Statement of Issues

7 February 2013

H.J. Heinz Company Australia Limited – proposed acquisition of Rafferty's Garden Pty Ltd

Introduction

1. Outlined below is the Statement of Issues released by the Australian Competition and Consumer Commission (**ACCC**) on the proposed acquisition of Rafferty's Garden Pty Ltd (**Rafferty's Garden**) by H.J. Heinz Company Australia Limited (**Heinz**) (**proposed acquisition**).
2. A Statement of Issues published by the ACCC is not a final decision about a proposed acquisition, but provides the ACCC's preliminary views, drawing attention to particular issues of varying degrees of competition concern, as well as identifying the lines of further inquiry that the ACCC wishes to undertake.
3. In line with the ACCC's Merger Review Process Guidelines (available at www.accc.gov.au/processguidelines) the ACCC has established a secondary timeline for further consideration of the issues. The ACCC anticipates completing further market inquiries by **28 February 2013** and anticipates making a final decision on **21 March 2013**. However, the anticipated timeline can change in line with the Merger Review Process Guidelines. To keep abreast of possible changes in relation to timing and to find relevant documents, market participants should visit the Mergers Register on the ACCC's website at www.accc.gov.au/mergersregister.
4. A Statement of Issues provides an opportunity for all interested parties (including customers, competitors, shareholders and other stakeholders) to ascertain and consider the primary issues identified by the ACCC. It is also intended to provide the merger parties and other interested parties with the basis for making further submissions should they consider it necessary.

Background

5. On 19 October 2012, Heinz provided its submission to the ACCC seeking informal clearance of the proposed acquisition. The ACCC commenced a public review on 29 October 2012.

The parties

Heinz

6. Heinz is a global manufacturer of a range of food and beverages, including infant food, and has manufacturing operations at various locations around Australia.

7. Heinz is the only supplier of wet infant food in cans and glass jars in Australia, aside from McCallums, which manufactures wet infant food in glass jars in New Zealand for supply in Australia. Heinz also supplies wet infant food in pouch-and-spout packaging and supplies a range of dry infant food, including rice cakes and teething rusks.
8. Heinz supplies wet infant food under the 'Heinz', 'Heinz Organic', 'Heinz Simply', 'Heinz Little Kids' and 'Homemade Heroes' brands. It supplies dry infant food under the 'Heinz Little Kids Snacks', 'Heinz Organic' and 'Farex' brands.

Rafferty's Garden

9. Rafferty's Garden is an Australian business which commenced in October 2007 and supplies both wet and dry infant food in Australia. Rafferty's Garden only supplies wet infant food in pouch/pouch-and-spout packaging.
10. It supplies a variety of wet infant food product types, including 'Smooth', 'Puree', 'Lumpy', 'Yoghurt Smoothy' and 'Flavours of the World''. Rafferty's Garden supplies a range of dry infant food, including rusks, snack bars and freeze dried fruits.

Areas of overlap

11. Heinz and Rafferty's Garden therefore overlap in the supply of both wet and dry infant food.

Industry background

Infant food

12. Packaged infant food may be used in addition to, or as a replacement for, home-cooked meals and snacks. There is no fixed age range for infant food products, but they are generally targeted at infants aged above the age of four months. Within dry infant food, infant snacks are generally intended for infants from the age of approximately 12 months.
13. Infant food can be broadly categorised into 'wet' and 'dry', accounting for approximately 75% and 25% respectively of the value of infant food products sold in Australia. This categorisation is based on the consistency of the product:
    - **Wet infant food** comprises products such as purees, custards, gels and jellies in sweet and savoury varieties.
    - **Dry infant food** includes a range of products, which can be categorised as snacks (such as rusks, fruit bars and rice cakes) and cereals (such as muesli and porridge), accounting for approximately 75% and 25% respectively of the value of the dry infant food category.
14. Wet infant food is supplied in a variety of packaging types:
    - **Cans**: Infant food in cans is sold at the lowest price, and tends to be consumed at home.
    - **Glass jars**: Infant food in glass jars is more expensive than cans, has the advantage of being visible through the packaging, is resealable and can be consumed in and out of home.
    - **Pouches**: Infant food in pouches is more expensive than glass jars and has the advantage of being light and relatively unbreakable.
    - **Pouch-and-spout**: Infant food in pouch-and-spout packaging is more expensive than pouches, has the advantage of being resealable and can be consumed by infants without their parents' assistance. See Figure 1 below for examples of pouch-and-spout packaging.

