

# **COMPETITION COMMISSION OF PAKISTAN**

## **ENQUIRY REPORT**

*(Under Section 37 (1) of the Competition Act, 2010)*

### **IN THE MATTER OF ALLEGED UNREASONABLE INCREASE IN THE PRICE OF INFANT NUTRITION PRODUCTS BY NESTLÉ PAKISTAN LIMITED**

**BY**

**Shaista Bano | Maliha Quddus**

**Dated: 25 May 2015**

## Table of Contents

<b>A. BACKGROUND</b> .....	<b>3</b>
<b>B. ISSUES</b> .....	<b>5</b>
<b>C. RELEVANT MARKET</b> .....	<b>6</b>
IFFO.....	7
Infant Cereal .....	12
Relevant Geographic Market.....	14
<b>D. DOMINANT POSITION</b> .....	<b>15</b>
I. IFFO .....	16
a. Skimmed Milk Powder (MSK) .....	20
b. Dollar Rate .....	22
c. Fresh Milk .....	23
d. General Inflation .....	24
e. Labour Costs .....	25
f. Maintaining Profitability .....	25
II. Infant Cereal.....	27
<b>E. SUMMARY OF FINDINGS</b> .....	<b>31</b>
<b>F. CONCLUSION</b> .....	<b>34</b>

1. This report concludes the enquiry initiated under Section 37(1) of the Competition Act, 2010 (the '**Act**') by the Competition Commission of Pakistan (the '**Commission**') on 30 March 2015 in the matter of alleged unreasonable increase in the price of infant nutrition products by Nestlé Pakistan Limited, (hereinafter referred to as '**Nestlé**').

## **A. BACKGROUND**

2. The Commission received a letter by the Prime Minister's Public Affairs & Grievances Wing, Ministry of Parliamentary Affairs on 20 February 2015 forwarding a consumer complaint regarding an exorbitant increase in the prices of infant formula and follow-on milk and *Cerelac* manufactured by Nestlé. A copy of the consumer complaint and the letter from the Ministry is attached as **Annex 'A'**.
3. The Commission, on 30 March 2015 decided to initiate a *suo moto* enquiry under Section 37(1) of the Act and appointed Ms. Shaista Bano and Ms. Maliha Quddus, (hereinafter the '**Enquiry Committee**') to investigate the matter for possible violations of Section 3 of the Act, and to submit a report to the Commission.
4. The consumer complaint alleges that Nestlé has been increasing the prices of infant formula and follow-on milk and infant cereal products before and after the budget even though the taxes on these products are negligible. A rate list for various brands of Nestlé's infant formula milk and infant cereal for April 2014 was also attached with the consumer complaint (Refer to Annex A).
5. It was stated in the consumer complaint that Nestlé have increased the price of infant formula milk at least 10 times in the last 2 years and every few months the price of the formula milk and *Cerelac* is increased by an amount of Rs30-Rs.40.

6. The consumer complaint further states that "*recently the price of Lactogen 3, which was selling at a price of Rs. 360, was increased to Rs.425 and the price of 175 gm pack of Cerelac was increased by Rs. 25 and is now selling for Rs. 185. Similarly the Nestlé have increased the price of all their infant milk products*".
  
7. Letters were written to Nestlé on 25 March 2015 seeking information on the current prices and the detail of increase in prices over the last three (03) years and the reasons for each increase. Nestlé in their letter dated 3 April, 2015 sought extension in time till 17 April 2015 for filing the required information. The Commission granted an extension till 10 April 2015. Nestlé submitted information on 10 April 2015. In the information submitted by Nestlé it argued that the reasons for increase in prices were cost increases, inflation and depreciation of major investment. The Commission on 14 April asked Nestlé to provide additional information regarding:
  - a. How decisions on price increases are made, along with a copy of the management's decision to increase prices;
  - b. Copies of price lists issued to retailers/wholesalers/distributors over the last three (03) years notifying them of price increases;
  - c. Cost structure with respect to each product;
  - d. Market shares of Nestlé in each category of products; and
  - e. Audited financial statements and cost audit reports for the last three (03) years.
  
8. In response, Nestlé sought extension in time for submitting information. The Commission granted an extension till 24 April 2015 (an extension of 3 days). Nestlé submitted their response on 24 April, 2015.

9. The Commission required further information in a letter written on the 4 May, 2015 and on request of Nestlé, invited officials of Nestlé for a presentation on the 11 May 2015 to elaborate the information submitted by Nestlé concerning the issues.
10. Nestlé provided the information requested on 9 May 2015 and gave a presentation to the Enquiry Committee at the Commissions' office on 11 May 2015. Nestlé attempted to provide reasons for the price increases and stated that due to local inflationary pressures, increase in USD/PKR exchange rate, higher sunk cost invested recently, increase in price of imported raw materials and to maintain profitability, the price was increased. During the presentation, Nestlé also answered various questions posed by the Enquiry Committee and provided information sought by it.
11. It is stated Nestlé is an undertaking under definition provided in Section 2(1)(q) of the Act. An undertaking is defined as:

*"any natural or legal person, governmental body including a regulatory authority, body corporate, partnership, association, trust or other entity in any way engaged, directly or indirectly, in the production, supply, distribution of goods or provision or control of services and shall include an association or undertakings".*

## **B. ISSUES**

12. In the light of the above background, following are the core issues to be addressed in the Enquiry Report:
  - a. Whether Nestlé holds a dominant position in the relevant market;
  - b. If yes, whether Nestlé has unreasonably increased the prices in the markets of:

- (i) domestically produced infant formula and follow on milk (hereinafter ‘**IFFO**’); and
- (ii) domestically produced, packaged cereal for infants (hereinafter ‘**infant cereal**’)

in violation of Section 3 of the Act.

### C. **RELEVANT MARKET**

13. Section 2(1)(k) of the Act defines ‘relevant market’ as:

*the market which shall be determined by the Commission with reference to a **product market** and a **geographic market**<sup>1</sup> and a product market comprises of all those products or services which are regarded as interchangeable or substitutable by the consumers by reason of the products’ characteristics, prices and intended uses. A geographic market comprises the area in which the undertakings concerned are involved in the supply of products or services and in which the conditions of competition are sufficiently homogenous and which can be distinguished from neighboring geographic areas because, in particular, the conditions of competition are appreciably different in those areas;*

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<sup>1</sup> Regulation EC n 1/2003 & Regulation EC n 139/2004 defines relevant market as:

The relevant market combines the product market and the geographic market, defined as follows:

- A relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer by reason of the products' characteristics, their prices and their intended use;
- A relevant geographic market comprises the area in which the firms concerned are involved in the supply of products or services and in which the conditions of competition are sufficiently homogeneous.

