

CHAPTER 7

Conclusions

THE MERGER SITUATION

162. Under the terms of our reference and the provisions of sections 69(1) and 75(2) and (4) of the Fair Trading Act 1973 we are required to investigate and report on the question whether a merger situation qualifying for investigation will be created if arrangements in progress or contemplation for the merger of Pilkington Brothers Ltd and UKO International Ltd are carried into effect. Under section 75(2), we are required to proceed in relation to the proposed merger as we could proceed if it had taken place immediately before the date of the reference. By virtue of section 64(8) the fact that two or more enterprises have ceased to be distinct enterprises in the circumstances described in section 64(1) is to be regarded as creating a merger situation qualifying for investigation. Although the offer by Pilkington to acquire the whole of the issued ordinary share capital of UKO has lapsed, it is clear that Pilkington intends, subject to clearance under the Act, to make a new offer. Arrangements are therefore in contemplation which, if carried into effect, would result in enterprises carried on in the United Kingdom by or under the control of Pilkington ceasing to be distinct from enterprises carried on by or under the control of UKO.

163. We are required by the terms of our reference to exclude from consideration section 64(1)(a). Section 64(1)(b) is satisfied if the value of assets taken over exceeds £5m. As shown in paragraph 54 the net assets of UKO amounted at 31 March 1976 to £16.5m. Section 64(1)(b) is therefore satisfied.

164. We conclude that a merger situation qualifying for investigation will be created if the arrangements in contemplation for the merger of Pilkington and UKO are carried into effect, and we proceed to consider whether the creation of that situation may be expected to operate against the public interest.

THE PUBLIC INTEREST

165. For a number of years Pilkington has been concerned with planning for the future of the company and has sought to identify areas into which it might successfully expand. It had decided some time ago to extend the company's ophthalmic glass interests by entering the mass lens finishing industry, and the company's strategic planning organisation had identified acquisition of UKO as being the preferred course for achieving this. The company emphasised to us what it regarded as the logic of this course and in particular the advantages which it claimed would result from faster technical progress and consequent increased competitiveness.

166. UKO regarded Pilkington's motives in making the bid as primarily defensive. UKO had become increasingly concerned as to some aspects of the quality of some of Pilkington's ophthalmic blanks and prior to the bid being made had indicated to Pilkington that it was seeking alternative sources of supply for some of its products. UKO rejected Pilkington's arguments about the benefits that would result from vertical integration between ophthalmic

glass manufacture and mass lens manufacture, and argued that the loss of UKO's position as an independent buyer from Pilkington would have adverse consequences for itself, for Pilkington and for the public interest.

The claimed 'logic' of the merger

167. The essence of Pilkington's case is that there is logic in the merger. This depends on the concept that ophthalmic glass, in the form of lens blanks, is a useless product which becomes useful only when it is turned into lenses and that it is illogical and unacceptable for Pilkington to be engaged in making the useless product and not to be concerned with the stage at which it is made useful. The making of glass blanks and lenses is seen by Pilkington as a single activity which should be in the hands of the same organisation.

168. Pilkington claimed that the principal benefit which would result from bringing the two companies together would be faster technological progress; it also claimed that there would be some savings in costs.

Technical progress

169. Pilkington argued that any major new development in the field of lenses, such as significant reduction of grinding and polishing or even elimination of grinding, could only come from a glass maker's research and not from the lens maker, whose technology was mainly concerned with grinding and polishing of ophthalmic glass blanks. Pilkington prides itself on its research, but argued that the separation of the manufacture of lens blanks from the manufacture of lenses hindered the effectiveness of its research effort by placing a barrier between Pilkington and the market for the lenses. If the merger took place its total research and development effort would be more effectively directed. For Pilkington to be in a position to assess the needs of the market and to anticipate new demands it needed to be closer to the market. Pilkington believed that for the full benefits of its research and development in ophthalmic glass to reach the lens market it must control a mass lens manufacturer to ensure that the latter took prompt and full advantage of the developments introduced by the ophthalmic blanks manufacturer. It claimed that it already had knowledge of grinding and polishing techniques; but it expected the merger to improve the exchange of information on technology, UKO feeding back information on grinding and polishing and Pilkington being able to tune the composition of glass to ease the work of grinding and polishing. Pilkington believed that the enhanced capacity to innovate which would result from the bringing together of itself and UKO would strengthen the British ophthalmic glass and lens making industry, making it more competitive in world markets.

