CCS Conducts Market Study on Supply of Formula Milk

Introduction

On 10 May 2017, the Competition Commission of Singapore ("CCS") published the findings of its market inquiry into the supply of formula milk products in Singapore. The market study had been conducted from October 2015 to December 2016 and focused on the supply of formula milk products for babies, infants, and young children of up to six years old (collectively referred to by the CCS as "Formula Milk").

Citing data from the Singapore Department of Statistics and various media reports, the CCS noted that the average retail price of Formula Milk in Singapore had more than doubled over the past nine years, with the prices of Formula Milk in Singapore today far exceeding prices in comparable markets such as the United States, Australia, Japan, and Korea.

The CCS market inquiry sought to provide an insight into why such significant price increases had occurred in the Formula Milk market through an examination and analysis of the nature of competition at each level of the Formula Milk supply chain. Further to its findings, the CCS also provided a number of policy recommendations with respect to how the functioning of competition in the Formula Milk market could be improved in order to counteract the soaring retail prices of Formula Milk in Singapore.

CCS Findings on the Nature of Competition

According to the CCS report, the most likely driver behind the increase in retail prices of Formula Milk in Singapore has been the heavy investment and expenditure by Formula Milk manufacturers into research & development and marketing activities. In line with the consumer’s focus on nutrition, safety, and brand name as the key factors influencing their purchasing decisions, Formula Milk manufacturers have been investing heavily in research & development activities in order to regularly introduce new ingredients to their product formulation, as well as aggressive marketing to highlight the nutritional improvements to their products.

Further, the CCS also noted that Formula Milk consumers typically exhibit a high degree of brand loyalty and are not likely to switch product brands once their child has begun drinking a particular brand of Formula Milk. Formula Milk manufacturers leverage on this by expending significant resources on marketing in hospitals and hospital sponsorships, so as to improve the chances of their Formula Milk being the first brand of Formula Milk offered to and/or selected by parents of newly-born children, thereby gaining an invaluable first-mover advantage.

The CCS found that the significant resources devoted by Formula Milk manufacturers towards product “premiumisation”, coupled with the strong sense of brand loyalty among consumers, have resulted in the creation of high barriers to entry into the Formula Milk market and have also limited the level of competition from new brands and other existing brands of Formula Milk. Given the nature of competition in the market, prospective entrants to the Formula Milk market would be forced to expend a large amount of resources to convince consumers of the “premium” status of their Formula Milk products via a combination of product innovation and marketing.
Competition & Antitrust

On the retail side of the market, the CCS noted that retailers such as supermarkets and pharmacies would generally only stock and offer Formula Milk brands which are in demand by consumers (i.e. brands which are already perceived as “premium”), thus reinforcing the brand loyalty of consumers and exacerbating the significant barriers to entry faced by potential entrants to the Singapore market. In addition, the complexity and difficulty in complying with Singapore food and safety regulations have caused retailers to shy away from obtaining Formula Milk brands through parallel importation from cheaper overseas markets or offering their own house brands of Formula Milk. Retailers instead choose to source Formula Milk products directly from the manufacturers or from established and experienced distributors in Singapore.

CCS Recommendations

Further to their findings as set out above, the CCS made three broad recommendations aimed at lowering the market barriers to entry and improving the degree of price-based competition.

First, the CCS has recommended that local consumers should be educated on the nutritional content of Formula Milk vis-à-vis the nutritional requirements of young children, in order to allow consumers to understand that all Formula Milk brands and products sold in Singapore, and not just the expensive premium brands, meet the quality, safety, and nutritional requirements imposed by the Health Promotion Board (“HPB”) and the Agri-Food and Veterinary Authority (“AVA”). The aim is that such educational measures would improve consumer awareness as to the availability and viability of cheaper product options in respect of Formula Milk products, thus improving price competition over time.

Second, the CCS has recommended that price competition in the Formula Milk market should be stimulated through a review of the existing regulatory rules which inhibit parallel importation (such as labelling and import documentation requirements) and the development of retailer house brand Formula Milk. These would serve to expand the pool of competing Formula Milk suppliers in the Singapore market.