14. In light of this definition relevant market entails :
- a. A product market; and
  - b. A geographic market
15. This enquiry pertains to the products manufactured by Nestlé related to child nutrition that include formula milk for infants, follow up milk and cereal based baby food that are all related but are not substitutable to each other. Therefore, it appears that for the purpose of this enquiry, the following different products are to be considered for defining a relevant market.
- a. IFFO for infants aged 0 to 12 months: Nestlé's brands that fall under this category are 'Lactogen 1' and 'Lactogen 2';
  - b. infant cereal for children aged between 6 to 24 months: Nestlé's brand that falls under this category is 'Cerelac';

### **IFFO**

16. While various definitions of IFFO are available, the most common definitions are reproduced below:

*"An artificial substitute for breast milk intended for feeding infants. It can come in powdered form to be mixed with water or in instant liquid form"<sup>2</sup>.*

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<sup>2</sup> <http://www.collinsdictionary.com/dictionary/english/formula-milk>

*"Infant formula is a manufactured food designed and marketed for feeding to babies and infants under 12 months of age, usually prepared for bottle-feeding or cup-feeding from powder (mixed with water) or liquid (with or without additional water)".<sup>3</sup>*

17. The United States law defines infant formula as, in part, a food for use by infants that simulates human milk or is suitable as a complete or partial substitute for human milk<sup>4</sup>. For infants who are not fed breast milk, infant formula often serves as the sole source, or the major source, of nutrition during infancy, particularly during the first four to six months of life. During this period of rapid growth and development, nutrient requirements are generally greater than at any other time of life. Without adequate nutrition, infants are unable to achieve the genetic potential for growth and development.
  
18. Infant formula is unique in comparison to almost all other foods in that it is often the sole source of nutrition in a rapidly growing and developing vulnerable population. Unlike foods that are included in a mixed diet, nutrient inadequacies in a product that constitutes the only source of nutrition in a diet cannot be compensated for by nutrients in other foods in the diet. Moreover, inadequate nutrition in infancy has the potential to result in serious and irreversible adverse effects. Thus, the importance of proper infant formula manufacture, composition, and nutrient levels cannot be overstated. Senator Metzenbaum, in the legislative history that accompanied the 1986 Amendments to the Infant Formula Act of 1980 in the US explained why infant formula needs more regulation than other foods when he stated, "*there is simply no margin for error in the production of baby formula. An infant relies on the formula to sustain life and provide the proper nourishment at a time of rapid physical and mental development*".<sup>5</sup>
  
19. It is important to highlight in accordance with the guidelines of World Health Organization (WHO), laws to protect breast-feeding for infant's health were enacted in

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<sup>3</sup> en.wikipedia.org/wiki/Infant\_formula

<sup>4</sup> 21 U.S.C. 321(z).

<sup>5</sup> [http://www.fda.gov/ohrms/dockets/ac/02/briefing/3852b1\\_01.htm](http://www.fda.gov/ohrms/dockets/ac/02/briefing/3852b1_01.htm)



Pakistan at both the provincial and national level. Under these laws there is a ban on advertising and promotion of infant formula milk in Pakistan and there are huge penalties in case of non-compliance.<sup>6</sup>

20. Keeping in view the above, it is also important to identify the dynamics of the relevant product markets in Pakistan for the products in question before proceeding to the relevant geographic market.
21. As explained above, IFFO is a product that is the closest acceptable substitute of mother's milk and is distinguished to be price inelastic due to the essentialness for adequate development of an infant. Presently there are a number of IFFO brands available in the Pakistani market. Some of the common brands available locally are listed below:

<b>Table 1</b>
IFFO (0-12 months)
<b>Brands</b>
Nestlé
Pfizer
Morinaga
Meiji
Fabimilk
Mead Johnson
Biomil
Celia
Cow & Gate

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<sup>6</sup> Protection of Breast-Feeding and Child Nutrition Ordinance, 2002 (xciii of 2002).

- Punjab Protection of Breast-Feeding and Child Nutrition (Amendment) Act 2012 promulgated on 11 Feb 2012
- Sindh Protection of Breast-Feeding and Child Nutrition Bill 2013 enacted on 14 Feb 2013
- The Balochistan Protection and Promotion of Breast-Feeding and Child Nutrition Act 2014 (Act no. i of 2014) enacted on 24 Jan 2014
- Khyber Pakhtunkhwa Protection of Breast-Feeding and Child Nutrition Act 2015 enacted on 9 Jan 2015

Sahha
Nutrilon
Abbott
Nuzzer

22. All these brands have the same intended use and are homogeneous to a reasonable degree with a similar packaging standard and appearance with minor differentiations and in terms of definition of the relevant product market provided above, may be considered to form part of the same relevant product market. It is however, important to distinguish that *Lactogen*, the brand of Nestlé is the only brand that is manufactured in Pakistan and has high price differential with imported brands. Furthermore, being present in the local market over decades, Nestlé's distribution network all across Pakistan is difficult to replicate for any other brand (whether locally established or foreign) in short span of time, even if the price becomes comparable.
23. The data and information submitted by Nestlé indicates that Nestlé increased the price of *Lactogen 1 & 2* (both 200g and 400g) at six instances constituting an overall increase of 38%. However, **Table 2** presented below indicates that in response to the price increases, the sale of *Lactogen* increased every year in both volume and value, showing that the customer did not switch to any other brand/ substitute product despite a considerable increase in price, probably due to high price differential.
24. The sales of *Lactogen (1&2)* in terms of volume and value have increased between 2012 and 2014 as shown in Table 2 below:

<b>Table 2</b>			
<b>Lactogen (1&amp;2)</b>			
	<b>2012</b>	<b>2013</b>	<b>2014</b>
Total Sales volume (No. of cases)	883,928	1,014,678	1,071,660
Total Sales value (PKR Billion)*	6.53	8.17	9.78

*Source: Sales volume in cases calculated from data provided by Nestlé Pakistan on 10th April (See AnnexB)*

*\*Total sales value was not provided by Nestlé. Estimated by multiplying sales volume with average sale price per case for each year. Given that each case of 200gm packs has 48 packets and each case of 400gm packs has 48 packets. Assuming this the weighted average price per case is PKR7396.8 PKR8059.2 and PKR9126.4 for 2012,2013 and 2014 respectively.*

25. The sales of *Lactogen (1&2)* in terms of volume rose by 21.2% and in terms of value by 49.6% between 2012 and 2014.
26. Applying the most commonly used Small but Significant Non-Transitory Increase in Price (SSNIP<sup>7</sup>) test on *Lactogen (1 & 2)* i.e. IFFO, it appears that customers would not switch to the any other imported brand of IFFO available locally.

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<sup>7</sup> In [competition law](#), before deciding whether companies have significant [market power](#) which would justify government intervention, the test of **small but significant and non-transitory increase in price** (SSNIP) is used to define the [relevant market](#) in a consistent way. It is an alternative to [ad hoc](#) determination of the relevant market by arguments about product similarity.

