

Non-Confidential document

**Evaluation of CCM Case:
IBL Consumer Goods Sales Contracts
with Retail Stores**

CCM Report

18 November 2011



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I. Executive Summary

1.1 On 09 September 2010, the Competition Commission of Mauritius (CCM) concluded its first abuse of monopoly situation case (INV 001) related to the market of block processed cheddar cheese in Mauritius. IBL Consumer Goods (now IBL BrandActiv) was found to have infringed Section 46 of the Competition Act 2007 and as remedy IBL Consumer Goods was directed to, inter alia, cease the practice of offering retroactive rebates on Kraft branded block processed cheddar cheese in exchange of premium shelf space for its Kraft branded processed cheddar cheese as well as other Kraft-branded products, including chocolates, biscuits and powdered juice.

1.2 It has been more than a year since the CCM intervened in the market for block processed cheddar cheese and nearly two years since this first investigation was launched. Though we are still in the early phase for the market to benefit fully from the remedies, the CCM decided to conduct a preliminary assessment of the impact of its intervention in the block processed cheddar cheese market in Mauritius. While competition law interventions can take substantial time to have significant results, some changes in the market have already materialised after the resolution of this case. The impact assessment has examined the price evolution of processed cheddar cheese, the change in the market structure and a calculation of possible savings to consumers.

1.3 The scope of this evaluation is restricted to the primary market of block processed cheddar cheese (250g) under INV 001 “IBL Consumer Goods’ sales contracts with small and medium sized retail stores investigation”. As per the findings of this investigation, this market represents more than 90% of the total cheese market in Mauritius. This evaluation has been conducted on the basis of information obtained from various governmental institutions as well as the market players themselves.

1.4 We conclude that the market for block processed cheddar cheese has evolved considerably in terms of the entry of two new brands, namely Bega and Melbourne with the market concentration, as measured by the Herfindahl-Hirschman Index (HHI) declining from 8,200 to between 4,000 – 5,000. The intervention was, among other things, intended to reduce barriers to entry. For the purposes of this study, we attribute the consumer benefits from changed market structure to the intervention.

1.5 In terms of the price evolution, we find that the average price of the two incumbents (Kraft and Chesdale) has only increased by 6% over the one year post-CCM intervention period, i.e. from September 2010 to August 2011. The annual average increase for the pre-CCM intervention period, i.e. from September 2007 to August 2010 was 16.5%. In addition, following the effective entry of Melbourne and Bega in February and April 2011 respectively, the average price of the two incumbents fell by 4.5%.

1.6 We find that the entry of the two new brands has led to more competition in this market. This has resulted in a significant drop in the price of block processed cheddar cheese in almost all the supermarkets across Mauritius with more frequent and lengthier promotion campaigns. For instance, the average cheapest price of block processed cheddar cheese of 250g when considered at 22 retail outlets (super/hypermarkets) was less than Rs 62.40 per unit. This is much lower than the average of Rs

72.30 per unit for the incumbents prior to the entry of Melbourne and Bega. This represents a fall of around 14%.

1.7 We estimate that consumers have already realised savings on expenditure ranging between Rs 8 million, on a very conservative basis, to Rs 39 million in the 4-month post-CCM intervention period May – August 2011. On an annual basis that would range between Rs 25 million – Rs 117 million. The expected benefits over a period of 6 years range from Rs 130 million – Rs 600 million.

2. Introduction

Background

2.1 IBL Consumer Goods (IBL) is the sole distributor of Kraft branded block processed cheddar cheese at the wholesale level in Mauritius. IBL has been selling Kraft cheese prior to the independence of Mauritius and has over this long time period built a strong brand loyalty for Kraft, making it the market leader by far in terms of market share and consumer preference.

2.2 In June 2009 it was alleged that IBL launched specific sales agreements, Top Store Programme (TSP), which offered retroactive retail stores discounts on 250g Kraft block processed cheese subject to specified minimum sales and shelf space requirements for Kraft-branded products.

2.3 The CCM investigated into the matter and found that:

- IBL was in a monopoly situation in the market for processed cheese with a market share exceeding 90% for its 250g Kraft-branded processed block cheese, well beyond the threshold of 30% specified by the Competition Act 2007 (the Act) for determining a monopoly situation.
- IBL entered into agreement with some 30 supermarkets for the period ending 2009 and kept on with its TSP with other supermarkets at the time of the investigation.
- These agreements offered discounts ranging from 2% - 4% to those supermarkets on 250g processed block cheese subject to specified percentage increases or minimum purchase volumes (growth rebates) and shelf space requirements for Kraft-branded cheese, biscuits, chocolates and powdered juice.
- In one instance, the TSP contract amounted to exclusive dealing in stating that Amila, a competitor to Kraft-branded Tang powdered juice, should not be listed.

2.4 The CCM concluded that such a discount scheme offered by IBL could have the object or effect of:

- preventing competition in the cheese market by foreclosing the entry of any potential new entrants in the market in the future.
- leveraging IBL's dominant position in the block processed cheese market in order to benefit unfairly the other Kraft-branded products marketed by IBL either through premium positioning and minimum shelf space provisions for those other products or by eliminating the effective access of potential or actual competitors in those non-block cheese markets.

2.5 In September 2010, the Commissioners of the CCM, based on the facts of the case and after conducting a public hearing, found IBL to be in breach of Section 46 of the Act and issued directions that IBL should stop offering such discount schemes.

