the range varied from 5 per cent. to 52 per cent. Molins says it would expect, as a private company, to earn a higher than average rate of profit and, since it has been a very successful company, it would expect to be near the top of the range.

(4) Conclusion

510. In conclusion, referring to the effect on the public interest generally, Molins repeats that the concentration of demand on the company's products results from superior inventiveness and efficiency, which enable the company to sell at competitive prices " machines which their customers consider to be superior to the machines of Molins' competitors ". This concentration, it is argued, serves the public interest " since the research and production facilities which Molins command in part as a result of their predominant position both give rise to economies of scale and enable them to compete the more effectively in export markets ". The market for machinery of the types Molins makes is relatively small; the greater the concentration, the greater the scope for savings in costs. Molins explains that it usually manufactures in batches of ten machines, although the current orders may be for less. This results in a saving which Molins could not achieve if its market were smaller. It submits that there is no natural market for the machines of any tobacco machinery supplier; each manufacturer must be perpetually creating demand by providing at competitive prices better machines than his competitors; the company says that it would cease to hold its present position if it ceased to fulfil this condition. It adds that there is nothing to prevent the company's existing United Kingdom competitors from expanding or newcomers from entering the field, nor anything to prevent Molins' major foreign competitors from exporting to the United Kingdom.

CHAPTER 16. CONCLUSIONS ON THE PUBLIC INTEREST AND RECOMMENDATIONS

I. Cigarettes and Tobacco

(1) Introduction

511. The value of manufacturers' sales in the home market of cigarettes and tobacco covered by the first of our references was about £933 million in 1959. The retail value of these goods was probably about £1,050 million. Customs duty represented on average more than 70 per cent. of the retail price, or more than 80 per cent. of the manufacturers' selling price.

512. Consumption of tobacco products in this country, measured in terms of weight, is now about three times what it was at the beginning of the century. The amount sold in the form of cigarettes is some twenty times higher, but consumption of tobacco in other forms has fallen by more than one-half; cigarettes which accounted for little more than one-tenth of total sales in 1900 account for nearly nine-tenths today. The retail prices of cigarettes are some ten times higher than they were 60 years ago, while retail tobacco prices have risen rather more steeply. Although progressive increases in the rate of duty, which is now more than twenty times what it was in 1902, have contributed largely to this increase in prices, it may be noted that at least until 1939 increases

in duty were not conspicuously out of proportion to increases in the other costs of tobacco products. From 1900 until 1939 the proportion of duty in the total retail expenditure on tobacco goods remained at about 45 per cent. Very sharp increases during and after the war brought the proportion up to practically 80 per cent. in 1947. Although there have been three further increases in the rate since 1947, duty now forms, on average, a rather lower proportion of price than in 1947. As a result of the various factors we have mentioned—the increases in the quantity of tobacco consumed, in the duty and other costs, and in the proportion consumed in the form of cigarettes—the turnover in value of the tobacco industry has multiplied some 40 times since 1900.

513. Imperial has been the dominant supplier of cigarettes and tobacco in this country since the beginning of the century. In 1903, after the existing American competition had been eliminated, its share of the home trade was nearly 50 per cent. By 1920 the proportion had risen to more than 70 per cent. and it has remained between 70 and 80 per cent. since then except in the period around 1930, when coupon trading was at its height, and again in the last few years when the company has lost ground to Gallaher Ltd. In 1959 Imperial's share of the trade was 63½ per cent.

514. The process of concentration in the manufacturing industry has continued fairly steadily up to the present time but has not affected Imperial's proportion which is little greater now than it was at the beginning of the 1914–18 war. The number of manufacturers has fallen from about 500 in 1900 to about 25 today. Most of the existing manufacturers have never had more than a minute share of the trade; some sell only in a small local area and some do not make cigarettes. Moreover, except for Gallaher, Imperial's larger competitors have lost ground in recent years. In 1959 Gallaher's share of the trade, at nearly 30 per cent., was larger than that of any individual competitor of Imperial throughout its history. Gallaher's advance has been made at the expense not only of Imperial but also of Imperial's other competitors.

515. The fall in the number of manufacturers may be explained to some extent by the elimination of small producers of pipe tobacco as the popularity of their products has declined; by the circumstance that a larger unit is able to effect economies in the manufacture of cigarettes as a result of quantity production; and by the increasingly onerous capital commitment required not only for plant and stocks of leaf but also for financing the duty (which the manufacturer has to pay on removal of the leaf from bond and which he does not recover until several weeks after the sale of his product). We are not convinced, however, that the present structure of the industry is due to these factors alone. We see no reason why production units smaller in size than Imperial, or than Gallaher, should not be able to operate on an economic basis if they were able to rely on a steady demand for their products. Public taste has become concentrated, however, on a few proprietary brands of cigarettes. Demand of this kind cannot be built up or sustained without heavy and continuing expenditure on advertising. The experience of Imperial's competitors generally over the past 25 years suggests that it is becoming increasingly difficult for the smaller or medium-sized manufacturer to maintain a steady level of business without quite disproportionate expenditure on brand promotion. Nevertheless, the history of Gallaher in recent years has shown that, given good management and the necessary financial resources, a comparatively small manufacturer can still expand his business by building up demand for a brand to a scale commensurate with the demand for

Imperial's most popular products. It may be that with the growth in consumption of filter tipped cigarettes popular demand will become more varied but, in any event, it appears probable that the bulk of the cigarette trade will remain in the hands of a very few manufacturers.

516. Having regard to our conclusion in paragraph 262, we are called upon to consider whether the conditions which prevail in the case of Imperial (because it has some two-thirds of the trade in the United Kingdom), or all or any of the things done by Imperial as a result of or for the purpose of preserving the conditions, operate or may be expected to operate against the public interest. It is relevant to our judgment on Imperial's present position to consider how that position developed and what use the company has made of its power during the period of its dominance. Other matters which require consideration are the level of profit earned by Imperial, its financial interests in certain other manufacturing and distributing companies, the degree of efficiency of its organisation (with particular regard to the branch system and the number and profitability of brands marketed), and its terms to and relations with the distributive trade (including questions about distributors' margins, direct sale to retailers, the Bonus Agreement and resale price maintenance). All of these matters call for review in order to determine whether the "conditions" as such operate or may be expected to operate against the public interest and some of them may also be considered to be "things done" as a result of, or to preserve, the conditions.

517. Arising from the conclusion in paragraph 263 we also have to consider the practice of resale price maintenance in a wider context. We have found that conditions to which sub-section (2) of Section 3 of the Act applies prevail because nearly all the cigarettes and tobacco supplied in the United Kingdom are supplied at all stages by manufacturers or distributors who restrict competition in as much as they operate this practice. We must, therefore, form a judgment upon the questions of public interest arising from this finding.

(2) The Development of Imperial's Position

518. There is no evidence that those responsible for the formation of Imperial in 1901 set out to monopolise the United Kingdom market, but it was clearly their view that only a much larger unit than any of the businesses which contributed to the amalgamation could hope to offer successful resistance to the competition from American interests which was being experienced at that time. The agreement with the Americans which followed shortly afterwards not only eliminated that competition but also reinforced Imperial's dominant position among British manufacturers through the acquisition of Ogden's Ltd. Imperial says that these early arrangements "laid a foundation on which a powerful and efficient enterprise could be built" but gave "no assurance whatever of continuing strength, and certainly no assurance of a dominant position in the trade". The company's dominant position is attributable, it says, principally to its successful use of the competitive weapons open to any manufacturer.

519. Since acquiring Ogden's Imperial has not absorbed any other substantial competitor.* It has, however, acquired interests in two tobacco manufacturers

* It has recently obtained control, however, through Ardath (U.K.) Ltd., of the manufacture and marketing of most of Godfrey Phillips' brands of cigarettes and tobacco, a matter to which we refer in paragraph 548.

(Gallaher and Ardath Tobacco Co. Ltd.) and in a machinery manufacturer (Molins Machine Co. Ltd.); it has acquired additional interests in the distributive side of the trade; it has developed its own leaf buying organisation and manufactures many of the other materials it requires. In the field of distribution the Bonus Agreements, which make the grant of an additional deferred allowance to distributors conditional on the grant of display facilities to Imperial, were introduced at an early date in the company's history and have remained a feature of its arrangements up to the present. At various times in the past Imperial has been a party to restrictive agreements and arrangements with other traders but these are no longer in force. Some of them—the Martin Agreement for the elimination of coupon trading and the arrangements of the Tobacco Trade Association for collective enforcement of manufacturers' prices and conditions of sale—were long-term arrangements affecting the whole of the cigarette and tobacco trade. Other long-term arrangements—those under which Imperial obtained some preferential treatment for its products from the Savoy Group of Hotels, J. Lyons & Co. Ltd. and the British Automatic Co. Ltd., and the understanding with certain other manufacturers not to install neon signs on distributors' premises—were of much narrower significance. Others were temporary arrangements to deal with particular situations; these included the arrangements entered into before the war to deal with competition from the Walters Tobacco Co. Ltd., those made after the war concerning the introduction of filter tipped cigarettes, and understandings reached from time to time as a result of discussions with other manufacturers and distributors about resale prices and trade terms for cigarettes.

520. Imperial says that though some of the matters mentioned in paragraph 519 have contributed to the efficiency of its undertaking, none of them, except possibly the bonus arrangements, has contributed significantly to the company's dominant position in the trade. It is scarcely necessary for us to determine whether this is so as regards the growth of Imperial's subsidiary interests in the manufacture of materials (see paragraphs 130–139), since we see no reason to criticise the development by the company of a degree of self-sufficiency in this respect and are satisfied that it has not hampered Imperial's competitors in any way. Of the arrangements which have now been brought to an end, those concerned with preferential treatment for Imperial's products (see paragraphs 208–210) and the arrangements about neon signs (see paragraph 247) can have had no material effect. The matters which call for further comment in relation to the development of Imperial's present position are the acquisition or extension of its interests in other manufacturing and distributing companies in the industry, the bonus system and, among former arrangements, the Martin Agreement, the T.T.A., the arrangements concerning Walters and the introduction of filter tipped cigarettes, and the occasional understandings about prices and terms for cigarettes.

521. In 1932, when Imperial bought a controlling interest in Gallaher (see paragraphs 172 and 173) the latter company was not Imperial's principal competitor. It had become a public company only a few years earlier and had not yet acquired the Senior Service or du Maurier brands of cigarettes or the Old Holborn brand of tobacco, all of which have played a great part in the company's subsequent success. We see no reason to believe that Imperial foresaw either the formidable nature of the competition it would have to face from Gallaher or the future value of the investment it was making. Imperial's

motive was to prevent control of Gallaher passing into the hands of the American Tobacco Company, which had already gained a footing in the United Kingdom market by acquiring J. Wix & Sons Ltd. and was believed by Imperial to be negotiating through that company for an interest in Gallaher. Imperial's action was, therefore, taken in order to preserve its own position against increased competition from that quarter. Imperial's interest ceased to be a controlling one in 1946. Both before and since that date Imperial has quite clearly carried out so far as the home market is concerned its undertaking not to interfere in any way in the management of Gallaher's business.

