6 Conclusions

The merger situation

6.1. Under the reference (Appendix 1.1) dated 13 March 1992 (made under sections 64, 68 and 69(2) of the Fair Trading Act 1973-the Act), we are required to investigate and report whether a merger situation qualifying for investigation has been created in that enterprises carried on by or under the control of Reckitt & Colman plc (Reckitt & Colman), incorporated in the United Kingdom, have within the six months preceding the date of the reference ceased to be distinct from enterprises carried on by or under the control of Sara Lee Corporation (Sara Lee). For this purpose, the terms of reference refer to the test specified in paragraph *(a)* of section 64(1) of the Act, the market share test, in respect of the supply in the United Kingdom of applied shoe care products. If the market share test is satisfied, the reference requires us to exclude the alternative assets test prescribed by section 64(1)*(b)* of the Act.

6.2. As stated in paragraph 2.36, Sara Lee Household & Personal Care UK Ltd (SL/HPC UK), a subsidiary of Sara Lee, acquired the United Kingdom shoe care business of Reckitt & Colman on 4 October 1991. Enterprises carried on by or under the control of Reckitt & Colman have therefore ceased to be distinct from enterprises carried on by or under the control of Sara Lee within the six months preceding the date of the reference to us.

6.3. As regards the market share test, we are required by section 64(1)*(a)* and (2) of the Act to be satisfied that, as a result of the enterprises having ceased to be distinct, at least one-quarter of the supply of applied shoe care products in the United Kingdom is by the same person (or persons by whom the enterprises are carried on)-or, if this was already the case, that the supply of these products by that person (or those persons) is enhanced. Applied shoe care products are defined in the terms of reference as `polishes intended for use on any type of footwear in such form as paste, wax, cream, liquid, gel, or impregnated sponge or cloth'. As shown in paragraph 3.49 and Table 3.12, prior to the acquisition of the shoe care business of Reckitt & Colman, Sara Lee, through its subsidiary SL/HPC UK, accounted for 31 per cent of supply of applied shoe care products as defined in the terms of the reference. The Reckitt & Colman share was 28 per cent, and so as a result of the acquisition Sara Lee's share has increased to some 59 per cent.

6.4. We conclude that the market share test has been satisfied in respect of applied shoe care products in the United Kingdom, and that a merger situation qualifying for investigation has been created. We have therefore to consider whether the creation of that merger situation operates or may be expected to operate against the public interest. The merger having only recently been completed, its effects are not yet fully apparent, and we have concentrated on whether it `may be expected' to operate against the public interest.

The companies

Sara Lee

6.5. Sara Lee is a multinational United States corporation with headquarters in Chicago, and operations in over 30 countries around the world. It employs more than 110,000 staff, and has a world-wide turnover (see Table 2.1) of some $12.4 billion. Its businesses comprise the manufacturing, marketing and distribution of high-quality branded consumer products; its stated aim is `to enjoy leading positions in each of the product and geographical markets in which it operates'.

6.6. Prior to the merger Sara Lee's main brands in the United Kingdom shoe care market were Kiwi and Tuxan. Its shoe care interests in the United Kingdom began in 1984 when it acquired Nicholas Kiwi, an Australian public company. Nicholas Kiwi was itself formed out of a merger in 1981 of two long-established Australian companies, namely Nicholas International Ltd and the Kiwi Polish Company Pty Ltd. Sara Lee's United Kingdom shoe care businesses, in which we are most interested, form part of the activities of SL/HPC UK. (Prior to a corporate reorganisation which took place in 1991 in connection with the group's sale of its pharmaceutical interests to the Hoffman-La Roche group, the relevant business in the United Kingdom was carried on by a different subsidiary, Nicholas Laboratories Ltd.) For management purposes, SL/HPC UK reports to Sara Lee/DE NV (SL/DE) in Utrecht, the management company for most of Sara Lee's European operations including its shoe care business based in France; SL/DE is wholly owned by Sara Lee. Sales of shoe care products in the United Kingdom were some £3.4 million in the year to June 1991.

Reckitt & Colman

6.7. Reckitt & Colman is a United Kingdom-based international group also engaged in the manufacture and marketing of consumer goods. Its products are sold in over 120 countries: total sales in 1991 were some £2 billion. Reckitt & Colman Products Ltd and Reckitt & Colman (Overseas) Ltd were the companies in the Reckitt & Colman group which dealt in shoe care products in the United Kingdom; gross sales of the United Kingdom shoe care operation were some £6.6 million in 1990.

