

# Condoms

**Review of the undertakings given  
by LRC Products Limited**

**March 2006**

(Advice provided to the Competition Commission, December 2005)

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Note: [...]

This report is published pursuant to section 4(4) of the Enterprise Act 2002. It has been edited for publication in accordance with Part 9 that Act. Among other things, this Part requires that the Office of Fair Trading has regard to the need for excluding from the published report, so far as is practicable, commercial information whose disclosure it thinks might significantly harm the legitimate business interests of the undertaking to which it relates.



# 1 EXECUTIVE SUMMARY

## Introduction

- 1.1 This report reviews the operation of the undertakings given by LRC Products Limited ('LRC') in 1994 not to enter into or carry out exclusivity agreements with retailers or wholesalers in exchange for material benefits.<sup>1</sup> Although condoms are distributed to users via three channels – retailers, the NHS and vending machines – the undertakings only cover distribution to wholesalers and retailers and therefore exclude distribution direct to the NHS and to vending machines. The Office of Fair Trading ('OFT') has reviewed the undertakings against the background of developments in the wholesale and retail of condoms in the UK since 1994.
- 1.2 The undertakings were given to the Secretary of State for Trade and Industry in 1994 under the monopoly provisions of the Fair Trading Act 1973 following a Monopolies and Mergers Commission ('MMC') report.<sup>2,3</sup> The full text of the undertakings is at Annexe A and a summary of the MMC report is at Annexe B. Similarly, summaries of previous MMC reports and undertakings into this market are given in Annexe C.

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<sup>1</sup> In 1994 LRC was a subsidiary of the London Rubber Company. It is now part of SSL International Plc.

<sup>2</sup> MMC 1994, Contraceptive sheaths: A report on the supply in the UK of contraceptive sheaths, Report Cm 2529.

<sup>3</sup> Although the undertakings were originally given to the Secretary of State for Trade and Industry, powers to vary, supersede or release undertakings have since been transferred to the Competition Commission (The Enterprise Act 2002 (Enforcement Undertakings and Orders) Order 2004, SI No. 2181).

## Summary of findings

- 1.3 The review has found that the structure of the supply of condoms in the UK is highly concentrated. SSL International plc ('SSL'), the owner of LRC<sup>4</sup> and the supplier of Durex brand condoms, alone has a share of supply to the retail sector of around 80 per cent and this has remained reasonably stable over the past decade.<sup>5</sup>
- 1.4 However, although the structure of supply has not materially changed since the MMC reported, the structure of the retail distribution channel through which condoms are sold to consumers has changed noticeably. In particular, more and more condoms, both in terms of overall numbers and in number of brands, are being sold in national supermarket chains than was the case a decade ago. This is significant, as the buyer power of these retailers has resulted in reductions in both wholesale and retail prices for condoms in recent years. Indeed, information given to the OFT shows that since 1999-00, wholesale prices for condoms have fallen by an average of almost 20 per cent, and in some cases by up to 50 per cent.
- 1.5 The OFT has not found any evidence that SSL has breached its undertakings. SSL is one of a number of condom suppliers stocked in large supermarket chains and high street pharmacies (retailers who account for at least two-thirds of condom sales in the UK). In many instances, considerable consumer choice is available both in terms of brand and type of condom.<sup>6</sup>

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<sup>4</sup> For the purposes of this report we refer to LRC as SSL for consistency. In addition, SSL is responsible for all aspects of LRC's business.

<sup>5</sup> SSL's share of supply figures for retail distribution in 1994 was [...] per cent (confidential version of the MMC report, Tables 3.10 and 3.11).

<sup>6</sup> The basic male latex condom is a homogenous product. However suppliers have incorporated a number of features (for example, ribbing, flavourings and addition of lubricant) and market a range of product lines. Each product line has different features.

- 1.6 In the relatively small number of instances where Durex is the only brand on offer, the OFT has not found any evidence that this is the result of exclusivity agreements. Rather, these situations tend to occur when the retailer only stocks a small number of condoms (for example, garage forecourts and convenience stores) and opts for Durex as the market leader and the brand most readily recognised by consumers. This brand leader approach is also used by these smaller retailers for other health and beauty products.
- 1.7 In addition, the OFT has been told that these outlets tend not to source their condoms directly from SSL but rather via a wholesaler, most of whom will also carry other condom brands.
- 1.8 Not only has the OFT not found evidence of exclusivity agreements but considers it unlikely that without the undertakings in place there would be a reversion to past practice. This is for two reasons. First, the national supermarket chains and Boots the Chemist generally seek to offer consumers a choice of condoms, in terms of both brand and type. In these circumstances they are unlikely to accept exclusivity agreements which run counter to this desire. In addition, their relative buying strength makes it unlikely that SSL would be able to impose exclusivity agreements on them.
- 1.9 Secondly, to the extent that they have anti-competitive objects or effects, the practices addressed by the undertakings are prohibited by Articles 81 and 82 of the EC Treaty and the Competition Act 1998 ('CA98'), which has come into force since the introduction of the undertakings. In the event of a breach of the prohibition, tough sanctions are available to the OFT, including financial penalties of up to 10 per cent of the global turnover of the offending company.

## **Conclusions and recommendation**

- 1.10 The review has not found any evidence that SSL's subsidiary LRC has breached its undertakings. Further, the OFT concludes that there has been a significant shift in negotiating power between suppliers and

retailers which has been the main factor in reducing prices in recent years. This represents a change in the circumstances of supply of condoms in the UK since the MMC report. The OFT also considers that it is likely that the practices addressed by the undertakings could, in any case, be covered by CA98. In light of these findings the OFT considers that the undertakings are no longer necessary.

- 1.11 Using its powers under section 88(4) of the Fair Trading Act 1973 the OFT recommends that the Competition Commission release SSL's subsidiary, LRC, from its undertakings in full.<sup>7</sup>

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<sup>7</sup> The relevant sections of the Fair Trading Act 1973 are still in force by virtue of Schedule 24 of the Enterprise Act 2002.



## 2 INTRODUCTION

### Introduction

- 2.1 This report reviews the effect of the undertakings given by LRC in 1994 not to engage in exclusivity agreements with wholesalers or retailers. The full text of the undertakings is at Annexe A. It should be noted that the undertakings do not include distribution of condoms for use in vending machines or direct to the NHS.
- 2.2 LRC is now a part of SSL plc, the manufacturer and supplier of Durex brand condoms. The OFT's review has examined the distribution of these, and other condoms, to wholesalers and retailers. It did not examine in any detail the distribution of condoms by retailers to consumers.
- 2.3 The undertakings were given by LRC to the Secretary of State for Trade and Industry following a report of the MMC in 1994.<sup>8</sup> This report and the subsequent undertakings were made under the monopoly provisions of the Fair Trading Act 1973 ('FTA73'). The key findings of the report are set out below, while a more complete summary is at Annexe B.
- 2.4 It is the duty of the OFT to consider from time to time whether, by reason of any change of circumstances, an undertaking should be varied, revoked or superseded by a new undertaking, and to give such advice to the Competition Commission ('CC') as it may think proper in the circumstances.<sup>9</sup>

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<sup>8</sup> MMC 1994, Contraceptive Sheaths: A report on the supply in the UK of contraceptive sheaths, Report, Cm 2529.

<sup>9</sup> Section 88(4) of the Fair Trading Act 1973.

2.5 In April 2005 the OFT announced this review of the undertakings concerning exclusivity agreements.<sup>10</sup> This review has been undertaken using statutory powers under the FTA73 and the Enterprise Act 2002 (EA02).<sup>11</sup> This report sets out the findings of the review. But first it gives a brief history of the existing undertakings.

### **MMC's key findings**

2.6 In analysing the supply of condoms in the UK in 1994 the MMC found that there were three distinct distribution channels: (i) to retailers and wholesalers for retail sales, (ii) to the NHS for free distribution, and (iii) via vending machines.<sup>12</sup> Retailing was found to be by far the largest channel.<sup>13</sup> LRC Products Limited was the biggest supplier accounting for approximately three-quarters of the overall supply of condoms in the UK at that time.<sup>14</sup>

2.7 The MMC concluded that LRC was a scale monopolist as it supplied at least one quarter of the total number of condoms which were supplied in the UK.<sup>15</sup>

2.8 The MMC found that LRC was selling to the NHS at prices below cost and recommending retail prices ('RRPs') to retailers. These were uncompetitive practices for the purpose of exploiting or maintaining the

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<sup>10</sup> [www.offt.gov.uk/News/Press+releases/2005/60-05.htm](http://www.offt.gov.uk/News/Press+releases/2005/60-05.htm)

<sup>11</sup> Section 88 of the Fair Trading Act 1973 and sections 4, 5 and 7 and paragraph 16 (3), Schedule 24 of the Enterprise Act 2002.

<sup>12</sup> MMC (1994), paragraph 8.7.

<sup>13</sup> MMC (1994), paragraph 8.27.

<sup>14</sup> MMC (1994), paragraph 8.6. This figure included supply to the NHS and to vending machines.

<sup>15</sup> MMC (1994), paragraph 8.8

monopoly situation.<sup>16</sup> However, it concluded that these practices might not be expected to operate against the public interest because, in the case of supplying to the NHS, it was difficult to assess the effect on competitors in the retail sector.<sup>17</sup> In the case of RRPs, most retailers did not observe the RRP when a price war broke out.

- 2.9 The MMC also found that LRC made three payments to major customers, in return for their agreement to stock only Durex condoms. The MMC considered this was aimed at closing important areas of the market to other potential suppliers and increased entry barriers for other would-be suppliers. It emphasised that this practice was unacceptable for a monopoly supplier with around 80 per cent of supply and was likely to weaken competition and reduce consumer choice.<sup>18</sup> The MMC concluded that the practice might be expected to operate against the public interest.<sup>19</sup>
- 2.10 The MMC recommended that LRC be required not to enter into agreements with wholesalers or retailers under which LRC would give the other party special benefits (for example, special payments or bigger discounts) in return for only stocking LRC condom products. It also recommended that LRC put in place the arrangements necessary to ensure that its staff comply with this requirement.<sup>20</sup>
- 2.11 LRC gave undertakings to this effect in June 1994. At the same time LRC was released from price controls (for further details on all three previous MMC reports refer to Annexes B and C).