522. Except as mentioned in the previous paragraph we have seen no evidence that any American tobacco manufacturer has seriously contemplated entering the British market on a large scale since 1902. Having regard to the circumstances in which the company was formed Imperial was, no doubt, pre-disposed to fear renewed competition from this source. The acquisition by Imperial of an interest in Gallaher alone could hardly have been sufficient in itself to prevent such an incursion had the Americans been determined to make the attempt. That action was not designed to weaken the competition which Imperial had to meet from British manufacturers and had no such effect. The subsequent growth of Gallaher's business has led to a situation which differs materially from that existing in 1932 and raises issues in relation to the public interest which we deal with in paragraphs 542 to 547.

523. There is no very clear motive for Imperial's acquisition in 1925 of its interest in Ardath (see paragraphs 175 and 176). Ardath at that time had little home trade and it may be presumed that the transaction by which Imperial and the British-American Tobacco Co. Ltd. jointly purchased the equity was principally due to B.A.T.'s initiative. Ardath's home market business, which Imperial manages,* appears to have enjoyed its period of greatest success in the years around 1930 when it practised coupon trading. It has made use of coupons again since 1957 but so far apparently without much success. On each occasion Imperial permitted Ardath to issue coupons at a time when it refrained from practising this method of trading for its own brands (though on the first occasion Imperial eventually issued coupons itself). Whatever Imperial's purpose may have been when it acquired its interest in Ardath, there is some evidence that it came to regard the company as a useful potential weapon against competitors who might use methods of trading which Imperial itself was not willing to adopt (see paragraph 180).

524. Imperial's interests in cigarette and tobacco distributing businesses (see paragraphs 141–158) appear to have little bearing on the development of the company's monopoly position. Imperial does not control, and has not at any time controlled, more than a very small proportion of the wholesale and retail channels of supply. Nor has it used those distributive outlets which it did control to discriminate against the products of other manufacturers. The shareholdings are said to have been acquired for fear that they would otherwise have fallen into the hands of competing manufacturers. Had that been allowed to happen we doubt whether Imperial's trade would have suffered much injury by discrimination against it. The investments, like that in Ardath, have not been very profitable for Imperial. We return to these matters when considering the current situation in paragraph 549.

* Under the recent reorganisation the home business has now been taken over by Ardath (U.K.) Ltd., a wholly owned subsidiary of Imperial (see paragraph 182).

525. The relations between Imperial and Molins have an important bearing on the Machinery reference and are discussed mainly in Part II of this chapter. So far as they are also relevant to the Tobacco reference we comment upon them in paragraph 552. In our view they have probably made only a limited contribution to the development of Imperial's monopoly position.

526. The Bonus Agreement (see paragraphs 238–251) is, as we have said, the only one of the matters mentioned in paragraph 519 which, in Imperial's view, may have contributed significantly to establishing the company's dominant position. The company says, in effect, that such advantage as it may have gained has been obtained by the perfectly proper use of a competitive weapon. We consider the merits of this argument in paragraphs 569 to 573. For our immediate purpose it is sufficient to note that while many of Imperial's competitors have tried to imitate its bonus arrangements none has succeeded in establishing so firm a link between the bonus allowed and the amount of display obtained. Only a supplier who was already in a dominant position could have applied such an arrangement systematically, and we have little doubt that it has helped to preserve Imperial's dominance.

527. The Martin Agreement of 1933 (see paragraphs 63–65) marks the beginning of a period, lasting until about 1956, when the trade was regulated largely by agreement between the leading manufacturers (though during and for some years after the war Government controls were superimposed). Imperial argues that the Martin Agreement itself served to preserve the positions of its competitors rather than its own, and that if there had been no such agreement Imperial would have been compelled to put all its strength into coupon trading. There is considerable force in this argument and it is, no doubt, one of the principal reasons why Imperial's competitors entered into the agreement. Once the agreement was in operation, Imperial quickly regained the share of the market which it had formerly enjoyed, and until 1945 it was paying compensation to its competitors, most of whom lost the business they had gained by coupon trading. At the same time there was close co-operation between the manufacturers in suppressing not only coupon trading but price cutting by distributors (see paragraphs 60 and 61), and this naturally led to discussions and understandings about margins and terms of sale. Imperial says that the measures taken with regard to margins and against price cutting affected all manufacturers alike; each manufacturer remained free to fix his own retail prices. In effect, under Imperial's leadership the period of unrestricted competition was brought to an end.

528. The developments referred to in the last paragraph helped Imperial to consolidate its position. Imperial's action in the case of Walters (see paragraph 68) contributed to the same result. In that case Imperial argues that it met a "new form of competition"—from a cigarette made of cheaper (Empire) tobacco which, though larger than the standard small cigarette, sold at the same price—primarily by successfully marketing a similar cigarette. By the time Imperial acquired Walters that company was, Imperial says, no longer a major competitor. Since the leading manufacturers were concerned to preserve their existing trade in small cigarettes of standard size they agreed that Imperial alone should launch a brand of the new type (Tenner Medium), while Imperial undertook that if it acquired Walters it would not then seek to increase sales of this type. We do not think this explanation justifies the action taken. Walters provided a cigarette for which there proved to be a substantial demand.

It was natural and proper that other manufacturers should try to meet this competition by marketing similar cigarettes but we can see little justification for concerted measures by the leading manufacturers to preserve the market for their own established products. As it happened Imperial obtained some special advantage from these measures because demand for the new type of cigarette remained unexpectedly high until the beginning of the war and Imperial alone was in a position to satisfy it. Manufacture of these brands ceased, as to Tenner Medium in 1949 and as to Walters in 1953.

529. The arrangements in 1949 whereby the leading manufacturers co-operated in introducing filter tipped cigarettes to the market and procuring the necessary machinery (see paragraph 84) do not appear to us to have any significant bearing on the problems with which we are concerned. They were entered into at a time when competition between manufacturers was in any event limited by scarcity of leaf and by Government controls. Imperial contends that if there had been no arrangement it could probably have gained an advantage over its competitors and we see no reason to dispute this.

530. There remain some features of Imperial's organisation and commercial policy over the years on which it is appropriate to comment. Imperial has told us that the circumstances in which it was formed " have had a profound effect on its organisation and structure ". Each of the constituent businesses had a long tradition behind it and was anxious to retain as much as possible of its individuality. Although many changes have since taken place in the company's structure and in particular the number of branches has been drastically reduced, Imperial is still organised, as it was in 1901, in a number of semi-autonomous manufacturing and selling branches of very unequal strength. Imperial defends its branch system on the grounds that it " reinforces the effects of outside competition in stimulating progressive increases in efficiency of manufacture and marketing and in ensuring a constant search for products which will best meet the requirements of the public ". It believes, therefore, that it enjoys the advantages both of internal competition and of large-scale production. The company recognises that it is inherent in its system that some branches will be less successful than others and ultimately may have to be suppressed as uneconomic; it points out that as a result of closing down unsuccessful branches the number has now been reduced to six (of which one does not manufacture) and will be further reduced to four in February 1961.

531. We have noted that there were still eleven branches in 1932 and that up to 1954 this number had been reduced only by one (see Appendix 4). It is, in fact, from 1954 onwards that the more drastic action has taken place. Such evidence as we have suggests that the branches which have now been closed were making little, if any, contribution to Imperial's profits for many years before they were closed. Imperial says it has always been reluctant to close any branch, first because the branch's fortunes might revive, secondly because the transfer of brands to another branch may lead to loss of goodwill and sales, thirdly because it believes in the highest possible degree of internal competition, and fourthly because it feels responsibility towards the employees involved. It is fairly clear that in the 1930's and during and for some years after the war considerations such as these were decisive in the minds of the management. It is arguable that the speeding up of the process of closing branches which has occurred from 1954 onwards is due not so much to a change of policy as to the

fact that the branches concerned were more conspicuously unsuccessful than they had been before. However this may be, we think it significant that when Imperial began to experience more determined and successful competition than it had had to meet for at least twenty years it found that it could no longer afford to maintain its branch structure in all the former diversity. The importance to be ascribed to internal competition must be taken into account when we come to consider the efficiency of Imperial's present organisation (see paragraphs 577–580), but it seems to us to be highly relevant that for many years Imperial was under no strong compulsion to count the cost of retaining its original structure. We think that the branch structure, as it existed up to about 1954, could not have survived for so long had Imperial been faced throughout its history with competition of the kind it faces today.

532. As a natural corollary of the structure adopted at its formation the company continued to market the brands of the component businesses it absorbed. Although there was some co-ordination of policy thereafter, the withdrawal of old brands and the issue of new ones were matters primarily of branch policy. Thus the number of brands marketed by the company as a whole was very large. We are informed that in 1938 Imperial was selling 191 brands of cigarettes and 596 brands of tobacco. By 1960 the figures had been reduced to 57 and 183 respectively. This reduction in numbers is to some extent connected with the closing of branches, many of the least successful brands being those of the least successful branches; but there has also been a considerable pruning of the brands of branches which remain in being. Imperial argues that a brand selling on a very small scale and which when considered in isolation appears to be unprofitable may nevertheless be making a useful contribution towards overheads. We discuss the question of unprofitable brands further when considering Imperial's current policy (see paragraphs 581–584). Whatever view may be taken as to the number of brands being marketed at present, we consider that Imperial's past policy in this respect, like its attitude to the closure of branches, reflected a state of affairs in which it was not under pressure to develop the maximum degree of efficiency.

533. Although in reviewing the history and development of Imperial we have mentioned certain points of criticism, we are of the opinion that, in general, the company has shown responsibility and restraint in the use of its monopoly position. We consider, however, that at any rate from 1933, when coupon trading was brought to an end, until 1954, when the full vigour of Gallaher's competition began to be felt in a free market, the absence of any effective stimulus to efficiency was reflected in Imperial's organisation and commercial policy. The episode of Walters apart, the matters arising from this review which require special consideration are the bonus arrangements and the company's shareholding in Gallaher—both of which have been of long duration and are still current—and any continuing effects on the company's efficiency of its comparative immunity from competition in the past.

(3) The Level of Profit

534. We have calculated the profits earned in certain years by Imperial on its capital employed in producing and supplying cigarettes and tobacco in the United Kingdom, capital being computed on the basis of the historical cost of fixed assets less depreciation at Inland Revenue rates. We have made similar

calculations for other leading cigarette and tobacco manufacturers, but in view of the loss of business suffered by most of them in recent years there is little purpose in comparing their results, except for Gallaher's, with Imperial's.

535. We have also, as in previous inquiries, examined the published results of a wide range of public companies in order to estimate as far as possible the average profits earned by manufacturing industry in general in the relevant years. Since all companies in their financial accounts do not value their fixed assets on a common basis, some values being at historical cost and others at replacement cost or arrived at in some other way, any average figure derived from the limited information given in published accounts is open to criticism if used as a standard with which to compare the results of a particular company computed on a particular basis. Imperial has put forward its own computation of average manufacturing profits, and in paragraph 377 we have set out the results of that method of calculation, as also of a variation of that method, and of the method which we have used in earlier inquiries. None of these methods can be claimed to provide a precise yardstick against which the separately computed results of individual companies can be judged, but in view of the conclusions at which we have arrived the question of the relative merits of these various methods is of purely academic interest and we do not feel called upon to express any views upon them.