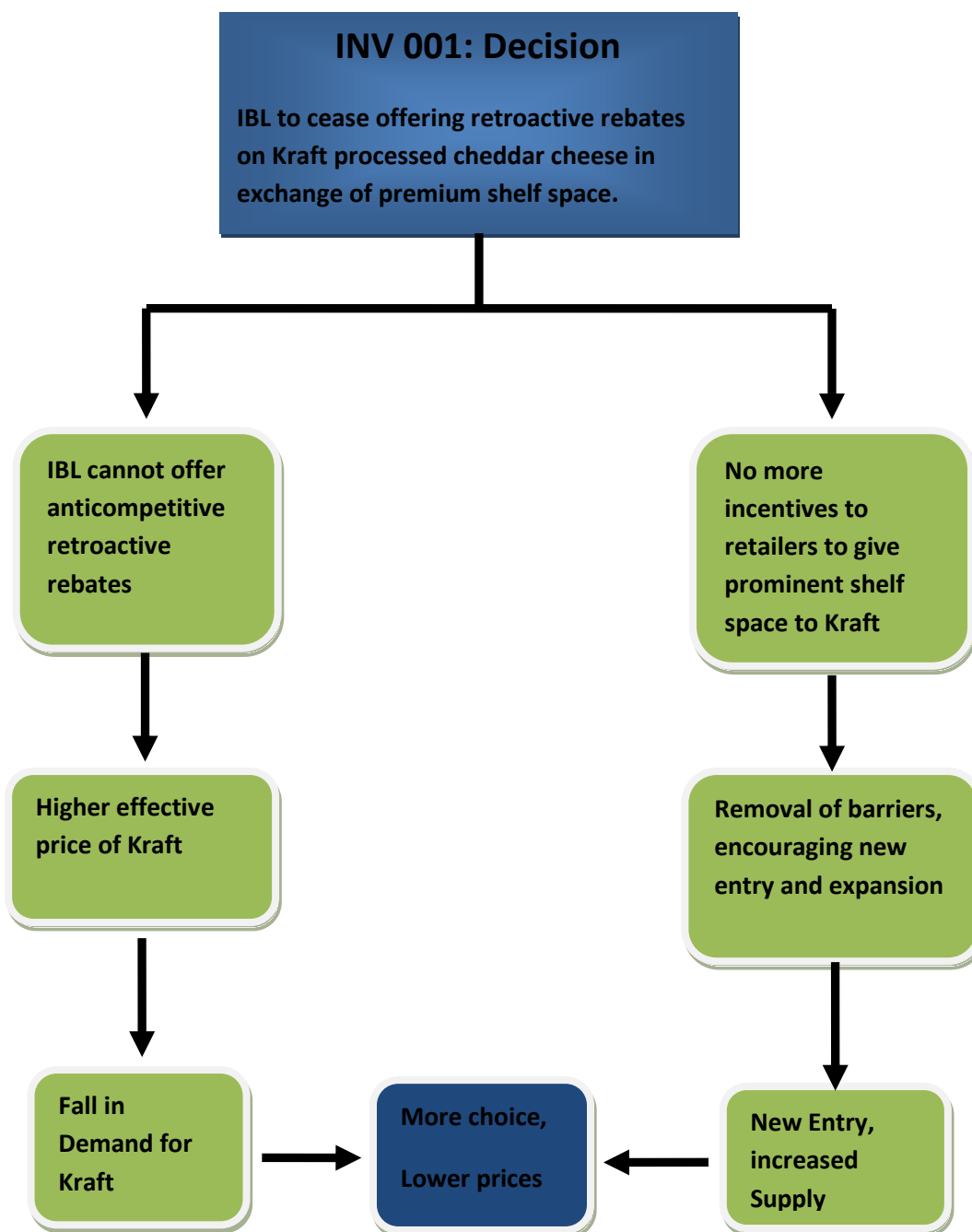
Objectives

2.6 The aim of this evaluation report is to assess the impact of the CCM's intervention in the market for block processed cheddar cheese 250g with regard to the abuse of the monopoly situation by IBL. In doing so, we hope to understand the extent to which the block processed cheese market has evolved. We also aim to quantify CCM's intervention in terms of the resulting change in consumers' surplus, i.e. how much consumers could have saved on their expenditure on block processed cheddar cheese. Note that the quantification of the consumer benefit is carried out only directly for the market of block processed cheddar cheese while the impact on the related products like biscuits, chocolates and powered juice in this investigation has not been evaluated. To this extent, the estimate is conservative, excluding certain potential effects of the intervention. The following assessment has been conducted:

- Prices – the evolution of average prices of Kraft-branded processed cheddar cheese as well as that of competing brands.
- Market structure – analysis of the change in the market structure of processed cheddar cheese since CCM's September 2010 decision and whether Kraft has been able to maintain its strong market dominance. The scale of entry and exit within the market and the extent to which new players have been able to establish themselves is of particular interest.
- Total Expenditure – an estimation of potential savings and gain in consumer surplus on processed cheddar cheese.

2.7 In order to evaluate the CCM's intervention, we have established a counterfactual to enable us to assess what would have happened had CCM not intervened in 2010. This process is clearly explained in Section 4, where we also present our quantitative assessment.

2.8 Figure 2.1 below is a decision tree of the expected impact of the 2010 CCM decision.

FIGURE 2.1 INTERVENTION LOGIC MODEL¹

2.9 The direct impact is likely to remove the exclusionary discounts offered by IBL and hence promote new entry and expansion of existing firms in the market. The increased level of competition is likely to increase the market penetration of competing brands and eventually result in lower prices to consumers together with more choice.

¹ Adapted from the model used by the OFT in its assessment of impact of its intervention with the NAPP abuse of Dominance Case (2011).