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<sup>16</sup> MMC (1994), paragraph 8.142.

<sup>17</sup> MMC (1994), paragraphs 8.142 and 8.153.

<sup>18</sup> MMC (1994), paragraph 8.129.

<sup>19</sup> MMC (1994), paragraph 8.157.

<sup>20</sup> MMC (1994), paragraph 8.159

## **The 1998 OFT review of undertakings**

- 2.12 In 1998 the OFT reviewed the undertakings and found no indication that exclusive arrangements of the type prohibited by the undertakings were in force. However, it noted that the market did not appear to be operating as the MMC had anticipated. LRC remained by far the largest supplier in both the commercial and NHS sectors and, importantly, prices were increasing following the abolition of the price cap. New entry had been limited to Boots the Chemists' ('Boots') own brand in the retail market.
- 2.13 At that time the OFT did not consider LRC should be released from the undertakings or that the undertakings needed to be varied or superseded by new undertakings.

## **The report**

- 2.14 Chapter 3 describes the condom market in the UK, considering the distribution channels, major suppliers and developments in the quality certification regime over the last decade. Chapter 4 provides an assessment of the competitiveness of the market, focusing upon the extent of new entry, how barriers to entry have changed over the last decade and changes to the prices of condoms. Chapter 5 evaluates compliance with and the effectiveness of SSL's undertaking, and the development of retailer listing policy over the last decade.

### **3 THE SUPPLY OF CONDOMS IN THE UNITED KINGDOM**

- 3.1 This chapter describes the background to the supply of condoms in the United Kingdom. It considers the channels through which condoms are distributed, the major suppliers and the quality certification regime.
- 3.2 The information in this chapter is based upon information provided to the OFT by condom suppliers, retailers and wholesalers. The OFT has also received information from individuals involved in the purchase of condoms for the NHS.

#### **Condoms**

- 3.3 Condoms offer protection against both unwanted pregnancies (contraception) and sexually transmitted diseases ('STDs') (prophylaxis). The latter property is unique to condoms. Although there is considerable superficial variation in the types of condoms available (for example, ribbed, thin and thick) there has been little fundamental change in the latex condom over the years.<sup>21</sup>
- 3.4 Condoms acquired in the UK are predominately manufactured abroad. They are manufactured in Europe (Spain and Germany), Thailand, Japan, India and the USA before being distributed within the UK.

#### **Distribution channels**

- 3.5 In this review the OFT has segmented its analysis according to the three distribution channels which were identified by the MMC and are still relevant to the industry.<sup>22</sup> These are condoms supplied to:
- retailers and wholesalers

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<sup>21</sup> Nevertheless, SSL has launched a polyurethane condom with the trade name Avanti.

<sup>22</sup> MMC (1994), paragraph 1.3.

- vending machine operators,
- the NHS for free distribution.

3.6 The proportion of condoms supplied by each channel is shown in Table 3.1 below. Retail is the largest sector for condom distribution in the UK, accounting for almost two-thirds of condoms distributed.

**Table 3.1: Proportion of condoms supplied in the UK by distribution channel 2005 (%)**

<i>Sector</i>	
Retail	62
NHS	30
Vending machines	8

Note: the retail sector includes sales over the Internet.

Source: Sambrook International Research, report commissioned by the Department of Health.

3.7 Some parties in the industry tend to be stronger in one of the distribution channels than in others, and they vary their branding, pricing, marketing strategy and packaging of the same product between these channels. A description of these channels is below.

## **Retail sector**

- 3.8 The retail sector is the most important channel for condom distribution in the UK. Last year, about 125 million condoms were sold in the UK for around £50 million.<sup>23</sup> These were supplied to wholesalers and retailers by the condom suppliers for around £25-28 million.
- 3.9 The main retailers are the major national supermarket chains, Boots, community and independent pharmacies and drug stores. Other types of outlets retailing condoms are convenience stores and garage forecourts. The changing proportions of condoms supplied by these retailers are discussed in Chapter 4.

## **Supermarkets**

- 3.10 The national supermarket chains, such as Tesco, Asda, Sainsbury's and Morrisons, account for around 40 per cent of total retail sales of condoms. Therefore, they constitute a major channel of distribution for the suppliers of condoms. Their impact on supply and competition is discussed in Chapters 4 and 5.

## **Pharmacies and drug stores**

- 3.11 The main pharmacy chains involved in condom distribution are Boots, Lloyds Pharmacy, Enterprise and Alliance Pharmacy. Of these, Boots is the largest seller of condoms. It alone accounts for around one in five condoms sold in the UK and over half of total pharmacy sales of condoms. Boots has its own brand of condoms, as does the high street drug store, Superdrug.
- 3.12 Condoms are also sold through community pharmacies and a number of high street drug stores (for example, Superdrug) although some smaller groupings such as Wilkinson and Savers are also significant distribution

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<sup>23</sup> Information Resources Inc (IRI) using data for the year to March 2005.

channels. The smaller retailers, such as community pharmacies, tend to buy their condoms from wholesalers rather than directly from the condom suppliers.

### Convenience stores and garage forecourts

- 3.13 Convenience stores, such as Spar, and garage forecourts, including BP, Esso and Shell, account for a relatively small proportion of condom sales (less than 10 per cent). Like community pharmacies, these types of outlets are more likely than the larger retailers to source their condoms from wholesalers.

### **National Health Service**

- 3.14 The NHS is the second largest distribution channel for condoms in the UK, accounting for around a third of total condoms distributed. It distributes condoms free to users via NHS clinics. Purchasing is decentralised with each of the home countries pursuing different purchasing policies. A summary of these policies is in Annexe D.
- 3.15 The English NHS represents around 90 per cent of total UK NHS spending on condoms (around £5 million). Each of the home countries has a number of suppliers providing condoms to them except for Wales. However, in Wales the OFT has been told that some clinics source some of their condoms directly from suppliers (that is, outside of the national contract system) which means, in practice, no one supplier is supplying condoms to the entire Welsh NHS.



## **Vending**

- 3.16 Vending is the smallest distribution channel in the UK, accounting for less than 10 per cent of the overall number of condoms distributed in the UK.<sup>24</sup>
- 3.17 Vending machines are primarily located in pubs and bars and will only stock one brand of condom with a limited choice in pack style and size.
- 3.18 The OFT has been told by some suppliers that vending is an important means for condom suppliers to raise awareness of their brands among younger people, by being located in venues which younger people frequent and because of the advertising which is present on the vending machines.

## **Main condom suppliers**

- 3.19 The next section considers the major condom suppliers to each of the distribution channels. Although market shares are referred to in this section our analysis of market shares can be found in Chapter 4.

### **SSL International Plc (Durex)**

- 3.20 SSL was formed from the merger of the Seton-Scholl group and London International, the former owner of LRC, in June 1999. It is involved in various activities in addition to the manufacture and supply of Durex condoms.
- 3.21 SSL's retail sales of condoms in the UK were around [...] million in 2004-05. Durex has been the market leader for many years, with a high and stable share of supply. It is a major global condom supplier with a presence across Europe, Asia, Africa and some of the Americas.

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<sup>24</sup> A number of differing estimates of the size of this market have been provided to the OFT. These figures are based on research done by Sambrook Research International for the Department of Health in January 2005.

3.22 SSL distributes condoms through all three distribution channels in the UK and is the largest supplier in both the retail and vending sectors. It has listings with all of the major retailers, such as the supermarkets and Boots, and many of the smaller retail outlets, such as convenience stores and garage forecourts.

### **Ansell Ltd (Mates)**

3.23 Ansell Limited ('Ansell') is a global condom company which owns a number of different condom brands. In the United Kingdom it is the owner of the Mates brand, which is currently the second largest supplier to retail outlets in the UK. While it distributes through both the NHS and the vending sector, it currently has limited vending machine operations and only a small share of supply to the NHS. It also manufactures condoms on behalf of other suppliers, such as Pasante.

3.24 Mates has retail listings with all of the major condom retailers including Boots, Tesco, Sainsbury's, Morrisons and Asda, and some pharmacy chains. At present it has only very limited distribution through convenience stores and garage forecourts

### **Pasante Healthcare Ltd**

3.25 Pasante Healthcare Limited ('Pasante') was formed from the condom wholesaling business of Paladone and established its own brand in the UK in 2002. It has a strong presence in the NHS market, where it has achieved a high share of supply over a brief period of time, but a much smaller presence in the retail sector. Pasante does not supply condoms for use in vending machines.

3.26 In the retail market Pasante currently has listings with Tesco (top 200 stores), Lloyds pharmacy, Alliance Pharmacy, Savers health and beauty and with some independent pharmacies. [...]. It is not distributed through convenience stores or the garage forecourt sectors.

## **Church and Dwight Co. Inc (Trojan)**

- 3.27 Trojan has been marketed in the UK by a UK subsidiary (Church & Dwight UK Limited) of Church & Dwight Company Inc ('Church & Dwight'), a US company. It entered the UK condoms market in 2003. The Trojan brand accounts for a large proportion of condom supplies in the US (with around a 70 per cent share) but in the UK it presently has a very small share of supply.<sup>25</sup>
- 3.28 Trojan condoms are sold in Boots, Superdrug and in some independent pharmacies. It has no presence in either the NHS or vending sector.

## **Condomania**

- 3.29 Condomania is owned by the Sexual Health Group, formed from Sutherland Health, formerly a distributor of Mates condoms. It started to supply own brand condoms to the NHS market in 2000 and has achieved a share of supply to the English NHS approaching 10 per cent.<sup>26</sup>
- 3.30 The company no longer wholesales other brands of condom (except specialist condoms like Femidom and the non-latex Durex Avanti brand). It has so far focused on supplying to the NHS and does not supply retailers.