536. The profits on capital employed earned by Imperial are, accordingly, compared with those earned by Gallaher and by manufacturing industry generally in the following table:—

	Imperial	Gallaher	Average for Manufacturing Industries		
			By Method 1(*a*)	By Method 2(*a*)	By Method 3(*a*)
	%	%	%	%	%
1949 ..	14·7	N/A	N/A	22·4	18·7
1950 ..	16·3	N/A	N/A	24·8	20·9
1951 ..	15·0	9·6	19·4	25·7	22·2
1952 ..	14·3	10·1	15·4	19·4	17·1
1953 ..	14·4	10·1	16·6	20·2	17·6
1954 ..	14·0	10·8	17·2	20·9	18·2
1955 ..	13·3	12·3	17·3	20·4	18·0
1956 ..	12·8(*b*)	13·0(*b*)	16·5	18·0	16·4
1957 ..	11·8	14·0	15·4	16·7	15·5
1958 ..	13·2	14 approx.	14·1	N/A	N/A
1959 ..	11·2	14 approx.	N/A	N/A	N/A

N/A = not available (see Appendix 6).

(*a*) The percentages computed by Method 1 are based on statistics published in "The Economist", those computed by Methods 2 and 3 on statistics published in "Economic Trends". For further details of the three methods of computation see Appendix 6.

(*b*) If exceptional profit on increase of duty were included these figures would be 14·0 for Imperial and 13·8 for Gallaher.

In the light of these figures, after making all due allowance for difficulties of comparison, it appears that throughout the period under review, whatever method of computation is adopted, Imperial's rate of profit in relation to the capital employed in its cigarette and tobacco business has been lower than average. It is also clear that in the last few years it has earned a lower rate of profit than Gallaher.

537. The fact that Imperial's rate of profit on capital has been consistently lower than the average for manufacturing industry does not in itself afford grounds for concluding that its profits are reasonable from the standpoint of the public interest. As we have mentioned, the circumstances of the tobacco industry are in some respects such as to falsify a comparison with industry at large. The proportion of net current assets to fixed assets is—principally because of payments in advance on account of duty—unusually high, and this exceptional degree of liquidity, combined with the stability of demand for the products of the tobacco trade, suggests that in the tobacco industry a return on capital employed lower than that in manufacturing industry generally might be regarded as acceptable. It might even be said that the special circumstances of the duty payments, along with the comparatively low degree of general risk, make it readily possible to finance the business to a large extent by loan capital without the need to offer the expectation of a relatively high return on equity capital, and indeed it happens to be the case that the fixed interest borrowing by Imperial approximates in amount to the sum locked up in duty.

538. Imperial, however, while agreeing that a lower return on total capital employed is acceptable in the circumstances of the tobacco industry has implied that there are no grounds for saying that any part of such capital should (or should not) be raised by borrowing rather than as equity, and that it would be artificial and academic to prescribe or assume a proportion of fixed interest borrowing. This we accept.

539. It is also possible to argue that Imperial, because of its dominant position in the industry, should be content with a lower return on capital employed than would be appropriate for a manufacturer facing more widespread competition. Imperial is not of course a monopolist in the absolute sense and is indeed at the present time exposed to vigorous and effective competition. None the less, we think that the relative security of Imperial's turnover and its present position of price leadership are factors to be taken into account in forming a judgment on the level of Imperial's profits.

540. Taking into account all the matters considered in paragraphs 536 to 539, we think that the profits achieved by Imperial are not unreasonable in today's conditions. With the recent appearance of really vigorous competition in the industry and the consequent increased exposure of Imperial's operations to the market test (on the assumption that these conditions are maintained), we see no reason to think that its rates of profit in the future are likely to be excessive.

(4) Interests in other Companies engaged in the Home Tobacco Trade

541. Imperial at present owns, directly or indirectly, 42½ per cent. of Gallaher's equity, 100 per cent. of Ardath (U.K.) Ltd.'s, Sinclair's and Bewlay's, and 49 per cent. of Finlay's. Gallaher is a manufacturer, Sinclair is a wholesaler and Bewlay and Finlay are both multiple retailers of tobacco products; Ardath (U.K.) markets its own brands of cigarettes and tobacco in this country though these are manufactured by Imperial.* The managements of Sinclair, Bewlay and Ardath (U.K.), which are subsidiaries of Imperial, are subject to control by the parent company. Gallaher and Finlay are under independent managements.

* As explained in paragraphs 182 and 183, the Ardath business has recently been reorganised. Previously Imperial and B.A.T. each had a 50 per cent. interest in Ardath Tobacco Co. Ltd., its home trade being managed by Imperial and its export trade by B.A.T. Ardath (U.K.) Ltd. has now taken over the home trade of Ardath Tobacco Co. Ltd. and the latter company is to become a wholly owned subsidiary of B.A.T.

542. Imperial's substantial holding in Gallaher, its principal competitor, is by far the most important of these interests. As we have indicated, we accept fully the evidence which both companies have submitted to the effect that Imperial does not interfere in any way in the management of Gallaher and regards itself as bound not to do so in future. We have discussed in paragraphs 521 and 522 Imperial's reasons for acquiring the shareholding in 1932 and have recorded our belief that Imperial at that time was very far indeed from envisaging the situation that has since developed. In the present context we have to consider the effects, not of what Imperial did in 1932, but of the existing situation. Since 1932 Gallaher's business and competitive strength have undergone such a transformation as to attach a significance to the relationship between the two companies entirely different from that created by the original purchase of shares. Imperial now has a large minority holding in the shares of its only really formidable competitor.

543. Imperial submits that the competitive position in the industry has not been and is not affected by its financial connection with Gallaher. Gallaher's progress is not, it says, in any way a consequence of the relationship. Nor would Imperial agree that its keenness to compete with Gallaher is blunted by the consideration that success on the part of Gallaher brings benefits to Imperial in the form of dividend income and capital appreciation of its investment; for it contends that the loss of profit when it loses trade to Gallaher outweighs the return from Gallaher. Imperial recognises, of course, that viewed simply as an investment the holding in Gallaher has been a very profitable one; and it does not consider that the moment has yet arrived when it would be advisable from the point of view of a prudent investor to dispose of the shares. It accepts, however, that its motives are more than those of the ordinary investor and that its future actions will not necessarily be dictated solely by its judgment in that capacity. It contends that there is still a danger that American tobacco manufacturers will attempt to regain a footing in the United Kingdom; since it would view with disquiet competition from this quarter, and also thinks this would be contrary to the national interest, it continues to regard the investment as an insurance against that risk.

544. As to the possible effects of the investment on the competitive position, we think that Imperial's submissions leave a number of considerations out of account. We accept that Imperial would prefer to maintain its own turnover rather than obtain such possible higher return from its investment as a loss of trade to Gallaher might produce. But we think it is also inherent in the present situation that Imperial, if it is to lose trade, must prefer to lose it to Gallaher rather than to any other competitor. Moreover the situation of an investor whose commercial interests as an independent trader may conflict with the interests of the company whose shares he holds might well become untenable. We have no doubt that Imperial gave in good faith its undertaking not to interfere in the conduct of Gallaher's business and that the present management of Imperial intends to continue to observe it. Circumstances could, nevertheless, arise where such an undertaking might be felt to conflict with the interests of Imperial's own shareholders. While we appreciate that it would be difficult to specify the precise effects of either of the considerations we have mentioned, we believe that they must tend to minimise the pursuit of the outright competition which we think desirable. In particular we think that Imperial's

investment in Gallaher has developed into a partial insurance against loss of profit due to loss of trade to Gallaher.

545. Imperial has stated its reasons for refraining from making any public announcement of its holding. Apart from the difficulties—which we do not think insuperable—of keeping the public advised of major changes once the existence of the investment has been announced, the company argues that public disclosure of the shareholding would inevitably lead the rest of the tobacco trade to assume a degree of control by Imperial over Gallaher which does not in fact exist; it goes on to say that " it would be quite wrong for there to be an impression abroad that we in fact in any way control or influence Gallaher's trading policy and that competition between us is in some way blurred and inhibited ". In fact, as Imperial agrees, it is widely assumed and has been repeatedly stated in the press that Imperial owns a large minority of Gallaher's shares, though the exact proportion is not known. We find it difficult to understand in these circumstances why Imperial should regard publication of the true facts as harmful.

546. We are not in a position to judge whether Imperial's view of the " danger " that American manufacturers might wish to gain control of Gallaher is a correct one. We think that more active competition with Imperial would have been beneficial in the past and that it is desirable to maintain the highest possible degree of competition in this industry in the future. We do not agree with Imperial that it would necessarily be contrary to the interest of the United Kingdom if competition were to be strengthened by foreign investment in a British manufacturer.

547. We have indicated in paragraphs 531 to 533 our view that, before it began to experience determined competition from Gallaher, Imperial was not compelled to exert its maximum effort. The company has lost trade to Gallaher in recent years and is now taking steps to recover its position. We consider that the stimulus to efficiency which Gallaher's competition provides might have been even greater if Imperial were not through its investment in Gallaher insured to some extent against the potential loss of profit. Imperial's interest in Gallaher renders less financially serious to Imperial the effect of any increase in Gallaher's share of the market at Imperial's expense, and this might tend to weaken Imperial's incentive to achieve the highest possible standard of competitive effort. In our opinion it is in the public interest that Imperial should be continuously exposed to the most strenuous competition and, although we see nothing improper in the company's attitude in this matter, we think for the reasons given above that the continuance of Imperial's investment in Gallaher operates and may be expected to operate against the public interest.

548. The circumstances surrounding Imperial's investment in Ardath are very different from those we have just reviewed since Imperial actively controls the Ardath business in the home market. As we have mentioned, Imperial appears, at times at any rate, to have regarded the Ardath business as a potential weapon against competitors but there is no evidence that it was effectively used for this purpose. It may be suggested that under independent ownership Ardath might have become a more formidable competitive factor in the market; but this is to suppose that Ardath's experience would in that event have differed from that of the majority of Imperial's independent competitors. On the whole we agree with Imperial's view that its investment in Ardath and control

of the home business have had only a limited effect on the competitive situation. As a result of the recent reorganisation the home and export businesses are now conducted by different companies. The company responsible for the home trade (Ardath (U.K.) Ltd.) is wholly controlled by Imperial; it does not manufacture but markets its own brands which are made for it by Imperial. Ardath (U.K.) is also entering into an agreement with Godfrey Phillips Ltd. under which it will control the manufacture and marketing in the United Kingdom of most of the latter company's brands of cigarettes and tobacco (see paragraphs 185–188). It is expected that manufacture of the Godfrey Phillips brands will be undertaken by Imperial and, in any event, it is clear that Imperial will in future have effective control of the supply in the home market of these brands as well as the Ardath brands. The home business of Godfrey Phillips, like that of Ardath, has not been successful in recent years, and this is no doubt the main reason why the two companies are virtually amalgamating their home cigarette and tobacco businesses. Although the initial approach was made by Godfrey Phillips the agreement may be regarded from Imperial's point of view as one of the steps it is taking to put its investment in the Ardath business on a more profitable basis than in the past. We think that Imperial's control of that business in the home trade, in itself, does not have, nor is likely to have, any material effect on the public interest, but that, for reasons we mention when considering Imperial's position as a whole (see paragraph 587), it is desirable that the connections between Imperial and Ardath should be known.