The merger

6.8. On 4 October 1991, SL/HPC UK acquired the Reckitt & Colman United Kingdom shoe care business, including its export business from the United Kingdom (the relevant Australian and New Zealand trade marks being assigned to Sara Lee's Australian subsidiary, Kiwi Brands Pty Ltd). Reckitt & Colman's USA shoe care businesses were at the same time acquired by Kiwi Brands Inc, another Sara Lee subsidiary. The brands acquired by SL/HPC UK were Cherry Blossom, Meltonian, Properts, Wrens and Magix; Reckitt & Colman retained, however, the Nugget brand (not recently sold in the United Kingdom), and its shoe care businesses in many countries of Asia, Africa and Latin America and some European countries, notably Spain. The sale contract includes a non-competition clause, lasting for three years, after which Reckitt & Colman would be free to re-enter the United Kingdom market. The total consideration for the United Kingdom and the USA transactions was some £[*] million. [*] of this amount was apportioned to the United Kingdom transaction, representing almost entirely trade marks and goodwill.

6.9. Certain stock was acquired, and a limited range of manufacturing equipment, in particular a liquid (angle neck) filling line, a jar line for creams, a dye line, and mixing tanks and other processing equipment for liquid and cream polishes. This equipment was transferred to Sara Lee's plant at Honley in Yorkshire, but one of the main products sold under the Cherry Blossom brand-paste polish-is now manufactured on Sara Lee's existing equipment together with the Kiwi paste polish. Reckitt & Colman continued to manufacture polishes under contract to Sara Lee for six months following the merger at its unit in Hull; this unit has subsequently been closed, and the remaining equipment sold or disposed of throughout the Reckitt & Colman group.

Reasons for the merger

6.10. As is apparent from Table 2.17, the Reckitt & Colman shoe care operations made a loss both in 1990, and in 1991 up to the time of its acquisition by Sara Lee. Reckitt & Colman told us that it had established its Shoe Care Division as recently as 1990, as a means of improving the profitability of its Household Division, in which shoe care was formerly included. Part of the purpose of this move was to simplify the Household Division, by removing the more complicated shoe care business, but the aim was also to improve the performance of the shoe care business, particularly in the special trades (discussed in

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*Details omitted. See note on page iv.

paragraph 6.17). The reorganisation had helped Reckitt & Colman to halt a decline in its market share of shoe care products in the United Kingdom over the previous five years; however, the contribution from shoe care proved to be substantially lower than anticipated, and the cost of operating a separate division, developing the Meltonian brand range and expanding market share turned out to be significantly higher than expected.

6.11. Reckitt & Colman accordingly considered a number of options to improve the profitability of the Shoe Care Division, one being the use of contract packers, which would have entailed a restructuring cost of £1.5 million. At around this time, Sara Lee approached Reckitt & Colman, initially to acquire only the Meltonian brand. Without this brand, however, the remaining Reckitt & Colman shoe care business would not have been viable. Reckitt & Colman therefore offered to sell all its United Kingdom and United States shoe care business and its brands, not only because of the poor performance of the business, but also because of its expectation of the lack of growth potential in the shoe care market, the complexity of the business (with some 600 product lines, resulting in lower sales per line than in any other of its businesses), and its substantial dependence on specialist distribution channels, ie shoe shops and shoe repair shops. Reckitt & Colman said that it preferred to focus its selling resources on those outlets through which virtually all its other products were sold, namely grocery outlets and chemists.

6.12. Sara Lee told us that it regarded shoe care as a core activity for the group world-wide, but before the acquisition it had lacked penetration through the specialist distribution channels in a number of important markets, notably the United Kingdom. For this reason, it had initially expressed an interest in acquiring the Meltonian brand, in response to which Reckitt & Colman had offered the whole of the United States and United Kingdom operations. The acquisition enabled Sara Lee to acquire a complete shoe care product range by adding a full complement of specialist applied shoe care products; Reckitt & Colman's know-how in supplying the special trades (see paragraph 6.17); and established distribution channels into the special trades sector. It would, Sara Lee told us, have been possible to have established a stronger presence in the special trades without an acquisition, but this could have taken up to three years to do. At the same time, the acquisition enabled Sara Lee to achieve the volumes necessary to justify continuing commitment to a declining market, and to increase production capacity at its Honley plant, which before the merger it had intended to close.

6.13. Sara Lee told us that, following the merger, it intended to maintain its Kiwi brands, as well as the brands acquired from Reckitt & Colman. There would, however, be some product rationalisation with the use of the same formulation for Cherry Blossom and Kiwi products where produced on the same filling line at Honley. Kiwi and Cherry Blossom paste polishes, for example, would be made to the Kiwi formulation; and the two liquid wax polishes-Kiwi Elite and Cherry Blossom Readywax-to the Readywax formulation.

