

ACCC assessment of Coca-Cola Amatil Limited's proposed acquisition of Berri Limited

On 8 October 2003 the Australian Competition and Consumer Commission determined that the proposed acquisition of Berri Limited by Coca-Cola Amatil Limited (CCA) would have the effect, or be likely to have the effect, of substantially lessening competition in the national market for the manufacture and wholesale supply of chilled and ambient fruit juice and fruit drink¹ (together 'FB'), in contravention of section 50 of the *Trade Practices Act 1974* (the Act).

In October 2003, CCA proposed section 87B undertakings to alleviate the Commission's competition concerns (the proposed undertakings).

On 19 November 2003, the Commission formed the view that the proposed undertakings, and behavioural undertakings generally, would be insufficient to adequately resolve all of the competition concerns that would be raised by the proposed acquisition.

The parties

CCA is an Australian publicly listed company. The principal activities of CCA are the manufacture, distribution and marketing of non-alcoholic beverages. CCA's portfolio of beverages include carbonated soft drink (CSD), wholesale packaged water, bulk bottled water, FB, cordial, sports drink, energy drink and iced tea. CCA's FB brands are *Fruitopia*, *Growers Choice* and *Fruit Box*. CCA does not produce or supply fresh fruit juices and its FB sales account for approximately 1 per cent of the national total.

Berri is an unlisted Australian public company. The core activity of Berri is the manufacture and marketing of fruit juice and fruit drinks. Its leading national FB brands include *Berri*, *Daily Juice Company*, *Australian Fresh*, *Mildura*, *Prima*, *Just Juice*, *Mr Juice*, *Patra* and *Squeeze*. Berri's other non-alcoholic beverage products consists of wholesale packaged water, sparkling mineral water, flavoured milk, cordial and water ice products.

The transaction

CCA proposed to acquire 100 per cent of the issued capital in Berri.

Market inquiries

The Commission conducted market inquiries regarding the proposed acquisition with a range of interested parties, including competing manufacturers, industry associations and retailers.

Market definition

The relevant markets were considered to be the separate national markets for the manufacture and wholesale supply of carbonated soft drink and the manufacture and wholesale supply of chilled and ambient fruit juice and fruit drink.

The Commission considered that a small but significant and non-transitory increase in the price (SSNIP) of FB is not likely to lead to significant changes in end-user demand for other non-alcoholic beverage products.

The Commission's inquiries indicated that FB and CSD are not such close substitutes with one another as to impose a competitive constraint. In this respect, the Commission noted functional differences for end-user consumption and also significant differences in the times of consumption during a day, for different types of beverages. On the supply side, there appeared to be limited substitutability opportunities as separate manufacturing operations are generally required for the production of different non-alcoholic beverages.

At the wholesale level, it was considered unlikely that retailers would respond to a SSNIP in FB by ordering less FB and more of other beverage products. Although their demand is derived from what they expect to be able to sell to consumers, FB and CSD form part of a range of beverage products that retailers need to carry to best meet end-user demand. On this basis, the Commission considered that FB, CSD and other non-alcoholic beverages are complementary rather than substitutable from a retailers' perspective.

The Commission considered the relevant geographic dimension of the FB market to be more national than state-based or regional in scope. Reasons for this view include that FB sold by the parties (and its major competitors) are marketed nationally; the parties appear to compete on a national basis; and major retailers of beverage products purchase, or are in the process of moving towards purchasing, FB on a national basis. The Commission noted, however, significant regional variations in the market shares of FB suppliers which would indicate the existence of regional competitive dynamics.

The relevant functional dimension was considered to be the manufacture and wholesale (rather than retail) supply of each of CSD and FB. The Commission noted that consideration of the relevant functional dimension requires examination of both the grocery and non-grocery segments.²

Sales through the non-grocery trade channels represent an important source of revenue for FB manufacturers. This is because higher prices and margins are achieved in those channels. The Commission's market inquiries suggest that operating margins for manufacturers appear to be approximately 10 to 15 per cent higher in the non-grocery channels for FB.

Market concentration

In the national market for FB, the merged firm would exceed the Commission's concentration thresholds for the exercise of unilateral market power. The merged firm would account for approximately 49 per cent market share.

Competition analysis

The Commission noted CCA's submission, on the basis of separate markets for CSD and FB, that there is limited overlap between the parties in the supply of FB.

