



The American  
Antitrust Institute

June 6, 2005

Susan Creighton, Director  
Bureau of Competition  
Federal Trade Commission  
6<sup>th</sup> and Pennsylvania Avenues, NW  
Washington, DC 20580

Dear Ms. Creighton:

We are writing in regard to Procter & Gamble's proposed acquisition of Gillette. The American Antitrust Institute is concerned that the proposed acquisition may tend to lessen competition in numerous markets, under standard modes of antitrust analysis. However, the essence of this letter is to urge the FTC to carry its analysis beyond the realm of products offered by both firms in the traditional relevant product market sense.

The AAI is an independent non-profit education, research and advocacy organization. See [www.antitrustinstitute.org](http://www.antitrustinstitute.org). We have no special knowledge of the facts in this merger, but have studied the relationship between category management models and competition, which we here apply to publicly available information in the hope that it will assist your investigation.

As you know, P&G and Gillette hold the 1<sup>st</sup> and 2<sup>nd</sup> or 3<sup>rd</sup> positions in several product categories, including deodorants/antiperspirants (and in particular men's deodorants/antiperspirants) and oral care. They are also present in numerous other product categories. Moreover, P&G and Gillette are category captains for some categories in some retail chains.

We believe that the proposed acquisition has the potential of injuring competition in numerous ways. We have categorized the injuries loosely as "injury to category captain competition," "injury arising from self-dealing" by the category captain, and "injury to competition arising from outside the scope of category management." We address each in turn. Our goal in outlining these theories is to suggest that the proposed acquisition presents issues that go beyond traditional antitrust analysis, and that understanding these issues can

be helpful in making any determination as to whether or not the proposed acquisition will be anticompetitive.

In particular, we wish to emphasize that the category management and portfolio effects that could arise from the proposed acquisition are particularly troubling in that they do not necessarily lend themselves to traditional relevant market analysis. In other words, even if there is a small degree of overlap in some of the products which P&G and Gillette sell (i.e., the HHIs are very low), there may still be the ability and incentive for the combined company to exercise super-competitive influence within the market. Only a more detailed analysis of the theories of harm described below would determine whether or not the proposed acquisition would substantially lessen competition.

We understand that you are already well into your second request phase of investigation of this proposed acquisition. Nonetheless, we shall highlight the areas of inquiry that we think crucial to answer whether or not this combination tends to lessen competition.

### **Injury to Category Captain Competition**

The proposed acquisition may harm competition because the merged entity will likely be the category captain in many product segments, particularly health and beauty aids (HBA). As the category management system has evolved, retailers sometimes confer power to category captains to oversee a broader range of products beyond those that the category captain itself offers. Retailers may employ vendors to be category captains for a particular aisle of goods, or even spanning several aisles, regardless of whether the category captain offers products for sale in each aisle.

The merger effectively reduces the number of potential category captains. Gillette and Proctor & Gamble appear as natural rivals in competition for this category captain position, particularly in the HBA segment. Each, in fact, holds the category captain position in some categories of products (which both firms offer) in some retail chains.

The FTC should consider the effects that the acquisition would have on such competition. A category captain that ignores the interests of its customer (i.e., the retail stores—who in turn are supposed to listen to their end-user customers), unduly disadvantages

its rivals, is inefficient, or otherwise engages in self-interested conduct that might injure the retailer, may find itself replaced by another vendor. In some instances, a firm that is not the category captain may act as a “validator,” looking over the shoulder of the category captain. However, if there is only one firm that could adequately fulfill the category captain function, then such a dysfunctional category captain would be very difficult to dismiss or discipline. Thus, an acquisition that substantially reduces the retailer’s alternatives in the selection of a category captain could have a negative impact on the balance of power between retailer and supplier.

Even if other competitors exist for the category captain role, their role in category management could well be greatly diminished. Whereas secondary players in a category could play the validator role, this secondary advisory role might be eliminated after the acquisition because P&G/Gillette will be looked to as the principal advisor for certain product segments, particularly HBA, based on its increased presence in the full category and its much larger store of consumer behavior knowledge than any other rival company.

Moreover, even if there are other potential category captains that could play some useful role, the combined firm could still yield anticompetitive effects using its category captain role. Category captains frequently serve as captains for multiple competing retailers in the same geographic market. This service as a hub could open the door to the possibility of various anticompetitive horizontal and vertical arrangements.

### **Injury to Competition Arising from Self-Dealing**

Category captains are able to use their position to disadvantage the products of rival vendors in numerous ways. First, the category captain role might exacerbate effects arising from any product market overlap. For example, in the context of oral care, P&G and Gillette overlap significantly in some products (*e.g.* power toothbrushes) but not in other products (*e.g.* mouthwash). Each is strong in some parts of the category where the other is weak or nonexistent. The combined firm could so dominate the overall oral care category across product lines that it can be expected to increase the number of retail chains over which it becomes the category captain in the years ahead.

The increased concentration of retail chains for which the combined firm is the category captain could raise entry barriers<sup>1</sup> and otherwise have exclusionary effects in particular product markets within oral care where the merged firm will be the leading vendor. In power toothbrushes, for example, the combined firm's category management role in an enhanced number of retail chains (particularly the resulting control over shelf space and promotional opportunities) could be exercised to deny smaller rivals sufficient retail access to remain viable.

In addition, the category captain has the ability to use its position to enhance sales of its own products to the detriment of its rivals. For example, the category captain has the ability to grant its items better shelf space than it would otherwise obtain. The category captain's suggested everyday pricing will also be biased to favor its items. Suggested promotional programs and which items are promoted will also favor the captain's goods. The category captain may even gain influence over the retailer's private label programs so as to diminish the intensity of the welfare raising results of vigorous competition between the leading national brand (usually from the captain's firm) and the retailers' lower priced private label imitation.