549. Imperial's interests in Sinclair, Bewlay and Finlay do not appear to us to be of serious significance. They do not give Imperial control of any substantial part of the distributive channels on which its competitors have to rely. There is no evidence whatever that Imperial has ever desired to obtain such control or that it is likely in future to regard its holdings as the nucleus of a more comprehensive distributive system to be built up under its control. We have had no complaints of discrimination against other manufacturers by Sinclair or Bewlay, whose position as subsidiaries of Imperial is public knowledge, or by Finlay, whose connection with Imperial is perhaps less well known. Although the two companies which Imperial controls have not proved very profitable investments, steps have been taken recently to improve their efficiency. Sinclair is, we understand, now operating on a reasonably profitable basis. As regards Bewlay, Imperial submits that its business is of an exceptional kind because it remains virtually a specialist retailer of tobacco goods and smokers' requisites and a number of its best shops occupy expensive sites. Imperial regards Bewlay's specialist shops as a medium for advertising smoking in general; " to the extent that they do that, that is of benefit to the whole trade and since we have a large share of the whole trade, it is to our benefit ". We think that Imperial's investments in these three distributor companies, like its investment in Ardath, do not have, and are not likely to have, any material effect on the public interest. The question of the desirability of public knowledge of such connections, which is pertinent to the case of Finlay, is referred to again in paragraph 587.

(5) Interests in other Companies connected with the Tobacco Industry

550. Imperial has four subsidiary companies which make packing materials and cigarette paper. As we have indicated in paragraph 520 we find no grounds for criticism of Imperial in this connection. The other interests of Imperial which call for comment are those in the British-American Tobacco Co. Ltd.

and in Molins. B.A.T. manufactures cigarettes and tobacco in the United Kingdom and overseas but does not sell in the United Kingdom. Imperial owns 28½ per cent. of its equity. Molins' activities as a manufacturer of machinery for the cigarette and tobacco industry are fully described in this report. Imperial owns 25 per cent. of its equity, another 25 per cent. being held by B.A.T.

551. Imperial's minority interest in B.A.T. derives from the arrangements made in 1902 with the American tobacco manufacturers, which also gave rise to the agreement between Imperial and B.A.T. which is still in existence (see paragraphs 51, 52 and 102–104). We think that the effects of this shareholding and of the agreement cannot properly be considered apart from one another, but we are precluded from pronouncing upon the agreement because it is registered with the Registrar of Restrictive Trading Agreements. Furthermore, B.A.T.'s trade is conducted outside this country and is, therefore, beyond the scope of our reference. In these circumstances we are not called upon to express any opinion about the bearing upon the public interest of Imperial's holding in B.A.T.

552. Imperial's interest in Molins is a matter we have to take into account in relation to the supply of machinery (see paragraphs 600 and 601). Here we are concerned with that interest only in so far as it may be relevant to Imperial's dominant position as a supplier of cigarettes and tobacco. To the extent that it has assisted Molins to develop and supply machines which many tobacco manufacturers appear to regard as the best of their kind this financial relationship has benefited the whole of the tobacco industry. It is true that during the period of development Imperial and B.A.T. had the right to claim exclusive use of new machines produced by Molins, a right which Imperial exercised extensively until about 1945 and thereafter less freely up to 1957. During the greater part of this period, however, Molins did not occupy the position of pre-eminence in the field of machinery that it now enjoys, and there is no evidence that any competitor of Imperial has been seriously hampered through inability to buy machines from Molins. We do not think that Imperial is to be criticised for acquiring its financial interest in Molins or for taking steps to ensure that if the investment proved a successful risk it should have some priority in benefiting from the results. Nor do we think that the public interest has suffered or is likely to suffer by reason of Imperial's holding in Molins.

(6) Distribution Policy

553. The principal features of Imperial's existing system of distribution which call for comment are, first, the extent to which it trades directly with retailers rather than through wholesalers, secondly, the level of the margins it allows to its distributors, thirdly, the company's practice of fixing and maintaining the resale prices of its products at all stages of supply, and fourthly, its practice of making an additional allowance by way of bonus to distributors who enter into an agreement under which they undertake, *inter alia*, to allow certain display facilities to Imperial.

554. None of these matters can be considered entirely in isolation. The company's policy on margins is, obviously, closely connected with its policies as to trading with retailers and as to the additional margin represented by the bonus. Moreover, unless resale prices are maintained the original supplier can

have no control over margins. It may be noted also that one of the undertakings given by distributor signatories of the Bonus Agreement is to maintain Imperial's prices. These four matters, therefore, need to be reviewed both individually and collectively.

555. We see no reason why Imperial should not trade direct with retailers to whatever extent may be compatible with maximum efficiency and minimum cost. Imperial, while observing that the " break-even point " cannot be determined precisely, tells us that its own studies of the question have led it to believe that retailers who can take 10,000 or more cigarettes at each delivery can be served most economically by direct sale rather than by sale through wholesalers. We are not in a position either to confirm or to dispute this opinion. In a fully competitive situation each manufacturer would be under compulsion to seek the right economic balance between sale to retailers and sale through wholesalers as a means of minimising his costs. In the tobacco industry competitive forces certainly affect the position. Imperial has told us that " the obtaining of direct accounts with retailers has always been an important element in the active competition which exists in the trade ", and that " if we ceased to have direct contact with . . . smaller outlets through our sales representatives we should be obliged on competitive grounds to canvass many of them—even though their orders were placed through wholesalers ". This means, in effect, that Imperial —and probably most of its competitors as well—regards some part of the cost incurred in maintaining accounts with retailers as a sales promotion cost rather than an inevitable distribution cost.

556. There is nothing unusual or improper in this attitude. If the " active competition " to which Imperial refers were primarily price competition there would be little, if any, risk that direct trading with retailers could be pursued by any manufacturer to a point where it became economically unjustifiable. In the present situation in the industry, where price competition between the leading manufacturers is limited and they are prepared to spend heavily on sales promotion, there is some risk that all of them may adopt methods of selling which though well designed to increase sales are detrimental to low-cost distribution. The rise in the proportion of sales going direct to retailers which has occurred since 1955 (roughly from 50 per cent. to 65 per cent.) is explained by Imperial as due to the operation of a free market at the end of the period of control in correcting a pattern of distribution which had become out of accord with current trading conditions. The average quantity sold per retail outlet was much higher in 1955 than in 1939 because the number of retail outlets had during the interval fallen by 20 per cent. and consumption had increased. In normal circumstances this would automatically have led to an increase in direct trading, but this did not happen during the period of control because few new direct accounts were then being opened. While the removal of controls partly explains the increase in direct trading since 1955 we think this increase is also attributable to keener competition in the industry during this period. We think that Gallaher has probably been at least as active as Imperial in encouraging direct trading and that this is not a practice stemming from Imperial's monopoly position. We discuss in paragraph 557 the effect of this tendency on the position of the wholesaler. In general we have no reason to think that direct sale by manufacturers to the larger retailers in inconsistent with efficient distribution.

557. That both wholesalers and retailers would prefer larger margins than those they are allowed is only to be expected. It is particularly understandable

that wholesalers may feel some sense of grievance about their position. They have seen the large manufacturers tend increasingly to by-pass them in distributing their products, and most of the smaller manufacturers, who could not have dispensed with their services, go out of business. Their status as wholesalers receives no recognition in the terms on which they are allowed to buy since they pay the same price as retailers buying direct from a manufacturer, subject only to quantity discounts which are open to both wholesalers and retailers. The retailer who buys from a wholesaler must, therefore, expect to pay a higher price than if he is able to buy direct from the manufacturer. As a result the function of the wholesaler tends to be confined to providing a service for the small retailers who do not qualify for direct accounts with manufacturers.

558. Specialist retailers, and those for whom the sale of tobacco goods is something more than a side line, support the wholesalers' arguments up to a point. The National Union of Retail Tobacconists, which is fairly representative of this class of retailer, says that the manufacturers' price structure leads to the proliferation of retail outlets, the wholesaler having no option but continually to seek new customers in order to maintain his business (see paragraph 417). It thinks, therefore, that wholesalers should be able to sell on the same terms as manufacturers, and it goes on to say that the costs of both manufacturers and retailers could be reduced by channelling trade through specialist outlets; in particular a larger turnover would enable the specialist retailer to manage on a smaller margin. The N.U.R.T. does not condemn direct trading with retailers, though it has told us that its members would probably not object to buying from wholesalers if they were able to do so on the same terms as the manufacturers offer them. We do not think that these various proposals amount to a coherent plan for an alternative price structure, but they do bring out the genuine feeling on the part of the more highly specialised retailers that they, like the wholesalers, are not encouraged to perform the kind of service for which they believe they are especially equipped. Both classes of trader think, in effect, that distribution would be more efficient if a higher proportion of supplies passed through their hands; both think that if their turnover is to be reduced their margins should be raised.

559. Arguments such as these are naturally put forward from time to time by groups of traders whose livelihood depends to some extent on their ability to drive a bargain with their suppliers. Although Imperial's point of view about many of these matters differs from that of the distributor, it says its relations with the distributive trade are on the whole good. The company says it endeavours, while keeping the retail price at a minimum, to provide the wholesaler and retailer with a reasonable and fair return for the services they perform. On the other hand it does not consider itself to be under an obligation to fix its margins with a view to ensuring that either a wholesaler or a retailer can earn a living by trading only in tobacco goods. Nor does it think the interests of the consumer would be better served by a policy which would tend to restrict the number of retail points of sale. It agrees that the margins it provides, if expressed as percentages of selling prices, appear low by comparison with many other industries. (These margins are approximately 10 per cent. for retailers—though rather lower if they buy from wholesalers—and between 2 and 3 per cent. for wholesalers—see paragraph 203.) It argues, however, that any such comparison is vitiated by the incidence of customs duty in the price, which has caused the manufacturers to grant terms of credit which have the

effect of financing a substantial part of their customers' stocks. Although the retailer's margin before the war was approximately 20 per cent. of his selling price, Imperial contends that the subsequent reduction is wholly justifiable for this reason, and it has put forward certain estimates designed to show that the increased cash yield of the margins since 1938 is approximately in line with the average increase in distributors' costs (see paragraph 468). It also suggests that rapid turnover and ease of handling are factors which justify a relatively low margin of gross profit, and has drawn attention, by way of illustration, to the analysis of the net profitability of wholesaling tobacco goods and other lines which was undertaken by Sinclair (see paragraph 374).

560. On the whole we find Imperial's attitude to this matter a reasonable one. The handling of these goods is not a service that calls for any great degree of skill. We agree that it should not be Imperial's aim to restrict it to a specialised class of trader. We think that the public prefers to be able to buy cigarettes and tobacco at as many points as possible, and that a policy which enables this service to be provided is not objectionable so long as it can be carried out economically and with due regard to the distributor's claim to a proper return. We do not think that the level of margins actually allowed could be said to be excessive. They appear, nevertheless, to be sufficiently attractive to induce a large number of persons to stock and sell the goods. Though we appreciate the difficulties of the specialist trader, it has to be recognised that the demand for his services has been declining over a long period, owing principally to the increasing demand for packed cigarettes and tobaccos of well-known brands. We think that there are no grounds for saying that Imperial should offer them higher margins or a greater volume of business with a view to arresting this trend. Leaving aside the question whether there is anything undesirable about the practice of fixing distributors' margins—a matter which we discuss in paragraphs 561 to 568—we do not think exception can properly be taken to the level of margins at present operating.