## **Other suppliers**

- 3.31 There are other smaller suppliers in the UK. For example, Condom Solutions Limited distributes condoms to university student union shops, Brook clinics and vending machines. It also distributes via the internet.

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<sup>25</sup> Information provided by Trojan.

<sup>26</sup> Information provided by the Sexual Health Group.

- 3.32 Condomi Health UK Limited has been present in the UK since the late 1990s. It initially received listings in a range of outlets and established a significant vending operation. In recent years its number of listings has decreased and it has reduced its activities in the UK.
- 3.33 Other suppliers include Safex Limited, which distributes mainly to the NHS and through the internet, and FCUK, which is distributed through some FCUK stores and Boots. Inspiral condoms are distributed by Boots and through the internet. Since the 1994 MMC report, two major retailers have set up own brand condoms, Superdrug and Boots. However, neither has established a significant share for its condoms.
- 3.34 It is also worth noting that the internet seems to be emerging as a distinct distribution channel for condoms. There are now a wide range of condom brands available from online retailers.<sup>27</sup> Each site offers a significant variety of condom brands, including a range of alternatives to Durex, ranging from between four to seventeen brands. Although internet distribution currently represents only about 1 per cent of total condom sales, it does indicate clearly that consumers with internet access do have ready access to a wide variety of condom brands.<sup>28</sup>

### Quality certification

- 3.35 In order for condoms to be supplied to users in the UK they have to meet a minimum quality level. There are currently two principal certifications of quality, the compulsory European standard (the CE mark) and the British Standards Institute's kitemark.<sup>29</sup>

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<sup>27</sup> Information based on the following sites: [www.britishcondoms.com](http://www.britishcondoms.com), [www.freedoms-shop.com](http://www.freedoms-shop.com), [www.condomcare.co.uk](http://www.condomcare.co.uk), [www.cheapercondoms.co.uk](http://www.cheapercondoms.co.uk), [www.condomchoice.co.uk](http://www.condomchoice.co.uk), [www.econdoms.co.uk](http://www.econdoms.co.uk). [www.condoms.co.uk](http://www.condoms.co.uk).

<sup>28</sup> OTC Contraceptives – UK Market Study, A report for the Department of Health by Sambrook International. January 2005. p.8.

<sup>29</sup> There is also an international standard but this is currently less prevalent.

3.36 The CE mark is required for all condom suppliers within the European Union.<sup>30</sup> Because condoms are classified as a high risk product they have to comply strictly with a range of rigorous product classifications. In the UK, standards are audited by the Medicines and Healthcare Products Regulatory Agency and inspected through a testing procedure every 6 months. The kitemark is a voluntary certification issued by the British Standards Institute, indicating that a condom has met a range of safety criteria. The competition effect of the regime is considered in paragraphs 4.11 to 4.14.

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<sup>30</sup> Medical Devices Directive, Council Directive 93/42/EEC of 14 June 1993. This was fully implemented in 1998.

## **4 COMPETITION IN THE SUPPLY OF CONDOMS**

### **Introduction**

- 4.1 This chapter examines competition in the market for the supply of condoms to retailers and the changes that have occurred since the MMC report. It focuses on the supply of condoms for retail as this is the sector to which the undertakings apply.
- 4.2 It finds that over the past decade there has been little change in the structure of supply. However, the chapter also finds that there has been a strengthening of buying power of retailers which has led to falling prices in both the wholesale and retail of condoms.
- 4.3 The chapter uses information given to the OFT from condom suppliers and retailers as well as retail data from the market research firm, Information Resources Inc. ('IRI').

### **The wholesale supply of condoms in the UK**

- 4.4 There are a number of suppliers of condoms to wholesalers and retailers in the UK. The two leading ones, as they were at the time of the MMC report, are SSL (maker of Durex condoms) and Ansell (maker of Mates condoms). These two comprise almost the entire supply of condoms to wholesalers and retailers in the UK with SSL accounting for around 80–85 per cent of the entire supply to UK retailers (Table 4.2 by volume and Table 4.3 by value).

**Table 4.2: Share of supply of condoms for retail in the UK by volume, 2002 to 2005 (%)<sup>a</sup>**

	<i>Sept 2002</i>	<i>June 2003</i>	<i>Mar 2004</i>	<i>Aug 2005</i>	<i>Mar 2005<sup>b</sup></i>
Durex	81	82	84	87	83
Mates	15	17	12	9	10
Trojan	-	-	2	2	2
Pasante	-	-	2	2	2
Condomi	4	1	1	-	-
Other	-	-	-	-	3

Source: IRI and Church & Dwight.

<sup>a</sup>The shares relate to 4 week periods ending: 7 September 2002, 14 June 2003, 20 March 2004, and 6 August 2005.

<sup>b</sup> Church & Dwight supplied shares calculated taking into account the fact that IRI data do not cover around 5 per cent of the retail sector.

**Table 4.3: Share of supply of condoms for retail in the UK by wholesale value, 2004-2005 (%)**

[...]

Source: Condom suppliers.

4.5 Durex's share of wholesale supply to retailers (that is, excluding supply to the NHS) has remained reasonably steady since 1992-93 when it was [...] per cent.<sup>31</sup>

4.6 The evidence shows that the supply of condoms to the retail sector is very concentrated. One way to measure concentration is to use the Herfindahl-Hirschman Index (HHI). This measure not only evaluates overall concentration but also takes into account the size of the individual suppliers' shares.<sup>32</sup> It is important that the HHI is seen as a measure of concentration and not evidence that a competition problem exists (although it may be used as one indicator of potential competition

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<sup>31</sup> MMC report (confidential version), Tables 3.10 and 3.11.

<sup>32</sup> HHIs are calculated by summing the squares of individual shares of supply. For example, if market A has three firms with individual shares of 60 per cent, 35 per cent and 5 per cent it will have a HHI of 4850. If market B also has only three firms but they have equal shares of one third each, its HHI would be 3333. So although both markets are served by only three firms, market A is considered the more concentrated as the three firms are more unequal in their position in the market.



concerns). The OFT is likely to regard a measure of 1800 as highly concentrated and 1000 as concentrated.<sup>33</sup> The share of supplies of condoms to retail outlets has a HHI of around 7006 to 7658 – well in excess of what is normally deemed to be highly concentrated.<sup>34</sup>

## **Entry, exit and barriers to entry**

### **Entry and exit**

- 4.7 There has been little change in the overall structure of supply over the past decade. SSL, through its Durex brand condoms, has consistently had a share of supply in excess of 80 per cent and Ansell has remained its most significant competitor, through its Mates brand of condoms. Other suppliers account for only a negligible share of supply and offer only limited, if any, competitive constraints on the leading suppliers.
- 4.8 Nevertheless, there has been both entry and exit in the supply of condoms to retailers and wholesalers in the UK (Table 4.4). Perhaps the most notable of these has been the entry of Church & Dwight with its Trojan brand condoms two years ago. Trojan is the biggest selling brand of condom in the US although, as yet, it has not managed to gain a material share of supply in the UK. A number of fashion related brands (for example, FCUK and United Colors of Benetton) have also entered.<sup>35</sup> The OFT has been told that fashion related brands have principally been interested in supplementing their brand image rather than attempting to gain a significant proportion of retail condom distribution. These brands have typically received limited distribution.

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<sup>33</sup> OFT 2003, Mergers: a substantive assessment guidance, paragraph 4.4.

<sup>34</sup> The HHI calculation used IRI volume data for August 2005 and data supplied by Church & Dwight for March 2005 (both in Table 4.2).

<sup>35</sup> Benetton has since exited.

**Table 4.4: Entry to and exit from the supply of condoms to UK retailers**

<i>Brand</i>	<i>Manufacturer</i>	<i>Entry date</i>	<i>Exit</i>
Ansell Lifestyle	Ansell	2001	by 2002
Boots (own brand)	Ansell	1996	-
Condomi	Condomi	1999	-
FCUK	Ansell	2000	-
Healthline	Guthrie	Present in 1993	by 2002
Inspiral		2000	-
Jiffi	Sime Health	Present in 1993	2001
Pasante	Ansell	2002	
Superdrug (own brand)		1997 (approximately)	-
Trojan	Church & Dwight	2003	-
United Colours of Benetton	Ansell	1997	by 2002

Source: Condom suppliers.

## Barriers to entry

4.9 In 1994 the MMC identified a number of barriers to entry to the supply of condoms for retail distribution channels in the UK. They were:

- the cost of obtaining the quality certification (BSE Kitemark)
- the cost of establishing a brand image
- getting listed with wholesalers and retailers,
- the possible reactions from incumbents once entry has occurred.<sup>36</sup>

4.10 The OFT has considered the extent to which the above factors are still relevant to the market using information provided by condom suppliers and retailers.

### Quality certification

4.11 Condom suppliers have informed the OFT that quality certification marks remain an important commercial pre-requisite for sales. As noted in Chapter 3, condoms must carry the CE mark before being sold in the EU. Both the introduction of the CE mark and its compulsion are changes since the MMC reported. Therefore, the cost involved in acquiring a CE mark is a regulatory condition to entry. Any supplier presently supplying condoms elsewhere in the European Union, which has achieved the CE mark for its condoms can now supply within the UK without the need for further certification. The kitemark remains as an additional quality certification, but is not compulsory.

4.12 None of the suppliers the OFT has contacted have indicated that the cost of obtaining the quality certification marks has been prohibitive. Both Ansell and Durex have told the OFT that the cost of obtaining the CE mark is relatively modest. It can cost between £15,000 and £20,000

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<sup>36</sup> MMC (1994), paragraphs 3.152-160.

to gain the initial CE certification, with lower prices in subsequent years to maintain the CE mark. The OFT has been told that the kitemark costs £5,000 per site, per year to maintain although this certification cannot be used in other countries.