Figure 1 - Examples of wet infant food in pouch-and-spout packaging

15. Dry infant food is generally packaged in packs and boxes, but also in pouch or pouch-and-spout packaging for certain products, such as wet packaged cereal.

16. The vast majority of infant food is supplied through the major supermarket chains (**MSCs**), Coles and Woolworths, with the remainder supplied through other grocery retailers (such as IGA and ALDI), discount department stores (such as BigW), baby and infant specialist stores (such as Toys'R'Us/Babies'R'Us), pharmacies and petrol and convenience stores.

Other suppliers

17. Other suppliers of infant food in Australia include:

- **McCallums**: A New Zealand-based company which supplies wet and dry infant food under the 'Only Organic' (organic) and 'Natureland' (non-organic) brands.
- **Organic Baby Food Company**: Supplies organic wet infant food under the 'Organic Bubs' brand.
- **Woolworths**: Sells organic infant food under the 'Baby Macro' brand.
- **Ella's Kitchen**: A UK-based company which currently supplies organic wet infant food exclusively to Coles.
- **Amyson**: Supplies dry infant food under the 'Baby Mum-Mum' brand.
- **Bellamy's**: Supplies organic dry infant food under the 'Bellamy's Organic' brand.
- **Nestlé**: Supplies infant cereals under the 'Cerelac' brand.

Industry trends

18. Until 2007, all wet infant food in Australia was supplied in cans and glass jars. In September 2007, Heinz had an approximate 90% share of the supply of wet infant food in Australia (by value).

19. In October 2007, Rafferty's Garden introduced pouch-and-spout packaging for its range of wet infant food products in Australia. Since then, this form of packaging for wet infant food has grown considerably in popularity.

20. Pouch-and-spout infant food is priced as a 'premium' product, meaning that its increasing popularity has increased the value of this segment, while overall volumes of wet infant food sold have remained relatively stable.

21. Heinz, McCallums and Organic Bubs started supplying wet infant food in pouch-and-spout packaging in 2010. By that time, Rafferty's Garden had achieved a share of approximately 25% of the supply of wet infant food (by value) across all packaging formats.

22. Since Rafferty's Garden entered the market, every new entrant for the supply of wet infant food has utilised the pouch-and-spout packaging format.

23. In March 2012, Ella's Kitchen started supplying wet infant food to Coles under an exclusive arrangement. In July 2012, Woolworths commenced selling wet infant food under its own 'Baby Macro' brand. ALDI sells wet infant food under the 'Mamia' and 'Baby's Own' brands.

24. The value of the dry infant food market has also grown considerably in recent years, particularly the infant snacks segment, which has more than doubled in value between FY2008 and FY2012.

Market inquiries

25. On 29 October 2012, the ACCC commenced market inquiries regarding the proposed acquisition. A range of interested parties provided responses, including competitors, customers and suppliers (co-packers).

With/without test

26. Section 50 of the *Competition and Consumer Act 2010* (**the Act**) prohibits mergers or acquisitions that would have the effect or be likely to have the effect of substantially lessening competition in a market. In assessing a proposed acquisition pursuant to section 50 of the Act, the ACCC considers the effects of the acquisition by comparing the likely future competitive environment post-acquisition if the acquisition proceeds (the "with" position) to the likely future competitive environment if the acquisition does not proceed (the "without" position) to determine whether the proposed acquisition is likely to substantially lessen competition in any relevant market.

27. In this case, the ACCC considers that the likely future competitive environment if the acquisition does not proceed would be the status quo, i.e. that Rafferty's Garden would continue to operate as a viable and effective competitor in the supply of wet and dry infant food.

Market definition

28. On the basis of market inquiries to date, the ACCC's preliminary view is that the following markets are likely to be relevant in assessing the proposed acquisition:

    - the wholesale supply of wet infant food in Australia; and
    - the wholesale supply of dry infant food in Australia.

    These are referred to in this document as **the relevant markets**.

29. Market inquiries have indicated that separate markets should be defined for wet and dry infant food as there is limited demand and supply-side substitutability between wet and dry infant food.