The SSNIP test is crucial in [competition law](#) cases accusing [abuse of dominance](#) and in approving or blocking [mergers](#). Competition regulating authorities and other actuators of anti-trust law intend to prevent [market failure](#) caused by [cartel](#), [oligopoly](#), [monopoly](#), or other forms of [market dominance](#).

27. Another locally available substitute of IFFO that is consumed in Pakistan include cow's milk, however, the nutrition value associated with cow's milk is sufficiently different to formula milk because it is not manufactured commercially using all ingredients necessary for catering to a newborn's nutrition requirements and does not have a consistent composition from pack to pack. Furthermore, the physical characteristics of cow's milk make it a substantially different product from IFFO because cow's milk is used afresh, it cannot be stored and transported easily and in majority of urban areas it is not even available, therefore, it cannot be considered as a suitable substitute for IFFO and hence cannot form the part of the relevant product market.
28. Packaged/formula milk for children aged above 12 months can be substituted with regular fresh milk as sole dependency of children on IFFO for adequate growth and development is reduced immensely at the age of one plus, and other substitutes can fulfill the nutritional requirements. Therefore, they fall under the category of foodstuff used by infants when appropriate. Complementary feeding is introduced and constitutes the principal liquid element in a progressively diversified diet of such infants.
29. In view of above discussion, for the purposes of this enquiry, one of the relevant product markets appears to be the market for IFFO catering to the requirements of children aged between 0-12 months.

### **Infant Cereal**

30. Processed cereal baby-food and baby foods are intended for use by infants when they are weaned, and by young children as a supplement to their diet and/or for their progressive adaptation to the ordinary food. Following are the common definitions of Baby Food.

"Baby food is any soft, easily consumed food, other than breastmilk or infant formula, that is made specifically for infants, roughly between the ages of four to six months and two years".<sup>8</sup>

"Special food for babies that has been cut into small pieces and cooked so that it is soft and smooth"<sup>9</sup>

31. Cereal-based complementary foods are prepared primarily from one or more milled cereals (for instance: wheat, rice, barley, oats, rye, corn, etc.), which usually constitute at least 25% of the final mixture on a dry weight basis; they are with addition of sufficient amount of nutrient supplements or other adjuncts and suitable to be consumed by infants and young children who are over 4 to 6 months old. These foods can be prepared for consumption with milk or other appropriate nutritious liquids.
  
32. In Pakistan, apart from Nestlé *Cerelac* various brands of baby food are available including the following:

<b>Heinz</b>		
<b>Baby Cereal</b>	<b>Baby Puree</b>	<b>Baby Biscuits</b>
Creamy Oat	Apple & Banana	Rasa Apple
Banana Cereal	Apple	Rasa Original
Peach & Apricot	Biscuit & honey	Rusk Banana
Oat & Banana	Mixed Fruit	Rusk Original
Peachy Porridge	Three Fruit	
	Chocolate Pudding	
	Egg Custard & Rice	
	Med. Veg & Rice	
	Rice Pudding	

<sup>8</sup> en.wikipedia.org/wiki/Baby\_food

<sup>9</sup> http://www.macmillandictionary.com/dictionary/british/baby-food

33. Although supplemental infant cereal also includes freshly homemade cereal made of wheat, rice etc, bread, fruits like banana etc, however, usually the most common choice of consumers is some kind of formula infant cereal due to the fact that not only is its nutrition composition known and well balanced, but also it is easy to prepare and is generally recommended by health care providers as the first solid food to be given to supplement breast milk or formula milk.
34. In view of above, we may consider the infant cereal as a relevant product market for the purposes of this enquiry.

### **Relevant Geographic Market**

35. For the purposes of this enquiry, the relevant geographic market appears to be the whole of Pakistan because there is no restriction on the movement/sale and supply of the products in question in any part of the Pakistan. The minor difference in the prices is due to the different transportation cost, otherwise, the legal framework, taxation and other factors are sufficiently homogenous for the products in question. As far as imports are concerned the import duty<sup>10</sup> regime applicable on import of formula milk excludes foreign brands from the relevant geographic market.
36. In view of above the relevant geographic market is the whole of Pakistan for the purposes of this enquiry.
37. Considering the above, two relevant markets may be considered for the purposes of this enquiry:

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<sup>10</sup> The Customs Duty on IFFO (HS 19011000 infant milk preparations for infant use, put up for retail sale) is 20% and the rate has remained unchanged over the last three years.

The first is the market for IFFO catering to the requirements of children aged between 0 to 12 months in Pakistan.

The second is the market for infant cereal in Pakistan.

#### **D. DOMINANT POSITION**

38. In terms of Section 2(1)(e) of the Act the

*‘Dominant Position’ of one undertaking or several undertakings in a relevant market shall be deemed to exist if such undertaking or undertakings have the ability to behave to an appreciable extent independently of competitors, customers, consumers and suppliers and the position of an undertaking shall be presumed to be dominant if its share of the relevant market exceeds forty percent.*

39. As mentioned in the paragraphs above, Nestlé's brand *Lactogen 1* is the only brand that is domestically produced to cater for the nutrition requirements of infants between 0-6 months of age and *Lactogen 2* is a follow up formula milk for children aged between 6 months to one year and it is also the only domestically produced brand. As far as the relevant product market for IFFO is concerned, Nestlé holds 100% market share. Even if we consider all the imported brands as well, the information provided by Nestlé in its letter dated April 24 2015 reveals that the market share of Nestlé's product *Lactogen 1 & Lactogen 2* (IFFO) is 72.8%. This market share is based on Nielsen Retail audit February 2015.

40. In terms of the definition of dominant position provided above it appears that Nestlé holds a dominant position in the IFFO market in Pakistan by holding 100% market share through its brands namely *Lactogen 1* (for infants from 0 to 6 months old) and *Lactogen 2* (for infants aged from 6 months to 12 months).

41. Considering the relevant market for infant cereal, Nestlé through its brand *Cerelac* holds a market share of 99.5% based on the Nielsen Retail audit February 2015 submitted by Nestlé in its letter dated April 24 2015. In view of the definition of dominant position provided in the Act, Nestlé appears to hold a dominant position in the relevant market of infant cereal in Pakistan through its brand *Cerelac* by having a market share of 99.5%.
42. Section 3 of the Act prohibits abuse of dominant position and in terms of Section 3 (3) (a) of the Act, read with Section (3) (2) and (3) (3);

*The expression “practices” referred to in sub section (2) shall include, but are not limited to –(a) limiting production, sales and unreasonable increases in price or other unfair trading conditions;”*

43. The enquiry pertains to alleged unreasonable increase in price of IFFO and Infant Cereal. We will now examine both product markets separately to determine if the price increases by Nestlé were unreasonable or otherwise.