- 4.13 An entrant brand can be manufactured on a contract basis by a producer (such as Ansell) with existing certification at a relatively small cost to the supplier ([...] has told the OFT that this can be at a third of the cost of a full certification). Information provided by a range of suppliers suggests that this is a realistic approach and Trojan, Boots, Pasante and FCUK have all decided to do this.
- 4.14 One supplier has emphasised that the introduction of the EU wide CE mark has made entry into the UK easier by allowing any supplier in possession of the CE mark to enter without the Kitemark, while still possessing a trusted quality certification standard. Trojan and Inspiral have both chosen to take advantage of this.

### Brand image

- 4.15 The image of the brand continues to be an important issue given the intimate nature of this product. The MMC, in 1994, noted that Durex was widely considered to be synonymous with condoms and this was likely to increase the difficulty to a competitor trying to establish its own strong brand.<sup>37</sup>
- 4.16 Most of the retailers contacted by the OFT said that Durex was a 'must stock' brand. Survey information provided to the OFT also indicated that consumer awareness of the Durex brand name is stronger than that of its major competitors. [...] (Chart 4.5).<sup>38</sup> [...]

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<sup>37</sup> MMC (1994), paragraph 3.155.

<sup>38</sup> The survey questioned over 500 people in 2004, all of whom had purchased a condom in the previous six months.

## Chart 4.5: Spontaneous awareness of condom brands, 2004

[...]

Source: Ansell

- 4.17 The same survey asked what factors were important to consumers in determining their choice of condom. The most important factor, with a little over half of the respondents citing it, was the brand of the condom. Other important factors were quality [...] respondents), the presence of the kitemark [...] and the price [...].
- 4.18 Condom suppliers have been prepared to invest in marketing activities to increase consumer awareness of brands and trust in brands. The average annual amount spent on advertising by each of the major suppliers between 2002-03 and 2004-05 varies (Table 4.6). [...].

**Table 4.6: Average annual advertising spend by suppliers  
(2003-2004) <sup>a</sup>**

[...]

Sources: Condom suppliers.

4.19 Two suppliers told the OFT that it was possible to gain significant awareness of new brands by supplying to the NHS. These suppliers have said that the increased awareness and trust conferred by being distributed by the NHS is a viable basis for a company to successfully enter the retail market without substantial advertising expenditure.

- 4.20 Overall it seems that branding is a significant feature of supply. However, as a barrier to entry it has not been insurmountable and suppliers have been willing to engage in significant marketing activity to increase awareness of their brands.

### Listings

- 4.21 The 1994 MMC report identified gaining a listing with retailers and distributors as a significant barrier to entry.<sup>39</sup>
- 4.22 Both [...] have told the OFT that gaining listings is not a significant issue. These suppliers noted that the greatest challenge was not getting listed with major retailers but maintaining a listing through meeting sales targets.
- 4.23 One supplier, on the other hand, has told the OFT that major retailers are more interested in stocking different products to the existing condoms that they stock. In some cases this can mean that major retailers are more prepared to list only those products with new features or those which involve premium pricing or enhanced marketing support. In practice, this approach does not seem to have prevented retailers from listing standard product lines and new products from condom suppliers.
- 4.24 In-store promotions are an important part of selling condoms in the UK's major retail outlets, and therefore being prepared to meet the costs of promotions is an important part of gaining a listing in them. Different retailers engage in different promotional activity which includes buy-one-get-one free, every day low prices, free extras and price discounting. Although promotional activity is a general feature of the retail market, the OFT has been told that it is strongest in the supermarkets.

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<sup>39</sup> MMC (1994), paragraph 3.57.

- 4.25 From the available evidence there seems to be a greater variety of condoms and product lines available than was the case in the early 1990s.<sup>40</sup> This indicates that getting listed has become easier. Indeed, several retailers, including Tesco and Boots, have told the OFT that having a range of condoms to offer consumers is an important criterion in deciding which brands to list, and have adopted listing policies which facilitate this.
- 4.26 Condom suppliers have indicated that retailers prefer to stock a range of condom brands in order that they are able to negotiate lower prices and better promotional funding from suppliers by making them compete with one another. Trojan has told the OFT that [...], as well as some other retailers, have adopted a strategy of stocking multiple brands in order to ensure that it has sufficient leverage over SSL and other suppliers.
- 4.27 In all, the evidence suggests that obtaining a listing in a major retailer has become more straightforward over the last decade and there is now a wider variety of condoms than was the case at the time of the MMC report.

#### Reactions from incumbents

- 4.28 In general, likely reactions from incumbents can sometimes impact on the decisions to enter a market. For example, threatened with an entrant, incumbents may lower prices to protect market share, thereby making entry potentially less profitable. The OFT considers that the reactions of an incumbent are only of concern if it involves predatory behaviour.
- 4.29 The OFT has no evidence that behaviour by incumbents in response to entry in the supply of condoms for retail has been predatory. Indeed, some new entrants have told the OFT that both SSL and Ansell have responded to the entry of others by behaving pro-competitively (that is,

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<sup>40</sup> This is discussed further in the next chapter.



offering new products, increased marketing spend and reduced the prices of the products).

### Channels of retail distribution

4.30 Besides the various factors of structure, entry, exit and barriers to entry in the supply of condoms to retailers, the retailers themselves have a considerable impact on competition in the supply of condoms. In the early 1990s supermarkets accounted for around a quarter of retail sales of condoms while pharmacies accounted for over a half (Boots alone accounted for one in four condoms sold in the UK).<sup>41</sup> Today, the supermarkets account for around 40 per cent of retail sales, a share mostly drawn from the pharmacies which have seen their share fall to 30 per cent (with Boots' share falling a little to over one in five condom sales). Therefore, national retailing chains (supermarkets, Boots and Superdrug) now account for at least 65 per cent of condom sales. This change in distribution trends is shown in Table 4.7.

**Table 4.7: Retail sector shares of condoms retailed in the UK by volume, 1992-1993 and 2004-2005 (%)**

	<i>1992-93</i>	<i>2004-05<sup>a</sup></i>
Boots	26	24
Supermarkets	23	42
Drugstores	10	7
Other(including pharmacy) <sup>b</sup>	42	28

Sources: MMC (1994) Table 3.15, SSL and Ansell. IRI information.

<sup>a</sup> information for 2004-05 is based on information provided by SSL and Ansell only.

<sup>b</sup> The other category includes pharmacy, mail order, forecourts, convenience stores and internet distribution. Some suppliers could not provide a volume figures for pharmacies preventing a calculation of a pharmacy figure.

Data does not total 100 due to rounding.

<sup>41</sup> MMC (1994), Table 3.15.

- 4.31 The change in the structure of condom retailing has been a significant influence on the supply of condoms in the UK. The OFT has been told by condom suppliers that as a result of the increased sales in national retail chains there has been a shift in the negotiating power from suppliers toward retailers. Both [...] have told the OFT that they have refused to accept increases in wholesale prices from SSL, between 2000 and 2002, as part of their every day low price policies – a distinct change from 1993 where the MMC noted that retailers often accepted price increases with only limited resistance.<sup>42</sup>
- 4.32 This is consistent with the experiences of SSL. In 1993-94, supermarkets accounted for [...] per cent of Durex sales but by 2004-05 this had increased to [...] per cent.<sup>43</sup> SSL has emphasised to the OFT that supermarkets are today more willing to use their buyer power which allows them to insist on promotional activity and place pressure on SSL to reduce wholesale prices.<sup>44</sup> The effect of the major retailers is shown most obviously in the wholesale prices for condoms, which is the focus of the next section.

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<sup>42</sup> MMC (1994), paragraph 3.107. This does not apply to the period in 1993 after which Superdrug had significantly reduced prices.

<sup>43</sup> Information provided by SSL.

<sup>44</sup> What is more, SSL is keen to have its line of Scholl footcare products listed in major supermarkets. SSL does not have the same large share of supply for these products as it does for condoms and the OFT has been told that supermarkets use this to increase their negotiating power when buying condoms.

## Wholesale prices of condoms

- 4.33 Wholesale prices are taken to be the prices charged by suppliers to intermediate sellers (that is, sales to wholesalers or directly to retailers).
- 4.34 For Durex condoms, wholesale prices have fallen by an average of 18 per cent over the past five years (Chart 4.8).<sup>45</sup> It does not seem that the product mix changes this trend to any material degree.<sup>46</sup> This trend, of course, does not indicate that prices are at competitive levels, simply that they have been decreasing.

### Chart 4.8: Average selling price per gross of Durex condoms, 1999-2000 to 2004-2005 (£)

[...]

Source: Confidential information supplied by SSL.

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<sup>45</sup> This is in nominal terms – that is, the figures have not been adjusted for inflation. If the figures were inflation-adjusted the fall in prices would be slightly larger. Further, the data given to the OFT by SSL contain the occasional irregularity – for example, differences in the timing of when a change in price occurred and when it was reported. These do not affect the overall result in any material way.

<sup>46</sup> Changing the product mix can change overall average prices quite substantially. For example, say company A sells two products X and Y with X being much cheaper than Y. Over time sales of X may increase and sales of Y may decrease. In this event the average price that company A receives (that is, of products X and Y taken together) will fall even though the individual prices for X and Y do not change.

4.35 The trend is borne out more sharply when analysing individual product lines. SSL's two biggest selling condoms are Fetherlite and Extra Safe, which accounted for [...] per cent and [...] per cent respectively of wholesale sales in 2004-05.<sup>47</sup> Average wholesale prices for these have fallen since 1999-00 although proportionally more for the larger pack sizes (by around [...] to [...] per cent for packs of 12 or 18 condoms) than for the smaller pack sizes (Charts 4.9 and 4.10). This is particularly significant because for both Fetherlite and Extra Safe condoms, two of the three most popular pack sizes are the 12 and 18 packs [...].