170. We find it hard to accept Pilkington's argument that it is too far from the market and that acquisition of UKO would be of significant benefit in this respect. It seems to us inconceivable that a company of Pilkington's size and resources and with so large a stake in ophthalmic glass can lack the means of being closely in touch with the market. In any case Pilkington already owns prescription houses, which take it nearer to the final market for spectacle lenses than would its ownership of a mass lens finisher. Moreover the British market is a small part of the total world market and it seems that UKO's usefulness in

this context would be limited. The usefulness of the British market as an indication of world-wide changes in demand and tastes is further limited by the fact that because a large proportion of spectacles are supplied under the National Health Service the British market is generally seen as lagging behind other markets in fashion and the demand for new types of spectacle lenses.

171. Pilkington claimed that the history of photochromic glass illustrated the point it sought to make. We do not accept that differences between Pilkington and UKO over the acceptability of Reactolite for UKO's purpose would necessarily have been solved satisfactorily had UKO been in the Pilkington group. Pilkington developed a new type of photochromic glass by a route independent of the patents taken out by Corning. Its characteristics differ from those of the Corning product. Pilkington claimed that in some respects its photochromic glass was superior to Corning's; for example in some cases it reacts to light faster than the Corning product. However, it has working characteristics which require different manufacturing techniques from those used by UKO in mass lens finishing. The evidence we received indicated that it was possible to adapt to the handling necessary for Reactolite in single or small scale working, but UKO said that for mass production of Reactolite it would have to set up a unit separate from its normal production line, which was not justified by the volume of photochromic glass which it would use. As a result Pilkington has been unable to sell Reactolite to UKO for mass production. Pilkington argued that if UKO had been in the Pilkington group this would not have happened since Pilkington would have been able to work with UKO to make the necessary changes in UKO's techniques. This may be so, but it implies that Pilkington would have been able to compel UKO to make the changes necessary for the use of Reactolite, not that Pilkington would have developed a photochromic glass more suitable for UKO's requirements.

172. The evidence indicated that a change in the glass composition of Reactolite would be necessary even for single or small scale production if no change whatever in handling methods were to be introduced. Pilkington has a highly developed, small scale lens grinding and polishing facility and we do not think that acquisition of UKO's mass production process is necessary for Pilkington to be able to make adjustments to the composition of glass to facilitate grinding and polishing. We note that elsewhere in the world glass makers and lens makers co-operate closely on technical and other matters without necessarily being vertically integrated. There is a well understood technical language to deal with problems of measurement but there is still a need for close co-operation between the blanks manufacturer and the lens manufacturer when either of them is developing an innovation. Although there appears to be close and fruitful co-operation between Pilkington and UKO on some technical matters and on production planning, we think it is regrettable that two companies who are so heavily dependent on each other should find difficulties in keeping each other informed on technical developments which appear to be vital to both of them. We see no real barriers in the way of effective technical communication between the companies without the proposed merger even if a Bausch & Lomb nominee is on the UKO Board and notwithstanding the ownership by Pilkington of the Birch group, both of which might appear to inhibit such co-operation.

173. Moreover we note the importance which Pilkington attaches to long-range research and radical improvements in glass technology, and we think

that there is a consequent danger that less priority would be given to more pedestrian requests for improvements in techniques of grinding and polishing. Pilkington has emphasised its determination to investigate the possibility of developing a process which would eliminate the need for grinding, but the achievement of this does not appear to us to be dependent upon Pilkington acquiring UKO. Moreover, Pilkington said that there was no likelihood of any such development maturing in the near future and no certainty of it even in the long term; in our view there is in the meantime a risk that if the merger takes place Pilkington will not give sufficient priority to the more immediate requirement of the British mass lens industry, which may possibly be of less interest from the point of view of glass technology.