The market for shoe polish products

6.14. Our terms of reference define applied shoe care products with particular reference to polishes. Polish is used by consumers to enhance or otherwise restore the appearance of shoes, to provide a degree of waterproofing, and hence to extend the life of shoes. Various other chemical products also serve this purpose-in particular whiteners for white shoes, and aerosols for cleaning suede shoes and waterproofing-and we have included these products when considering the relevant market. The product definition we have adopted is also that used by Nielsen Market Research in its analysis of polish sales in the grocery sector, and comprises pastes, liquids, creams, whiteners, sponges and aerosols. Some 26 per cent of these sales are accounted for by pastes, 24 per cent by creams, 23 per cent by aerosols, and 13 per cent by liquids (although we note Sara Lee's comment that the allocation between these categories may be arbitrary for some products).

6.15. The total value of shoe polish products on this definition in the United Kingdom in 1991 was about £13 to £13.5 million at manufacturers' prices, and about £26 million to £27 million at retail prices. It is a small but complex market. As well as consisting of a number of different products, as already discussed, there is also a wide range of colours, as well as different types and sizes of container.

6.16. Demand for shoe polish products has been static or declining, one reason being a switch from formal shoes to trainers, another being reduced interest on the part of consumers in the appearance of their shoes. Overall demand is relatively insensitive to price, and because the products are an infrequent purchase, and the items are comparatively low-priced, consumers tend not to shop around or be sensitive to differences in price between retail outlets. These are considerable: we have noted within two small areas of London variations in retail prices of a standard tin of black polish from 40p (an own-label polish) to 99p (a branded polish), depending on the brand and type of outlet. Retail margins are also high-about 50 to 60 per cent of the selling price, reflecting in part the low turnover of the product: suggested retail prices are extensively followed or exceeded, other than by multiple grocers.

The supply of shoe polish products

6.17. All parties to whom we spoke agreed that it was useful to distinguish market sectors by means of distribution (see paragraph 3.22). Some 43 per cent of sales by value (a higher share by volume) are through the `self-selection' outlets, the majority of these being the multiple grocery retailers, the main supermarket chains such as Sainsbury, Tesco and Safeway. Distribution through these channels is often by the retailer's own distribution system, and the range of products stocked is relatively limited. The remaining 57 per cent of sales by value are through the `special trades', namely shoe shops and shoe repair shops. They stock a far wider range not only of shoe polish products, but also other shoe care products such as insoles, laces, and shoe horns. In the case of shoe shops, shoe polish products are often not displayed, but sold on the recommendation of the sales assistant, at the time shoes are purchased: the range of colours sold will therefore match the current colours of shoes sold. We were told that shoe repair shops were also seeking more actively to encourage their customers to buy shoe polish and other shoe care products. Consumers are, of course, free to purchase from either sector-self-selection or special trades-but as mentioned in paragraph 6.16 they are largely insensitive to the differences in prices between retail outlets: prices tend to be substantially higher in shoe retail and shoe repair shops compared with the self-selection sector, reflecting, we were told, the greater element of customer service and wider range of products provided.

6.18. Because the market is small, individual retail outlets tend to stock only one or two brands (rarely more) of any particular product. Competition between suppliers, therefore, tends to take the form of competition to secure retail shelf space by offering favourable terms, including selective discounts, and efficient distribution, rather than competition for the consumer at the point of sale between a range of brands on the basis of retail price, quality or brand name.

The suppliers

6.19. We are aware of ten suppliers of shoe polish products in the United Kingdom; their estimated share of self-selection outlets, the special trades sector, and the market as a whole are as follows.

TABLE 6.1 **Share of sales of shoe polish products in the United Kingdom in 1991**

	Self-selection outlets	*Special trades*	*Total*
			per cent
Reckitt & Colman	30	27	29
of which Meltonian brand	7	20	14
of which Cherry Blossom brand	22	2	10
Sara Lee	44	9	24
Sara Lee total following merger	74	37	53
Punch	9	38	26
Dunkelman	-	10	6
S C Johnson	7	-	3
Carr & Day & Martin	9	1	4
Dougmar	-	5	3
Salamander (Woly)	-	4	2
Salzenbrodt (Collonil)	-	5	3
Mars Oil	-	1	1
Total	100	100	100
Value of sales (£m at producer prices)	5.7	7.5	13.2

Source: MMC study.

Note: Figures may not sum due to rounding.

6.20. Before the merger some 45 per cent of Reckitt & Colman sales were to the self-selection outlets and 55 per cent to the special trades, sales to the special trades being mainly of the Meltonian brand, and sales to self-selection outlets being mainly Cherry Blossom. Sara Lee sales, on the other hand, were concentrated mainly on the self-selection sector. Following the merger Sara Lee supplies about 74 per cent of sales of shoe polish products to self-selection outlets, 37 per cent of sales to the special trades and 53 per cent of total sales.