30. From the consumer's perspective, wet and dry infant foods are generally differentiated products which serve distinct purposes, although there are some products which could be described either as dry or wet infant food. For example some cereal products are supplied in a pre-mixed 'wet' form, but are generally classified as dry infant food. On the supply-side, the ACCC understands that wet and dry infant foods are manufactured using different ingredients, equipment, machinery and processes, and co-packers/manufacturers of infant food generally specialise in either the manufacture of wet or dry infant food, but not both.

Wet infant food

Product dimension

31. Although retailers are the customers of infant food suppliers, in practice retailer demand is primarily driven by consumer demand, meaning that retailer demand – and therefore demand-side substitutability – closely mirrors that of consumers.

32. The ACCC has considered whether separate narrow product markets should be defined for infant food in pouch/pouch-and-spout packaging and infant food packaged in cans/jars or whether a broad wet infant food market is the relevant market definition.

33. While each of the different packaging formats has some distinct functional attributes, market inquiries have indicated that consumers do substitute between wet infant food in different packaging types.

34. The ACCC's preliminary view is therefore that a wet infant food market is the appropriate basis for assessment. However, the ACCC proposes to continue exploring the degree of substitutability between wet infant food in different packaging formats.

Geographic dimension

35. The ACCC considers that the appropriate geographic scope of the market is national, as wet infant food suppliers distribute their products on a national basis from centralised operations. Market inquiries have indicated that wet infant food is durable in storage and there appear to be no limitations on supplying wet infant food across Australia.

Dry infant food

Product dimension

36. Market participants generally regard snacks and cereals as forming part of the same market. However, market inquiries have suggested that there is a degree of differentiation within dry infant food – between infant cereals (such as muesli and porridge) and infant snacks (such as teething rusks and rice cakes) from both a demand and supply-side perspective.

37. Market inquiries indicate that the manufacturing processes involved in producing infant cereals may be distinct to infant snacks. In addition, from a demand-side (i.e. a consumer perspective):

    - infant cereals are generally targeted at infants aged 4 months and above, whereas infant snacks are generally targeted at infants aged 1 year and above; and
    - infant cereals may be used as a meal (e.g. breakfast) and therefore may be a closer substitute for wet infant food, whereas infant snacks (e.g. teething rusks or muesli bars) tend to be for snacking between meals.

38. The ACCC proposes to continue assessing the degree of substitutability between the different product types within dry infant food. For the purpose of this Statement of Issues, infant cereals and infant snacks are grouped together as dry infant food.

Geographic dimension

39. The ACCC considers that the appropriate geographic scope of the market is national, as dry infant food suppliers distribute their products on a national basis from centralised operations. Similar to wet infant food, market inquiries have indicated that dry infant food is durable in storage and there appear to be no limitations on supplying dry infant food across Australia.

The ACCC invites comments from market participants on its proposed definition of the relevant markets. In particular, market participants may wish to comment on:

(i) the extent to which wet infant food is substitutable for dry infant food (and vice versa) from a demand or supply-side perspective;

(ii) the extent to which different types of wet infant food (e.g. flavours or packaging type) are substitutable; and

(iii) the extent to which different types of dry infant food (e.g. cereals and snacks) are substitutable.

Statement of issues

40. The issues identified by the ACCC in this matter fall within the category of "issues of concern".

41. The ACCC's preliminary view is that the proposed acquisition is likely to substantially lessen competition in the relevant markets. In particular, the ACCC is concerned that:

    a. the proposed acquisition would result in the removal of a close competitor of Heinz in the wholesale supply of wet infant food; and

    b. the proposed acquisition would result in the removal of a close competitor of Heinz in the wholesale supply of dry infant food.

42. The ACCC will accept submissions from industry participants on these issues and will further consider potential competition issues if it considers that such an assessment is warranted.

Removal of a close competitor in the wholesale supply of wet infant food

Heinz is the historic market leader

43. Before Rafferty's Garden entered the market for the wholesale supply of wet infant food, Heinz was the clear market leader, supplying infant food in cans and jars with a market share of approximately 90%.

44. Market inquiries indicate that Heinz has established strong brand equity, trust and recognition as a result of its longstanding position as a major supplier of infant food in Australia. Heinz has supplied a variety of infant food in Australia for decades.