#### **I. IFFO**

44. The following table sums up the increases in the prices of *Lactogen (1&2)* during the past three years i.e. 2012, 2013 & 2014.

Price Increase	2012			2013		2014	
Product	Jan	Feb	May	Mar	Sep	Apr	Dec
Lactogen1 400g	315		345	365	375	425	435
Lactogen 1 200g	165	185		195	200	225	230
Lactogen 2 400g	315		345	365	375	425	435
Lactogen 2 200g	165	185		195	200	225	230

*Source: Data provided by Nestlé*

45. As we can observe from the table above, Nestlé have been increasing prices of *Lactogen (1 & 2)* at regular intervals. On average, the increase in prices of *Lactogen (1&2) 400*

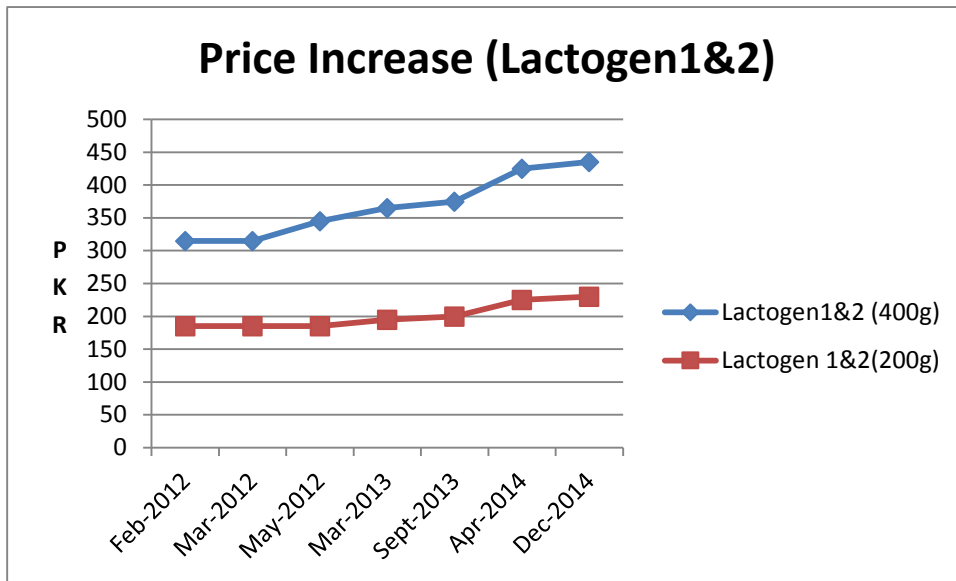


grams between 2012 and 2014 was 38% and *Lactogen (1 &2) 200 grams* 39% (as shown in Table 4 below) and indicated in Graph 1 below.

<b>Table 4</b>						
<b>Product</b>	<b>Price increase in 2012-13 (PKR)</b>	<b>Price increase in percentage 2012-13 (%)</b>	<b>Price increase in 2013-14</b>	<b>Price increase in percentage in 2013-14</b>	<b>Total Price increase between 2012-2014</b>	<b>Total Price increase in percentage in 2012-2014</b>
Lactogen1 400 grams	PKR 60	19%	PKR 60	16%	PKR 120	38%
Lactogen1 200 grams	PKR 35	21%	PKR 30	15%	PKR 65	39%
Lactogen2 400 grams	PKR 60	19%	PKR 60	16%	PKR 120	38%
Lactogen2 200 grams	PKR 35	21%	PKR 30	15%	PKR 65	39%

*Source: Calculations based on Table 3*

**Graph 1: Price Increase (Lactogen 1&2)<sup>11</sup>**



*Source: Calculations based on Table 2.*

46. Nestlé submitted during their presentation held at CCP on 11 May 2015, that the price increase between 2012-14 has been due to the following factors:
- General inflation in Pakistan as measured by the Consumer Price Index (CPI) calculated by Pakistan Bureau of Statistics;
  - Average cost increase of imported Skimmed Milk Powder (MSK);
  - Devaluation of the Pakistani Rupee (PKR) against the US Dollar (USD);
  - Increase in fresh milk price given to farmer;
  - Labour rate inflation: Nestlé experienced a sharp rise in labour costs as they had to make over 500 workers at their plant permanent and provide severance pay to their laid off staff;

<sup>11</sup> Lactogen 1&2-400 grams have identical prices; Lactogen 1&2--200 grams have identical prices.

f. Increase in fixed factory overhead costs (FFOH) and depreciation: as a result of installation of the new Egron plant by Nestlé.

47. The cost structure for *Lactogen (1&2)* as provided by Nestlé, on 11 May during the presentation, is as follows:

**Table 5**

	LACTOGEN (1,2 &3)					
	Cost Component	Cont. to total cost	Cost Component	Cont. to total cost	Cost Component	Cont. to total cost
	2014	2014	2013	2013	2012	2012
██████████	██████████	█	██████████	█	██████████	█
██████████	██████████	█	██████████	█	██████████	█
██████████	██████████	█	██████████	█	██████████	█
██████████	██████████	█	██████████	█	██████████	█
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██████████	██████████	█	██████████	█	██████████	█

Source: Nestlé Pakistan Presentation to the Commission on 11<sup>th</sup> May

48. Overall the contribution of raw materials to total cost for *Lactogen* has declined between 2012 and 2014 from █ to █. The share of conversion costs on the other hand increased from █ to █ in the same period.

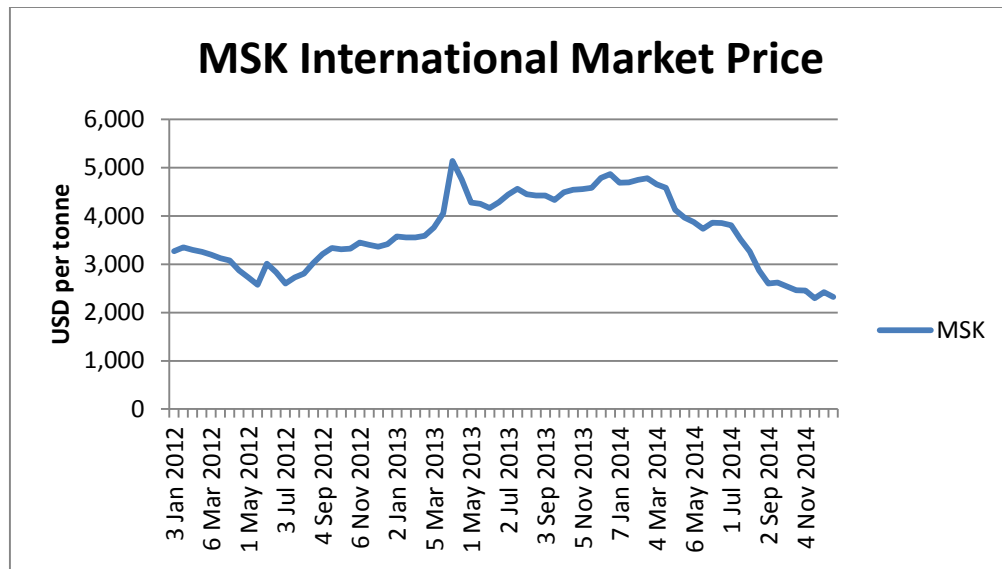
49. We now examine each cost item cited by Nestlé as the reason for price increases in the subsequent paragraphs:

**a. Skimmed Milk Powder (MSK)**

50. MSK is an important component for *Lactogen* accounting for ■■■ of total cost and ■■■ of the raw material cost, in 2014. Nestlé stated that due to certain quality standards/specifications, they have to use imported MSK in *Lactogen*. Therefore, it is important to look at international MSK prices. According to Nestlé, they only hold approximately one months' inventory for MSK and hence are sensitive to international price movements. The international price of MSK fluctuated during the period under consideration, however it may be noted that on overall basis the international prices of MSK fell by 29% between 2012 and 2014.

51. The first price increase in *Lactogen* (1&2) 200 grams was of PKR 20 (12%), in February 2012. During this period prices of MSK experienced an upward trend rising from USD 3354 per tonne in November 2011 to USD 3424 in December 2011, a 2% increase. Subsequent to this, prices continued to decline and reached a level of USD 2573 per tonne in May 2012 (a 25% fall). However, Nestlé made a second upward revision in prices of PKR 30 (9.5%) for *Lactogen* 1&2 (400 grams) in May 2012. Prices of MSK started experiencing an upward trend from August 2012 reaching a level of USD 3554 per tonne in February 2013 (a 27% increase). Nestlé increased prices by 20 PKR (5.7%) increase for *Lactogen* in March 2013 in line with this increase. MSK prices experienced a substantial rise in March/April 2013, due to shortages/drought in New Zealand, one of the main suppliers, reaching a level of USD 5142 per tonne in April 2013.

**Graph 2: MSK Intl' Market Price**



Source: <https://www.globaldairytrade.info/en/product-results/skim-milk-powder/>

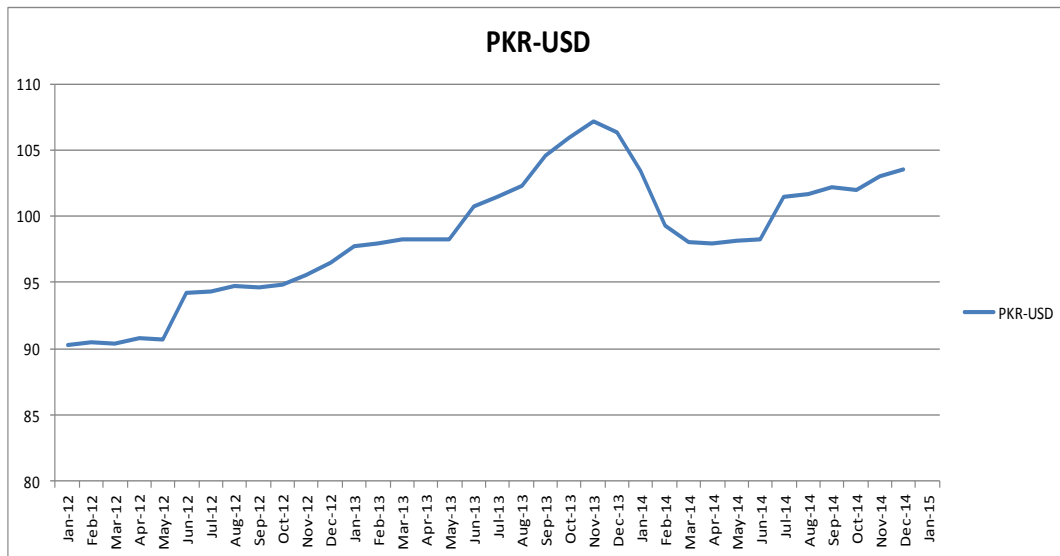
52. MSK prices started falling after the unprecedented rise but Nestlé increased prices of *Lactogen* again in September 2013 by PKR 10 (2.7%). As supplies from New Zealand started increasing there was downward pressure on MSK prices that continued to fall but Nestlé again increased prices of *Lactogen* in April 2014 by 50 PKR (13.3%). Nestlé made another upward revision in prices on December 2014 this despite the fact that MSK prices had come down significantly to USD 2320 per tonne (a 34.7% overall decline from the record USD 3554 per tonne in February 2013).
53. In another document provided by Nestlé showing the cost structure of *Lactogen*, also appears to reinforce the fact that the price of MSK has fallen. Under the head 'cost of MSK 2013' the figure is PKR [REDACTED]; the next year's sales volumes show an increase of 6% (according to the sales volume provided by Nestlé) and the cost of MSK has come down to [REDACTED]. If the cost of MSK had increased by 32%, as claimed by Nestlé, and considering the volume increase in sale, the figure should have been [REDACTED] which in actual is not close to half of this. The same is applicable to Lactose as a component of raw material because the price of lactose also followed a similar trend.

54. In view of above discussion, it appears that Nestlé has passed on the increases in price of MSK to its customers, however, the benefit of significant reduction in prices has not been passed on; in fact it appears that the undertaking continued to increase prices despite decrease in price of MSK. Therefore, the increase in price of Lactogen (1&2) does not appear to be justified on the basis of prices of MSK.

**b. Dollar Rate**

55. As is the case with MSK prices, the Dollar rate also varied during the period under consideration. Overall the Pakistani Rupee has depreciated against the US Dollar between 2012-14 by 14.6%, however it may be noted that the Dollar depreciated between January 2012 to October 2013, and then also fell sharply below the Pakistani Rupee 100 level during February to June 2014, but this decrease in Dollar value does not appear to be reflected in the price of Lactogen. Furthermore, apparently the price of dollar is only relevant to the imported raw material i.e. MSK price, that decreased significantly during the time period under review, as mentioned in paragraphs 51, 52 and 53 above. Therefore, a change in the exchange rate does not seem to justify the price hike.