Structure of the report

2.10 The report provides a review of the market for processed cheddar cheese in Mauritius and an evaluation of the impact of the CCM's 2010 decision:

- Section 3, 'The market for processed cheddar cheese in Mauritius', gives a description of the product under review, the various distributors in the market and their respective market shares.
- Section 4, 'The impact of the 2010 CCM decision', contains the core empirical analysis, focusing on the most easily quantifiable benefits in the block processed cheese market in terms of price evolution, market concentration prior and post CCM's intervention and quantification of most easily measureable consumer surplus in the market for block processed cheddar cheese and not the related products like biscuits, chocolate and powdered juice in the INV 001.
- Section 5, 'Conclusions', summarises the findings of the evaluation.

3. The Market for Block Processed Cheese in Mauritius

Introduction

3.1 This section describes the market for block processed cheese in Mauritius, including a broad description of the product, the various brands on the market and the practice of buying shelf space.

Product description

3.2 Block processed cheddar cheese is a processed cheese made from the cheddar cheese, which is relatively hard, yellow to off-white, and sometimes sharp-tasting cheese, produced in several countries around the world. It has its origins in the English village of Cheddar in Somerset.

3.3 It is the most popular cheese in the United Kingdom, accounting for 51% of the country's £1.9bn annual cheese market and the second most popular cheese in the United States, behind Mozzarella, with an average annual consumption of 4.5kg per capita. In Mauritius, the total annual consumption is between 5m – 7m units of 250g or a per capita of around 5 units / 1.2kg. In terms of consumer expenditure, this would amount to around Rs 350m - 450m.

3.4 Processed cheese has several technical advantages over unprocessed cheese, including extended shelf-life, resistance to separation when cooked, and uniformity of product. Its production also enjoys significant economic advantages over traditional cheese making processes, most often through the ability to incorporate any of a wide variety of less expensive ingredients.

3.5 In our investigation INV001, we delineated the relevant market as being that of block processed cheddar cheese 250g. Chilled cheeses and softer processed cheeses were considered to be in a different market as the products differ from the block processed cheese, in terms of taste, softness, packaging, price and shelf life. Though there could have been some degree of substitution between block processed and softer processed or chilled cheeses, we found in our investigation that the volume for the latter types of cheese is not significant and as such does not fundamentally change our analysis.

Suppliers and brands

3.6 In Mauritius, the consumption of block processed cheddar cheese dates back to colonial times, when refrigeration as a means of storage was not available. The packaging in block form in units of 250g represented a convenient and cheap source of supply of cheese in Mauritius.

3.7 IBL has been in the distribution of Kraft branded block processed cheddar cheese prior to 1968. This long history of the presence of Kraft cheddar cheese in Mauritius resulted in a strong form of brand loyalty towards the product. The product is imported from Australia.

3.8 We have been informed that Bega branded block processed cheese was introduced in Mauritius some 4-5 years ago but did not have a successful market penetration. [X].

3.9 Chesdale (earlier known as Sunny South) is one of the competing brands. Despite its low market share, it has been in the market for the last 20 years or so. Chesdale is imported by Edendale Ltd from New Zealand.

3.10 In 2011, Bega was reintroduced and Melbourne was introduced in the market by Panagora Marketing Ltd and Variety Foods Ltd, respectively. Both brands are imported from Australia and are manufactured and supplied by the same manufacturer, Bega Cheese. Bega with its aggressive advertising campaign and promotional prices have been able to capture an important share of the market. Melbourne has also captured a smaller but significant proportion of the market.

The retail / distribution chain in Mauritius

3.11 In Mauritius, both the traditional and modern distribution channels are equally important. The traditional retail trade consists of a large number of small shops and convenience stores. The modern chain consists of supermarkets and hypermarkets. We are given to understand that the share sales of Fast Moving Consumer Goods (FMCGs) is increasing and accounts for some 50% and if community supermarkets are added to this figures, this could reach to as high as 80%. The remaining 20% would be through the traditional chain².

3.12 Promotional prices are very common and the frequency very high in the modern chain and increasingly in the community supermarkets as well.

The practice of buying shelf space

3.13 In our investigation report, we highlighted the importance of shelf space in retail stores. Distributors are in constant negotiation with retailers to have prominent shelf space in terms of eye-level display and facings. While this is a common practice in this line of business, incentivising retailers to stock more of a particular brand through anticompetitive discounts scheme can potentially foreclose exiting firms and new entry in the market. This is the reason the CCM in its direction issued to IBL requested the latter to stop this practice of buying shelf space through its retroactive discounts scheme.

3.14 IBL has informed the CCM that it is no more entering into sales agreements with retailers that offer retroactive rebates on Kraft branded processed cheddar cheese in exchange for premium shelf space for its products.

3.15 In so doing, IBL is not only complying with the directions issued to it by the CCM in 2010 but an important barrier to entry faced by new firms has also been removed ensuring a level playing field for non-dominant rival firms.

² The traditional chain includes small retail shops and convenient stores.

4. Impact of CCM's Intervention in the Processed Cheese Market

4.1 This Section deals with the impact of CCM's intervention in its first abuse of monopoly situation case related to the market for block processed cheese in Mauritius. We first present the approach and assumptions applied in this impact assessment, followed by developments in the market in terms of entry/exit and an evaluation of the benefits to consumers in term of choice and lower prices. While, we have calculated the monetary value of the direct benefit to consumers resulting from increased competition, the quantification of the resulting benefits in terms of increased choice and quality differentiation has not been calculated mainly given the complexity involved in doing so and the narrower scope of this study.