Rafferty's Garden has led innovation in the market

45. In 2007, Rafferty's Garden entered the market with a clear point of difference to the range of wet infant food available at the time – its pouch-and-spout packaging. This was a significant innovation and market inquiries indicate that Rafferty's Garden has also led innovation in other non-price aspects of wet infant food, such as branding, packaging design, product quality and flavours.

46. Other suppliers have responded to these innovations either by imitating them (as is particularly the case in relation to pouch-and-spout packaging) or by seeking their own points of difference.

Merger parties' current market position

47. Heinz and Rafferty's Garden are the two largest suppliers of wet infant food by a significant margin. Based on FY2013 year-to-date (to 28 October 2012) sales figures, the proposed acquisition would result in a substantial increase in concentration in the wet infant food market with a merged Heinz/Rafferty's Garden accounting for approximately 78% of sales in wet infant food.

48. Whilst Rafferty's Garden has achieved and maintained a market-leading position, particularly in relation to the supply of non-organic wet infant food in pouch-and-spout packaging, Heinz retains a leading position in the supply of wet infant food in cans and glass jars. Heinz has also been able to establish a significant position in the supply of wet infant food in pouch-and-spout packaging.

Table 1 – Shares of sales in wet infant food (by value)

Supplier	Total wet infant food Share (%)	Cans & Jars Share (%)	Pouch & spout Share (%)
Heinz	~46	~85	~18
Rafferty's Garden	~32	0	~57
Merged entity	**~78**	**~85**	**~75**
Baby Macro (Woolworths)	~5	0	~9
Ella's Kitchen	~3	0	~6
McCallums	~10	~15	~5
Organic Bubs	~3	0	~5
Nourish Foods	<1	0	<1
Total	**~100**	**~100**	**~100**

Source: AC Nielsen Scan Data, FY2013 YTD (from 1 July 2012 to 28 October 2012)

49. The ACCC notes that the recent entry of Baby Macro (in the case of Woolworths) and Ella's Kitchen (in the case of Coles) has resulted in significant changes to some suppliers' market shares, particularly within the pouch-and-spout segment of the market. For the period 1 July 2012 to 28 October 2012, Baby Macro and Ella's Kitchen appeared to gain an approximate 5% and 3% share (respectively) of the wet infant food market. The ACCC will investigate further the significance of this recent entry, including more recent changes to suppliers' market shares.

50. The ACCC is continuing to consider the competitive dynamic between wet infant food suppliers. Market inquiries to date have indicated that there is a range of factors in relation to which suppliers compete. Consumers vary in their approach to purchasing decisions and the criteria that they apply. The potential criteria include the following:

    - Brand
    - Flavour (e.g. sweet/savoury, meat/fruit/vegetable-based)
    - Ingredients (e.g. organic, made in Australia)
    - Packaging appearance/design
    - Packaging type
    - Price
    - Promotions
    - Shelf space/position.

51. For example, market inquiries have indicated that while some consumers may prioritise price (including promotions), other consumers may only purchase organic infant food. These considerations apply also to competition for the supply of dry infant food (see following section).

52. Market inquiries indicate that Heinz and Rafferty's Garden are particularly close competitors in relation to the following:

    a. *Brand equity* – Both Rafferty's Garden and Heinz's brands appear to have brand loyalty. Market inquiries indicate that the strengths of these brands may lie in different areas, Rafferty's Garden's brand connoting fresh and natural ingredients and Heinz's brand equity being based on history and trust. The other suppliers in the market do not appear to have the same level of brand equity, and tend to focus their appeal on niche areas.

    b. *Range of flavours* – Heinz and Rafferty's Garden supply the greatest number of distinct products (as measured by the number of stock keeping units, or 'SKUs'). Rafferty's Garden and Heinz both primarily supply non-organic products (whereas the products of most other suppliers are organic).

    c. *Promotions* – Heinz and Rafferty's Garden appear to engage in a high level of effective promotional activity on an on-going basis (the extent to which this promotional activity of the merger parties is in response to each other is an area the ACCC proposes to explore in further detail).

    d. *Shelf space* – Heinz and Rafferty's Garden often have prominent shelf positioning and more shelf space than other suppliers.