**Graph 3: PKR --USD Rate**



Source: Dollar Exchange Rate, Source: [www.exchangerates.org.uk](http://www.exchangerates.org.uk)

**c. Fresh Milk**

56. One of the reasons attributed to the price hike by Nestlé was the increase in the cost of ‘Fresh Milk’<sup>12</sup>. In the Total Cost for *Lactogen* in 2014, the cost of Fresh Milk went up by 40% from last year; [REDACTED] from [REDACTED] in 2013. The volumes of sales as mentioned above have increased by 6%. Taking that into account the price hike is calculated to be 33.85%. However it is important to identify that Nestlé is one of the biggest companies buying fresh milk in the country. In the CSV<sup>13</sup> Report of 2013 published by Nestlé, the following extract is highlighted on page 26:

*“In 2013 alone, Nestlé Pakistan procured nearly half a billion litres of milk from farmers and made a payment of approximately PKR 20 billion.”*

57. From this statement it appears that the price per litre is approximately PKR 40. In the subsequent year, in the Nestlé CSV Report of 2014 on page 3, a diagram is provided. In the diagram it is stated that Nestlé paid PKR 23 Billion to farmers in the form of milk purchases. If we keep all else equal and assume that the quantity purchased was even the same, which is favourable to Nestlé’s case; the price increase appears to be of only 15%. Also slide 19 in the presentation, given by Nestlé, clearly indicates that the price inflation given to farmers is 10.6% not [REDACTED]. Similarly as per the CPI, there has been an increase of 16% on average between January 2012 and December 2014 for fresh milk.

58. Although, as per Nestlé, Fresh Milk is a major component of *Lactogen*(1&2), however, merely 16% increase in the price of Fresh Milk over a period of three years does not appear to justify the price increase of *Lactogen* (1&2).

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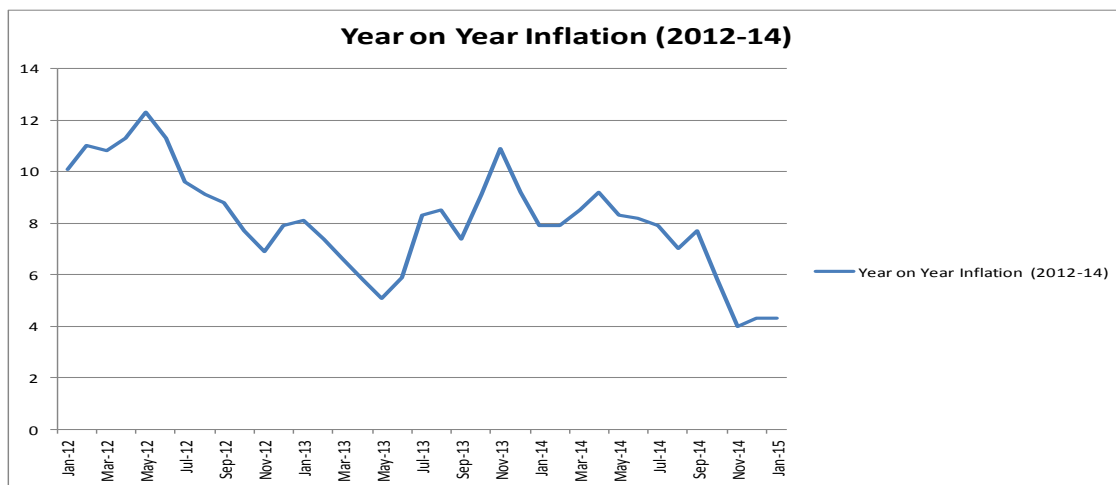
<sup>12</sup> As explained by Nestlé during the meeting with the Enquiry Committee, by Fresh Milk they mean the milk collected domestically in liquid form by Nestlé and converted to the powder at their plant in Pakistan and it is full cream milk, not skimmed.

<sup>13</sup> CSV- Creating Shared Value- Reports published by Nestlé Pakistan Limited about activities of the company.

**d. General Inflation**

59. Local inflationary pressures are directly correlated to increased input costs. However general inflation may increase from time to time, without affecting certain segments in the market drastically or at all. For example, the increase in the price of wheat does not affect the price of cotton in the market. Inflation would increase without having any effect on the price of cotton. In the case of Nestlé infant formula products, the major components are imported and local inflation does not therefore directly affect the cost of raw material drastically. The two major components that are locally produced as shown by the cost break up of *Lactogen* are Fresh Milk and sugar. The price of sugar has not gone up drastically in the past three years. It is also a very small component in the mix of components required for manufacturing Lactogen, less than ■ as a cost component. The case of Fresh Milk has already been discussed in paragraphs 50 and 51 above.
60. Year on year inflation trends show inflation declining from September 2013 onwards and reaching record lows as the impact of falling petroleum prices is felt. Owing to the reasons given above, the increase in price does not appear to be justified on the basis of general inflation in economy.

**Graph 4: Year on Year Inflation**



Source: Pakistan Bureau of Statistics



**e. Labour Costs**

61. Nestlé has argued that there was a 50% increase in labour costs between 2011 and 2012 due to awarding permanent status to temporary staff working on core positions. It may be noted that the increase in this cost component relates to dozens of other products in Nestlé's portfolio and may have been spread across all products, as per applicable accounting practices. As can be observed from Table 5, the conversion cost (which includes labour cost and factory overheads), rose from █████ to █████ as a component of total cost. Therefore, the increase in labour costs does not appear to justify the price hike of Lactogen (1&2) to the extent claimed by Nestlé.

**f. Maintaining Profitability**

62. Nestlé in its response and in the presentation dated (11 May 2015) mentioned that the price hike of *Lactogen (1&2)* was necessary to stay profitable, as per the commitment of the management to the shareholders of the Company. The following Table 6 presents an analysis of the profit margin on *Lactogen(1&2)* calculated on the basis of figures given by Nestlé to the Enquiry Committee:-

<b>Table 6</b>			
	<b>2012</b>	<b>2013</b>	<b>2014</b>
████████████████████	████████	████████	████████
████████████████	████████	████████	████████
████████████████	████████	████████	████████
████████████████	████████	████████	████████
████████████████	████████	████████	████████
████████████████	████████	████████	████████

██████████	██████████	██████████	██████████
██████████	██████████	██████████	██████████
██████████	██████████	██████████	██████████
█	█	█	█
█	█	█	█
██████████	██████████	██████████	██████████
██████████	██████████	██████████	██████████

Source: Nestlé presentation 11th May, 2015(See 'Annex B' for Child Nutrition Segment profitability data provided by Nestlé)

\* Total sales value for Lactogen 1&2 has not been provided by Nestlé. Therefore in order to calculate the sales revenue, weighted average revenue per case was calculated. Also note that Lactogen in Table 6 refers to Lactogen 1, 2 & 3.

63. It appears from Table 6 that the profit margin of *Lactogen* increased in between 2012 to 2014 from ██████ to ██████ or in PKR, the profit increased by PKR ██████ from PKR ██████ in 2012 to PKR ██████ in 2014. This appears to negate Nestlé's argument that it increased prices in response to increased costs. Furthermore, the increase in profit margin by █ indicates that the sale price has been increased disproportionately in excess of increase in costs.
64. Table 6 further suggests that in 2014 *Lactogen* accounted for only ██████ of the total sales revenue of Nestlé's Child Nutrition segment but had a share of ██████ in the segment's total profits. It appears that since the demand for Lactogen is fairly inelastic, Nestlé may have been cross subsidizing cost of other products in the Child Nutrition Segment that may have a fairly elastic demand.
65. Although earning and maintaining profits is of the core objectives of any corporate entity, it appears that Nestlé has increased prices and added to the profits of *Lactogen* by way of abusing its dominant position, apparently at the cost of exploiting its innocent consumers who are facing the dilemma of having no choice but to buy the product of a dominant player.

