



Briefing 12/04 January 2012

OFT refers aggregates, cement and ready-mix concrete markets to the Competition Commission

To: All contacts in England, Wales, Scotland and Northern Ireland

Key issues:

OFT investigation taken to next stage.
Proposal for Competition Commission to commence further investigation.

1. Introduction

The Office of Fair Trading (OFT) has been considering the UK aggregates sector since September, 2010 when it launched a market study into the sector noting that "Aggregates is an important sector in its own right but it is also part of the larger construction industry which plays a key role in the country's economy. Because the cost of aggregates is reflected in the price consumers, and tax payers, pay for essential infrastructure, from housing through to roads and major capital building projects, it is important that the market is as competitive as possible."

The OFT published its report in August 2011 and proposed to refer the sector to the Competition Commission (CC) for more detailed investigation. Prior to that it had undertaken a consultation exercise. Following this, it has referred the aggregates, cement and ready-mix concrete markets in Great Britain to the CC. Having carried out the consultation on its provisional decision and considered all the responses received, the OFT continues to be of the view that competition may not be working well in Great Britain, but has decided not to refer these markets in Northern Ireland because the features identified are not present to the same degree. It has concluded that GB and NI are likely to be distinct markets for these products and because the features identified in GB are not present to the same extent in NI. However, in reaching this conclusion, the OFT has not come to a view about whether or not the markets in NI meet the test set in s131 of the Enterprise Act 2002 (EA02) and it reserves its position to look at this geographical market in future.

Under section 131 of the EA02, the OFT may make a market investigation reference to the CC where it has reasonable grounds for suspecting that any feature, or combination of features, of a market in the United Kingdom for goods or services, prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK. The OFT will only exercise its discretion to make a reference when particular criteria have been met, as set out in Market Investigation References: Guidance about the making of references under Part 4 of the Enterprise Act (March 2006).

2. Main points of the report

The report notes that the aggregates, cement and ready-mix concrete sectors, with turnovers of about £1.4bn, £0.9bn and £1.0bn respectively, are key contributors to the construction sector, representing some 7% of GDP or £110bn a year of expenditure. The public sector accounts for around 40% of construction expenditure – for schools, hospitals, roads and other physical and social infrastructure – with central Government being the industry's biggest customer.

It describes how over the last couple of decades the aggregates, cement and readymix concrete sectors have experienced substantial consolidation, mainly through acquisition. Five major multinational companies – Lafarge, Hanson (part of Heidelberg Cement), Tarmac, Aggregate Industries (part of the Holcim Group) and Cemex – account for the majority of sales in each of these markets.

The study of the aggregates sector revealed concerns among stakeholders about how competition operates with most concerns about competition in the market related to the extent of vertical integration between the aggregates, cement and ready-mix concrete sectors and to the conduct of the vertically integrated majors. A particular source of concern was an alleged squeeze between the price of cement upstream (supplied by the majors) and the price of concrete downstream with the result being the extent of the scope of the study to cover cement and ready-mix concrete.

3. Competition in the industry

In particular, the OFT has concerns regarding structural features of these markets and reasonable grounds for suspecting that these are preventing, restricting or distorting competition.

In its study the OFT identified a number of features of the sectors which could prevent, restrict or distort competition. These relate both to structural features that may dampen competition, and to the conduct of major firms towards smaller operators.

The report concludes that the industry displays a number of features which may adversely affect competition. These include:

- High barriers to entry in aggregates and cement due to the difficulty of obtaining planning permission and the level of investment required.

- High and increasing concentration: five major players account for over 90 per cent of the cement market, 75 per cent of aggregates sales and 68 per cent of ready-mix production.
- The effects of vertical integration: the major firms are integrated across aggregates, ready-mix concrete and cement. We have received complaints about vertically integrated firms refusing to supply or discriminating against non-integrated competitors through their pricing.
- Multiple contacts and information exchanges across the markets, with major firms supplying each other with both aggregates and cement, and engaging in joint-ventures and asset swaps.
- An apparent squeeze between rising cement prices and stable or falling ready-mix concrete prices, affecting independents which both buy cement from vertically-integrated majors and compete against them in the ready-mix concrete market.

The combination of barriers to entry, transparency, homogeneous products and multi-market contact has the potential to reduce competition in settings with high levels of concentration. Taken in the round, OFT are concerned that competition is not working well in these markets, and that competition problems are rooted in underlying features of the market that could only be addressed by the kinds of remedies available to the Competition Commission. They are concerned that there may be consumer harm through higher prices in the short term, possibly exacerbated by further erosion of independent competition in the medium to long term.

These features, in combination, may have the potential to reduce competition in settings with high levels of concentration, particularly given the largely homogenous nature of the products, and may lead to the erosion of independent competition in the medium to long-term. The effect in the long-term could be a further weakening of competition between the firms, resulting in higher prices for aggregates, cement and ready-mix concrete.

The OFT feel there are reasonable grounds to suspect that there are features of this market that prevent, restrict or distort competition in the UK. As such they are minded to exercise their discretion to refer the supply of aggregates, ready-mix concrete and cement in the UK to the Competition Commission for further investigation on the basis that:

- The industry is large and important and the three sectors are critical for the national economy.
- There is a reasonable prospect of finding appropriate remedies to the concerns outlined, for example by considering structural or behavioural remedies to address the features which facilitate coordination or exclusionary behaviour.
- A Market Investigation Reference (MIR) is the most appropriate tool for investigating and potentially remedying the features of a market that underlie persistent competition problems.

The purpose of an MIR is to determine whether the process of competition is working effectively in markets as a whole. OFT believe this is the best course of action to address endemic competition problems rooted in the underlying features of the market.

4. Other market study findings

The report also found some evidence to suggest there may be room for improving efficiency in the procurement of aggregates, particularly by the public sector. Aggregates are often procured as part of a construction contract. It is not clear that rebates associated with bulk purchases of aggregates are passed directly back to buyers. Some heavy users of aggregates have made significant savings by bringing procurement of aggregates directly under their own control.

This aspect does not form part of the basis for the proposed reference. We simply recommend that large users of aggregates – in particular public sector buyers – consider whether it may be possible to make savings by bringing procurement of aggregates directly under their own control.

5. Comment

APSE welcomes the proposed investigation to further consider competition within this sector. Local councils spend a significant amount of money with this sector and anything which can help to provide better value for money will be gratefully received.

APSE members should look to remain aware of developments in this area not only because of the impacts on the supply and price of products but also because of some of the other findings made. The issue related to rebates associated with bulk purchases of aggregates not being passed directly back to buyers, is a relevant one for all with procurement responsibilities and it will be interesting to see what the CC report has to say about improving efficiencies in procurement of aggregates in the public sector in general.

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