53. The ACCC is continuing to explore the degree to which Heinz and Rafferty's Garden are close competitors to each other in relation to the wholesale supply of wet infant food and the extent to which other suppliers provide a competitive constraint.

Removal of Rafferty's Garden as a vigorous and effective competitor

54. The ACCC's preliminary view is that the proposed acquisition is likely to result in the removal of Rafferty's Garden, a vigorous and effective competitor that appears to be the closest competitor of Heinz and the most effective competitive constraint on Heinz and the other suppliers in the market for the wholesale supply of wet infant food.

55. Market inquiries indicate that, post-acquisition, other suppliers are not likely to be as vigorous and effective competitors as Rafferty's Garden currently is, because they have weaker brands and/or focus on niche areas, and this is reflected in their having less supermarket shelf exposure and narrower available product ranges.

56. Market inquiries indicate that there are significant barriers to entry and expansion in this market that would impede the ability for other suppliers to enter or expand in a timely and sufficient manner in response to an exercise of market power by the merged entity. Since those barriers are similar to the market for the wholesale supply of dry infant food, they are discussed in further detail in a separate section below (under 'Other issues under consideration').

57. Market inquiries also indicate that, while the MSCs may have a level of countervailing power, this appears unlikely to be sufficient to prevent an exercise of market power by the merged entity. The ACCC considers that the proposed acquisition is likely to result in a reduction in retailers' countervailing power. Since the countervailing power aspects of this market are similar to the market for the wholesale supply of dry infant food, they are discussed in further detail in a separate section below (under 'Other issues under consideration').

58. The ACCC is concerned that the removal of Rafferty's Garden as an independent competitive constraint on Heinz (and vice versa) would result in a substantial lessening of competition in the market for the wholesale supply of wet infant food.

59. The ACCC is considering whether the proposed acquisition would give Heinz the ability and incentive, relative to the future without the proposed acquisition, to:

a. increase wholesale prices (which would be likely to have a consequential impact on retail prices) for Heinz and/or Rafferty's Garden's wet infant food products – the ACCC is including trading terms within the scope of 'wholesale prices' in this context;

b. reduce the frequency, duration and/or depth of price promotions for Heinz and/or Rafferty's Garden's wet infant food products – market inquiries have indicated that negotiations between suppliers and retailers often focus on the amount of promotional funding that suppliers will provide; and/or

c. reduce the quality and/or level of innovation of Heinz and/or Rafferty's Garden wet infant food products.

The ACCC invites comments from market participants on:

(i) the extent to which Heinz and Rafferty's Garden are close competitors in relation to the supply of wet infant food, including examples which demonstrate your views;

(ii) the extent to which other wet infant food suppliers provide a competitive constraint on the merger parties, including whether other suppliers could prevent an increase in price or reduction in promotions, quality or innovation by the merged entity, rather than being limited to a minor role or niche position in the market; and

(iii) the significance of the recent entry by Baby Macro and Ella's Kitchen at Woolworths and Coles respectively.

Removal of a close competitor in the wholesale supply of dry infant food

60. Rafferty's Garden entered the dry infant food market in 2007, supplying four products at Coles and Woolworths. Prior to Rafferty's Garden's entry, Heinz had an approximate 90% share of dry infant food sales at Coles and Woolworths. Market inquiries indicate that Rafferty's Garden was able to expand its presence in the dry infant food market based on the brand reputation it established through the supply of wet infant food, coupled with an expansion in overall demand for dry infant food products.

Table 2 - Share of sales in dry infant food, infant cereal and infant snacks (by value)

Supplier	Total dry infant food Share (%)	Infant cereal Share (%)	Infant snacks Share (%)
Heinz	~47	~45	~48
Rafferty's Garden	~23	~28	~22
Merged entity	**~70**	**~73**	**~70**
Amyson (Baby Mum-Mum)	~9	0	~11
McCallums	~3	<1	~3
Bellamy's	~7	~9	~6
Nestle	~5	~19	0
Other	~7	<1	~9
Total	**~100**	**100**	**100**

Source: AC Nielsen Scan Data, FY2012

61. As can be seen in Table 2 above, Heinz and Rafferty's Garden are the top two suppliers of infant cereal, infant snacks and dry infant food more broadly. The proposed acquisition would therefore result in a substantial concentration of dry infant food suppliers, with the merged entity having approximately 70% share of sales in the dry infant food market and the next closest rivals being Amyson with approximately 9% share and Bellamy's with approximately 6%.