## II. Infant Cereal

66. Nestlé has increased the prices of its product *Cerelac* in the last three years at regular intervals as shown in the Tables 8.1 and 8.2 and Graph 5 below:

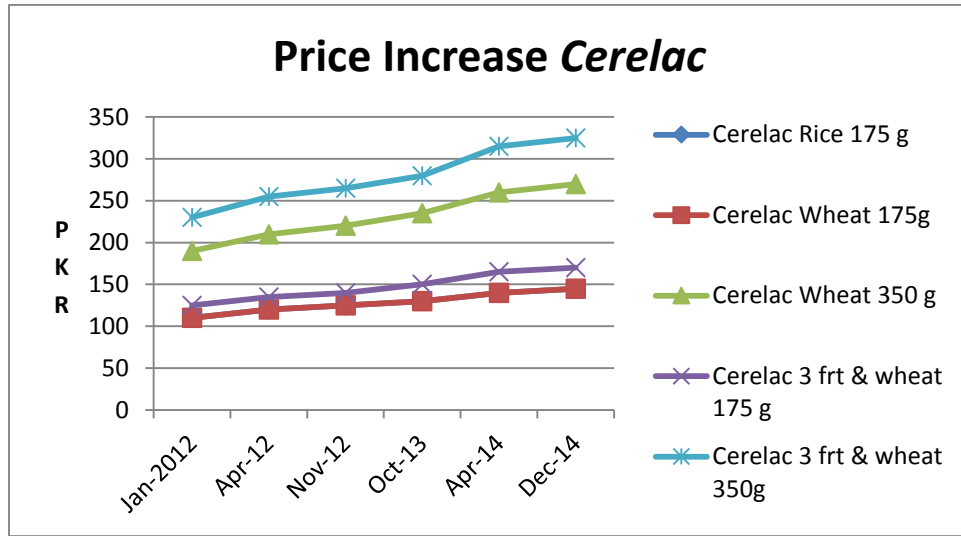
<b>Table 8.1</b>						
<b>Price Increase (PKR)</b>	<b>2012</b>			<b>2013</b>	<b>2014</b>	
<b>Product</b>	<b>Jan</b>	<b>Apr</b>	<b>Nov</b>	<b>Oct</b>	<b>Apr</b>	<b>Dec</b>
<i>Cerelac</i> Rice 175 g	110	120	125	130	140	145
<i>Cerelac</i> Wheat 175g	110	120	125	130	140	145
<i>Cerelac</i> Wheat 350 g	190	210	220	235	260	270
<i>Cerelac</i> 3 frt & wheat 175 g	125	135	140	150	165	170
<i>Cerelac</i> 3 frt & wheat 350g	230	255	265	280	315	325

*Source: Information provided by Nestlé*

<b>Table 8.2</b>				
<b>Price Increase (PKR)</b>	<b>2012</b>		<b>2014</b>	
<b>Product</b>	<b>Jan</b>	<b>Nov</b>	<b>May</b>	<b>Sep</b>
<i>Cerelac</i> Sachet Rice 25g	12	13	14	15
<i>Cerelac</i> Wheat 25 g	12	13	14	15
<i>Cerelac</i> 3 Frt. & wheat 25 g	12	13	14	15

*Source: Information provided by Nestlé*

**Graph 5: Price Increase Cerelac**



Source: Calculations based on data from Table 8.1

67. The average increase in the prices of different flavors/categories of *Cerelac* between 2012 and 2014 was 32.2%. The increase in each different flavor/category as follows:

<i>Cerelac</i> Categories	Price increase from January 2012 to December 2014
<i>Cerelac</i> Rice 25 gram	PKR 3 (25%)
<i>Cerelac</i> Wheat 25 gram	PKR 3 (25%)
<i>Cerelac</i> 3 Fruit Wheat 25 gram	PKR 3 (25%)
<i>Cerelac</i> rice 175 gram	PKR 35 (31.8%)
<i>Cerelac</i> Wheat 175 gram	PKR 35 (31.8%)
<i>Cerelac</i> Wheat 350 grams	PKR 80 (42%)
<i>Cerelac</i> Fruit and Wheat 175 gr.	PKR 45 (36%)
<i>Cerelac</i> Fruit and Wheat 350 gr.	PKR 95 (41%)

68. The sales volume of different *Cerelac* flavors/categories increased by 10.8% between 2012 and 2014 as shown in Table 10 below.

<b>Table 10</b>			
<b>Sales Volume</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
<i>Cerelac</i>	521,935	523,386	584,752
<i>Cerelac 2</i>	519,687	536,184	552,537
<i>Cerelac 3</i>	49,179	48,207	31,797
<i>Cerelac 4</i>	N.A	15,897	39,843
<b>Total</b>	1,090,801	1,123,674	1,208,929

*Source: Nestlé data provided by Nestlé Pakistan on 10th April (See Annex B)*

69. Nestlé have, in their response, argued that the price increase between 2012-14 has been due to the following factors:
- a. General Inflation in Pakistan as measured by the Consumer Price Index (CPI) calculated by Pakistan Bureau of Statistics;
  - b. Average cost increase of imported MSK;
  - c. Devaluation of the Pakistani Rupee (PKR) against the US Dollar (USD);
  - d. Labour rate inflation: Nestlé experienced a sharp rise in labour costs as they had to make over 500 workers at their plant permanent and provide severance pay to their laid off staff;
  - e. Increase in fixed factory overhead costs (FFOH) and depreciation: as a result of installation of the new Egron plant by Nestlé.
70. The cost structure of *Cerelac* provided by Nestlé is as follows:

Table 11						
	CERELAC					
	Cost Cmpt.	% of Cost	Cost Cmpt.	% of Cost	Cost Cmpt.	% of Cost
	2014	2014	2013	2013	2012	2012
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Source: Nestlé Pakistan Presentation to the Commission on 11th May, 2015

- 71. As is apparent from the cost structure, and as mentioned by Nestlé in their presentation to the Commission, the unique formulation of *Cerelac* means that there is no Fresh Milk added and hence a major ingredient is MSK which accounts for [REDACTED] of total cost. This would make *Cerelac* sensitive to price increases in MSK.
- 72. Taking the prices of *Cerelac* Wheat 350 grams, we can observe that between January 2012 and April 2012 per bag prices increased by Rs.20 (From PKR 190 to PKR 210) a rise of 10.5%. However, during this period the prices of MSK in the international market were fairly stable with no major increase, with prices remaining on the decline from USD 3269 per tonne to USD 3125 per tonne.