6.21. We are aware of only three other firms supplying self-selection outlets: Punch Sales Ltd (Punch), S C Johnson & Co Ltd (S C Johnson) (which sells only one product, a sponge applicator), and Carr & Day & Martin Ltd (CDM). [*Details omitted. See note on page iv.*]. Before the merger, Punch was the largest supplier to the special trades, with some 38 per cent of sales; and it accounts for about one-quarter of the market as a whole. The remaining five firms of which we are aware-Dougmar Ltd, Dunkelman & Son Ltd, Salamander AG (a German company, which supplies the Woly brand), Salzenbrodt GmbH & Co KG (also German, which supplies the Collonil brand) and The Mars Oil Company Ltd (which has a very small share of the market)-supply only the special trades.

6.22. Market shares also vary by product. As shown in Table 3.12, Sara Lee is estimated after the merger to account for about 80 per cent of the supply of pastes (the largest product category), between 60 and 70 per cent of liquids and wheteners, and about 50 per cent of sponges.

Prospects for entry into the market

6.23. Market share has to be considered in the context of the prospects for new entry into the market or expansion by existing competitors. We have found no evidence of `formal' or regulatory barriers to entry-for example trade barriers, product standards, or patents.

6.24. As regards manufacturing costs, the process is straightforward and equipment easy to acquire, although new entrants could be at some disadvantage in competing with Sara Lee, a relatively high proportion of Sara Lee's capital costs being `sunk costs' (see paragraph 3.76). The minimum cost of establishing facilities has been variously estimated at £150,000 to £200,000 (Punch), £350,000 to £380,000 (Sara Lee), £350,000 (CDM). These are not particularly high figures, even for such a limited market, and it was suggested to us that the cost would be lower still if second-hand equipment was to be used. Higher figures of up to £3 million capital investment have, however, been quoted for a new supplier of a full range of shoe polish products.

6.25. Various possible economies of scale have been mentioned to us. Reckitt & Colman doubted whether there was much scope for these in production terms but thought (as did Punch and others), that they might apply to the purchase of metal tins and particularly printed metal lids. A new entrant could, however, overcome some of the diseconomies of low production by use of contract packers.

6.26. Some companies referred to economies of scale in distribution. Punch, for example, said that a turnover of £3 million per year was necessary to cover costs of selling, warehousing and dispatch, although this in part reflects the emphasis it has put on providing national distribution and a particularly high standard of service. An alternative is to use wholesalers. A further possible economy of scope arose from the requirement of some retailers in the special trades for a full range of applied and other shoe care products, although others preferred to select individual products from different suppliers.

6.27. These factors do not appear to us individually or cumulatively to be major barriers to new entry, or to expansion by existing smaller competitors. Potential entrants might, however, regard as intrinsically unattractive a small, stable or declining market, with long-established, financially strong suppliers, particularly as these are in a position to offer selective discounts against competitors which are not transparent in the market (see paragraph 3.59).

Sources of entry

6.28. Among the potential entrants mentioned to us by Sara Lee were existing European suppliers of shoe polish products, and suppliers of similar household or cleaning products. We saw no evidence of any potential interest by producers of other household goods in supplying shoe polish products. One adhesives firm in the United Kingdom told us that the merger could itself deter it from trying to enter the shoe polish market.

6.29. We have discussed the European market for shoe polish in paragraphs 3.51 to 3.54. Sara Lee is itself believed to be the leading supplier of shoe care products in Europe as a whole with about 22 per cent of the European market. We are, however, aware of other European suppliers which may be in a position to supply the United Kingdom.

6.30. Transport costs appear modest. These were, for example, estimated as 5 per cent of producer sales value for products manufactured in the United Kingdom, 7 to 8 per cent for products from elsewhere in Europe, and 12.5 per cent for products from outside Europe.

6.31. Punch, whose products are manufactured in Ireland, has achieved a substantial share of the United Kingdom market and has competed successfully with domestic manufacturers, in part by developing a particularly effective distribution system. Continental European suppliers, however, have not to date been successful in the United Kingdom. Werner & Mertz (one of the largest suppliers in Germany and Austria, with a significant market share in France and Netherlands) attempted to break into the market in the 1980s but subsequently withdrew. Similarly Henkel KGAA had limited success in the United Kingdom with the Pilofix brand. The Woly and Collonil brands are supplied to the United Kingdom market, but only in the more expensive shoe shops; they have minimal market shares and their presence in the market does not exert any downward pressure on the general level of prices.