561. By prescribing and enforcing the prices at which its products shall be sold at every stage of supply Imperial ensures, first that the public pay uniform prices for identical products without regard to the particular cost of conveying the product to the particular customer, and secondly that each distributor's gross profit per unit sold is fixed without regard to his particular costs. Imperial argues that the practice of maintaining resale prices is of benefit to the distributor because he can rely on a known and reasonable rate of profit and on protection against " loss leader " tactics by his competitors; to the manufacturer because sufficient numbers of distributors are encouraged to stock and sell his goods; and to the public, which likes a standard price and a large number of buying points. An additional argument which has been advanced is that the risks of allowing credit to distributors would be greatly increased if their selling prices and margins were not protected. While some distributors might, even in face of the withdrawal of credit facilities, be able to cut prices, others would find that they would need a higher margin to finance their stocks and, if they could not secure it by increasing prices, they could not continue to trade and the number of retail outlets would to that extent be reduced.

562. We have not invited other manufacturers or the distributors to submit evidence as to the merits of this practice, but it is clear that it has the general support of the industry in which, in this country, it is applied without significant exception. It is not a practice peculiar to this industry. It has been found to

operate in a number of industries which the Commission have already investigated, and has also been reported upon as a general practice on a number of occasions, the most recent comprehensive report on the subject being that made in 1949 by the Lloyd Jacob Committee.* Since that report was made resale price maintenance as formerly practised in many industries, including the cigarette and tobacco industry, has been modified in conformity with Part II of the Restrictive Trade Practices Act, 1956. This Act on the one hand prohibited agreements for the collective enforcement of conditions as to resale prices and on the other hand strengthened the powers of individual suppliers to enforce their conditions by legal proceedings. Each of the principal cigarette and tobacco manufacturers prescribes the prices at which his products shall be bought and sold by any subsequent distributors; they were doing so before 1956 and have continued to do so since. Until 1956, however, the relevant conditions of sale were collectively enforced by the body of manufacturers and distributors represented in the T.T.A. Since 1956 there has been no collective agreement on the subject of resale price maintenance and enforcement has been a matter for the individual manufacturer. As we have explained in paragraph 263 the conditions we have to consider in their bearing upon the public interest arise from the fact that nearly all the cigarettes and tobacco supplied in the United Kingdom are supplied at all stages by persons who practise resale price maintenance and who are therefore restricting competition in as much as each of them acts in such a way as to prevent price competition in the supply of particular brands.

563. If this practice were terminated each distributor would be free to determine and vary his own margins according to his knowledge of his costs and of his own particular market. The ostensible advantage would be more intensive competition among distributors, leading in turn to an increased effort to reduce costs. In theory at least, the lower cost distributors would be able to reduce their selling prices and expand their turnover, while those with higher costs might be compelled to find ways of reducing them or to be satisfied with lower margins or to stop selling these goods or, if the services they offered were sufficiently attractive to the public, to charge higher prices to recoup themselves. Thus the public would have some choice of prices for identical goods, and would buy from the higher-price suppliers only in so far as they were prepared to pay for the services offered; the general tendency would be to encourage purchase through the most economical channels and, therefore, to reduce the total cost of distribution. Moreover, manufacturers, who with few exceptions do not at present compete with one another in price for products of the same class, might be more willing to vary their own selling prices if there were no longer any standard retail prices.

564. There are, however, several factors to be taken into account which, in this industry, may detract from the apparent benefits of terminating resale price maintenance. Principally because of the high rate of customs duty, distributors' margins in this trade account for a lesser percentage of the end price than usual. We have already concluded that the margins ruling are, in general, not excessive (see paragraph 560). We think in these circumstances it might well be the case that any reduction in price which even the most efficient distributor could make while still trading on an economic basis could only be small. One of two results might then be expected to follow. On the one hand the public might not think it worth while to seek out the "cut-price" shop

* Report of the Committee on Resale Price Maintenance: Cmd. 7696, June 1949.

for the sake of a small cut. On the other hand if a sufficient number of smokers took their custom to the "cut-price" shops there might be a substantial reduction in the number of retail outlets. It might be said that the advantages gained by some smokers through reduced prices were counter-balanced by the inconvenience caused to others by a reduction in the number of sources of supply and by the possible damage to those engaged in the trade generally.

565. Another point that needs consideration is the possible emergence of "loss leader" selling. Cigarettes are sold in a very large number of shops and in most of them the cigarette turnover is small compared with the turnover in other goods. It is not improbable that some retailers, if free to do so, would sell some cigarettes at prices below cost for the purpose of attracting customers into their shops. We do not suggest that there is any impropriety in following this practice but we think that there are two reasons why, so far as this particular industry is concerned, the argument based upon it cannot be ignored. In the first place, for the reasons mentioned above, cigarettes lend themselves more than most commodities to the use of such methods. Secondly, if they were to be used at all they would be used principally by way of cutting the prices of the most popular brands. The effect would be to increase the sales of these brands to the detriment of other manufacturers. In practice this might well mean that Imperial in the first place, and Gallaher secondarily, would benefit at the expense of other manufacturers. We do not think it would be desirable to weaken the competition Imperial has to meet from other manufacturers for the sake of intensifying competition in the distributive trade.

566. Imperial, as we have mentioned, has also suggested that if distributors could no longer rely on fixed margins the manufacturers might have to reconsider their terms of credit, since the incidence of bad debts might be greatly increased. This again is a consideration which could be more important in this trade than in most others, because the value of retailers' and wholesalers' stocks, financed at present by the manufacturers, is at all times very high owing to the level of the duty. Any considerable withdrawal of credit on the part of manufacturers would presumably have to be accompanied by an increase in distributors' gross profits to allow for the cost of financing their own stocks. It is unlikely that all the individual distributors could borrow as cheaply as the manufacturers, so that the total cost of financing stocks by distributors might well be higher than it is at present. We doubt whether the withdrawal of resale price maintenance would be a determining factor in the granting of terms of credit but in so far as this may be so we think that the effects of terminating the practice might be disadvantageous.

567. In weighing the arguments set out above consideration must be given to the effect of Imperial's position as the dominant supplier, even though we are satisfied that the policy of maintaining resale prices has not been adopted for the purpose of preserving that position. Thus it may be argued that Imperial can, in effect, determine the method of retail trading for the great bulk of the supply, and that it may be considered a disadvantage from the standpoint of the public interest that opportunities for doing business on terms other than those at present imposed should be so narrowly limited, since this produces uniformity and rigidity in trading methods to the detriment of experiment and innovation in distribution.

568. On a balance of the foregoing considerations we conclude that in this trade (with which alone we are concerned), and so long as competition between

manufacturers continues on the present scale, resale price maintenance does not, either as a practice of Imperial or generally, operate against the public interest nor may it be expected to do so.* We wish to emphasise that this conclusion relates only to the cigarette and tobacco industry and must not be taken to imply any judgment on the desirability of the practice as applied in other industries.

569. As to the linking of bonus payments with the grant of display facilities, Imperial says that the practice originated as a means of giving customers a share in the company's prosperity but is also regarded as " a competitive weapon of some importance ". It argues that it has not been a decisive weapon nor has it been abused; it is intended to offer an inducement to distributors, over and above their normal margin of profit, to stock and promote the sales of Imperial's products and to ensure that the company is given a reasonable share of such point-of-sale display as is devoted to tobacco goods. Imperial says that the principle of " balance " in display, as applied by the company in practice, although preventing the signatory distributor from giving to competing manufacturers more than a certain share of the display he devotes to tobacco goods, does not operate unfairly against those competitors. In support of this submission it tells us that a sample survey undertaken in 1958 showed that the average proportions of display given to Imperial's goods by traders who were signatories of the Bonus Agreement and by those who were not were 67 per cent. and 56 per cent. respectively (see paragraph 476). These figures show, it is argued, that the proportion of display stipulated by Imperial for the purpose of bonus (50 per cent.), besides being lower than Imperial's share of the trade, is below the average proportion of display which traders tend to give to Imperial in their own interests. The bonus, it is said, forms a very small part of the average margin—about one-twentieth for retailers; and since other manufacturers allow a roughly equivalent bonus the distributor does not lose if he sells more of their products and less of Imperial's. Imperial adds that it is open to any competitor to buy the right to predominant display by offering a distributor the equivalent of the amount of bonus he would lose if he were to abandon his agreement with Imperial. While agreeing that the obligations of the distributor signatory in relation to display are not precisely defined in the agreement, the company thinks there is little or no danger that he will give more than is necessary to qualify for his bonus for fear of giving less; it says that its own interpretation of the obligations is well understood by its competitors, who are only too ready to correct any misunderstanding on the part of a distributor.

570. So far as we can judge Imperial does not obtain, on average, a share of the space allotted by distributors to display of tobacco goods which is larger than the company's share of the trade; it may well be smaller. The value of display cannot, of course, be measured solely by the proportion of space occupied. By interpreting the agreement to mean not only that it must have 50 per cent. of the display but that it must have preference for " centre displays " (see paragraphs 245 and 246) Imperial does, we think, effectively ensure that more than half of the value of signatories' displays accrues to the company. The answer to the question whether Imperial's share of display, in terms of real advertising value, is in line with its share of the trade, or above or below it, is, therefore, rather more open than the company has suggested, but it is not a question that we can or need to answer.

* See Note of Dissent by Professor Allen regarding resale price maintenance (paragraphs 612–618).

571. Point-of-sale display is, of course, a valuable advertising medium. It is natural and proper that manufacturers should compete for their shares of display. They can do so only by offering rival inducements to the distributors who control it. Imperial, however, does not pay for display by amount. It pays for a proportion of display; that is to say it ensures that if a competitor is given a good display its own will be still better, and conversely that if its own goods are poorly displayed its competitors will receive worse treatment. The effect of this, over a high proportion of the most valuable retail display, is that the division of display facilities between Imperial and other manufacturers tends to become stabilised, and it therefore appears to us to be a device which does have some restrictive effect on competition. We do not think that the artificial division of such facilities is compatible with free competition between manufacturers. Manufacturers in competition with one another require to be free to conduct concentrated advertising campaigns at particular times and in particular places. The effect of Imperial's bonus arrangements appears to us to be that that company is in a position to use a majority of the most desirable point-of-sale display space and deny it to its competitors.

572. There is no doubt some force in Imperial's argument that it is open to its competitors to buy these facilities at roughly the price that Imperial pays. But we think this argument leaves out of account some of the effects of Imperial's dominant position in the industry. Imperial's competitors themselves allow a bonus to distributors which is about equal to Imperial's bonus. They do so primarily because they could not hope to compete with Imperial unless their terms to distributors were, in total, at least as good as Imperial's. Though they do their best to obtain some minimum of display in consideration of the bonus they allow, none of them has been able to make this a firm condition of the allowance. Thus any competitor of Imperial who bought a predominant share of display by compensating the distributor separately for the loss of Imperial's bonus would in effect be making an extra payment for facilities which Imperial obtains by allowing no more than the equivalent of the normal trade terms allowed by other manufacturers. Moreover, he would have to compensate the distributor over a considerable period even if he did not need the display facilities over the whole of it. This situation arises because only a manufacturer in a dominant position could successfully have operated a scheme such as Imperial's.

573. Imperial's bonus scheme therefore limits the extent to which competing manufacturers can obtain display facilities. This is a clear case of restriction of competition and in view of the importance we attach to strenuous competition in this industry we conclude that the scheme operates and may be expected to operate against the public interest.