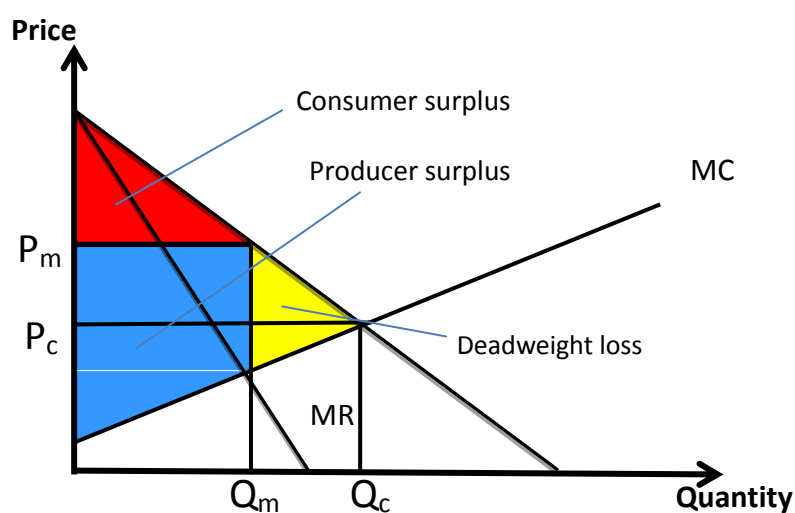
Methodology

4.2 Consumer surplus is used as a measure of quantifying the direct impact of the CCM's intervention in the market for block processed cheddar cheese. This is a widely accepted measure used by competition authorities to assess the effectiveness of their enforcement actions.

4.3 We believe that the end result of more competition is to bring more value to consumers in terms of lower prices, wider choice and improved quality through innovation.

4.4 Consumer surplus is the difference between the price consumers are willing to pay and the actual price they are paying for a given quantity of a good. This can best be illustrated by the standard diagram below:

Chart 4.1: Consumer Surplus



(a) In the diagram above, the monopolist sets the price P_m where its Marginal Revenue (MR) is equal to its Marginal cost (MC) and thus maximising its profits. At this price, the quantity demanded will be Q_m . The resulting consumer surplus is the area above P_m and below the demand curve, as represented by the red shaded area. Producer surplus is the difference between the market price, P_m as set by the monopolist, and its cost MC. This is given by the shaded area in blue.

(b) The total welfare to the society is given by the area in red plus the area in blue. There is a deadweight loss given by the area in yellow, as the monopolist has contracted output to benefit from a higher price and profits but at the detriment of the society. The society may have benefitted from more output and a lower price.

(c) According to economic theory, more competition in a monopolistic market results in the price to decrease to P_c and increase demand to Q_c . Now the society gains in terms of the yellow area being partly consumer surplus and producer surplus. Consumers gain in terms of increased consumer surplus represented by the area above P_c and below the demand curve (i.e. shaded area in red and partly of blue and yellow).

4.5 The trends in the average price of the different brands of block cheddar cheese, the market share in term of sales volume and the cost information, including FOB and CIF price, domestic inflation rate have been assessed.

4.6 The Herfindahl-Hirschman Index (HHI) is used to measure the level of concentration in the market. The HHI is the sum of the squares of the market shares of all the firms in a market, where their shares are expressed as percentages.

4.7 The data used for the purpose of this evaluation has been obtained mainly from the industry players themselves, through our market intelligence, and supplemented by the publications obtained from the Observatoire des Prix, Customs Department and Central Statistics Office.

4.8 The data have been classified as follows: (i) From September 2007 to August 2010 as the pre-CCM intervention period; and (ii) From September 2010 to August 2011 as the post-CCM intervention period under assessment. In the post-CCM intervention period, we have taken the four months starting May 2011 and ending August 2011 as being the period where effectively there has been an increase in competition from new entrants. The two new entrants in the processed cheddar cheese market, Melbourne and Bega, were launched in February and April 2011 respectively. However, as is normally the case, it is believed that there is initial market penetration period required for new players and we have set this period as being 2 months for Melbourne and 1 month for Bega. The latter had aggressive advertising campaigns and a shorter market penetration time of 1 month.

The Counterfactual

4.9 The counterfactual is an analysis that expresses what has not happened but which could, would or might have under differing conditions. The counterfactual in this case is what would have been the conditions of the market had the CCM not intervened in this market.

4.10 Had the CCM not intervened in this market, IBL would have continued to offer, inter alia, retroactive discounts on Kraft branded block processed cheddar cheese.

4.11 These retroactive discounts would continue to have exclusionary and foreclosure effects by locking-in retailers to stock and sell more of Kraft brand and less of the other brands. This is so because retailers would still have had the same incentive to increase their profit by achieving the sales target set by IBL. Retailers would not venture to buy from different sources and therefore lose discounts in case they do not meet the set target. This would mean that new brands would have more difficulty expanding due to retailer resistance and new entry would be foreclosed.

4.12 Consequently, absent the intervention, we would have expected that this market would not have evolved in the way it did and that the market conditions would have been as follows:

- (a) Only two brands of block processed cheddar cheese, namely Kraft and Chesdale would have been present in the market. Even if other brands had entered, the IBL discount scheme would have foreclosed much of the new brand expansion.
- (b) The market share for Kraft would have still been at its pre-CCM intervention level of 90% or more.
- (c) There could have the same trend in the price for both Kraft and Chesdale as in pre-intervention period September 2007 to August 2010 that is an increase of around 16.5%³ per annum.

Entry, market share and concentration

4.13 In a competitive market, there are no (or very low) barriers to entry and exit. Markets which are profitable will attract new firms hence impacting on the industry structure in terms of the number of firms, the respective market shares, market concentration, and profitability. The more a market exhibits the characteristics of a competitive one, the better it is for the industry, consumers and eventually for the economy. Competition can bring more efficiency, productivity and innovation as firms have to strive for their survival. Inefficient firms are forced out of the market and hence scarce resources are re-allocated to more productive uses. At the end, this process brings more benefits to consumers in terms of lower prices, improved quality and a wider choice.