174. We think that there is a further implication of Pilkington's interest in glass technology and indeed of its commitment to glass generally. In some foreign countries the share of the total market taken by plastic lenses is much larger than it is in the United Kingdom, and the evidence we have suggests that the demand is likely to grow both in this country and abroad. There is an opportunity in plastic lenses for the British lens making industry. It is in the public interest that it should be able to meet the home demand against competition from imports as well as to take advantage of export opportunities. UKO is aware of the possibilities and we see no reason why, if it remains independent, it should not exploit them. The company has arrangements whereby it can use the manufacturing methods of an overseas manufacturer to make plastic lenses and intends doing so in the United Kingdom once sales of plastic lenses in the United Kingdom reach a certain level (see paragraph 155). Pilkington told us that it regarded plastics as a legitimate optical medium alternative to glass and that if the merger took place it would not allow its interests in glass to interfere with the development of plastic lenses by UKO. We accept that this represents a genuine intention on the part of Pilkington. Nevertheless, one of Pilkington's purposes in acquiring UKO is to protect an outlet for ophthalmic glass, and we think that there is inevitably a risk that Pilkington would not give the same priority to plastic lenses as UKO might if it remains independent. Pilkington argued that part of the case for the merger was that it would make the industry better able to identify and take advantage of opportunities; in the case of plastic lenses we think that there is a risk that the merger would have the opposite effect.

Cost savings

175. Pilkington believed that, with the closer co-operation between the two companies which would result from the merger, better forecasting of UKO's demand for blanks from Pilkington would be possible, and that this would allow more effective production planning by Pilkington and a reduction in the total stocks of blanks held by the two companies. With more effective production planning there would be scope for avoiding irregularity in the actual call-off of glass blanks by UKO against projected call-off; this would lead to longer production runs and minimise the costs associated with production changes.

176. We accept that cost savings resulting from longer runs and reduced stocks are a possibility, but co-operation between the two companies on production planning appears to have been very close until now and we see no reason

why it should not continue to be so whether or not the merger takes place. There seem to be no particular reasons why co-operation in demand forecasting and production planning should not be as close between a supplier and an independent customer as between two companies within the same group. In any case it is doubtful how far a mass lens maker's demand for blanks can be accurately forecast. It appears that the demand for lenses is liable to substantial fluctuation and that it is also difficult to predict the demand for particular types of lenses. For this reason it seems likely that some changes from projected call-off of blanks from Pilkington are inevitable. For the same reason substantial stocks of both blanks and lenses are held by UKO and it is unlikely that there is much scope for reduction. Even if it were possible to make substantial reductions in the stocks of blanks held by UKO, the cost savings as a proportion of total costs would seem to be small. UKO showed that in value terms stocks of blanks were low in relation to stocks of finished lenses and that a 10 per cent reduction in the stock of blanks would reduce the value of UKO's total stocks by only 0.6 to 0.7 per cent. In our view any cost savings arising from better production planning and from stock reduction are unlikely to be significant.

177. On the advantages of vertical integration between Pilkington and UKO, as claimed by Pilkington, our view may be summarised as follows. While there may be some advantages in respect of innovation and in respect of cost savings to be gained from co-operation between the two companies, these are limited and do not require the merger for their realisation. The evidence of different degrees of vertical integration of glass making and lens making in other countries is inconclusive (see paragraphs 21, 108 and 136). Vertical integration might indeed have some adverse consequences, in so far as the glass making interests of Pilkington might overshadow the lens making interests of UKO. In particular we believe that Pilkington might give priority to its long term objectives in connection with ophthalmic glass over more immediate considerations such as the demand for blanks manufactured to the tighter tolerances for which UKO has been pressing to enable it to introduce technical improvements in grinding and polishing. Moreover Pilkington might give less support to the development of the British market for plastic lenses.

Competition and the importance of an independent UKO

178. The merger of Pilkington and UKO would bring together the only United Kingdom manufacturers of lens blanks and of mass produced lenses. The principal relationship between Pilkington and UKO is that of supplier and customer. A merger between the two would not therefore directly influence competition by changing concentration in either the supply of lens blanks or in the supply of lenses, though it would reduce potential competition in the supply of lenses since if the merger does not take place Pilkington may nevertheless enter the mass lens making industry in competition with UKO. Pilkington asserted that the merger would have no effect on competition, but UKO argued that the elimination of its position as an independent buyer from Pilkington would have adverse effects on the public interest resulting from the disappearance or reduction of its bargaining power *vis-a-vis* Pilkington and of the effectiveness of foreign competition.