### **Injury to Competition Might Occur Without Retailer Knowledge**

Injury to competition might take place absent retailer knowledge. As has been argued elsewhere,<sup>2</sup> retailers often lack sufficient information, human resources, and expertise to challenge more than a very small portion of the presentations by a dominant category captain. It is difficult, if not impossible, to overcome this information asymmetry. Whereas a leading manufacturer typically has available a large staff of experts with graduate degrees who can focus on a small number of categories, each of which is of great importance to the manufacturer, the typical retailer has a small staff, not specially educated, each of whom may have to oversee a dozen or more categories. The result is that the retailer's staff does not—and indeed cannot—carefully monitor all the actions of the category captain and what are formalistically recommendations generally seem to carry the

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<sup>1</sup> See FTC STAFF REPORT, REPORT ON THE FEDERAL TRADE COMMISSION WORKSHOP ON SLOTTING ALLOWANCES AND OTHER MARKETING PRACTICES IN THE GROCERY INDUSTRY 51 (2001)(hereafter "FTC Staff Report")("A captain that is able to control decisions about product placement and promotions could hinder the entry or expansion of other manufacturers, leading to less variety and possibly higher prices.").

<sup>2</sup> See, e.g., D. Desrocher, G. Gundlach, and A. Foer, *Analysis of Antitrust Challenges to Category Captain Arrangements*, 22 J. PUB. POL'Y & MARKETING 201 (2003); Robert Steiner, *Category Management—A Pervasive New Vertical/Horizontal Format*, 15-Spring ANTITRUST 77 (2001).

weight of adopted plans. This is not to say that the retailer would not notice if the category captain were to recommend against entry for the hottest new product to come down the road. But these situations are rare. Most decisions are incremental, involve considerations at the margin, and are easily subject to manipulation by the category captain.<sup>3</sup> This helps explain why manufacturers willingly expend large amounts of resources in the process of serving as category captain, in some cases actually bidding for the role.

Information asymmetries are particularly likely in the case of P&G/Gillette. Through its brand management operation, P&G has long and famously had a stable of highly trained individuals with graduate degrees in advertising, marketing, market research and other related disciplines. This crew is now part of the category captain's team.

In some situations, retailers may know about potential injury to competition, but not care. Retailers might be sharing monopoly profits that result from the category captain system. This would be consistent with our theoretical explanation of how the system is a structure that can facilitate hub-and-spoke collusion, an explanation which we stress is only offered as theory.

Even if retailers are not sharing monopoly profits, their failure to complain does not preclude the possibility of anticompetitive effects resulting from the use of category captains. In a previous merger investigation where we thought category captaincy was a relevant consideration; retailers did not provide confirming information. In part, the problem appeared to be that retailers were not asked the right questions or that they were not eager to volunteer information that could undermine their relationships with key suppliers. In part, the problem may also have been that retailers have an inflated and false belief in their own abilities to manage category captains. Such a situation, of course, can lead to anticompetitive outcomes.

### **Injury to competition arising from outside the scope of category management**

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<sup>3</sup> See Thomas B. Leary, *A Second Look at Category Management*, 6 (2004). Commissioner Leary notes: The best strategy for a captain may be to recommend a plan that will preserve its already strong market position rather than blatantly enhance it - - a plan that will also channel existing competition away from "disruptive" initiatives and discourage maverick entry. ... A strategy of this kind may not be perceived as biased and may also be attractive to the retailer, particularly if the same captain or a like-minded counterpart gives similar advice to the retailer's own competitors. (Page 22.)

Beyond the category captain role, the proposed acquisition may lessen competition by creating enhanced ability and incentive to use its broad portfolio of products to prevent rivals from selling particular products that compete with a particular line offered by the combined firm.

For example, many large companies operating in numerous product categories have marketing plans that condition the amount of rebates or allowances that retailers can earn on the number of categories of the manufacturer's line that they carry. P&G is certainly in a position to offer such rebates. The combined firm will increase the number of categories in which P&G operates. The effect could be to erect mobility and entry barriers to firms whose product lines are confined to just a few categories. When the merged company wants to enter a new category, the retailer may be penalized by a reduction in the rebate it has been earning in other categories if it fails to stock the merged company's entry. Obviously, this can cause the retailer to select the combined company's entry at the expense of a more specialized manufacturer whose line may be dropped or who is also trying to enter the category. Thus, an acquisition of this sort may have the foreseeable effect of motivating other competing companies to combine, so that they might have stronger portfolios that will help them remain competitive. Such mergers would not be explainable in terms of efficiencies for the economy, but rather in terms of logical strategic responses to other combinations. The subsequent reduction in choices both for retailers and for consumers is the opposite of what merger policy is intended to achieve.

## **Conclusion**

In sum, focusing only on the horizontal concentration of product offerings within particular antitrust product markets may prove to be an insufficient way to analyze the competitive effects of the proposed combination. The combined firm's enhanced category captain role and its potential abuse of such a role in combination with the increased breadth of product offerings and the nature of store shelf competition raise issues that should be closely examined before the merger can be approved. Even if such an examination ultimately fails to provide evidence requiring further enforcement action in this particular merger, we urge the Commission to use this golden opportunity to explore in depth the increasingly important role of category captains in consumer goods industries.

Sincerely,

A handwritten signature in black ink that reads "Darren Bush". The signature is written in a cursive, slightly slanted style.

Darren Bush  
Assistant Professor of Law  
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Albert A. Foer  
President