**Chart 4.9: Average wholesale prices for Durex Fetherlite condoms, 1999-2000 to 2004-2005 (£)**

[...]

Source: Confidential information supplied by SSL.

**Chart 4.10: Average wholesale prices for Durex Extra Safe condoms, 1999-00 to 2004-2005 (£)**

[...]

Source: Confidential information supplied by SSL.

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<sup>47</sup> This is aggregated across pack variants.

- 4.36 For other types of Durex condoms (for example, Avanti, Silky Smooth, Performa, Ribbed and Ultra Strong) a similar trend is present although the extent of the price falls varies.
- 4.37 Ansell has told the OFT that its wholesale prices have remained static since 1999.

### **Evidence of wholesalers and retailers**

- 4.38 One large wholesaler, one of the largest wholesalers in the UK, gave pricing information to the OFT for the period 2002 to 2005. Over this period, the price the amount paid for Durex condoms overall increased by 2 per cent. This is less than the rate of inflation, so in real terms the price paid to SSL for Durex condoms had decreased slightly since 2002. For the two biggest selling Durex condoms – Fetherlite and Extra Safe – the prices it paid remained reasonably steady (with an increase of around a mere 0.5 per cent each, unadjusted for inflation).
- 4.39 For Mates brand condoms a different, more mixed picture emerged. Prices charged to the wholesaler for Mates condoms overall increased by [...] per cent. Mates Natural 3 pack and Mates Variety 3 pack, two of the largest selling products in Mates' range, seemed to have had particularly large increases in prices charged to the wholesaler (by [...] and [...] per cent respectively). However, it also seems that for some of the other popular Mates condoms (for example, Mates Natural 12 pack and Mates Variety 12 pack which both outsell their 3 pack counterparts) prices have fallen over the period.
- 4.40 Not all retailers source their condoms from wholesalers – some will acquire them directly from the condom supplier. [...] has provided information to the OFT saying that the prices it pays for its Durex and Mates condoms have not changed since 1999. Similarly, [...] has told the OFT that the prices it pays for Durex condoms has not changed since 2002. [...] has provided information showing that the prices it pays for Durex and Mates condoms have not changed over the past year. For [...], the prices it has paid since 1999 have not followed a consistent

trend. Prices for Durex condoms have remained quite steady whereas the prices [...] have paid for Mates condoms have fallen quite substantially. [...] did not provide to the OFT pricing information but did comment that prices for condoms have fallen in recent years.

## **Retail prices of condoms**

4.41 As with wholesale prices, retail prices have, on average, fallen over the past few years – albeit by a lesser proportion than wholesale prices. According to IRI data, the aggregate value of retail condom sales in the UK fell by almost 3 per cent in the year to 2004-05 despite the aggregate number of condoms being sold increasing.

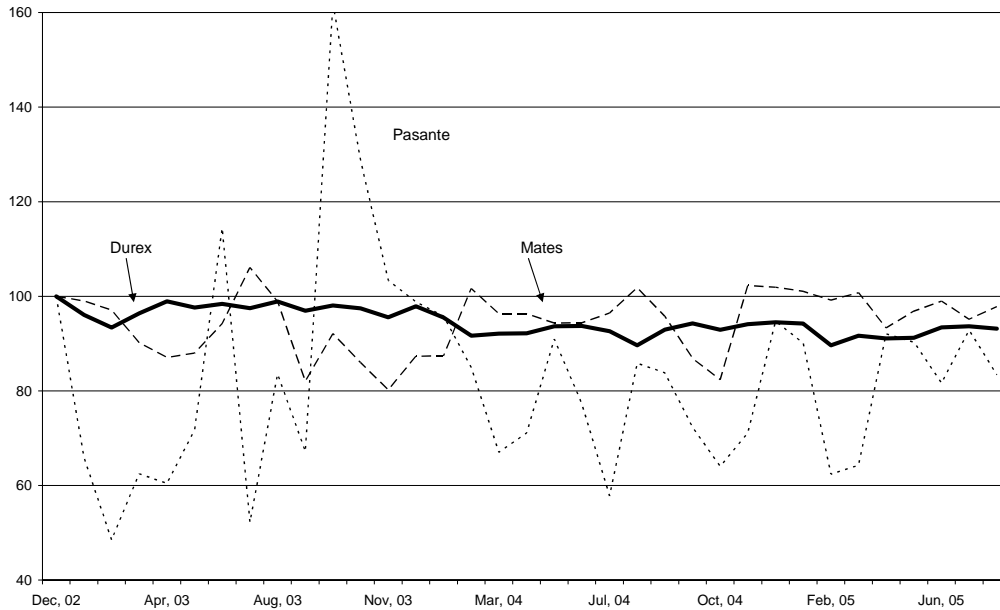
4.42 Chart 4.11 shows the indices of average retail prices for Durex, Mates and Pasante condoms from December 2002 to August 2005.<sup>48,49</sup> Over that period average retail prices have fallen by around 5 per cent for Durex and Mates condoms and around 15 per cent for Pasante condoms (although both Mates and Pasante show much more fluctuation in average prices than does Durex, making them more sensitive to beginning and end points).

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<sup>48</sup> The average price is average of prices paid across a supplier's range of condoms weighted by the number of each type sold.

<sup>49</sup> It is important to note that indices do not offer any information on the level of prices, only the trend of price movements. Whatever each supplier's average prices were at December 2002 are set to an index of 100 and their average prices since then are reported relative to what they were at December 2002, not relative to other suppliers' average prices. In this way the chart shows price trends, not levels.

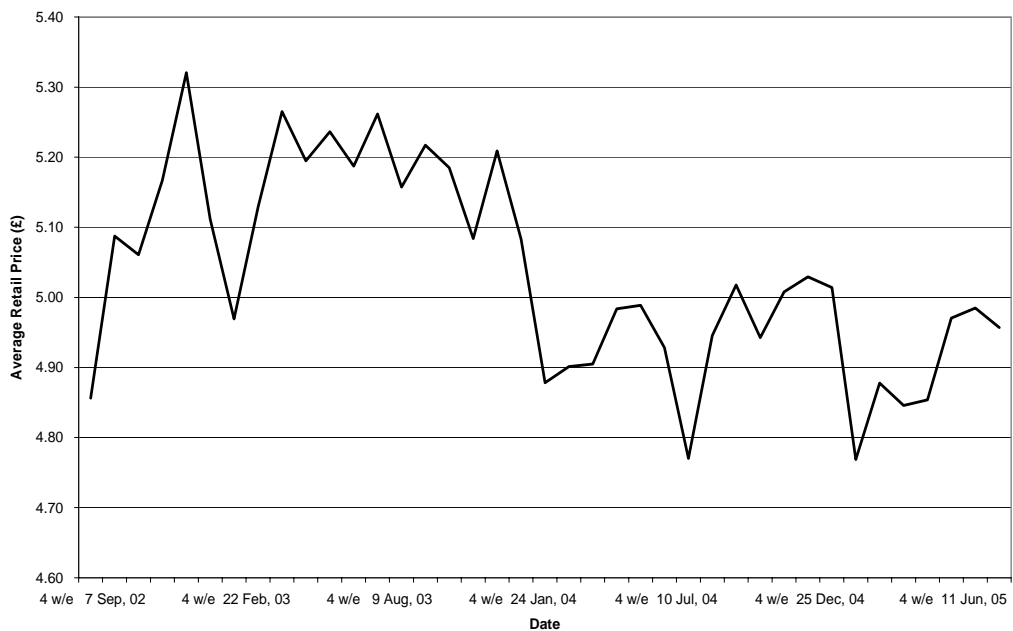
**Chart 4.11: Indices of average monthly retail prices, December 2002 to August 2005 (December 2002 = 100)**



Source: IRI.

4.43 Chart 4.12 shows the average retail prices for Durex condoms in money terms. As with many products in retailing, promotions play a big role in the day to day and month to month selling of the product. This explains why retail prices (for Durex as well as other brands of condoms) jump around from month to month. The OFT has smoothed the data as much as is reasonable in order to see the overall trend in price movements. In recent years average prices have been falling

**Chart 4.12 – Average retail prices for Durex condoms, September 2002 to August 2005 (£)**



Source: IRI.

- 4.44 This pattern of decreasing retail prices is also true for most other brands in the market. Annexe E includes data on the average retail prices of both Mates and Trojan which shows a similar pattern to that observed for Durex condoms.
- 4.45 There are a number of reasons for this decline in retail prices. The OFT considers the biggest reason is that national supermarket chains have expanded as condom retailers over the past decade. As such, they have been able to use their considerable negotiating strength to buy in condoms at lower prices and to pass on these efficiencies to consumers through various promotions.



## Wholesale prices abroad

- 4.46 In order to help the OFT gauge how condom prices in the UK compare with those in other countries, SSL provided to the OFT information on its 2003 wholesale prices for nine types of condom in a range of European countries. From this the OFT was able to calculate the difference in overall average prices between the UK and these countries. Details of the analysis are in Annexe F.
- 4.47 It shows that despite falling average wholesale prices in recent years, average wholesale prices in the UK for Durex condoms are still significantly higher than they are in most other western European countries. The two exceptions are the Netherlands and the Republic of Ireland. Average condom wholesale prices in these two countries are more expensive than they are in the UK for all the condom types that SSL supply there.
- 4.48 Nevertheless, similar pricing information for 2001 provided by SSL indicates that, on the whole, prices have become a little more equalised between the UK and these other countries from 2001 to 2003.

## Conclusion

- 4.49 The OFT review has found little change in the overall structure of supply since the time of the MMC report despite there being some churn (for example, Trojan has recently entered while United Colours of Benetton has exited). Durex brand condoms still account for the large majority of condom sales.
- 4.50 Brand awareness among consumers is still considered to be the most significant barrier to entry. Gaining a listing in a major retailer now seems easier than it was in the early 1990s.
- 4.51 However, despite there being little change in the supply of condoms, on the retailing side there have been significant changes. National retail chains have significantly increased their share of condom sales. Supermarkets have almost doubled their share over the past decade.