574. Our review of the four features of Imperial's system of distribution mentioned in paragraph 553 has not led us to make any substantial criticism except in relation to the bonus scheme.* It does not appear to us that abandonment of that scheme must imply a radical reconstruction of the whole of the system. The system considered as a whole is, we think, reasonably efficient and economical and, with the exception we have mentioned, does not disclose any undesirable use of monopoly power.

* See Note of Dissent by Professor Allen regarding resale price maintenance (paragraphs 612–618).

575. We should also refer to another scheme operated by Imperial in relation to point-of-sale advertising. In selected cases Imperial is (independently of the bonus scheme) prepared to dress the windows of a distributor without payment for the service, provided that 75 per cent. of the display is given to Imperial (see paragraphs 233 to 235). This arrangement appears to us to be a legitimate method of advertising Imperial's own goods, paid for in services outside normal trade terms, and is therefore unobjectionable.

(7) Imperial's Monopoly Position as a Whole

576. Our review of the development of Imperial's monopoly position has led us to conclude that the absence of the stimulus of effective competition was reflected for many years in the company's organisation and commercial policy but that in spite of certain points of criticism Imperial has exercised responsibility and restraint in making use of its power as a monopolist (paragraph 533). In examining certain features of the existing position we have also concluded that Imperial does not earn a rate of profit which is so high as to be contrary to the public interest and, in the conditions of present-day competition, is not likely to do so (paragraph 540); that it is contrary to the public interest that Imperial retains its substantial investment in the equity of Gallaher (paragraph 547) but that its interests in Ardath, Sinclair, Bewlay and Finlay are of little significance (paragraphs 548 and 549); that its interests in Molins and in companies making packing materials and cigarette paper are unobjectionable (paragraphs 550 and 552); and that its distribution system is unobjectionable* except for the bonus arrangements, which are contrary to the public interest (paragraphs 573 and 574).

577. We have mentioned (in paragraph 531) the drastic reduction in the number of Imperial's branches which has occurred from 1954 onwards and recorded our opinion that this is connected with the intensity and success of the competition experienced recently. By February 1961 the branches will consist of Wills, Player, Ogden and the newly formed Churchman, Lambert and Ringer branch. As reorganised, therefore, the company will consist of the two principal and two smaller branches. In recent years the Player branch has been responsible for nearly half the company's sales and the Wills branch for another 40 to 45 per cent.

578. Imperial, as we have mentioned, defends its branch structure on the ground that internal competition is a stimulus to efficient manufacture and marketing. It is clear that the branches are marketing products which compete with one another as well as with the products of manufacturers other than Imperial. Although the small branches do not cover the whole of the field there is no exclusive allocation of any part of the field to particular branches, either geographically or by type of product. Nevertheless, competition between branches is regulated to some extent by central control, as described in paragraphs 115 to 126. Imperial has told us that " our objective in the whole of this control of the company from the centre is to leave as much freedom of effort in manufacture and in selling and cost control to our branches [as practicable] while endeavouring from the centre to look at the whole company picture and to ensure that as a group we get the maximum benefits we can from our collective bargaining power . . . in terms of purchasing, finance and so forth ". The company goes on to say that as a result of central control " each brand brought out by each branch at a price level which competes should yield a gross profit margin roughly

* See Note of Dissent by Professor Allen regarding resale price maintenance (paragraphs 612–618).

comparable with the company standard at that price. That means that we are putting each branch in the position of being able to compete in terms of the value offered in the product equally ".

579. As we have explained in paragraph 349 the standard gross profits are not rigidly enforced, and it is accepted that gross profits on brands of the smaller branches and on those with a small turnover may be rather below the level for the better-selling brands. In as much, however, as each brand is expected to earn a certain minimum level of gross profit, the system may be presumed to offer some incentive to any branch whose manufacturing costs are high to find ways of reducing them. Apart from this it does not appear that Imperial values inter-branch competition primarily as a means of providing comparisons to indicate ways of reducing costs. Nor indeed would the branch system be necessary for such a purpose so long as the company continued to produce at a number of factories. The company in its explanations appears rather to place the emphasis on market competition between the branches. We are told that, although advertising expenditure is subject to approval by the Executive Committee, the branches' proposals are normally approved provided they seem reasonable in relation to brand gross profits and sales prospects, and that " there is very wide scope for Branch initiative in the advertising field ".

580. The merits claimed for the branch system are not susceptible of proof or disproof. We have already expressed the opinion that in the past the survival of numerous branches could be attributed to the absence of external competition. We think that some of the branches were retained partly out of reluctance to disturb a long-established structure and partly for fear of diminishing the company's share of the total market, though not all branches were profitable. Imperial's position was such that it could maintain relatively or wholly unprofitable branches and yet continue to earn, for the company as a whole, a level of profit which it regarded as sufficient. According to our computation of profits from 1951 to 1957 the Player branch earned a substantially higher rate of profit than the undertaking as a whole, as to a lesser extent did the Wills branch. Competition between the branches may provide some incentive to effort and enterprise, but in our view internal competition is at best a poor substitute for real competition and it is perhaps significant that the recent emergence of powerful outside competition has in fact caused Imperial to make very considerable changes in its branch structure. There can be little doubt in our opinion that the result of these changes must be an improvement upon the structure that existed up to about six years ago.

581. Much of what has been said on the subject of the branch system is also relevant to the question of the number of brands which the company markets. In March 1960, Imperial was selling 57 brands of cigarettes and 183 brands of tobacco (as well as many types of loose tobacco). The numbers, as we have shown (paragraph 532), represent a substantial reduction from the corresponding figures for 1938. In 1957 about 91 per cent. of the company's cigarette sales were accounted for by four brands and about half its tobacco sales by six brands (see paragraphs 368 and 370). The four leading brands of cigarettes earned about 93½ per cent. of the total profit on cigarettes; the remaining brands were therefore not all unprofitable though we found that a number of them incurred net losses. The six leading brands of tobacco, however, earned a profit of £350,000 although the company's total profit on tobacco was only £108,000; of the remaining brands more than half incurred losses.

582. Although some brands of cigarettes are unprofitable, the small-selling brands as a whole contribute to the company's profits. The position with regard to tobacco brands needs to be examined more closely, first because, as we have shown, most brands have been incurring losses which in aggregate have offset a high proportion of the profits earned by the few successful lines; and secondly because tobaccos as a whole have been earning a much lower rate of profit than cigarettes. We have noted in this connection the complaints made to us by one or two small tobacco manufacturers to the effect that Imperial fixes prices for its tobacco brands which are " uneconomic " but which other manufacturers must, in practice, follow; the complainants infer that Imperial is able to do this by subsidising its tobacco trade out of its profits on cigarettes.

583. Imperial argues that the principal reason for the relative unprofitability of tobacco is that the trade has for many years been a declining one. Although there has been some increase in demand for tobacco for hand-rolling of cigarettes this is more than offset by the fall in demand for pipe tobaccos. Moreover, pipe smoking tends, we are told, to be increasingly concentrated among older people, many of them of limited means. For many years, therefore, Imperial has had to face the problem of deciding as a matter of commercial judgment whether price increases which appeared to be justified by increases in costs would only result in such a further loss of turnover as to reduce rather than increase the profitability of the tobacco business. In these circumstances the company has charged the prices it believed the traffic would bear, and in its judgment tobacco will not bear prices which yield the same level of profit as can be earned on cigarettes.

584. These arguments appear to us to be reasonable. We do not think that Imperial can be expected to abandon its trade in pipe tobaccos so long as there is any significant demand for them, but we recognise that the trade is not a buoyant one and is scarcely likely to be a very profitable one for any manufacturer. We doubt, therefore, whether the small manufacturers whose complaints we have mentioned would find that they could afford to charge higher prices even if they felt free to do so, and we do not think that Imperial is to be criticised on this score. The company says that the large number of brands marketed is due principally to the fact that there are some twenty types of tobacco, each catering for a different taste on the part of the smoker, and that each type is made in a number of different qualities at different price levels. Whether the number is justified at any given moment is, we think, a matter of commercial judgment which the company alone is in a position to decide.

585. In the instance mentioned in paragraph 582, what was represented to us by one or two witnesses as being the result of undue exercise of monopoly power on the part of Imperial appears in fact to be largely a consequence of factors which are outside Imperial's control. The same may be said of many other representations which have been made to us. The criticism received during this inquiry has been large in volume though, for the most part, moderate in tone. Some of it is directed against particular practices of Imperial, such as the bonus arrangements, trading with retailers, or the margins allowed to distributors; we have taken these representations into account in dealing with the arguments about those matters. Some of the criticism, however, is not focussed particularly on Imperial but either is directed towards the larger manufacturers in general or consists rather of complaints that developments in the industry are to the disadvantage of the witnesses in question. We have drawn attention

in paragraphs 514 and 515 to the continuing process of concentration in the manufacturing industry, which is not associated with any increase in Imperial's share of the trade. We think much of the complaint and criticism is a result of this process rather than of Imperial's dominant position; this applies especially to the representations from manufacturers and former manufacturers, who say that they cannot compete with the "big combines", and to those from leaf merchants, whose trade has diminished with the elimination of the many small manufacturers who formerly depended upon their services.

586. In spite of these criticisms, therefore, we have formed the view that Imperial continues to observe restraint in exercising the power derived from its still dominant position in the trade. We think this restraint is evident in its policy on prices and profits and in its responsible attitude to the rest of the industry. Even in the matter of the bonus although we have found grounds for criticism we think we should also record that the company appears to have been more accommodating in recent years than formerly; it has made some effort to meet the objections of its competitors and has enforced its agreements less stringently. Although we may not agree with Imperial's views at all points we are satisfied that the company has long been conscious that because of its dominant position it must pay special regard to the public interest. Our own criticism is rather that during the long period of its dominance its structure and commercial policies have not been designed to achieve the maximum degree of efficiency. Successful competition from Gallaher has caused Imperial to make some radical changes and we believe that the company is now better equipped to meet competition from this or any other quarter than it was a few years ago.

587. A question which calls for some further comment before we record our findings on Imperial's monopoly position is that of the disclosure of its substantial minority interests in certain other companies in the industry. The reasons advanced by Imperial for not making any public announcement of its holding in Gallaher (see paragraph 545) also apply to its interests in Finlay, Molins and Ardath Tobacco Co. Ltd. It follows, of course, from our conclusion that Imperial's retention of its holding in Gallaher is contrary to the public interest that we think the existence of that holding should be known. In any event we consider it desirable that unless there are very compelling reasons to the contrary the full extent of the interest of a monopoly supplier in the industry concerned should be known, and we do not think that Imperial has advanced any such reasons.*

588. What we have called, for convenience, Imperial's "monopoly position" has been, over the past 50 years, a position in which the company's share of the total home trade in cigarettes and tobacco has varied roughly between 60 and 80 per cent. Its share at the present time does not greatly exceed 60 per cent. and the competition it is now experiencing is probably more intense and certainly more concentrated than at any time in the company's history. The competition provided by Gallaher in recent years is a welcome development. We consider that a situation in which there are two very large manufacturers competing with each other is preferable to the former position where Imperial had no competitor of comparable stature; competition from Gallaher has

* So far as Ardath is concerned the relationship which Imperial preferred not to disclose—namely, that with Ardath Tobacco Co. Ltd.—will shortly cease to exist. Imperial has not, as far as we are aware, yet publicly disclosed the fact that Ardath (U.K.) Ltd. is its wholly owned subsidiary (see paragraph 182).

already led Imperial to put its organisation on a more economical basis. This is not to say, however, that the present situation in the industry is an entirely satisfactory one.