³ Increase in the average price from Rs 51.60 to Rs 68.80 over the period Sep 07 – Aug 08 to Sep 09 – Aug 10.

4.14 Barriers to entry can limit entry and hence the benefits of competition. While in some industries, society can at times benefit from having a concentrated market, other markets including that of processed cheddar cheese can be expected to operate better with more competition.

4.15 The assessment of the characteristics of a market in terms of number of firms, market share and concentration provides a useful indication as to the degree of competition within that market. We, therefore, analyse the changes in the market structure following CCM intervention in 2010 and their implications on the level of competition in this market.

4.16 Prior to CCM's intervention, Kraft had a very high market share of around 90%⁴ while the other only competing brand, Chesdale, in this market had around 10%. The retroactive discounts scheme offered by IBL to retailers may have created a strong barrier to entry in this market, as retailers had less incentive to stock and sell competing brands for fear of not meeting the sales target for Kraft and the discount.

4.17 Following CCM's intervention, two new brands, namely Bega and Melbourne entered the market. Bega and Melbourne are imported from Australia and distributed at wholesale level by Panagora Marketing and Variety Foods Ltd, respectively. Both brands are supplied by the same upstream overseas manufacturer Bega Cheese. We are, however, given to understand that both Panagora and Variety Foods Ltd have exclusive distribution agreements with Bega Cheese with regard to the brand they distribute in Mauritius. Exclusive distribution agreements are normal practice in FMCGs.

4.18 With the entry of Bega and Melbourne, the number of brands and suppliers in the market for block processed cheese has increased to four compared to only two in 2010. Now consumers have more choice.

4.19 In terms of sales volume, the two new entrants have been remarkably successful over a short time period. For instance, Bega launched around April 2011 has an average monthly sale [X] while that of Melbourne is [X].

4.20 We also find that in the pre-CCM intervention period, sales volume for both Kraft and Chesdale were on declining trend. [X]. In terms of consumer expenditure, we estimate⁵ that on average consumers have been spending about 5% more on Kraft on an annual basis though the quantity purchased had been going down.

4.21 In the post CCM's intervention, sales for Kraft and Chesdale continued to decline but at the same time Bega and Melbourne have increased their sales by taking up part of the demand in the contestable market of the existing market players, Kraft and Chesdale. The overall sales volume in the market has, therefore, increased by around 10% - 15% in Sep 10 – Aug 11 compared to Sep 09 – Aug 10.

⁴ Based on the INV 001 IBL consumer goods' sales contracts with small and medium sized retail stores Investigation report.

⁵ We have taken the average monthly price multiply by the monthly sales volume to arrive at the consumer expenditure figure.

4.22 In terms of the evolution of market shares⁶, we also found significant changes. Both Bega and Melbourne have captured significant share of the market, thereby reducing that of Kraft and Chesdale by [X] and [X] respectively.

4.23 We estimate that Bega has currently 15% - 25% of the market share while Chesdale and Melbourne have around 0% - 10% each and Kraft [X].

4.24 Market concentration is an important indicator of the level of competition within a market. However, it should not be interpreted in isolation. We could have a very highly concentrated market but with limited or no barriers to entry. Under such conditions, the existing firms would behave in the same manner as being in a perfectly competitive market, as they are faced with competition from potential entry. For instance, if these firms were to increase their prices above cost, new firms will enter the market which in turn will affect their sales and profit.

4.25 Firms with market power in a highly concentrated market can create artificial barriers to entry through their anti-competitive behaviours to protect their market shares, for instance with retroactive discounts, as in the case of IBL. This would limit entry and expansion. In this case, a market which remains highly concentrated with firms having market power is not beneficial to consumers as it limits the scope for competition and its ensuing benefits.

4.26 We use the HHI to estimate market concentration in the block processed cheddar cheese market. The HHI can vary from 0 to 10,000 – 0 is a market with a very large number of small firms (perfect competition) and 10,000 is when there is a single firm supplying the whole market (monopoly). For the pre-CCM intervention period, we estimate the HHI to be around 8,200 that is very close to maximum of 10,000, thus showing a highly concentrated market.

4.27 In the post-CCM intervention period and following the entry of Bega and Melbourne, the HHI is estimated to be between 4,000 – 5,000. This is a 40 – 50% fall in the concentration index, making the market less concentrated and hence an indication of a lower market power for the dominant firm, IBL.

4.28 We believe that the intervention of the CCM in 2010 has removed the competitive constraints imposed by IBL through its discounts scheme. This has been very beneficial to the conditions of this market. The table below summarises the market evolution following the intervention of the CCM.

⁶ Given that Bega and Melbourne have not been in operation over a full twelve month period; for the purpose of calculating market share, the average monthly sales has been used over the respective periods Bega and Melbourne have been in operation during Sep 10 – Aug 11. The monthly sales figures for Kraft and Chesdale are based on the monthly sale over the twelve month period Sep 10 – Aug 11.

Table 4.1: Evolution of the market for block processed cheddar cheese (250g)

	Pre-CCM Intervention	Post-CCM Intervention
Number of Suppliers/Brands	2	4
Market Share⁷		
Kraft	90%	[X]
Chesdale	10%	0% - 10%
Bega	-	15% - 25%
Melbourne	-	0% - 10%
HHI	8,200	4,000 – 5,000

Source: CCM

4.29 We conclude that the market for block processed cheddar cheese in Mauritius has evolved in terms of having 4 brands compared to 2 prior to our intervention. The market shares for the incumbents have fallen, in particular that of the dominant firm – IBL by [X] and consequently the market has become less concentrated. The HHI index has fallen from 8,200 to 4,000 – 5,000. The changes of these indicators clearly show an increase in the level of competition in this market.