Nevertheless, the Commission considered that the proposed acquisition would be likely to substantially lessen competition in the national market for FB for the following reasons:

(i) CSD and FB are complementary products

Complementarity relates to demand-side linkages between product markets. It occurs where there is a significant degree of commonality in terms of buyers served or where the strength of demand for one product is positively correlated with the strength of demand for another. For example, complementarity may arise in the form of:

- commercial complements: products that form part of a range of products that distributors need to carry, and
- technical complements: products that for technical reasons must be consumed together (for example, computer hardware and software).

As noted above, the Commission considered that, from a retailers' perspective, FB, CSD and other non-alcoholic beverages are close complements on the basis that they form a range of beverage products that retailers need to carry to best meet end-user demand.

(ii) CCA possesses market power in the national market for CSD

CCA was considered to possess market power in CSD for a number of reasons.

Firstly, CCA possesses tremendous brand loyalty with its *Coca-Cola* product. Market inquiries suggested that the *Coca-Cola* brand is considered to be a 'must stock' item by retailers. Retailers also appear to use promotions of the *Coca-Cola* product as a 'traffic builder'. That is, a means by which retailers could attract customers into their stores and thereby encourage sales of other products.

Secondly, CCA has an unrivalled network of in-store refrigeration equipment in the non-grocery trade channels through which it can distribute its beverage products. As access to refrigerator space in these channels is of vital importance to a beverage manufacturer, the supply of refrigeration units by beverage manufacturers can significantly affect their share of shelf space and therefore product sales.

The strength of CCA in CSD is reflected in its overall market share of approximately 67 per cent. The Commission noted that CCA's share of sales in the non-grocery trade channels were significantly higher.

(iii) CCA would have the ability and incentive to leverage its market power in CSD to increase distribution of Berri's FB product to the exclusion of rivals in the non-grocery trade channels

The Commission's investigation indicated that the merged firm would have several means by which it could bundle, tie or otherwise link sales of the Berri FB products to CCA's leading portfolio of products and, in particular, to its 'must stock' *Coca Cola* product. Further, the Commission was concerned that the merged firm could do

so with the effect of foreclosing competition to rival FB suppliers in the non-grocery trade channels.

The merged firm could link its CSD and FB products by only supplying the tying product (*Coca-Cola*) if the buyer agreed to take the linked products (Berri FB). Tying may also be implemented through contractual arrangements, or through use of discounts and rebates. Alternatively, the merged firm could bundle the Berri FB products with its existing CSD product or broader portfolio of products by supplying the relevant bundle at a reduced price compared with the price at which the products could be acquired separately.

The Commission considered that CCA could also effectively tie or bundle its CSD and FB products through restrictions upon the use of its in-store refrigeration units. These restrictions include requiring that its units be stocked only with, or with a high proportion of, CCA products.

The Commission also considered that the merged firm would have greater opportunity to structure its various discounts, rebates and other promotional offers to encourage retailers to purchase the largest possible volume of its products. Examples would include discounts granted to retailers retrospectively on the basis of volume targets to be achieved over a certain time period.

Other means by which the merged firm could leverage its market power in CSD to increase distribution of Berri FB products to the exclusion of rival suppliers include, but would not be limited to, the supply of discounts, refrigeration units and other inducements, or threats to remove the same, on the basis of retailers' purchases of CCA products, or retailers limiting their acquisition of competing products, or limiting their allocation of shelf space to competing products.

Based on evidence provided to the Commission, CCA currently uses its discount structures and its supply of in-store refrigeration units to achieve in-store exclusivity or, at least, a very high proportion of shelf space for CCA products, sometimes to the exclusion of competing products. For example, the Commission noted that CCA presently offers a 'core range' discount to non-grocery retailers on the basis of the retailer stocking a range of beverage products including CSD, sports drink, packaged water and, in some cases, FB.

The Commission also noted CCA's existing ability to use its strength in CSD to promote its *Fruitopia* brand in the non-grocery channels. After only a relatively short period in the market under CCA ownership and despite being a non-freshly squeezed juice product, *Fruitopia* appears to have achieved the widest physical distribution of any FB brand in non-grocery and a significant share of the traditional route segment.

The Commission considered that there would be sufficient incentive for the merged firm to engage in the above conduct, in the form of higher revenues and margins derived from sales in the non-grocery trade channels.

Based on information before it, and taking into account the commercial incentives for the merged firm, the Commission considered there would be a sufficient likelihood that leveraging of CCA's market power into FB would occur.