Third, the CCS has also recommended that the authorities review the present practice of sponsorships and payments being provided by Formula Milk manufacturers to hospitals in an attempt to improve their chances of their Formula Milk products being offered to parents. This recommendation is targeted at eliminating or reducing a significant entry barrier for new and existing brands, stemming from the key first-mover advantage currently associated with such hospital sponsorships and payments.

Regulatory Responses

The HPB and the AVA, together with the Ministry of Health (“MOH”), issued a joint press statement on the same day the CCS report on its market inquiry was released, announcing a number of notable regulatory and policy measures that are aimed at collectively improving price competition in the Formula Milk market.

The AVA announced its intention to streamline the import regulations for Formula Milk so as to facilitate the entry of more suppliers and brands of Formula Milk into the Singapore market. The AVA will also be making changes to the regulations governing the advertising of Formula Milk products which will prohibit Formula Milk manufacturers from using nutrition and health claims, as well as idealised images that make drinking Formula Milk look attractive, in their product advertisements. These regulatory amendments have been projected to be implemented by the end of 2017.
In addition, the HPB will be embarking on a five-year campaign to educate the public on the merits of breastfeeding and on the sufficiency of cow’s milk as a nutritional substitute for children above 12 months of age.

The MOH will also be strongly encouraging all hospitals that are providing maternity services to adopt and adhere to the international Baby-friendly Hospital Initiative certification, which prevents hospitals from entering into sponsorship arrangements with Formula Milk companies. At present, this scheme has not been adopted by any of the private hospitals in Singapore. Additionally, the MOH also noted that only premium Formula Milk brands are presently being offered in the ready-to-feed form suitable for consumption by newly-born infants in hospitals. The MOH will therefore also be looking into how cheaper Formula Milk brands can also be made available in the appropriate ready-to-feed form.

Our Comments

Based on the results of the CCS market inquiry, it appears that the high retail prices of Formula Milk in Singapore is not the result of any anti-competitive conduct by market players, such as collusion amongst Formula Milk manufacturers or an abuse of dominance by any dominant Formula Milk manufacturer. Although the CCS has identified that contractual restrictions imposed by manufacturers on overseas Formula Milk distributors that restrict the latter from selling to overseas retailers and/or for overseas consumption (such as to Singapore) may be one barrier to parallel import, it is unlikely that the CCS will take action against these vertical restraints, given the vertical agreement exemption under the Singapore Competition Act, as well as the availability of alternative means for parallel importers.

Accordingly, the proposals by the CCS to remedy the situation are in the form of policy recommendations to change the demand and supply characteristics of the market. With respect to demand, the CCS’s first recommendation to improve consumer awareness is aimed at reversing the anomalous trend today where consumer demand increases with price (as consumers regard price as an indication of quality due to information asymmetry). With respect to supply, the CCS’s second recommendation is to encourage parallel import and private labels so as to increase the sources of supply, and hopefully stimulate greater price competition. The third recommendation to review the practice of sponsorship in hospitals seeks to change the supply and demand dynamics at the earliest stage of consumption.

Given the time taken to change consumer attitudes and purchasing habits, the third recommendation to review the sponsorship and milk rotation practices in hospitals may have a more immediate impact on reducing the market power of incumbents and enhancing price competition. However, certain proposals outlined under this recommendation, such as considering whether Formula Milk supplied for use in hospitals can be “brand-free” (i.e., parents would not be able to identify which brand of Formula Milk had been provided) may have a wider impact (e.g., parents will have to do their own trial and error as to which brand their infants take to, and potentially result in higher incidence of allergic reactions of infants) and will require careful further review by the relevant authorities.

Certainly, the regulatory and policy measures proposed thus far will be of great interest and concern to Formula Milk companies, who will have to monitor the development of this situation closely and carefully consider how their respective business strategies may have to be adapted or even revamped to cope with such changes in the regulatory landscape.
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