4.52 The supermarkets have managed to utilise their buying power effectively. This seems to have more than offset the impact of any lack of price competition that may exist in the supply of condoms. The OFT has found that, on average, both wholesale and retail prices have fallen in recent years.

## 5 ASSESSMENT OF THE UNDERTAKINGS

### Introduction

- 5.1 This chapter draws on the evidence discussed in previous chapters in order to assess the undertakings and their effectiveness. The undertakings prohibit SSL from entering into exclusivity agreements with wholesalers or retailers and require it to put in place arrangements to ensure its staff comply with the undertakings.
- 5.2 The chapter finds no evidence of exclusivity agreements between SSL and wholesalers or retailers. What is more, changes in competition laws combined with a shift in negotiating strength between condom suppliers and retailers lead the OFT to conclude that the undertakings are no longer necessary.

### Evidence of exclusivity agreements

- 5.3 The MMC found in 1994 that the great majority of retailers selling condoms appear to stock only Durex, or if not just Durex then Durex and Mates.<sup>50</sup> Today the pattern of stocking only Durex condoms is significantly less common. Major retailers prefer to offer as wide a choice as possible to their customers, a policy which has been discussed in Chapter 4.
- 5.4 The OFT has found that most retail chains and wholesalers offer a range of condom brands and that SSL does not usually enjoy the position of being sole supplier. Indeed, retailers or wholesalers which supply more than one brand of condom accounted for around 80 per cent (by volume) of condoms supplied by SSL for retail in the UK in 2004-05. Overall, the

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<sup>50</sup> MMC (1994), paragraph 3.84.

OFT estimates that these retailers account for at least three-quarters of all condoms supplied to retailers and wholesalers.<sup>51</sup>

5.5 This is similarly the case in large pharmacy chains and a number of other retailers. Table 5.13 demonstrates how the range of condoms stocked by some of the largest retail groups has changed since 1993.

**Table 5.13: Condoms brands stocked by the major retailers in 1992-1993 and 2004-2005**

	<i>1992-93</i>	<i>2004-05</i>
Boots	Durex, Mates	Durex, Mates, Trojan, FCUK, Boots own brand, Inspiral
Tesco	Durex, Mates, Femidom	Durex, Mates, Pasante
Sainsbury's <sup>a</sup>	Durex	Durex, Mates
Asda	Durex, Mates	Durex, Mates
Lloyds	Durex	Durex, Pasante
Superdrug	Durex, Mates, Femidom	Durex, Mates, Trojan, Super drug own brand condoms

Sources: MMC (1994) paragraph 3.82 and condom suppliers.

<sup>a</sup> Sainsbury's has told the OFT that a wider range of condoms may be available in its in-store pharmacies.

<sup>51</sup> Comprising Unichem, Tesco, AAH Pharmaceuticals, Lloyds pharmacy, Numark, Morrison's, Sainsbury's, Superdrug, Asda, Waitrose, Enterprise, Somerfield, Multiple forecourts and Boots.

- 5.6 The table indicates that large retail groups list a range of different condom brands, in most cases stocking alternatives to Durex or Mates. There has been a marked increase in the number of brands stocked in Boots, a significant source of condom distribution, which in addition to stocking a larger number of branded condoms than it did in 1993, also stocks its own brand condom.
- 5.7 What is more, Asda, Superdrug and Alliance pharmacy have stocked the Condomi brand over the last several years and Boots and Superdrug have both stocked Benetton branded condoms. This indicates a willingness among retailers to offer a wider range of condoms than was the case in 1993, although of course this does not guarantee that each brand or type will sell successfully.
- 5.8 This is also consistent with consumer perceptions. When asked about the range of condoms available, consumers considered that supermarkets and pharmacies offered a wide choice of condom brands.<sup>52</sup>
- 5.9 Larger wholesalers, such as Alliance Unichem or Palmer and Harvey, also stock at least two brands of condom. AAH Pharmaceuticals, a major wholesaler to the pharmacy business, at the present time stock only Durex, however it has stocked four other brands over the last four years. This indicates that larger wholesalers are willing to stock a wider range of condoms other than simply Durex branded condoms.

### **Smaller retailers and impulse outlets**

- 5.10 The OFT has found that forecourt and convenience retailing distribution sectors, as well as some of the smaller multiple retailers (for example, Waitrose and Somerfield) tend to only stock one brand of condom – Durex.

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<sup>52</sup> Pasante Active Market Research, April 2005,p.21.

- 5.11 They have indicated to the OFT that this is in response to consumer demand for the market leader, the limited shelf space that these retailers have to display condoms and the limited emphasis given to health and beauty categories in these stores.
- 5.12 This segment of the retail distribution chain accounts for less than 10 per cent of the distribution networks for retail condoms in the UK.

### **Compliance with the undertakings**

- 5.13 The OFT has received no evidence from any of the parties approached to suggest that SSL has not complied with the undertakings.
- 5.14 For those retailers and wholesalers that stock only Durex brand condoms (mostly convenience stores and forecourts) the OFT has not found any evidence that this is a result of exclusivity agreements with SSL or that these companies have accepted material benefits or discounts in return for stocking only Durex condoms. Instead, the listing policies of these retailers seem to be a reflection of commercial requirements.

### **Views of SSL**

- 5.15 SSL has told the OFT that it considers that the undertakings are no longer required. It believes that the market has moved away from exclusivity generally as most retailers stock more than one brand. Further, SSL considers that the conduct and exclusivity agreements which are prohibited under the undertakings would be caught by other competition law provisions and therefore the undertakings are no longer required.
- 5.16 SSL has told the OFT that it has not been approached by any retailer offering exclusive supply of Durex. SSL has also told the OFT that if such an approach was made it would not enter into such an agreement and would document the approach. It assured the OFT that London International and SSL has taken its obligations seriously.

5.17 SSL also stated to the OFT that it has a vigorous compliance policy in relation to exclusive supply agreements and other matters of competition law. The sales force and senior management have received training on competition issues. Copies of the training presentations were provided to the OFT. The OFT is satisfied that these steps help SSL to comply with the provision in the undertakings to ensure SSL staff comply with the undertakings.

### **Views of other parties on the undertakings**

5.18 In reviewing the undertakings the OFT met with all the main condom suppliers and discussed the effectiveness and desirability of the undertakings. All gave some view on the undertakings although views were not always strongly held and not always backed up with comprehensive reasoning.

5.19 [...] has told the OFT that it considers that the undertakings should remain in place. If SSL were to be released from its undertakings [...] would be concerned that SSL put in place a series of exclusivity agreements with wholesalers and retailers making it more difficult for [...] to gain listings.

5.20 Further, [...] believes that the undertakings make it easier for the OFT to investigate any possible exclusivity arrangements. It considers that SSL has generally complied with the undertakings.

5.21 Likewise, [...] would like to see the undertakings remain as it considers that it would be more difficult for [...] to establish itself in the UK without the undertakings.

5.22 [...] regards the undertakings as providing a useful check on the behaviour of SSL although it considers that the undertakings have been limited in their effectiveness.

5.23 [...], on the other hand, do not consider the undertakings to be effective and is therefore ambivalent as to whether SSL is released from them.

5.24 Both [...] and [...] told the OFT that they were concerned about SSL's position in the supply of condoms to the NHS (which falls outside of the scope of the undertakings).

### **The relationship with competition laws**

5.25 The statutory undertakings that bind SSL concern vertical agreements between it and wholesalers and/or retailers. The OFT has reviewed the undertakings by considering the supply of condoms as a whole. It has not examined individual agreements. While vertical agreements in general do not raise competition concerns, in some instances they might (for example, if one party possesses market power or if there is a network of similar agreements).<sup>53</sup> This section discusses the competition laws that govern commercial activity in the UK.

5.26 Article 81 of the EC Treaty prohibits agreements between undertakings which may affect trade between Member States which have as their object or effect an appreciable prevention, restriction or distortion of competition within the common market. There is a block exemption for most vertical agreements, which provides a safe harbour for these agreements from the prohibition in Article 81(1).<sup>54</sup> An exclusive supply agreement will fall within the scope of the block exemption unless the buyer has a share in excess of 30 per cent of the relevant market or the benefit of the block exemption is withdrawn because the agreement has effects which are not capable of exemption (for example, because it forms part of a network of similar restraints).

5.27 Article 82 of the EC Treaty prohibits abuse by an undertaking with a dominant position in the common market (or in a substantial part of it) which may affect trade between Member States. A dominant undertaking which offers financial inducements to its customers in return

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<sup>53</sup> OFT 2004, Vertical Agreements, understanding competition law.

<sup>54</sup> Commission Regulation 2790/99/EC.



for a commitment to exclusive supply is likely to infringe Article 82 if such conduct forecloses its competitors.<sup>55</sup>

- 5.28 Since 1 May 2004, the OFT is required to apply Article 81 to agreements between undertakings which may affect trade between member states if it applies national competition law to them.<sup>56</sup> Likewise, if it applies national competition law to abuse prohibited under Article 82, it must also apply Article 82.
- 5.29 The Competition Act 1998 (which came into force in March 2000) contains prohibitions which are based on Articles 81 and 82 (the Chapter I prohibition and the Chapter II prohibition respectively) which apply to agreements and conduct which affect trade within the UK. In the past vertical agreements in the UK have not been subject to the Chapter I prohibition because of the Vertical Agreements Exclusion Order.<sup>57</sup> However, in May 2005 this order was revoked, allowing vertical agreements to be subject to the Chapter I prohibition. However, agreements which fall within the scope of the EC block exemption for vertical agreements will be exempt from the Chapter I prohibition although the OFT has the power to withdraw the benefit of that parallel exemption.
- 5.30 Undertakings which infringe Article 81, Article 82 or the prohibitions in CA98 may be fined up to 10 per cent of total worldwide turnover in the undertaking's last year of business.<sup>58</sup>

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<sup>55</sup> Joined cases 40/73 to 48/73 etc, *Suiker Unie and Others v Commission* [1975] ECR 1663, Case 85/76 *Hoffman-La Roche v Commission* [1979] ECR 461.