589. Imperial has submitted that the decline in the number of its competitors is due to forces largely outside its control; that its predominant position is due principally to its successful use of competitive weapons which are open to any manufacturer; that outside competition is nevertheless active and effective; that the existence of competition within the company is an important additional safeguard for the public interest; that it has exercised its power with moderation and has not impeded its competitors unfairly; and that it has been active in promoting the public interest by research, by the development of Commonwealth sources of leaf, and by co-operation with the Government. We can agree with some of these submissions. We think the company takes a responsible attitude in its relations with the Government and we agree as to the value of its research and its efforts to develop new sources of leaf. We consider that Imperial's predominant position is due to a number of causes, including the high quality of its products, the circumstances of the company's formation, its success in exploiting the demand for mass-produced cigarettes in its earlier years, and the various steps it has taken to preserve its influence in the market as indicated in the foregoing chapters. We do not regard the internal competition provided by the company's branch structure as a substantial safeguard of the public interest or a satisfactory substitute for external competition. We think it essential that Imperial should continue to feel the stimulus of such competition.

590. As we have indicated we think it desirable to eliminate the risk that competition between Imperial and Gallaher might be inhibited by the existence of a financial link between them. We consider that the retention by Imperial of its shareholding in Gallaher is a " thing done " by Imperial to preserve its monopoly position which operates and may be expected to operate against the public interest. We have also indicated that Imperial's practice of allowing a bonus to distributors conditional on the grant to the company of a proportion of their display facilities has an undesirably restrictive effect on competition in the industry generally. We consider that this practice is a " thing done " by Imperial as a result of and for the purpose of preserving its monopoly position which operates and may be expected to operate against the public interest. We have made some other criticisms of Imperial, and particularly of matters which reflect upon the company's efficiency in the past. The company no longer enjoys the degree of dominance which it had before the war, but the points of criticism referred to arise largely from the continuing effects of its former situation. While we do not think that Imperial's present practice in regard to its branch structure and the range of brands is contrary to the public interest we have no doubt that the company will continue to review its policy in these respects. The competitive conditions now prevailing in the industry are likely, in practice, to compel the company to make any further changes that may be necessary in order to minimise its costs.

591. In spite of the criticisms we have made of particular practices we do not think it can be said to be undesirable that Imperial should continue to be responsible for a high proportion of the trade so long as outside competition remains as intense as it has been in recent years. We do not find, therefore, that the conditions which prevail by reason of Imperial's share of the trade operate or may be expected to operate against the public interest.

II. Machinery

592. Sales of cigarette and tobacco machinery are naturally liable to fluctuate from year to year. Average annual sales in the United Kingdom in the eight years from 1951 to 1958 were approximately £2·1 million. The principal manufacturer, Molins Machine Co. Ltd., was responsible for about 55 per cent. of these sales. About 45 per cent. of the total home sales, including about 58 per cent. of Molins' home sales, went to Imperial.

593. The machinery with which we are concerned covers many different types, and few manufacturers can supply the whole range. Molins makes many of the most important types, including cigarette making and cigarette packing machines. Molins exports, on average, about three-quarters of its output and its principal competitors in its export markets are manufacturers in Western Germany and in the United States. Western Germany also exports to the United Kingdom and has enjoyed a rising percentage of total sales, amounting to about 11 per cent. in 1958. Some United States machinery made under contract in the United Kingdom is also sold here. None of the other British manufacturers is a serious competitor with Molins in the field of cigarette making machines though one of them has been making such machines for its parent company, Gallaher.

594. In the light of our conclusions in paragraph 342 we have to consider whether the conditions which prevail—in the case of Molins by reason of the proportion of total supplies for which it is responsible, and in the case of Imperial by reason of the proportion which it purchases—operate or may be expected to operate against the public interest, and we must also consider the " things done " by the two parties.

595. Molins and its predecessors have been operating in this country for more than 60 years, but it is during the past 30 years that the developments have occurred which have transformed a comparatively small business into one of the world's leading specialists in cigarette and tobacco machinery. Molins says that its present position is mainly due to its " ability to invent and develop better machines than its competitors ". It acknowledges, however, that in building up that position it has benefited from its connections with the Associated Companies (Imperial and B.A.T.). Through its financial and trading agreements with the Associated Companies it obtained (i) capital to proceed with development " in a manner and at a rate which might not otherwise have been possible ", (ii) facilities for production trials of its machines, and (iii) a potential though not guaranteed market if it produced good machines. Molins acknowledges that the trading agreement gave the Associated Companies certain advantages over competitors up to 1957, namely preferential terms as to prices and royalties and the right (which only Imperial exercised) to obtain exclusive use of certain machines. It contends that it was reasonable that the Associated Companies should enjoy such advantages having regard to the risks they took in investing in a company whose inventions had still to be proved better than those of anyone else. It adds that it is a common practice to grant advantages of this kind under the terms of patent licences, and that in the present instance the competitors of the Associated Companies had access to a number of alternative sources of supply of machinery. Finally it is said by Imperial—whose arguments generally support those put forward by Molins—that although the trading agreement of 1927 remained in being until 1957 Imperial exercised its exclusive rights much less rigidly from 1945 onwards than it had done before the war.

596. We see no reason for criticising either Molins or Imperial for the actions and arrangements which have led to Molins' present dominant position. In 1927 Molins' subsequent success could by no means have been taken for granted. It has been achieved through superior inventions and the ability to develop and apply them commercially, and through enterprising management backed by the financial resources of Imperial and B.A.T. We do not think that Molins can be blamed in any way for seizing the opportunity presented by such an association or for accepting the terms on which it was offered. It was reasonable on the part of the Associated Companies that they should expect some preferential advantages from any success Molins might achieve. It is no doubt true that some of their competitors, as they have told us (see paragraphs 425 and 426), would have bought certain Molins machines earlier than they did had not the exclusive arrangements prevented it, but none of them has alleged that this had a serious effect on their competitive position. It would be a different matter if the Associated Companies had persisted in maintaining all their advantages long after Molins had established itself as the leading manufacturer of these machines. In fact, the trading agreement of 1927 was terminated in 1957, and the residual advantages to Imperial and B.A.T. afforded by their current agreements with Molins are of a very limited nature.

597. The terms of the present trading agreements together with those of the financial agreement of 1927 which is still operative constitute two of the principal matters whose bearing upon Molins' current monopoly position we have to consider. A third consideration to be taken into account is the level of profit Molins has been earning. We deal with these three matters below before considering Molins' monopoly position as a whole.

598. Under Molins' present trading agreements with Imperial and B.A.T. the two latter companies have the right to a 60-day trial of any new machine and are afforded certain safeguards as to the prices to be paid for all types of machinery, including spares. We have described the trial provisions in paragraphs 336 and 337. In its agreement with Imperial, Molins undertakes not to offer the machine under trial to a competitor of Imperial until the trial is completed, but the agreement with B.A.T. contains no similar provision. Both Molins and Imperial contend that the trials are of substantial value to Molins and ultimately to all Molins' customers, since they frequently lead to modification of the machine in the light of its performance under factory conditions. They also observe that Imperial gains little, if any, advantage over its competitors as to deliveries since the agreement provides that "Molins shall in allocating their manufacturing capacity have regard to reasonable and probable requirements of other customers". The price provisions of the two agreements are explained and discussed in paragraphs 386 to 388; as we have said there they do little more than ensure that no other purchaser in the countries in which Imperial and B.A.T. will use the machines may receive any price advantage over them.

599. We see every advantage for Molins and for all Molins' customers in the provisions for testing new machines. We do not think the advantages are likely in practice to be greater for Imperial than for any other customer except in so far as Imperial buys on a larger scale than its competitors. The price provisions confer no material advantage on Imperial or B.A.T., but do not preclude either company from using its bargaining powers. It appears to us, indeed, that these two agreements are of very little significance except for the testing provisions.

600. By the terms of the financial agreement of 1927, Imperial and B.A.T. each now owns 25 per cent. of the voting shares of Molins as well as approximately 25 per cent. of the rest of the share capital. The two companies have the right to nominate directors to the board of Molins, but the number so nominated must always be less than half of the total number of directors. This right has never been exercised though representatives of Imperial and B.A.T. have been appointed alternate directors for members of Molins' board. Molins says that Imperial and B.A.T. " have never in fact sought to influence the policy of the company ". The alternate directors, it is said, " hold no more than a watching brief ", and the board of Molins " has exercised full and independent control of the policy and affairs of the company ". Imperial has expressed similar views, saying that it exercises no more influence on Molins' policy than " that appropriate to a large buyer of its machinery ".

601. The evidence we have had generally supports the case submitted by Molins and Imperial. Although the representatives of Imperial and B.A.T. who act as alternate directors of Molins receive monthly reports and attend board meetings, this appears to be no more than a means of keeping the two shareholding companies informed without giving them executive authority. It is clear that the management of Molins has been anxious to maintain its independence and that Imperial and B.A.T. have respected its wish to do so. We have already indicated our view that the association of Imperial with B.A.T. in holding 50 per cent. of Molins' equity is not a matter that calls for criticism so far as it is relevant to Imperial's position as a monopoly supplier of cigarettes and tobacco (see paragraph 552). We see no reason to take a different view after considering the matter in relation to the supply of machinery.

602. The profits earned by Molins in its home trade in the eight years 1951 to 1958, expressed as percentages of capital employed (computed on the basis of the historical cost of fixed assets less depreciation at Inland Revenue rates), were as follows:—

	Per cent.
1951	42·7
1952	24·6
1953	28·2
1954	39·6
1955	29·2
1956	29·0
1957	45·6
1958	43·6
Average for 8 years	36·2

There is no United Kingdom manufacturer of this machinery with a business which resembles that of Molins sufficiently to make any comparison of profits as between it and Molins worth while.

603. When we compare Molins' profits with the average for manufacturing industry generally we find that, after making all due allowance for the difficulties of comparison to which we have already referred (see paragraph 536 and Appendix 6), it is quite clear that during these eight years Molins' level of profit on its home business was much higher than the average. Molins does not dispute this but has submitted certain figures designed to show that some other specialised engineering businesses earn very high rates of profit and has

put forward a number of arguments in justification of its own profits (see paragraphs 396 and 503–509). We do not necessarily accept these arguments in their entirety but deal below with those that appear pertinent.

604. Molins sells only about a quarter of its products in the home market. As we have shown in paragraph 394, a higher level of profit was earned on exports than on home sales during most of the period covered by our survey. This was due principally to the preferential terms provided for in the company's former agreement with Imperial and B.A.T., which was not terminated until 1957. In 1958 the rate of profit on exports was rather below that for the home trade. Molins contends that a price policy which discriminates between one customer and another or one market and another is a dangerous one to adopt, since it lays the seller open to counter-measures, amounting possibly to a complete embargo, in some countries. The company says that it would always have preferred to sell at uniform prices and that it is now doing so and intends to continue to do so, subject only to any quantity allowances that may be justified by savings in cost. It says, accordingly, that the profits it earns in the home market must depend upon the prices it fixes for the whole of its market, and that any reduction in prices and consequently in profits on home sales must be accompanied by a corresponding reduction on export sales.