Price evolution

4.30 Analysis of the price evolution provides a good assessment of the conditions of competition in a market. A competitive market with initial high prices is likely to attract new entrants, which would eventually put a downward pressure on the price levels. This would be in the interests of consumers and would also encourage firms to adopt more cost effective production techniques and bring more innovation.

4.31 On the other hand the absence of competition, in particular in a concentrated market, may lead to exploitative behaviour in the form of excessive price increases and high profit margins.

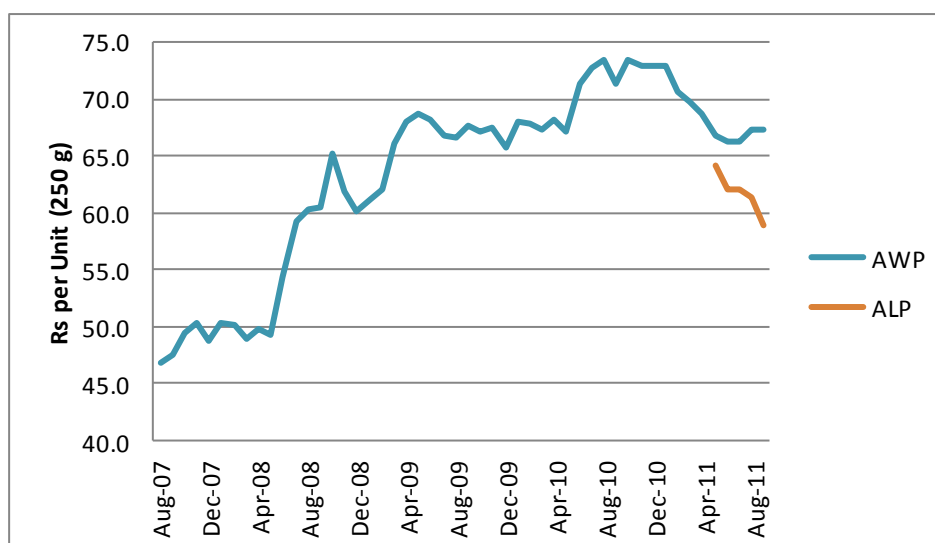
4.32 For the purpose of analysing the price evolution in this market, we have obtained the average price of the two incumbents, namely Kraft and Chesdale/Sunny South from 11 outlets across Mauritius. We have also computed the average price for all brands using a weighted average price method. We have used the respective market shares as the weights.

⁷ For the Post-CCM intervention period, we have computed the market shares on the basis of the average monthly sales volume for period May-August 2011.

4.33 We have also computed the average lowest price (ALP) for the 4 months (May – August 2011) post-CCM intervention following new entry from the publications of the bulletin of the Observatoire des Prix (OP). The prices obtained from OP are the cheapest block processed cheddar cheese taken from 22 super/hyper markets from the 9 districts across Mauritius.

4.34 The graph below provides the evolution of the average monthly weighted price (AWP) of block processed cheddar cheese 250g covering both the pre and post CCM intervention period. It also shows the trend in the average lowest price (ALP) at the 22 super/hyper markets across Mauritius.

Chart 4.3: Average Prices



Source: CCM

4.35 We find that the AWP per unit of 250g has been rising in the pre-CCM intervention period from September 2007 to August 2010 increasing from Rs 47.50 to Rs 73.40 that is by Rs 24.90 or 54.5%. However, AWP fell from Rs 71.30 in September 2010 to Rs 67.30 in August 2011. This represents a fall of 5.6% or Rs 4 per unit.

4.36 We also analysed the changes in average weighted price on a yearly basis. We find that for the pre-CCM period Sep 07 – Aug 09, the average increase in price per unit is 25% over the period Sep 07 – Aug 08 and by 6% over the period Sep 08 – Aug 09. The average price increase for these two periods would, therefore, be 16.5%. For the post-CCM one year intervention period Sep 10 – Aug 11, we find that the average price increase is 4%, suggesting that price increases slowed substantially after CCM intervention.

4.37 We also find that the average lowest price at the 22 super/hyper markets to be much lower than the average price for the whole island. The ALP fell to Rs 61.40 in Aug 11 and even lower for the month of Sep 11 at Rs 58.80. The average ALP over the 4-month post-intervention period and following

new entry (i.e. from May – August 2011) was Rs 62.40. This represents a decrease of around Rs 8.70 or 12.7% compared to the AWP for similar period in 2010.

4.38 We believe that the fall in the price was mainly driven by the intensified competition in the market following new entrants. This also explains the significant increase in sales volume of around [X] for the period May – Aug 2011 compared to May – Aug 2010.

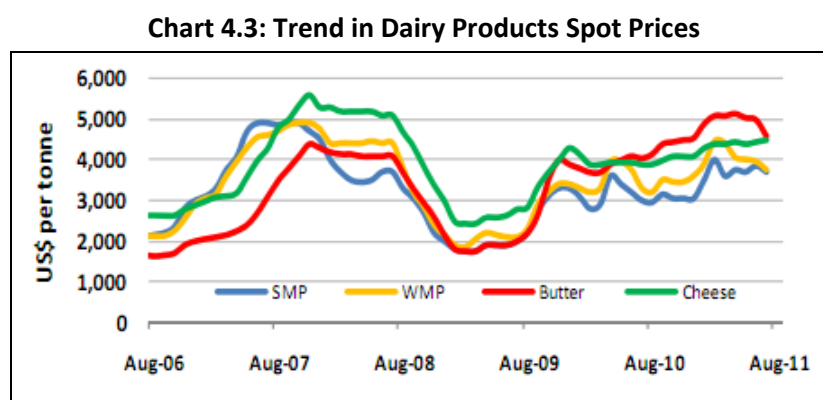
4.39 The increase in sales volume may partly be attributed to the increase in the process of rivalry resulting in lower prices but also from other factors such an increase in advertising expenditure and promotional campaigns which can also be attributed to the intensified competitive pressures faced by the players in this market. We note that both Kraft and Bega have been very aggressive on advertising and promotional campaigns since April 2011.