<sup>56</sup> Article 3(1) EC Regulation No. 1/2003.

<sup>57</sup> Competition Act 1998 (Lands and Vertical Agreements) Order 2000, SI No. 310.

<sup>58</sup> Or where the infringement ended prior to 1 May 2004, up to 10 per cent of turnover in the UK of the undertaking in the financial year preceding the date when the infringement ended, multiplied pro rata by the length of the infringement up to a maximum of three years.

## Conclusion

- 5.31 The OFT has not found any evidence of SSL's subsidiary LRC breaching the undertakings. Where retailers or wholesalers do stock only Durex condoms it seems that this is because they only wish to stock a small number of condoms and opt for the market leader. But even in these cases there is competition between suppliers to get listed.
- 5.32 The OFT also notes that the conduct identified by the MMC in 1994 as operating against the public interest and resulting in these undertakings appeared to be limited in scope in terms of the size and number of payments made and the number of customers affected. SSL/LRC has taken steps to bring the conduct in question to an end.
- 5.33 The OFT has found that there now exists considerable choice of condoms – both in brands and in types of condoms – in the major retail outlets, especially the supermarkets who have almost doubled their share of condom retail sales from a little over 20 per cent in the early 1990s to over 40 per cent today (Table 4.7). This represents a substantial change from the time of the MMC report.
- 5.34 The supermarket chains and other major retailers such as Boots have told the OFT that they prefer to stock a range of brands as it improves their customer offer as well as increases the amount of in-store promotional spending. This provides an incentive for retailers to continue to stock a range of brands making a reversion to a more restrictive listing policy unlikely (paragraph 4.26). The OFT does not consider that the undertakings are required any longer to ensure suppliers other than SSL have the opportunity to get listings in major retailers.
- 5.35 The OFT considers that these developments in the retailing of condoms represent a change of circumstances since the undertakings were originally given, which in themselves justify the release of SSL from the undertakings.

- 5.36 Taking account of these circumstances, the OFT has also had regard to the potential application of the Competition Act prohibitions and Articles 81 and 82 as providing effective and tough sanctions in the event that SSL engages in similar conduct in the future. This should help allay the fears of SSL's competitors.
- 5.37 The OFT considers that SSL's subsidiary LRC should be released from its undertakings.

# ANNEXES

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## A THE UNDERTAKINGS

1 LRC PRODUCTS LIMITED ('LRC') HEREBY GIVES THE FOLLOWING UNDERTAKINGS TO THE SECRETARY OF STATE PURSUANT TO SECTION 88 OF THE FAIR TRADING ACT 1973:

(1) LRC shall not enter into, or carry out any agreement with wholesalers or retailers under which LRC gives, or agrees to give the other party a material benefit - whether in the form of special payments, higher discounts or in any other form - in return for that party's undertaking to stock only LRC condoms, or not to stock the condoms of any named supplier. The undertaking shall not apply in respect of an agreement with a wholesaler or a retailer who operates solely in the vending machine sector.

(2) LRC shall, as far as is reasonably practical, put in place the arrangements necessary to ensure that its staff comply with the requirement specified at (1) above.

2 In these undertakings: - 'Agreement' means any agreement or arrangement in whatever way and in whenever form it is made, and whether it is, or is intended to be legally enforceable or not.

**Date of Undertaking:** 30th of June 1994

## **B SUMMARY OF THE MMC REPORT ON CONTRACEPTIVE SHEATHS (1994)**

### **MMC findings**

- B.1 In 1994 the MMC found LRC Products Ltd ('LRC') and its parent company, London International Group Plc, were scale monopolists as defined in the Fair Trading Act 1973 (with a share of around three-quarters of total condom supply).
- B.2 The MMC concluded that there were three distinct trade channels: supply to retailers and wholesalers for over-the-counter ('OTC') sale in shops, which represented 60 per cent of the total, supply to the National Health Service (NHS) for free distribution (23 per cent), and supply via vending machines (16 per cent). While there were interactions between all three, it found that the NHS was a separate market, where supply prices were much lower than, and moved independently of, those in the two commercial sectors.
- B.3 The MMC concluded that the markets had changed since its previous investigation in 1982, primarily as a result of concern about AIDS and the consequent recognition of the condom's unique ability to protect people against sexually-transmitted diseases.
- B.4 Mates condoms were launched in 1987 and quickly achieved a significant share of sales, although its share fell back in the years before 1993. It is also noted that Jiffi had entered the market. By 1993 condoms were being stocked by an increasingly wide range of outlets, including supermarkets. In May 1993 Superdrug initiated the first condom price war by cutting a third off the price of all its condom lines.

## Price controls

- B.5 At the time of the 1994 MMC investigation price controls were still in place. LRC told the MMC that if the price controls were lifted it would seek to raise its trade prices in the commercial market to average European levels over a period of about five years.
- B.6 While LRC's entrenched position and the strength of its Durex brand were significant barriers to the entry and growth of competitors, the MMC concluded that the changes in the market had made it much more likely that other suppliers would be prepared to challenge LRC if price control were removed and LRC tried to raise prices. Some, drawing on lower cost imports, had already established a presence, particularly in vending.
- B.7 The MMC noted that since condom retailing was becoming a more competitive business, increases in trade prices would not necessarily be fully reflected in retail prices. Retailers would be receptive to new suppliers who could present a credible alternative to LRC. Competitors would be likely to come in with prices below those of Durex so that the general level of trade prices would not increase at the same rate as LRC's. LRC itself would no longer be able to justify price increases to its customers with the argument that the increases accorded with the price control system.
- B.8 In the NHS buyers showed a growing tendency to bargain keenly, to coordinate their efforts and to promote products offering the best value for money. The NHS, the MMC found, was much more concerned with specification and price than with brand image and can look for quality suppliers on a worldwide basis. The MMC considered that there was sufficient competition present to protect the NHS if price controls were removed. Moreover, the MMC expected that the introduction of a European Standard in 1994 would significantly increase the number of suppliers within the UK which would give the assurance of quality required by both NHS and OTC customers.

- B.9 The MMC paid close attention to its implications for the fight against AIDS. It concluded that increased competition would generate much more commercial advertising and other promotional activity, resulting in a greater usage of condoms, particularly among the young. The MMC argued that this would outweigh any loss of welfare resulting from higher prices. It concluded that the balance of argument clearly favoured the removal of price control.

### **Recommendations**

- B.10 The MMC examined a number of LRC's individual trading practices. It concluded that two practices were steps taken by LRC for the purpose of exploiting or maintaining its monopoly position: selling to the NHS at prices below full cost, and recommending retail prices.
- B.11 In addition, the MMC concluded that LRC entering into exclusive agreements with customers whereby they agreed to stock only LRC condoms was an action taken by LRC, attributable to its monopoly position, and which operated against the public interest by restricting the ability of other suppliers to enter the market. It recommended that LRC be required to desist from this practice. LRC gave an undertaking to that effect in 1994.

## C SUMMARY OF PREVIOUS MMC REPORTS

### The 1974 MMC report and aftermath

C.1 The MMC made its first report on the supply of condoms in 1974.<sup>59</sup> The report concluded that LR Industries Limited ('LRI'), the predecessor of LRC, held a monopoly position. It found LRC's pricing policy operated against the public interest in that:

- it resulted in excess profits
- its differential nature deterred competitors and potential competitors, and
- retail prices were higher than they would otherwise have been.

C.2 The MMC recommended that LRI's home market selling prices should be reduced to bring about a reduction in the average selling price of 40 per cent from the average price of the previous year or, if costs had risen significantly, a reduction to provide a return on capital of around 20 per cent on a historical cost basis.

C.3 Following discussions with the company it was finally agreed that its prices should be set so as to yield a profit of some £525,000 in 1975-76. The company gave undertakings to the Secretary of State for Prices and Consumer Protection on 15 October 1975 which stipulated that changes in the home market prices of condoms had to be approved by the then Director General of Fair Trading ('DGFT'). It was estimated that the profit which had been agreed for 1975-76 represented a return on capital employed in the home contraceptive sheaths business of 35.5 per cent on a historical cost basis. The OFT continued to take this as the

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<sup>59</sup> *Contraceptive Sheaths: a report on the Supply of Contraceptive Sheaths in the United Kingdom*, HC 135, 1974-75, February 1975.



maximum permitted rate of return when considering LRC's applications for price increases.

- C.4 In May 1981 LRC applied for an increase in home prices from July of that year which, in the view of the OFT, would have led to an excessive rate of return. Approval was given for the increase to be implemented from December 1981, but only after the DGFT had decided to make a reference to the MMC, which he did on 15 October 1981. The Secretary of State for Trade released LRC from its undertakings to facilitate the MMC's inquiry.

### **The 1982 MMC report and aftermath**

- C.5 The MMC reported in November 1982 that a monopoly situation existed in favour of LRC (which held 90 to 95 per cent of the UK condoms market) and that its prices might be expected to become excessive and hence against the public interest.<sup>60</sup> The MMC recommended that the average realized prices of LRC's condoms should not increase at a greater annual rate than 1.5 percentage points less than any percentage rise in a special cost index designed to reflect LRC's input costs. LRC gave an undertaking to this effect on 28 September 1983.
- C.6 The OFT reviewed the undertakings in 1989. It recommended to the Secretary of State for Trade and Industry that they should be retained in their existing form for a further two years, after which they should be reviewed again. The 1993 reference was the outcome of that further review. After the MMC's 1994 report the price cap was dropped.

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<sup>60</sup> *Contraceptive Sheaths: a Report on the Supply in the United Kingdom of Contraceptive Sheaths*, Cmnd 8689, November 1982.