605. Molins' high profits have been earned in the face of formidable competition because its customers have been willing to pay the price for a Molins machine; its prices, that is to say, have passed the test of the market. It is catering for the special needs of a small number of purchasers in a market which is world-wide and its operations in the home or any other particular market cannot be considered in isolation. Its principal competitors are overseas. It depends for its livelihood on its ability to remain ahead of its competitors in inventiveness and in practical application of inventions. The company can have no assurance that its business will remain profitable; the risks are high because the market is a narrow one and a competitor who produces a better machine can quickly obtain a great part of the potential custom.

606. A high rate of profit is not necessarily against the public interest. Molins is exposed to a high degree of risk and earns its profits in fully competitive conditions. Although exports, as such, are not within our terms of reference we cannot but have some regard to the inter-dependence of Molins' home and export business and to the benefits which the latter brings to the national economy. For all these reasons we do not find that Molins' pricing policy or the level of profit which results from it are against the public interest.

607. To a large extent our review of Molins' trading and financial agreements with Imperial and B.A.T. and of its level of profits has covered the considerations that have to be taken into account in forming a judgment upon Molins' position as a monopoly supplier. Molins says that its dominant position is due to its inventiveness and efficiency which enable it to sell at competitive prices machines which its customers consider superior to the products of its competitors. The company goes on to say that concentration of production and supply of this machinery serves the public interest " since the research and production facilities which Molins command in part as a result of their predominant position both give rise to economies of scale and enable them to compete the more effectively in export markets ". There is, it is said, no danger that this concentration

could have harmful effects in the future, since Molins is not protected from competition and can retain its dominant position only for so long as it keeps the lead in inventiveness and sells its products at competitive prices.

608. In general we accept these submissions as justified in relation to Molins' present position. Although in reaching its present position the company benefited, as it acknowledges, from its connections and agreements with Imperial and B.A.T., we do not think that the existing relations between the three companies afford Molins any material advantage over its competitors. Molins does not, in fact, enjoy the assured market of a monopolist but its exposed to strong competition. We conclude, therefore, that neither Molins' monopoly position nor anything done by the company as a result of or for the purpose of preserving that position operates or may be expected to operate against the public interest.

609. Imperial's position as the purchaser of more than one-third of the machinery supplied in this country is a result of its monopoly position in the cigarette and tobacco trade. The only question of any practical consequence we need consider is whether anything done by Imperial as a result of that position is contrary to the public interest. It follows from what we have said on the subject of Molins that we do not think Imperial's connections and agreements with that company have had undesirable effects. Imperial, as we have said, contends that it exercises no more influence on Molins' policy than that appropriate to a large buyer of its machinery. We think it desirable that Molins should continue under independent management and without interference on the part of Imperial. We know of no other action on the part of Imperial that calls for remark in this connection, and we conclude that neither Imperial's position as the predominant buyer of machinery nor anything done by the company in that capacity operates or may be expected to operate against the public interest.

III. Summary of Conclusions: Recommendations

610. Our conclusions as to the bearing upon the public interest of the " conditions " and the " things done " with which we are concerned under these two references may be summarised as follows:—

Cigarettes and Tobacco

Imperial's monopoly position, as such, does not operate against the public interest nor may it be expected to do so. The retention by Imperial of its shareholding in Gallaher and Imperial's practice of allowing a bonus to distributors conditional on the grant to the company of a proportion of their display facilities are both, however, things done by Imperial, in the one case for the purpose of preserving its monopoly position and in the other both as a result of and for the purpose of preserving that position; both of these things operate and may be expected to operate against the public interest (paragraphs 590 and 591).*

For the reasons given in paragraph 551 we have not considered the effects of Imperial's agreement with and shareholding in B.A.T.

Machinery

Neither Molins' monopoly position nor Imperial's position as the predominant buyer nor any things done by either company operate or may be expected to operate against the public interest (paragraphs 608 and 609).

* See Note of Dissent by Professor Allen regarding resale price maintenance (paragraphs 612–618).

611. We are required to consider whether any, and if so what, action should be taken by way of remedy for the matters which we have found to be against the public interest in connection with the Tobacco reference.

(*a*) So far as Imperial's shareholding in Gallaher is concerned we recommend that Imperial should divest itself of any direct or indirect financial interest in Gallaher.

(*b*) As regards the bonus arrangements we recommend that (1) Imperial should terminate its existing Bonus Agreements, (2) any bonus or allowance granted to a distributor by any tobacco manufacturer, whether by written agreement or otherwise, should in future be related solely to that distributor's turnover in the products of the manufacturer concerned, (3) any such bonus or allowance should be completely dissociated from the grant of continuing advertising or display facilities by distributors (special arrangements for "campaign" advertising are in our view in a different category and unobjectionable), and (4) no tobacco manufacturer should in future enter into an arrangement with a distributor the effect of which is that if the distributor advertises a competing product he must also advertise that manufacturer's product.

R. F. LEVY (*Chairman*)

G. C. ALLEN
(*Subject to Note of Dissent below*)

ANDREW BLACK

BRIAN DAVIDSON

I. C. HILL

W. E. JONES

FRANK SHIRES

A. S. GILBERT (*Secretary*)
6th January, 1961

612. To my mind the convincing arguments against resale price maintenance that are advanced in paragraphs 563 and 567 are not disturbed by anything said in favour of that practice in paragraphs 564 to 566. I, therefore, dissent from the conclusion reached in paragraph 568. I consider that the weight of evidence and argument shows that resale price maintenance in the tobacco industry is against the public interest and that this restrictive practice should be abolished.

613. The argument in favour of the practice opens with the statement (paragraph 564) that "the margins ruling are, in general, not excessive". This statement, in my view, is irrelevant in that it refers to *average* margins throughout the trade. What is significant in this context is the divergence of costs among the various distributors in circumstances in which cost differences cannot be reflected in the retail prices charged. The Commission proceed to speculate on what might happen if resale price maintenance were abolished and if some retailers sold their goods at lower prices than others. One possibility, they think, is that there would be little or no change in the way customers distribute their favours. If this result were at all likely, I find difficulty in understanding why the manufacturers should have bothered to prescribe uniform resale prices—a policy that must have cost them money and trouble—or why in the past the trade should have devised elaborate methods for ensuring that the fixed prices were maintained. Experience supports my scepticism. In the days when the evasion of resale price maintenance was possible the cut-price shops did a thriving business. The Commission then turn to what I regard as the more probable outcome, namely the transference of a good deal of custom to the shops that reduce their prices. They think that this would diminish the number of retail outlets and would cause inconvenience to certain customers, presumably to those for whom low-price shops would have little attraction or, in other words, those to whom a choice between high and low prices for cigarettes is a matter of comparative indifference. For my part, I can see no reason why consumers in general should be prevented by the arbitrary decisions of the manufacturers from choosing how they shall distribute their custom—as between buying their cigarettes at high-cost and high-price shops which may afford them some convenience of location and service, or at low-cost shops which are ready to pass on their economies to the purchasers. If resale price maintenance were abolished the number of retail outlets and the structure of the distributive trade in cigarettes would come to depend on the preferences of consumers as expressed in the way they chose to spend their money, and not, as at present, on the manufacturers' dictate which frustrates their freedom of choice in one important respect. If the number of outlets were reduced this would be because an insufficient number of customers was prepared to pay a price high enough to cover the costs of supplying them at certain high-cost points of sale—in other words, because of the effective competition of the low-price shops. Surely, nothing is here for complaint!

614. The Commission's contention that the amount of any possible price reduction would be very small is debatable. Over a period of months even a moderate smoker might save a substantial sum by buying from low-cost retailers. Further, it must be stressed that the present habits of purchasers have been moulded by the existing restrictive arrangements. Under a system of resale

price maintenance purchasers have no inducement to seek out low-cost distributors or to make purchases in quantity. If freedom in pricing were allowed then shopkeepers in search of the advantages of a high turnover would doubtless reduce prices for purchases in quantity (as occurs in the cigarette trade in some countries). This would affect the consumer's purchasing habits and, by enlarging the unit of sale, would open the way to additional economies in distribution. At a time when revolutionary changes in retail distribution are rendering resale price maintenance obsolete in many branches of retailing, it is hard to understand why purchasers of cigarettes should be excluded from the benefits of such changes.

615. The objections to the present system are all the stronger because of the structure of the tobacco manufacturing industry. The Commission say (paragraph 567) that " it may be argued that Imperial can, in effect, determine the method of retail trading for the great bulk of the supply ". This is an understatement. It appears to me that, because of its dominant position, Imperial can exert a decisive influence on methods of sale throughout the trade. The Commission go so far as to admit that it is *arguable* that it is " a disadvantage from the standpoint of the public interest that opportunities for doing business on terms other than those at present imposed should be so narrowly limited, since this produces uniformity and rigidity in trading methods to the detriment of experiment and innovation in distribution ". I should have thought that this proposition was self-evident.

616. In paragraph 565 the Commission predict that freedom in pricing would lead to " loss leader " selling, a practice which (they think) would be objectionable in this industry because it might bring about a further concentration of production. But " loss leader " selling is effective only for those goods for which standard, uniform retail prices have been fixed and are widely known to the public. Where such prices do not exist (and they would cease to exist in the tobacco trade if resale price maintenance were abolished) the practice of " loss leader " selling can have few charms. Even if some retailers, in an attempt to attract to themselves the goodwill created by manufacturers for certain popular brands, offered those brands at exceptionally low prices, it cannot be taken for granted that Imperial would be the chief beneficiary of their policy. Gallaher might benefit to an even greater extent. Indeed, under a regime of freedom in pricing, the way would be open for enterprise and innovation in distribution and the effects on the structure of the industry cannot be foreseen. Greater concentration among the manufacturers is thus only one of several possible results that might attend the introduction of price competition into the retail trade. Can one justify a policy that retards improvements in distribution and deprives consumers of access to cheaper supplies simply in order to provide a safeguard against a danger that may never appear? Even if the Commission are correct in their prediction, it is very doubtful indeed if restrictive practices should be kept in being and price competition excluded for the purpose of preserving a fringe of independent firms which, *ex hypothesi*, would be those which were unable to supply the market as effectively as the dominant producer or producers.

617. There is another argument against resale price maintenance as it affects this trade that has not been examined in the report. It is possible, indeed probable, that retailers, if they themselves were subject to keen price competition, would bring pressure on the manufacturers to reduce prices to the trade. In

other words, price competition among retailers might work back to the manufacturers. If, as is probable, the latter's marketing efforts were then to be diverted from the forms of competition that raise selling costs (e.g. competitive advertising) to such forms as lead to lower prices, then the public interest would be promoted.

618. Finally, I refer briefly to the argument (paragraph 566) that in the absence of resale price maintenance the incidence of bad debts might increase with the result that the manufacturers might have " to reconsider their terms of credit ". Obviously this effect would relate only to the marginal retailers, for the credit of those who enlarged their turnover would be improved—and doubtless their bargaining power *vis-à-vis* their suppliers. It would be reasonable to expect that the danger predicted by Imperial would be confined to the period of transition to the new distributive system when those retailers who had previously been sustained by the restrictive practice were under the pressure of effective price competition. If improvements in the ordering of economic affairs were to be successfully resisted whenever it could be shown that their first impact would have disagreeable consequences for a minority of high-cost traders, then little material progress would be possible.

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