62. As explained above (see paragraph 50), consumers take into account a range of factors when purchasing dry infant food, which are similar to those taken into account when purchasing wet infant food. However, market inquiries indicate that the dry infant food market has a higher degree of differentiation than wet infant food in terms of the range of products supplied. This may facilitate the introduction of a product with a point of difference in this market. However, barriers to entry and expansion remain, including the brand equity of incumbent suppliers. The success of Rafferty's Garden in the dry infant food market may be attributed in large part to its existing brand equity in wet infant food which it has been able to leverage into the supply of dry infant food.

63. Considerations relevant to barriers to entry and expansion and retailer countervailing power (for both wet and dry infant food) are discussed in a separate section below.

64. Market inquiries have indicated that there is a high degree of brand loyalty in the dry infant food category, and that Heinz (which owns the 'Farex' brand) and Rafferty's Garden are two of the key brands and compete closely for the same customers. The ACCC is continuing to explore the degree to which Heinz and Rafferty's Garden are close competitors to each other in relation to the wholesale supply of dry infant food in Australia and the extent of constraint provided by other suppliers.

65. The ACCC is concerned that the removal of Rafferty's Garden as an independent competitive constraint on Heinz (and vice versa) would result in a substantial lessening of competition in the market for the wholesale supply of dry infant food.

66. The ACCC is considering whether the proposed acquisition would give Heinz the ability and incentive, relative to the future without the proposed acquisition, to:

    a. increase wholesale prices (which would be likely to have a consequential impact on retail prices) for Heinz and/or Rafferty's Garden's dry infant food products – the ACCC is including trading terms within the scope of 'wholesale prices' in this context;

    b. reduce the frequency, duration and/or depth of price promotions for Heinz and/or Rafferty's Garden's dry infant food products – market inquiries have indicated that negotiations between suppliers and retailers often focus on the amount of promotional funding that suppliers will provide; and/or

    c. reduce the quality and/or level of innovation in Heinz and/or Rafferty's Garden's dry infant food products.

The ACCC invites comments from market participants on:

(i) the extent to which Heinz and Rafferty's Garden are close competitors in relation to the supply of dry infant food, including examples which demonstrate your views; and

(ii) the extent to which other dry infant food suppliers provide a competitive constraint on the merger parties, including whether other suppliers could prevent an increase in price or reduction in promotions, quality or innovation by the merged entity, rather than being limited to a minor role or niche position in the market.

Other issues under consideration

67. As indicated above, there are two issues which are relevant to the competition analysis in both relevant markets: barriers to entry/expansion and retailer countervailing power. The considerations are the same or very similar for both relevant markets, and are accordingly described together below.

Barriers to entry and expansion

68. The ACCC is considering the extent to which the threat of expansion by existing suppliers or new entry could constrain the merged entity post-acquisition. Market inquiries to date have indicated that suppliers face significant barriers to entry and expansion in the relevant markets.

Brand equity

69. Market inquiries have indicated that the brand equity of incumbent infant food suppliers is a key barrier to entry in the relevant markets because consumer trust is critical to the success of an infant food brand. Establishing a successful new brand in this context is challenging, particularly for new suppliers. It requires a significant investment in time and money to build a trusted brand. In addition, incumbent suppliers may have established a loyal customer base for their brands. As well as deterring consumer switching to alternative products, this may mean that a retailer bears a lower risk if it takes on a new product from an existing supplier rather than from a new supplier.

70. In some cases, a supplier may have an established brand in related product categories. For example:

    - Woolworths was able to leverage its Macro brand when it started supplying wet infant food under the 'Baby Macro' brand.

- Rafferty's Garden was able to leverage its brand reputation in wet infant food when it started supplying dry infant food.

71. Without an established brand reputation, a supplier needs to have a particularly compelling or unique offer, as discussed further below.