179. Pilkington emphasised the positive benefits it considered would arise from the merger. Nevertheless, although Pilkington's purpose may not have been primarily defensive, the company was undoubtedly influenced by a desire to preserve UKO as a customer for ophthalmic glass in spite of the fact that UKO told Pilkington that it was prepared, if it remained independent, to obtain at least 75 per cent of its total requirements from Pilkington (see paragraphs 105 and 119). Pilkington's ophthalmic glass business (and consequently its optical glass business) could be seriously affected by UKO in a number of ways. UKO might, for example, simply decide to buy its blanks elsewhere or it might be taken over by some other international glass maker, or it might at some time in the future lose its ability to compete with foreign lens makers. Pilkington told us that its case for the merger did not rest mainly on defensive arguments, but it explained to us the threat to the economic viability of its ophthalmic and optical glass production from the loss of UKO business, and the importance of a secure home market as a springboard for success in export markets. It is clear that Pilkington regarded the retention of UKO's custom as a desirable outcome of the merger.

180. Pilkington assured us that it would not restrict the sources from which UKO might obtain any ophthalmic glass blanks which Pilkington 'did not, could not, or would not make'. It also said that it would give the same assurance as it gave in a previous inquiry in respect of Triplex (see paragraph 132); this would mean that UKO would be free to purchase ophthalmic glass from foreign suppliers when UKO 'interests so dictate', that is to say 'if there should be a breakdown in supply by Pilkington, if purchase from abroad should give better value for money, if Pilkington should be unable to supply particular specifications of glass or, more generally, for the purpose of keeping open alternative lines of supply'.

181. We accept that this assurance would be given in good faith, but whereas the assurance offered by UKO (see paragraph 179) would be from an independent customer to a supplier, this assurance would be from a parent company concerning its subsidiary. We think it inevitable that, once within the Pilkington group, UKO would be less able to obtain its requirements, or a larger part of its requirements, of ophthalmic glass from a foreign supplier and that therefore the existing threat of foreign competition would in some degree be reduced. Pilkington argued that in any case it needed to be competitive internationally and that it was 'unthinkable' that it should allow itself to become inefficient merely by removing pressure by UKO. Nevertheless, UKO takes a very substantial proportion of Pilkington's United Kingdom sales of ophthalmic glass (see table 5 in Chapter 2 and also paragraph 70 in Chapter 3); UKO is of great importance to Pilkington and is therefore in a position, as long as it remains independent, to exert pressure on Pilkington. We regard bargaining pressure from UKO as being particularly important in encouraging Pilkington to maintain its competitiveness in the world market for ophthalmic glass blanks both in technical progressiveness and in quality.

182. Pilkington claimed world leadership in process technology in glass making, and we think that its development of double-sided polishing of plate glass and of the float glass process justify this claim. Pilkington told us that it

gave particular attention to the processes of glass making while other important glass making companies were more concerned with the application of scientific research to the composition of glass. In the ophthalmic field Pilkington has tended to match competitors' developments and respond to customers' demands rather than to invent novel types of glass. We believe that UKO and Pilkington's foreign customers play an important role, through the threat that they might take their business elsewhere, in encouraging Pilkington to keep up with technological development in the ophthalmic glass industry. We note that a number of Pilkington's ophthalmic glasses have been formulated specially to meet the requirements of individual customers. The replacement of SW1, Pilkington's original standard spectacle white glass, by SW3 and the introduction of WX1, Pilkington's chemically toughenable white glass, both followed pressure from UKO. The latter was needed specifically to enable UKO to attack the United States market (see paragraphs 113 and 158).

183. A major source of UKO's dissatisfaction has been Pilkington's attitude to its requests for blanks to be produced to closer tolerances for special purposes (see paragraphs 113 and 159). While pressure from UKO was not entirely successful in removing UKO's dissatisfaction, we believe that pressure of this sort from an independent customer is likely to be more effective than is pressure from a subsidiary company.

184. In our view it is less likely that the British ophthalmic glass industry and the British lens industry will remain internationally competitive if UKO ceases to be an independent company in a position to exert pressure on Pilkington. UKO can exert pressure effectively only as long as the threat to go elsewhere for its ophthalmic glass remains credible. We recognise that the only alternative available to UKO is imported foreign glass, but particularly in view of the value of lenses being substantially greater than that of blanks we consider that the importance of UKO being able to be competitive internationally in lenses outweighs the desirability of minimising imports of blanks. In any case we think it likely that Pilkington has the technical ability to justify maintaining its position as UKO's main supplier. We recognise the advantage of a securely based home market for Pilkington's blanks, but we do not think that this depends on UKO being acquired by Pilkington.