In reaching its view, the Commission has not proceeded on any assumption that the merged firm would engage in conduct which contravenes the Act.

(iv) Non-grocery retailers would have commercial incentives to bundle Berri's FB products with CCA's existing portfolio of beverages themselves

The Commission considered that the Proposed Acquisition would create sufficient commercial incentives for non-grocery retailers to bundle the Berri FB product with CCA's leading portfolio of beverages themselves. Potential benefits to these retailers included: reduced transaction costs from purchasing complements from the same seller; reduced logistics costs; the supply of in-store refrigeration units at minimal or no cost; and increased discounts and/or promotional benefits from the merged firm.

The Commission noted that the above incentives would be likely to lead retailers to bundle the relevant products themselves even if CCA were not to actively leverage its market power as detailed above.

(v) The merged firm would gain significant cost savings from the likely effects of the proposed acquisition

The Commission's investigation indicated that the merged firm would derive significant cost savings from the proposed acquisition generally. These would include the joint acquisition of inputs, of PET bottles and containers in particular, and the joint distribution of its ambient products to grocery and non-grocery retailers. The Commission considered that the merged firm would also derive some transaction cost savings by jointly negotiating supply terms and promotions with retailers.

The Commission considered that, in the absence of effective competitive constraints on the merged firm, cost savings accruing to CCA would be unlikely to be passed on in the form of lower prices.

The Commission also considered that cost savings derived from the Proposed Acquisition could be used to entrench the merged firms' dominant position. For example, the merged firm could supply greater numbers of in-store refrigeration units or fund greater levels of discounts to retailers and other promotions for exclusivity or taking a bundle of CSD and FB products.

(vi) The combined effect of the above would raise rivals' costs

The Commission considered that the likely combined effect of leveraging by the merged firm; retailers acting upon their own incentives to take a bundle of CCA CSD and FB products; and the ability of the merged firm to entrench its position through potential cost savings arising from the proposed acquisition would be to foreclose a substantial amount of the non-grocery channel to competing FB suppliers.

As a result, competing suppliers would be deprived of the higher revenues and profit margins derived from sales of FB in these channels. Further, the loss of these sales and profits would have the effect of depriving rivals of economies of scale and scope and thereby increase their unit operating costs overall.

The Commission considered that another consequence would be to detrimentally affect competing FB suppliers' ability to provide a competitive constraint in the grocery channel by increasing the amount that rivals would need to spend on promotional activity and marketing in order to acquire and/or maintain shelf space.

Further, given CCA's ability to extract significant cost savings in its acquisition of PET bottles and containers, costs of PET bottles would be increased at least relatively, if not absolutely, to rival producers.

As a result of the above, the Commission's analysis indicates that it is likely a number of competitors would exit the FB market.

(vii) Imports are unlikely to provide a competitive constraint upon the merged firm

As finished FB is bulky, of low value and thus relatively expensive to transport, actual or potential imports are unlikely to constrain the merged firm to any significant degree in the future.

(viii) The proposed acquisition would be likely to substantially raise structural and strategic barriers to entry and expansion

Capital costs to entry into the FB market, on a small or regional scale, appeared to be relatively low. In this respect, the Commission noted the existence of a significant number of smaller or regional players.

However, the fact that entry on a small or regional scale may be relatively easy does not necessarily mean that such entry can effectively constrain others in the market. This may be particularly so given the merged firm's size and financial resources, leading portfolio of products and brands, and its dominant distribution network of in-store refrigeration.

The Commission considered that the proposed acquisition would be likely to substantially raise structural and strategic barriers to entry and expansion in the FB market such that, in order to effectively constrain the market power of the merged firm, an entrant would face substantial barriers in the form of access to distribution and refrigerator space, economies of scale and scope and brand loyalty.

A national scale entrant would require significant time and incur substantial costs in establishing a national distribution system. It is also likely that significant economies of scale would be required for efficient distribution into the non-grocery trade channels. Further, if a new or existing fruit juice manufacturer was to attempt to replicate CCA's network of in-store refrigeration units, substantial barriers may be faced in the form of limited floor space for their refrigeration units as well as the significant financial expenditure associated with access to such space and installing such units.