Shelf space

72. A supplier is unable to impose a competitive constraint on rivals unless it is able to access retail shelf space. Retailers have only limited shelf space available for infant food products and cannot accommodate the full range of all potential suppliers. Market inquiries indicate that accessing shelf space (or accessing a greater amount of shelf space) is not straightforward and can represent a barrier to entry in the relevant markets.
73. Market inquiries indicate that retailers take into account a range of factors in their decisions on which suppliers' products to stock. The key consideration for retailers is the likely margin that the products will generate, where margin is a function both of the likely volume of sales and the associated margin per unit that retailers receive.
74. Market inquiries indicate that retailers' ranging decisions are therefore based in large part on their expectations of the future level of consumer demand for a product, and retailers anticipate this based on historic sales performance and past experience of comparable products or innovations. This means that although suppliers are competing against one another to be attractive to retailers in order to access shelf space, this drives head-to-head competition between suppliers to be attractive to end consumers.
75. Market inquiries indicate that a new supplier will generally only be able to obtain shelf space if its products offer a sufficient point of difference to existing products. This is based on an expectation that replacing existing products with 'me too' products (i.e. products which do not provide a point of difference) is less likely to generate additional profit for retailers or to improve the range available to consumers at that retailer.
76. In Australia, Rafferty's Garden was the first to market with pouch-and-spout wet infant food in 2007. Rafferty's Garden obtained supermarket support due to its strong 'point of difference', and this innovation in infant food packaging has now been emulated by other suppliers. In the absence of another major innovation in infant food, it appears that it would be difficult for other suppliers to replicate the success that Rafferty's Garden has experienced in this category and enter or expand to be a key supplier in a sufficiently timely manner in the foreseeable future.
77. Since the entry of Rafferty's Garden, other than Heinz, entry/expansion by the other infant food suppliers in the major supermarket chains in Australia (for instance, McCallums, Organic Bubs, Nourish Foods and Baby Macro) has generally been on a small-scale and/or targeted at niche segments – for instance, certified organic products or 'Australian made and owned' claims – through which these suppliers seek to offer a point of difference. The ACCC considers that this reflects the significant barriers to entry and expansion in the relevant markets.
78. The main relevant factors on which suppliers can differentiate their products are those listed in paragraph 4950 above. For example:
    - Organic Bubs's point of difference is that all of its products are certified organic, carbon neutral and Australian owned and manufactured.
    - Nestlé's point of difference is the inclusion of probiotics in its cereal products.
    - Rafferty's Garden's point of difference (when it entered) was the introduction of pouch-and-spout packaging.

79. Market inquiries indicate that there may be more scope for introducing new dry infant food products with a point of difference, since it is inherently a more differentiated product market.

80. Market inquiries also indicate that having an existing range of products may provide a greater ability to introduce new products, since an existing supplier may request that a retailer substitute new products in place of their own existing poorly-performing products, rather than requiring the deletion of another supplier's product lines.

81. Market inquiries indicate that a supplier will often provide promotional funding for a new product for a period of time after it is introduced. This prompts more consumers to test the new product than might otherwise occur in the absence of a promotion, while giving the retailer a lower effective wholesale price. However a supplier will only be able to retain the new shelf space if sufficient consumers change their longer-term purchasing preferences during the promotional period.

Manufacturing

82. Market inquiries indicate that manufacturing infant food is not likely to present particular challenges to a potential new entrant or to expansion by an existing supplier. There appears to be manufacturing capacity available, for example at third party co-packers who currently provide manufacturing services for infant food suppliers.

The ACCC invites comments from market participants on the significance of barriers to entry and expansion in the relevant markets – i.e. the likelihood of significant and timely new entry into the relevant markets or expansion by existing suppliers if prices were to increase or product quality were to decrease. In particular, market participants may wish to comment on:

(i) the extent to which brand loyalty is a significant barrier to entry/expansion; and

(ii) the extent to which the need for a point of difference (to access shelf space) is a significant barrier to entry/expansion.

Countervailing power of retailers

Framework

83. It is a feature of the relevant markets that there is a level of dependence on two customers – the MSCs – as a means for suppliers to distribute their products to consumers. In this context, the ACCC is considering whether the MSCs may have countervailing power which is sufficient to limit the extent of any detriment (i.e. higher prices or inferior non-price aspects) arising from the loss of competitive tension between Heinz and Rafferty's Garden as a result of the proposed acquisition.