6.32. The limited market share currently accounted for by the continental European suppliers may reflect the effectiveness of competition between the United Kingdom producers (and also Punch), and the resulting level of prices in the United Kingdom. We therefore asked a number of companies about the scope for competition from continental European manufacturers should prices increase. A large wholesaler told us of a recent increase in interest from European suppliers, one of which had previously quoted prices some 5 per cent above the United Kingdom level, which could therefore be competitive were United Kingdom prices to rise. On the other hand, the largest shoe retailer (British Shoe Corporation) and a major shoe repairer (Timpson Shoe Repairs Ltd) told us that they would be reluctant to source outside the United Kingdom, since service could be subject to greater uncertainty. One European company, indeed, currently supplying the United Kingdom on a small scale, itself expressed concern about the merger and about Sara Lee's market power elsewhere in Europe.

6.33. As mentioned in paragraph 6.23, there are no formal barriers to trade within Europe. Manufacturing costs (notably labour costs) may be slightly higher on the Continent, and there would be some additional transport costs, but these are not a major impediment to trade. There might, on the other hand, be some difficulty in meeting the service requirements of some of the larger customers, and a need to establish warehousing and distribution facilities in the United Kingdom, particularly if the suppliers were attempting to service the supermarkets and shoe repair outlets which require and demand rapid service delivery in order to minimise their own product stockholding. The success of Punch, however, has shown that such problems can be overcome by a determined new entrant, at least in the special trades sector.

Brands

6.34. The barrier to new entry into the market, or to expansion by existing suppliers which was most frequently mentioned to us by the parties from whom we heard, is the strength of the long-established brands-in particular Kiwi and Cherry Blossom in the self-selection sector, and Meltonian in the special trades sector. The importance of brands varies by sector.

6.35. Kiwi and Cherry Blossom seem not to be of great significance among shoe retailers, where own-label products or other brands, in particular Punch, are successfully sold on the recommendation of sales assistants. Among shoe repairers, on the other hand, one company believed that some sales- but not very many-would be lost if established brand names were not available; it was reluctant to pit an unknown brand against the established brand names. A major wholesaler to the shoe repair business (although not against the merger) also suggested that repairers could not do without established brands, the most successful of which he regarded as Punch, Meltonian and Dasco.

6.36. In our view, the strength of the established brands is not a major barrier to entry to the special trades, particularly in the case of shoe shops. New products need to be promoted mainly to the buyers or owners of these outlets, with competition on the basis of price and service: products can be promoted to the consumer by the sales assistant. Sara Lee estimated a cost of £20,000 to £30,000 to promote trade awareness in this sector.

6.37. The importance of the Kiwi and Cherry Blossom brands lies mainly in the self-selection sector. Some of the evidence we received referred to `considerable brand recognition, but little brand loyalty' (a phrase used by both Sara Lee and Punch). On the other hand Punch, now the main competitor to Sara Lee, said that it was very difficult to attack the established brands particularly for paste (the largest single product category in which it still has a very limited market share of less than 2 per cent); hence it had developed alternatives to paste. Similarly CDM said that brand names were the most significant factor in maintaining customers. One of the supermarket groups also referred to what is in effect a dual brand loyalty: consumers would buy whichever of Kiwi or Cherry Blossom was available. In view of the extensive testimony as to the strength of brand loyalty in the self-selection sector, we are unconvinced by Sara Lee's evidence (including the market research study referred to us by Sara Lee-see paragraph 3.16 and Appendix 3.1) purporting to show that customers are relatively indifferent to brands.

6.38. In a small market, the cost of consumer advertising to promote a new brand would be prohibitive. In our view, the only realistic entry on any scale in the self-selection sector of the market would be through sale of own-label products, to which we now turn.

Own-label

6.39. Own-label represents a potential means of entry for a manufacturer wishing to avoid the cost of promoting awareness of a new brand, and for a retailer to provide a means of competition to a well-established brand. Own-label is well developed, at a price premium, in shoe shops, where consumers appear willing to give weight to the recommendation of sales assistants, but not in shoe repair shops; and it is also relatively limited compared with other grocery items in multiple grocery retailers.

6.40. Multiple retailers' own-label polishes are currently confined to Sainsbury, Superdrug, and one other soon to be discontinued. Sainsbury's own label accounts for over 50 per cent of its polish sales and is sold at a retail price some 15 to 20 per cent less than the branded polishes, with a lower price to the manufacturer than on branded products. The retailer mentioned in paragraph 5.89, however, told us that own-label did not successfully compete against branded products, despite a 20 per cent lower retail price-hence its decision to discontinue them. We cannot infer from the limited development of multiple retailers' own-label to date how great a price differential would be necessary were own-label to be promoted more widely. The price differential required to promote an unknown brand in the self-selection sector would be likely to be greater than that required to promote own-label.