4.40 Before drawing a firm conclusion that lower prices come from competition, it is important to analyse other potential sources of lower prices. If costs have fallen we would expect prices to fall as well. The two main costs we can examine are transport and cheddar cost.

4.41 To understand the possible changes in the cost of importation of processed block cheese, the changes in the cost of production in Australia as the reference country, insurance and freights for importing, exchange rates and inflation rates have been analysed.

4.42 On cost of production, we have analysed data from Dairy Australia, the national services body for dairy farmers and the industry, regarding the Free On Board (FOB) price of dairy products and in particular, cheese.

4.43 The graph below illustrates the trend in the spot prices (FOB) for Australian dairy products: Skim Milk Powder (SMP), Whole Milk Powder (WMP), Butter and Cheese.



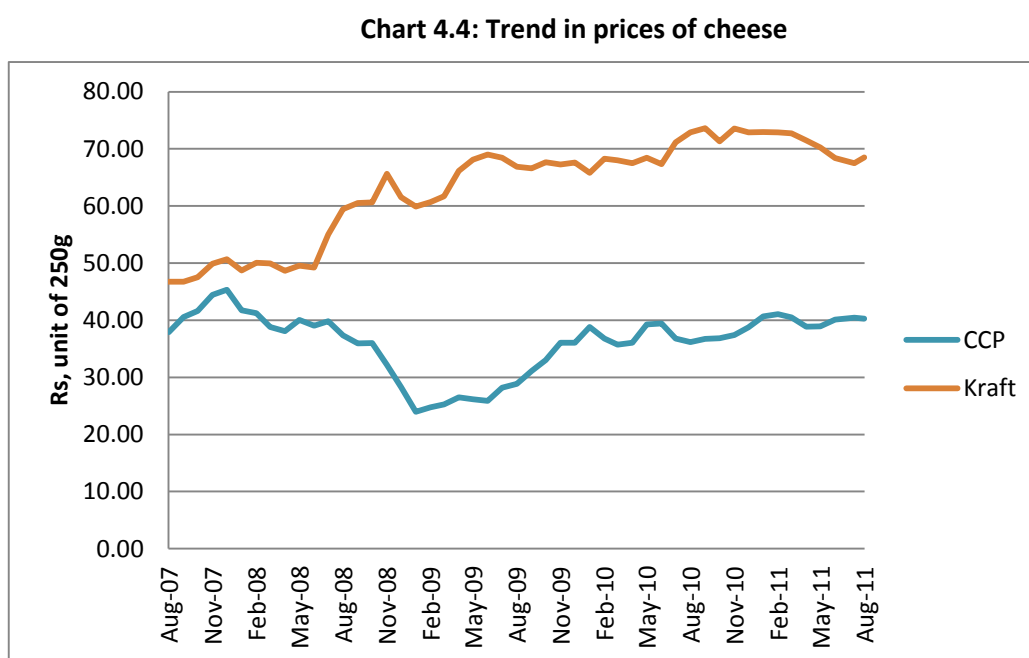
Source: www.dairyaustralia.com.au

4.44 The graph shows a general increasing trend in the prices for the different dairy products for the period September 2010 to August 2011. For Cheese, the spot price increased from around USD 3,900 per tonne in Sep-10 to around 4,400 in Aug-11, an increase of around 14%.

4.45 Insurance and Freight, which represents around 2-3% of the total cost of cheese also rose by around [X] in the post-CCM intervention period Sep10 – Aug11.

4.46 The USD/MUR spot exchange rates have been used to convert the spot price for cheese (USD/t) into Rs/unit of 250g. This calculated MUR price is then adjusted for the prevailing Consumer Price Index with Aug 07 as the base month over the period under consideration. Adding the Insurance and Freight per unit to this inflation-adjusted FOB MUR price results in a comparative local price.