73. The price of the *Cerelac* 350 gram wheat pack further increased by PKR 10 between April 2012 to November 2012. Whereas prices of MSK did start to increase towards August but before the increase there was a significant fall in MSK prices that was not passed on to consumers. The next major price increase in the *Cerelac* 350 gram wheat pack was in October 2013 when the prices rose by PKR 15 per pack. This increase can be attributable to the record high prices of MSK in the international market. The next price increases in the abovementioned pack rose in April 2014 and December 2014 by PKR 25 and PKR 10 respectively. During this period there was a significant decline in international MSK prices with prices falling as low as USD 2320 per tonne which was even lower than 2012 levels.
74. Looking at the cost structure of *Cerelac* from 2012 to 2014 it appears that the share of all other cost components in total cost (including conversion costs, which are a significant component) remains constant<sup>14</sup>. This makes the price rises attributable mainly on the prices of MSK.
75. As noted in earlier paragraphs, since there was an overall decline of 34.7% (from the record USD 3554 per tonne in February 2013) in the price of MSK, the increase in price of *Cerelac* does not appear to have been justified, instead it appears that Nestlé has been increasing the prices on the pretext of increase in price of MSK, however, subsequently the prices have not been reduced as a result of decline in the price of MSK.

## **E. SUMMARY OF FINDINGS**

In view of the above discussion, following is a summary of the findings of this enquiry:

76. In terms of paragraphs 29, 34 and 37 above, there are two different relevant markets to be considered for the purposes of this enquiry; One of the relevant markets is the market

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<sup>14</sup> This is in contrast to the cost structure of Lactogen where we can see some variations in the share of conversion costs which rise from ■■■ to ■■■.

for IFFO catering to the requirements of infants aged between 0 to 12 months in Pakistan, and the second is the market for infant cereal for infants aged 6 to 24 months in Pakistan.

77. In terms of paragraph 39 above, Nestlé holds a dominant position in the market for IFFO for infants aged between 0 to 12 months in Pakistan by having a 100% market share through its brands *Lactogen* (1 and 2).
78. In terms of paragraph 40 above, Nestlé holds a dominant position in the market for infant cereal for infants aged between 6 to 24 months in Pakistan by holding 99.5% market share through its brand *Cerelac*.
79. It was alleged in the consumer complaint that Nestlé has unjustifiably increased prices of IFFO products *Lactogen* (1 & 2) and the infant cereal *Cerelac*.
80. As per the data submitted by Nestlé, the price of *Lactogen* was increased by PKR 120 for 400 grams and PKR 65 for 200 grams per unit respectively, representing an average increase of 38%; and the price of *Cerelac* has been increased by PKR 90, representing on average a 32% increase between the years 2012 to 2014.
81. Nestlé submitted that the price increase between 2012 to 14 has been due to the following factors:
  - a. General inflation in Pakistan as measured by the CPI, as calculated by Pakistan Bureau of Statistics;
  - b. Average cost increase of imported MSK;
  - c. Devaluation of the Pakistani Rupee (PKR) against the US Dollar (USD);
  - d. Increase in fresh milk price given to farmer;



- e. Labour rate inflation: Nestlé experienced a sharp rise in labour costs as they had to make over 500 workers at their plant permanent and provide severance pay to their laid off staff;
  - f. Increase in fixed factory overhead costs (FFOH) and depreciation: as a result of installation of the new Egron 2 plant by Nestlé.
82. As explained in the analysis above, upon consideration of each individual factor the price increase does not appear to be justified.
83. It appears that Nestlé has passed on the increases in price of MSK to its consumers; however, the benefit of significant reduction in prices has not been passed on. In fact it appears that the undertaking continued to increase prices despite a decrease in the price of MSK. Therefore, the increase in price of *Lactogen* does not appear to be justified on the basis of prices of MSK.
84. As is the case with MSK prices, the Dollar rate also varied during the period under consideration. Whereas the Pakistani Rupee has depreciated against the Dollar between January 2012 to October 2013, it then also fell sharply below the PKR 100 level during February to June 2014, but this decrease does not appear to be reflected in the price of *Lactogen*. Therefore, change in the exchange rate does not seem to justify the price hike.
85. Although, as per Nestlé, Fresh Milk is a major component of *Lactogen*, however, a mere 16% increase in the price of Fresh Milk over a period of three years does not appear to justify price increase of *Lactogen*.
86. Year on year inflation trends show inflation declining from September 2013 onwards and reaching record lows as the impact of falling petroleum prices is felt. Therefore, the increase in price does not appear to be justified on the basis of general inflation in the economy.
87. Nestlé have argued that there was a 50% increase in labour costs from 2011 to 2012 due to awarding permanent status to temporary staff working on core positions. It is noted

that the increase in cost is related to dozens of other products in Nestlé's portfolio and should be spread across all products. Therefore, it appears that the increase in labour costs does not justify the price hike for one product to that extent.

88. Profitability of *Lactogen* has risen between 2012 and 2014 with profit margins rising from ██████ to ██████. This seems to contradict Nestlé's argument that the price hikes were carried out to cover for rising costs. The analysis of data seems to suggest that the increase in price per unit was greater than the increase in costs per unit thus leading to higher profit margins.

## **F. CONCLUSION**

89. In view of the findings in paragraphs 54,55,58,60,61 and 65 above, it appears that Nestlé has abused its dominant position in the relevant market for IFFO in Pakistan by unreasonably increasing prices and exploiting innocent consumers, *prima facie*, in terms of Section 3(3)(a) read with Section 3(2) which constitutes a violation of Section 3(1) of the Act.
90. In view of paragraph 75 above, it appears that Nestlé has abused its dominant position in the relevant market for infant cereal in Pakistan by way of unreasonable increase in prices, *prima facie*, in terms of Section 3(3)(a) read with Section 3(2) which constitutes a violation of Section 3(1) of the Act.
91. IFFO is a sensitive and highly regulated sector in almost all the countries of the world. Whereas breast milk is the best source of nutrition for infants, there are many instances where some infants cannot be fed breast milk and have to rely on infant formula and follow on milk. The increase in the price of *Lactogen* i.e. the only domestically produced infant formula and follow-on milk, is most relevant to the consumers belonging to low income groups, who as a result of the recent increase in prices, may be inclined towards reducing the prescribed serving per feed for the infants, with the mindset to curb

expenditure. Since it is the sole source of nutrition for a vulnerable population i.e infants, any reduction in adequate feed would lead to undernourishment.

92. Keeping in view the sensitivity of the issue, and in public interest, it is proposed that proceedings may be initiated against the company in terms of Section 30 of the Act for *prima facie* violation of the provisions of Section 3(1) of the Act.

Shaista Bano  
Senior Director/Enquiry Officer

Maliha Quddus  
Assistant Director/Enquiry Officer