6.41. Other multiple retailers told us that they did not stock own-label polishes, because of the small level of turnover of these products. Among the other specific factors mentioned to us were the number of separate products involved; the cost of establishing own-label (because, for example, of the need to specify and monitor the product), for a limited benefit; the minimum production runs; and the need for large stockholdings.

6.42. We considered the argument that the limited development of own-label to date may in part reflect effective competition between brands, but that it could nonetheless represent a source of potential competition were prices to rise. We asked all the multiple retailers whether an increase in price to them would cause them to introduce own-label shoe polish products: their replies are included in Chapter 5. Several told us that the low level of turnover in these products would still probably preclude them from introducing own-label. Others said that they could consider introducing own-label if prices increased: in one instance, a 12 per cent increase in prices would be necessary before this would happen. Some suggested that they could attempt to introduce other branded products if prices increased by 6 to 10 per cent. Several, however, indicated that they would have to pass on any increase in prices. One multiple retailer currently stocking own-label products suggested that its prices would follow any increases in prices of branded shoe polish products, with little risk to its levels of sales.

6.43. On the evidence we have seen, we believe that there could be a substantial increase in price to the multiple retailers, possibly of 10 per cent or more, before they sought to introduce own-label products, or other alternative suppliers. Shoe polish products are low-value items, infrequently purchased, and demand is largely insensitive to price. The products are unlikely to figure in retailers' promotional campaigns. In this context, there is relatively little incentive for supermarkets to resist price increases, nor is it easy for them to do so given the strength of the Sara Lee brands.

6.44. For manufacturers, therefore, while entry into multiple retailers' own-label may be one means of overcoming the brand loyalty barrier, it also has disadvantages. Supermarkets would be reluctant to take these products, unless offered at significantly lower prices, which would limit the profitability of such new entry. Punch told us that it preferred to sell its own branded products, and did not have a policy of deliberately seeking to supply own-label in grocery outlets. On the other hand, [*] has been particularly successful in own-label sales.

The effects of the merger

6.45. Sara Lee argued that the merger would not have any adverse effects, on the grounds, *inter alia*, that:

(a) there was little overlap in the special trades sector before the merger; and

(b) the supermarkets, on the other hand, had countervailing power as they were able to develop own-label products or buy branded products from other companies including overseas sources.

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*Details omitted. See note on page iv.

6.46. It was generally agreed among the parties from whom we heard that there had been strong competition in the market between Sara Lee and Reckitt & Colman before the merger, particularly over the past two years, with retailers able to seek competing bids from the two suppliers. The financial performance of Reckitt & Colman's Shoe Care Division had clearly been unsatisfactory, but it had been considering alternative means of staying in the business, possibly by using contract packers, which would have entailed a restructuring cost of some £1.5 million. Another option it was considering was to dispose of some only of its brands. In our view, therefore, there is insufficient evidence to suggest that the level of competition prevailing before the merger could not have been sustained.

The effect on competition in the special trades sector

6.47. As is shown in Table 6.1, the effect of the merger is to increase Sara Lee's direct share of the market in the special trades from some 9 to 37 per cent mainly from the acquisition of the Meltonian brands. A French subsidiary of Sara Lee also supplies polish to one of the other suppliers in this sector of the market, but that firm expressed no concerns about the merger, and would be free to source elsewhere.

6.48. Punch is an established competitor in the special trades sector, with a market share similar to that of Sara Lee following the merger. It offers effective competition, particularly in sales to shoe retail shops, and there are six other companies with a more limited presence in the market. Furthermore, entry into this sector is relatively easy; the strength of the established brands is a less important barrier: other products, including own-label, can be successfully promoted by sales assistants at higher prices than in the self-selection sector of the market. Shoe retailers and shoe repairers (and wholesalers supplying these outlets) were fairly evenly divided between those who felt the merger had reduced competition and those unconcerned about its effects. We conclude that there is little cause for concern about the effect of the merger on competition in the special trades sector.

The effect on competition in the self-selection sector

6.49. The self-selection sector of the market accounts for 43 per cent of sales by value, and is the sector where retail prices are lowest. Table 6.1 shows that the effect of the merger is much more pronounced in this sector, where Sara Lee's market share is now some 74 per cent. Table 6.2 demonstrates that the impact is greatest in pastes, liquids, whiteners and aerosols. Generally, the increase in Sara Lee's market share arises from the acquisition of the Cherry Blossom brand, but in the more limited product area of whiteners it reflects the sales of Meltonian products (see also paragraph 3.37).