(ix) It is unlikely that customers of the merged firm would have any significant ability to by-pass the merged firm due to the brand strength of Coca-Cola and its use by retailers as a 'traffic builder'

Countervailing power exists when it is possible for a customer to by-pass the merged firm. This can be done by promoting an existing small player, encouraging a new entrant or by importing. House-brands or generic products can also be developed as a source of substitute supply. The Commission noted in relation to the latter that Berri is a major supplier of generic products to grocery retailers.

Non-grocery retailers are unlikely to possess any significant degree of countervailing power due to the large number and small size of these retailers. In relation to the grocery chains, it was considered unlikely that they would have sufficient incentive or power to engage in by-pass given the 'must stock' nature of the *Coca-Cola* product and their use of that product as a means of encouraging sales of other products. The Commission also considered that the proposed acquisition would give CCA greater leverage against grocery retailers in terms of shelf space, pricing and promotional programs by combining category leadership in CSD, packaged water, sports drinks with the leading FB products and brands.

(x) *Availability of substitutes*

As noted above, there are a number of competitors to the merger parties. The Commission noted that several of these competitors offered a range of beverage products. However, the Commission considered it unlikely that a competing bundle of beverages would be successful against the merged firm given the latter's portfolio of leading brands and, in particular, its 'must stock' *Coca-Cola* brand.

(xi) *Dynamic characteristics*

Markets which are growing rapidly are more likely to see new entry and the erosion of market shares over time.

Based on the information before the Commission, the FB market has experienced minimal volume growth over the last several years. This may, however, increase given the general consumer shift towards healthier beverage products and that the FB market is characterised by some degree of product and packaging innovation.

However, the Commission also noted that the FB market has experienced a significant degree of consolidation between the larger suppliers such that the three leading firms currently account for over 70 per cent of total FB sales. While there is evidence of small or regional entry occurring to some extent, very few have captured meaningful or substantial shares in recent years.

Further, the Commission's investigation suggests that, as a result of the proposed acquisition, structural and strategic barriers to entry would be raised that would likely have the effect of foreclosing new entry as a result of consumption growth in the FB market.

CCA's proposed undertakings

In its proposed undertakings, CCA offered to not bundle or tie the Berri fruit juice products and attempted to take into account the means identified by the Commission through which CCA could link its CSD and FB products.

The Commission's analysis indicated that the behavioural remedies proposed by CCA could not fully address the long term competition harm arising from the proposed acquisition.

Firstly, it was considered highly unlikely that undertakings could be framed so as to capture all existing and potential conduct by the merged firm that would have the effect of linking Berri's fruit juice products to CCA's soft drink products.

The Commission considered that, even if this were possible, the likely form of the undertakings would be so complex and prohibitive so as to be unworkable in operation, unduly interfering in the competitive process and inflexible to market changes. This would be particularly so given the very large number of retail outlets affected by the undertakings.

The behavioural undertakings also could not adequately address the structural market changes arising from the proposed acquisition, including the incentives for retailers to purchase a bundle of beverages from CCA to the exclusion of other fruit juice suppliers.

The Commission further considered that, in view of these incentives of both CCA and non-grocery retailers, monitoring and potential enforcement of the undertakings may not be effective. These incentives would also have significantly hampered monitoring of the undertakings by competitors to the merged firm and their attempts to seek redress pursuant to the undertakings.

Accordingly, the Commission determined that the proposed undertakings, and behavioural undertakings generally, would be insufficient to adequately resolve all the competition concerns that would be raised by the proposed acquisition.

Conclusion

Accordingly, the Commission considered that the proposed acquisition would have the effect, or be likely to have the effect of substantially lessening competition in the national market for the manufacture and wholesale supply of chilled and ambient fruit juice and fruit drink, resulting in a breach of section 50 of the Trade Practices Act.

Notes:

- (1) A '**fruit juice**' product is one that contains 100 per cent fruit juice. Fruit juice may be produced using fresh fruit, concentrate or a blend of both. Fruit juice is supplied in a chilled or an ambient (or shelf stable) format. '**Fruit drinks**' are fruit based products with anything less than 100 per cent juice content and generally contain about 25 per cent fruit juice.

- (2) There are a number of non-grocery trade channels including:
- the petrol & convenience channel (which includes petrol stations and chained convenience stores)
 - the traditional route channel (which includes outlets such as milk bars, corner stores)
 - the vending machine channel
 - the food service channel (for example, restaurants, cafes, schools, catering)
 - the licensed and leisure or 'on-premise' channel (which includes on-premise consumption such as pubs, clubs, and leisure areas such as arenas and cinemas).