## **D DISTRIBUTION OF CONDOMS THROUGH THE NATIONAL HEALTH SERVICE**

### **Condom distribution through the National Health Service**

- D.1 The NHS sector is the second largest distribution channel in the UK and distributes free condoms through clinics. Purchasing is decentralised with each of the home nations pursuing different purchasing policies.
- D.2 Although NHS distribution of condoms is excluded from the scope of the undertakings it is nevertheless considered in order to gain a more complete understanding of the supply of condoms in the UK and what interactions between different channels exist. The OFT has been told by suppliers that presence in the NHS can increase awareness and trust in condom brands and can have a direct bearing on consumer demand for condom brands in the retail market. The OFT considers the purchasing policies of each of the home nations below using information provided by NHS organisations.

### **NHS England**

- D.3 The NHS Purchasing and Supply Agency ('PASA') is the central buying operation for the NHS in England and supplies around 43 per cent of condoms which are purchased by NHS providers in England, with the remainder being purchased directly by health authorities (individual primary care trusts, health authorities and clinics). It negotiates contracts with a range of condom suppliers through a tendering mechanism and establishes a list of contracted condom suppliers.<sup>61</sup> NHS bodies in England can then purchase what they require, the condoms are delivered by NHS Logistics Authority. A new tender takes place every three years. The NHS in England accounts for approximately 90 per cent of the £5 million value of sales to the UK NHS.

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<sup>61</sup> Tendering is open to suppliers throughout the European Union.

- D.4 In awarding the contract NHS PASA takes into account the suitability of suppliers against a number of criteria. These include quality of condoms (including quality certification), reliability of suppliers, brand, range or type of condoms offered, price, quality of service supplied by condom supplier and customer preference when allocating contracts.
- D.5 NHS PASA currently has contracts with a range of condom suppliers: Condomania, FP Sales Ltd, Mates Healthcare, Pasante Healthcare, Safex Suppliers and SSL. Their shares of the total PASA supply are shown in Chart D.14.

**Chart D.14: Proportion of condoms supplied to PASA by suppliers, 2002-2003 to 2004-2005**

[...]

Source: NHS PASA

- D.6 According to information the OFT has received from NHS PASA the prices of condoms supplied through NHS PASA have declined by up to 15 per cent in recent years.

**NHS Scotland**

- D.7 Scottish Healthcare Supplies manages the condoms contract on behalf of NHS Scotland. The contract is awarded through a European tender. Once completed purchasing is undertaken by local health providers from the contracted suppliers. Tenders are evaluated taking into account

quality, price and level of service offered. Only condoms with an appropriate quality certification would be successful.

- D.8 There are presently four companies on contract: SSL, Ansell, Pasante, and Safex. No indications of the share of the market by each supplier have been provided to the OFT.

### **NHS Wales**

- D.9 Welsh Health Supplies contracts on behalf of all NHS organisations in Wales. Its present practice is to contract for a single national supplier of condoms.

- D.10 Any company wanting to tender for condoms would need to apply to become an approved supplier. Welsh Health Suppliers would then consider the company in terms of whether their product of the required quality standard. It would then consider suitability of the range of products. Those that fulfil these criteria will then be considered on price. Contracts are for a two year period.

- D.11 In the most recent tender bid the OFT has been told that SSL won the contract. This is a relatively small contract and the OFT understands that some Welsh clinics and NHS organisations have also been sourcing from other suppliers, outside the national contract.

### **NHS Northern Ireland**

- D.12 All NHS organisations in Northern Ireland procure condoms from the Central Supplies Agency ('CSA'), the central purchaser of a number of medical items. This means that condom companies need to be contracted to CSA to supply the NHS in Northern Ireland.

- D.13 The OFT has been told brand is not a significant element in awarding contracts as quality, specification, delivery date, price and after-sales service are the most important factors. Pack size presentation is also important. The OFT has been told that there are few barriers to a

supplier selling their product providing they follow the contract route.  
The three year contract is awarded following an EU tendering process.

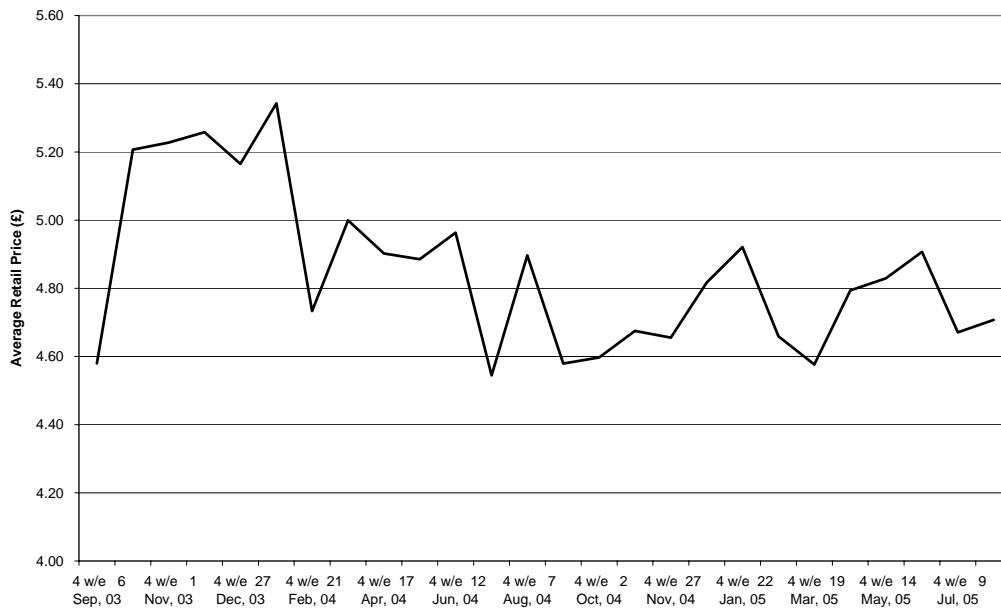
- D.14 SSL has won a place on the new contract, alongside Condomi, at the expense of Pasante. The value of the contracts is relatively small compared with total NHS spending on condoms: only about £36,000 per year.
- D.15 The companies which were successful in winning the tender in Northern Ireland did not always offer the lowest prices, but were able to gain the contracts as they offered training and information leaflets and appropriate pack sizes.

## E AVERAGE RETAIL PRICES OF TROJAN AND MATES CONDOMS

### Introduction

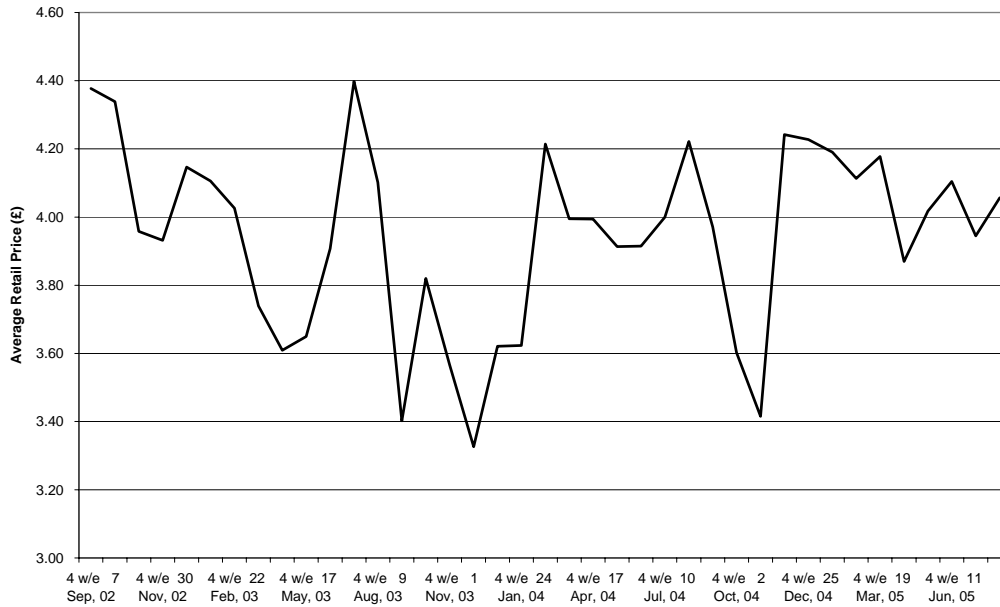
E.1 This annexe graphically presents the information on retail prices for two of the Durex brands competitors, Mates and Trojan. A brief conclusion summarising the findings of this analysis is included below.

**Chart E.15: Average retail price for Trojan condoms, 2002 – 2005**



Source: IRI.

**Chart E.16: Average retail price for Mates condoms, 2002 -2005**



Source: IRI.

## Conclusion

E.2 Chart E.15 shows that Trojan's retail prices are trending downwards over the period. Chart E.16, for Mates, shows a slight upward rise in the price around 2004 this is due to the rising price in impulse outlets. For supermarkets and chemists, our information indicates that the price has trended downward. The pattern of decreasing retail prices from these brands is the same as our findings for SSL.

## **F INTERNATIONAL PRICES**

### **Introduction**

F.1 This annexe presents the data for our analysis of the comparison between UK wholesale prices and those in a number of national markets. Chart F.17 graphically illustrates how the percentage differential between UK and some EU countries has changed while Tables F.18 and F.19 include data on comparative UK/EU condom prices. This is based upon information provided by SSL.

### **Data**

**Chart F.17: Difference in average wholesale prices for Durex Basic condoms between UK and selected European countries, 2001 and 2003 (%)**

[...]

Source: Information provided by SSL.



**Table F.18: Average wholesale prices for certain Durex condom types condoms in some EU member states, 2003 (Euros)**

[...]

Source: Information provided by SSL.

**Table F.19: UK percentage differential in average wholesale prices for certain Durex condom types with some other EU member states, 2003 (%)**

[...]

Source: Information provided by SSL.