84. The ACCC is therefore considering:

    a. the number and strength of suppliers that are available to retailers as alternatives to Heinz and/or Rafferty's Garden, as against the alternative retailers that are available to Heinz and/or Rafferty's Garden;

    b. the ability of retailers to sponsor new entry or expansion; and

    c. the ability of retailers to vertically integrate into supply of infant food.

85. The ACCC's preliminary view, for the reasons outlined below, is that the MSCs' countervailing power is not likely to be sufficient to constrain the merged entity post-acquisition and, moreover, that the level of MSCs' countervailing power would decrease due to the proposed acquisition as a result of the removal of a key alternative supplier.

Number and strength of alternative suppliers

86. The ACCC considers that the availability of Heinz and Rafferty's Garden as alternatives to each other contributes to the MSCs' countervailing power in negotiations with them. In contrast, other suppliers are likely to be less viable alternative suppliers to a merged Heinz and Rafferty's Garden, because they have weaker brands and/or focus on niche areas, and this is reflected in their having less supermarket shelf exposure and narrower available product ranges. In addition, Heinz has a significant presence across multiple categories (for example, through its strong brand equity in other categories such as tomato sauce and baked beans products) which tends to improve its bargaining position when negotiating with retailers.

87. It therefore appears that the availability of alternative suppliers is unlikely to be sufficient to constrain the merged entity from exercising market power post-acquisition. Furthermore, the MSCs' countervailing power would be reduced if Heinz and Rafferty's Garden were no longer available as alternatives to each other.

Ability of retailers to sponsor new entry or expansion

88. The ACCC considers that a retailer could potentially sponsor new entry or expansion by assisting a supplier to overcome one of the key barriers to entry or expansion, namely access to shelf space. However the ACCC notes that other significant barriers to expansion (outlined above) remain, including the brand equity of the incumbent infant food suppliers. In this respect, the ACCC is considering the example of Coles' support for the entry of Ella's Kitchen to the wholesale supply of wet infant food.

Ability of retailers to vertically integrate into supply of infant food

89. In the context of the relevant markets, a retailer may vertically integrate by introducing a private label product. Market inquiries indicate that private label products have the potential to impose a price constraint on branded products sold at the relevant retailer. However, they are likely to present a weaker competitive constraint on suppliers in relation to non-price elements, since they tend to imitate existing products rather than drive innovation.

90. The need to have a strong brand in the supply of infant food (in contrast to a more homogeneous product, such as milk) may limit the extent to which private label products would appeal to consumers and may mean that retailers would face significant challenges successfully introducing private label brands into infant food. It appears that Woolworths' Baby Macro range benefits from the 'Macro' brand's existing reputation in health food categories, which may be particularly suited to a range of organic infant food. However, market inquiries indicate that there is likely to be a limit on the market presence that even a relatively successful private label brand, like Macro, is able to achieve.

The ACCC invites comments from market participants on the issues raised above relating to the countervailing power of retailers. In particular, market participants may wish to comment on whether the level of retailers' countervailing power would be sufficient to overcome the loss of competitive constraint between the merger parties post-acquisition including:

(i) the impact on retailers' countervailing power post-acquisition if they no longer have Heinz and Rafferty's Garden as alternative sources of supply to each other; and

(ii) the ability and incentive of retailers to sponsor new entry or expansion, particularly in light of consumer brand loyalty towards the incumbent brands of infant food;

(iii) the extent to which private label infant food is, or would be, a competitive constraint on branded infant food, including any potential limits on their expansion (given that private label products have only recently entered the relevant markets); and

(iv) the success to date and competitive constraint offered by Woolworths' 'Baby Macro' infant food products on branded infant food.

ACCC's future steps

91. The ACCC will finalise its view on this matter after it considers market responses invited by this Statement of Issues.

92. The ACCC now seeks submissions from market participants on each of the issues identified in this Statement of Issues and on any other issue that may be relevant to the ACCC's assessment of this matter.

93. Submissions are to be received by the ACCC no later than **28 February 2013**. The ACCC will consider the submissions received from the market and the merger parties in light of the issues identified above and will, in conjunction with information and submissions already provided by the parties, come to a final view in light of the issues raised above.

94. The ACCC intends to publicly announce its final view by **21 March 2013**. However the anticipated timeline may change in line with the Merger Review Process Guidelines. A Public Competition Assessment for the purpose of explaining the ACCC's final view may be published following the ACCC's public announcement.