TABLE 6.2 **Market shares of self-selection sector in 1991**

per cent

	Pastes	*Liquids*	*Creams*	*Whiteners*	*Sponges*	*Aerosols*	*Total*
Reckitt & Colman	29	17	23	58	38	30	30
Sara Lee	55	59	44	27	14	53	44
Total following merger	84	76	67	85	52	84	74
Other	16	24	33	15	48	16	26
- of which Punch	-	15	28	10	12	16	9
- of which S C Johnson	-	-	-	-	36	-	7
- of which CDM	16	9	5	5	-	-	9
Value of sales (manufacturers' prices, £m)	2.5	0.7	0.8	0.3	1.2	0.3	5.7

Source: MMC study.

Note: Figures may not sum due to rounding.

6.50. As mentioned in paragraph 6.45, Sara Lee argued that the supermarkets in particular had countervailing power, and could sell other branded polishes supplied from other United Kingdom or overseas sources, or sell own-label products acquired from such suppliers. Most of the retailers in the self-selection sector from whom we heard, however, suggested that the merger would have adverse effects on competition, referring to their strong negotiating position prior to the merger and their previous ability to play Reckitt & Colman off against Sara Lee, a negotiating position now much reduced.

6.51. The effect of the merger on competition in the self-selection sector of the market is the main issue in our inquiry. In evaluating this effect, it is necessary to weigh the loss of competition between the two most successful brands, Kiwi and Cherry Blossom, against the prospect of effective competition developing from companies that have not effectively competed to date in the sector.

6.52. As discussed in paragraphs 6.23 to 6.27, there are no formal barriers to trade, or to entry to the market; we also feel that economies of scale are unlikely to be sufficient to deter new entry, or expansion by existing, smaller competitors. We believe, however, that the strength of the long-established brands in the market is an important practical barrier, reducing the prospect of entry of new branded goods into the self-selection sector from other United Kingdom suppliers, or from overseas: the cost of promoting a new brand is likely to prove prohibitive in such a small market and one which is static or declining. We do not therefore accept the argument that entry into this sector of the market is so easy that prices can be regarded as determined primarily by potential domestic or international competition, and that we should be unconcerned about the loss of actual competition between the two most successful brands.

6.53. In our view, the only realistic possibility of competition in the self-selection sector is from own-label sales, currently confined to only three of the multiple retailers, one of which is to discontinue such sales, and one other of which is currently supplied by Sara Lee. However, as we discussed in paragraphs 6.41 to 6.43, shoe polish products are an unattractive area for the development of supermarket own-label sales, mainly because of the low volume of sales. They are low-value items, the demand for which is largely insensitive to price, and in our view there is little incentive for the supermarkets to resist price increases, nor would it be easy to do so given the strength of the Sara Lee brands.

6.54. It follows therefore that we do not believe that the supermarkets have effective countervailing power; nor do we believe that reliance can be placed on the emergence or potential emergence of new brands or new own-label products to maintain competition in this sector of the market.

6.55. Before the merger, strong competition between the Sara Lee and Reckitt & Colman brands served to constrain the level of prices in the self-selection sector of the market. Following the merger, and the loss of competition between the two dominant brands in this sector, we believe there is scope for a substantial price increase, possibly of 10 per cent or more (see also paragraph 6.43), without putting at risk Sara Lee's market share.

6.56. We believe therefore that the merger may be expected to have effects adverse to the public interest. These are that there is a significant reduction in competition in the supply of shoe polish products to the self-selection sector of the market; Sara Lee has the opportunity, of which it may be expected to take advantage, to introduce substantial increases in prices to retailers without constraining forces being brought into play; and such increases are likely to be passed on to consumers.

Other issues

6.57. A number of other concerns were raised with us. First, it was suggested that the merger would result in a loss of choice from rationalisation of products, some Kiwi and Cherry Blossom products now being identical. We do not regard this suggested detriment as significant, it being generally agreed that there was little quality difference between the products before the merger.

6.58. Secondly, there was concern that Sara Lee would be in a position, by temporary reductions in price, to cause smaller competitors to withdraw from the market, whereupon it would raise prices again; a similar concern was that Sara Lee would reduce prices in retaliation against new entrants to the market. There is no evidence that Sara Lee has initiated such practices to date. There may be an opportunity to engage in selective price reductions against competitors, by use of discounts and retrospective overriders. Most suppliers, however, were confident that they could stay in the market; and retailers themselves may not wish to lose their alternative sources of supply. We have insufficient grounds for supposing that Sara Lee would engage in any such anti-competitive practices, although it is possible that the fear of retaliation by Sara Lee could itself deter new entry to the market.