4.47 The chart below illustrates the trend in the average price of Kraft and the computed comparative local price.

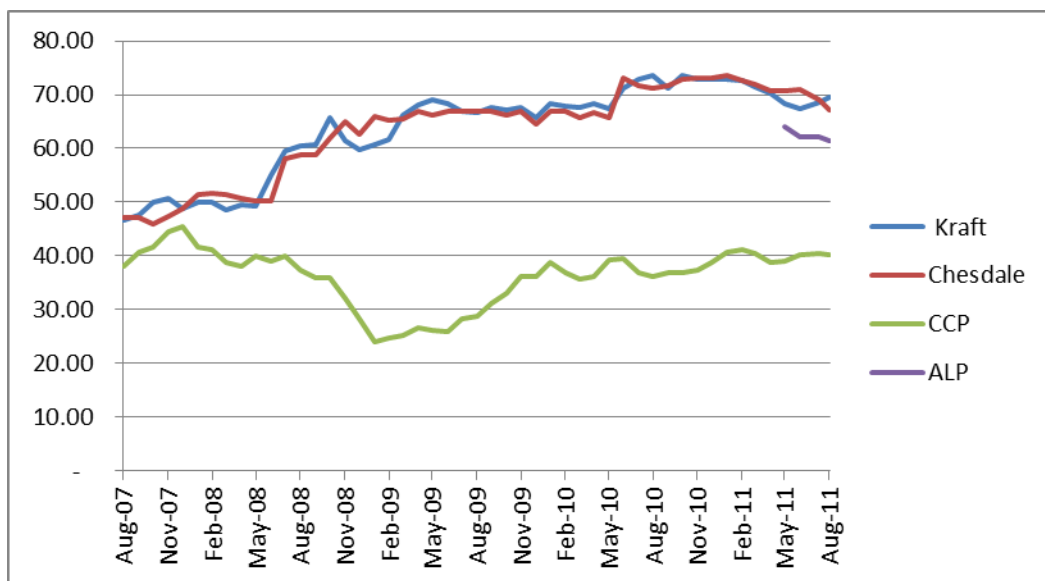


Source: CCM

4.48 No positive correlation is found between the average Kraft price in Mauritius and the computed comparative price (CCP) for the period under consideration, i.e. Sep 07 to Aug 11. For instance, in the pre-CCM intervention period May 08 – Feb 09, while the CCP is declining that of Kraft has been increasing. This could imply that Kraft should have been earning a higher margin, either at the level of its international supplier or locally. Whereas, in the post-CCM intervention period, the gap between these two prices has narrowed, thereby potentially implying a drop in margin from the sale of Kraft.

4.49 Furthermore, the CCP is compared to the average price of Chesdale and the lowest average price for block processed cheddar cheese (250g) in 22 super/hypermarkets in Mauritius. The chart below shows the trend:

Chart 4.4: Trend in prices of cheese



Source: CCM

4.50 The chart shows a similar pattern in the gap between CPP and average price of the two incumbent cheese brands in the pre-CCM intervention. However, in the post-CCM intervention period, in particular May – Aug2011, with more firms competing in the market for processed cheddar cheese, the gap has narrowed. The graph also shows that the gap between ALP and the CCP is smaller than that with the price of the Kraft and Chesdale.

4.51 This analysis supports the argument that prices in the processed cheddar cheese market has declined following the increase in competitive pressure from new entrants in the market.

Estimation of resulting change in consumer's surplus

4.52 To quantify the resulting monetary benefits to consumers in terms of lower consumer expenditure, as measured by the increase in the consumer surplus, we start with a simple model giving the most conservative estimate. We then propose a counterfactual based model using the concept of Price Elasticity of Demand (PED) in estimating the 'what would have been' demand and price in the absence of CCM's intervention.

Conservative Model

4.53 In the simple conservative model, we have considered the following:

- (a) The post-CCM intervention competitive period from May to August 2011;

(b) Average Weighted Price (AWP) of Rs 66.66 obtained from the 11 outlets across Mauritius as the competitive price for the period May – August 2011 and the total sales volume of 2m – 3m units.

(c) May – August 2010 as the pre-CCM intervention period. The corresponding AWP and sales volume of Rs 71.2 and 1m – 2m respectively.

4.54 From these inputs, the increase in consumer surplus for the 4-month period May – August 2011 as opposed to May – August 2010 is Rs 8.35m and on an annual basis that would be around Rs 25m, representing approximately 6% of the total value of sales of processed cheddar cheese in Mauritius. The estimated benefit over a period of 6 years at a 6% discount rate⁸ is Rs 130m.

Counterfactual Model

4.55 For the counterfactual model, the Price Elasticity of Demand (PED) for the pre-CCM period is estimated. The PED covering the pre-CCM intervention period Sep 2007 – Aug 2008 is estimated to be 0.57.

4.56 We assume that, in the absence of successful entry in the processed cheddar cheese market, the rising trend in average price of 33% over the 2 year time period Sep 2007 – Aug 2008 to Sep 2009 – Aug 2010 or 16.5% annually would have continued. This would imply that in the absence of new entrants and intensified competitive pressures in the market, the average price could have been around Rs 79.50 for the period Sep 2010 – Aug 2011 compared to the average lowest price of Rs 62.40 observed in 22 supermarkets for the post-CCM intervention period May – August 2011.

4.57 The actual total sales volume for the 4-month post-CCM intervention period (i.e. May – August 2011) ranging between 2m – 3m units. Had CCM not intervened in this market, the total sales volume could have been around 1.5m – 2.5m units on the basis on the estimated PED of 0.57.

4.58 We, therefore, come up with an estimated resulting increase in consumer surplus of around Rs 39m over these 4 months. On an annual basis that would be around Rs 117m and the total benefit over a period of 6 years with a discount rate of 6% would be around Rs 600m.

⁸ Based on the yield on latest Government Treasury Notes.

5. Conclusions

5.1 This report concludes that the CCM's 2010 decision has had a significant impact in the market for block processed cheddar cheese in Mauritius in terms of removing barriers to entry leading to new entrants in the market, reduction in price paid by consumers and the resulting consumer surplus.

5.2 IBL has discontinued with the practice of offering anticompetitive retroactive rebates in exchange of prominent shelf space. This has removed the entry barrier created through such discounts.

5.3 We find that two new brands namely, Bega and Melbourne have entered this market. They have successfully penetrated the market with growing sales volume. The market has become more competitive with a lower concentration level, as measured by the HHI declining significantly from 8,200 in year 2010 to 4,000 – 5,000 by August 2011.

5.4 The market has evolved significantly following the entry for the benefit of consumers. Not only do consumers now have more choice, they have saved on expenditure.

5.5 We find prices for block processed cheddar cheese 250g falling significantly in the post CCM's intervention period May – Aug 2011. Consumers are now paying on average Rs 62.40 per unit in a supermarket compared to Rs 72.30 in early 2011, prior to new entry.

5.6 We estimate that consumers have already realised savings on expenditure for this product that is worth Rs 8m, based on conservative assumption, to Rs 39m in the 4-month post-CCM intervention period May – August 2011 based on the counterfactual model. On an annual basis that would range between Rs 25m – Rs 117m. The expected benefits over a period of 6 years, assuming a 6% discount rate would range between Rs 130m – Rs 600m.

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