of oral care products (Gillette being weak in toothpaste and P&G in toothbrushes), the combination of the parties’ product portfolios will make them more eligible as category managers in the oral care sector post-merger.

The Commission tested therefore in its enquiry the impact of existing category management by the parties vis-à-vis competitors’ overall sales and prices. It compared the evolution of market shares and sales of P&G, Gillette and their competitors in cases in which the parties were category captains and when they were not. Furthermore, the Commission examined the evolution of prices in product categories as well as the evolution of the number of competitors and brands on the shelves and whether delisting of competitors’ brands happened when the parties were category captains. The Commission considered as well possible ‘mitigating’ circumstances, e.g. whether and to what extent the plan-o-gram was implemented or whether parties had lost the position as category manager in the past.

According to the answers to the investigation, it appears that the main beneficiaries of category management are brands that sell well not necessarily those of category captains, as well as private labels, and that the relative losers are the remaining competitors (i.e. those supplying non-leading brands). This is especially true at the so-called ‘recommendation-level’. (?) It is also true after implementation of the plan-o-gram, though private labels benefit more than leading brands. This shows that the retailers favour their own private label products even more than foreseen in the ‘recommendations’, thereby reducing the benefits by the leading brands.

Moreover, as concerns the possibility that category managers could provide ‘biased’ recommendations to retailers, the market investigation has shown that there is no significant information asymmetry between retailers and suppliers which could be abused. While ten or fifteen years ago retailers did not have sufficient data to verify the category manager’s proposal, most retailers have very sophisticated sales and customer data nowadays.

Another potential concern with category management for the Commission was that in some cases large retailers with strong private-label presence may share an interest with the parties in excluding other manufacturers of branded goods. Such exclusionary practices require a credible commitment by the retailer not to carry other suppliers’ products. By way of example, the retailer can purchase the full-line from the parties and contractually commit to pay damages if he carries brands from other suppliers. Alternatively, when the parties are category managers, the retailer may forego a discount if he fails to follow the parties’ recommendations. However, as it was shown above, the market investigation has shown that retailers often deviate from the recommendation of their category manager. Furthermore, exclusivity contracts are not prevalent in the product categories affected by the merger where multi-sourcing is the norm and only underperforming brands get delisted.

Indeed, most of the parties’ competitors and some of the retailers, through their private labels, provide a full range of oral care products, sometimes similar or even broader than the parties’ range, which prevents the parties from forcing retailers to buy a full line of their own branded products. The Commission’s market investigation has demonstrated that most of the retailers are willing to keep at least one competitor and one private label brand alongside the leading brand. Retailers have applied a similar multiple sourcing strategy in the case of the merger between P&G and Wella, in which the parties’ combined market shares were even higher than in the present case. Therefore retailers will be able to defend their private label market shares against parties’ recommendations in favour of their own brands.

(?) Recommendations are the result of an agreement between suppliers and the retailers upon the plan-o-gram before its implementation.
Moreover, a category manager cannot prevent its own products from being delisted. Indeed, customers have confirmed that P&G and Gillette ‘must stock’ brands have in some cases been delisted at the time when these two undertakings were category captains. If products of competitors were actually delisted, this was due to their underperformance and not to the mere recommendation of the category manager.

Regardless of the actual impact of category management, already the hypothesis that the parties would be more often eligible as category managers post-merger was only supported by a part of the customers. Even if the merged entity might be more eligible as category captain than before, nothing indicates that the parties would have a more important role in category management than their main competitors, especially taking into account that their current position in category management is relatively modest given their incomplete product portfolio in the oral care sector.

Moreover, the market investigation has shown that category management does not lead to the elimination of competitors. In addition category management is likely to be beneficial for both retailers and consumers. The market investigation for the products in question in this case has shown that the overall sales in a given category increased as a result of the implementation of category management (e.g. by allowing retailers to better compare best practices in the retail sector, better placement of products which meet better the shoppers’ demand). In addition, category management tends to reduce listing fees, which are favourable to larger suppliers. Indeed, category management represents a management policy according to which shelf allocation decisions reflects end-consumers’ demand and possibly not, as in the past, the willingness of a supplier to pay listing fees. As category management is based on shoppers’ habits, it leads as well to higher customer satisfaction as it meets better demand expectation. Furthermore, category management allows retailers to achieve economies of scale as it reduces stocks and ensures that the optimal quantity of products is presented timely and directly on the shelves. Finally, category management enables suppliers to achieve economies of scale through more efficient promotion as the suppliers are able to better anticipate the demand and to tailor their promotion.

In conclusion, category management policy would be seen as providing an advantage to the brands that meet the shoppers’ needs (best selling brands in general). Although an abuse of the position as category manager cannot be excluded in some cases (1) when it might lead to foreclosure vis-à-vis competitors, category management may also be largely pro-competitive, as it makes it easier for retailers to stock the most demanded brands and easier for consumers to find them in sufficient quantities on the shelves.

4. Conclusion

This case shows that even in the limited time of a first-phase procedure, the Commission is ready to launch an extensive and thorough investigation that addresses both horizontal as well as non-horizontal competition concerns in order to clarify the likelihood of potential competition harms as soon as possible. In particular the investigation of the various questions related to the non-horizontal effects of the merger required a careful economic analysis which was carried out in close cooperation with the Chief Economist Team.

(1) See Ruling of the US Supreme Court in Conwood Co. v United States Tobacco Co (2003).