6.59. Thirdly, concern was expressed that Sara Lee might seek to extend its range of other shoe care products sold to specialist outlets by `full-line forcing' of such products or use of solus agreements or retrospective discounts to the same effect, with adverse effects on other suppliers. Some shoe retailers and repairers have themselves seen advantage in acquiring a full range of shoe care products from one supplier, and Sara Lee's general policy of widening its product range is not unreasonable. Punch and some of the smaller suppliers appear to do the same. Sara Lee had inherited various `solus' agreements from Reckitt & Colman, but denied that it had a policy of entering into such agreements, although one supplier of accessories complained that this was happening already. We have insufficient reason, however, to conclude that the merger has placed Sara Lee in such a dominant position in the supply of shoe care products to specialist outlets that it could act in this way.

Benefits of the merger

6.60. We considered whether there were any benefits from the merger that could offset the adverse effects identified in paragraph 6.56. The main benefit brought to our attention was related to the future of Sara Lee's plant at Honley (although the merger also had the immediate effect of a reduction in employment at Reckitt & Colman's plant in Hull). Sara Lee's Board minutes and other internal papers show that a decision in principle was taken by the company in October 1989 to consolidate all its shoe care manufacturing in Europe on one site in Rouen. Any move with respect to Honley was, however, delayed for two to three years, following which production costs and other matters were to be again reviewed. After the merger the decision in principle taken earlier was shelved. We recognise that the merger has undoubtedly removed the uncertainty as to the Honley plant for the immediate future. Sara Lee told us that the decision to maintain production at Honley would be reviewed should it be required to divest any of the brands or assets acquired, and the greater the extent of any divestment the higher the probability that production would be moved to Rouen. There is, however, no certainty that Sara Lee would not in any event reconsider at some future time its decision concerning the maintenance of production at Honley.

6.61. We believe that the benefits described in paragraph 6.60 are insufficient to outweigh the adverse effects of the merger described in paragraph 6.56.

Conclusion

6.62. We have therefore concluded that the merger situation we identified in paragraph 6.4 may be expected to operate against the public interest by reason of the particular effects adverse to the public interest identified in paragraph 6.56.

Recommendation

6.63. We are therefore required to consider what action, if any, should be taken for the purpose of remedying or preventing these adverse effects. These arise only in the self-selection sector of the market. They result mainly from the acquisition by Sara Lee of the Cherry Blossom brand which is sold principally to the self-selection sector (see paragraphs 6.20 and 6.49), and an appropriate remedy is therefore divestment of that brand.

6.64. This remedy will not directly address the reduction in competition in respect of whiteners, which results from the acquisition by Sara Lee of the Meltonian brand (see paragraph 6.49). Whiteners, however, make up such a small part of the market (about 5 per cent) that it would in our view be disproportionate to recommend divestment of the Meltonian brand by way of remedy. We have in mind, too, that sale of the Cherry Blossom brand would incidentally enable the purchaser to offer competition for Sara Lee in whiteners under a well-established brand name. In these circumstances we make no separate recommendation with regard to whiteners.

6.65. We have considered whether divestment of the Cherry Blossom brand would be a disproportionate remedy, in the light of Sara Lee's submission to us that it would give rise to another review of the future of the Honley plant. The Honley plant would still benefit from the production of the other brands acquired: on the other hand, Sara Lee argued that its profitability would be worse than before the merger, since production of other products had been transferred out of Honley, to make room for the additional shoe polish products acquired, and it would not be worthwhile to relocate them back to Honley. The outcome of any review of the future of the plant must be speculative and, to judge from the papers we have seen relating to the earlier review (in 1989), may depend on the balance of a wide range of factors, many of which are unrelated to the direct or indirect consequences of the merger. In all the circumstances we do not regard the remedy as disproportionate.

6.66. Among other possible remedies which we have considered is price control, which Sara Lee told us it would be prepared to accept. Such a remedy, however, would not directly address the loss of competition resulting from the merger and is in our view a poor second best.

6.67. We therefore recommend that Sara Lee should be required to divest itself of the Cherry Blossom brand and associated trade marks and, pending divestment, to keep the brand and trade marks in good standing by, for example, maintaining production of the branded products, their quality and their prices at present levels. Prior to reaching our conclusions and making this recommendation, we have given full consideration to the arguments put forward in the note of dissent which follows.

P H DEAN *(Chairman)*

R O DAVIES

J EVANS

R YOUNG

A P L MINFORD, being a member of the Group, dissents from the conclusions for the reasons set out in the note of dissent included in this report.

S N BURBRIDGE *(Secretary)*

17 June 1992