185. UKO criticised Pilkington for the large increases in the prices of its blanks in recent years, and claimed that its prices were no longer fully competitive internationally (see paragraph 143). We accept that UKO has been able to obtain quotations for some imported blanks selectively at more favourable prices, but we do not accept that UKO's criticisms represent a fair picture of Pilkington's prices, which we do not think have become generally uncompetitive. UKO argued that as an independent customer of Pilkington it was able to exert pressure on the prices charged by Pilkington for its blanks. UKO considered that without that pressure the merger would result in Pilkington charging more for its blanks with the result that UKO's lenses prices would also increase. We are in no doubt that UKO, as a large independent customer, is able to exert pressure on Pilkington's prices for blanks, as is shown by the fact that UKO was able to secure a quantity rebate from Pilkington (see para-

graph 142). Although Pilkington stated that UKO as part of the Pilkington group would be free to go elsewhere for its supplies, we think it inevitable that the merger would weaken UKO's buying power. In the event of the merger taking place the price of the blanks would be an internal transfer price charged by a division of Pilkington, Chance-Pilkington, to a subsidiary, UKO. We cannot foresee how this price would be determined, but even if Pilkington were disposed to increase the transfer price of blanks this would not necessarily lead to an increase in the price of lenses. It would depend upon market conditions affecting the supply of lenses. At the present time the prices of imported lenses appear to be generally above the prices of British lenses (although there have recently been some imports of cheaper foreign lenses, for example from Brazil). This suggests that there is some scope for an increase in British lens prices, with or without the merger, before competition from imports becomes generally effective. The ability to increase lens prices is, however, at present restrained by the controls under the Price Code. The present Price Code is operative only until July 1977 and it is not known whether it will continue. The Health Departments' arrangements for reimbursing opticians for National Health Service spectacles take account of prices charged by mass lens makers to prescription houses (see paragraph 14), and we consider that under these arrangements there would be some risk of a rise in the price of lenses following an increase in the price of blanks to UKO for whatever reason. As the arrangements operated before 1973, the Health Departments scrutinised only the costs and profits of the lens manufacturers. An increase in the price of blanks could therefore be passed on in the price of lenses and the reimbursement payments to opticians adjusted. Indeed we note that, although the DHSS was not opposed to the merger taking place, it had reservations and thought that a number of assurances were necessary including one that Pilkington should be prepared to accept a measure of price control for supplies to the National Health Service if and when the current price legislation is abolished.

The United Kingdom balance of payments

186. Both companies emphasised to us the contribution they had made to the United Kingdom balance of payments and, while Pilkington argued that the merger would benefit the balance of payments by expanding exports and reducing imports of both lenses and lens blanks, UKO argued the opposite.

187. Pilkington argued that technical improvements in lens making and greater efficiency of UKO (both of which it claimed would result from the merger) would assist UKO in competing against imports of finished lenses, and that the same factors together with the importance which Pilkington attaches to exports and its world-wide marketing organisation would lead to an increase in exports of finished lenses. Moreover, the secure domestic market for its blanks as a result of its ownership of UKO would provide Pilkington with a base for expanding its exports of ophthalmic glass.

188. UKO argued that, although acquisition of UKO by Pilkington would remove the risk of an increase in the imports of lens blanks resulting from UKO seeking an alternative supplier of blanks, any such increase in imports would be small and, because the bulk of value added in lens manufacture was by the lens maker rather than by the glass maker, balance of payments considerations

could not justify the protection of United Kingdom ophthalmic glass blanks at the expense of lens manufacturing. The detrimental effects on the balance of United Kingdom foreign trade in spectacle lenses would, in UKO's view, arise because of adverse effects of the merger on the efficiency and technical standards both of UKO and Pilkington. UKO argued that Pilkington's glass export marketing organisation would be of little assistance to UKO's lens exports because of the differences in the type of customer and in marketing techniques. In addition UKO argued that the merger would reduce Pilkington's exports of lens blanks since overseas lens manufacturers would be reluctant to purchase their glass from a supplier who was also a competitor in mass lens manufacturing.

189. We believe the export prospects of the two companies to be good whether or not the merger takes place. The effect of the merger upon the United Kingdom balance of payments depends largely upon its effects on the efficiency and technical progressiveness of the two companies. As we have noted above, any technical benefits of the merger seem at best long term and the merger offers very limited opportunities in cost savings. Moreover the elimination of an independent UKO is likely to reduce the pressure on Pilkington to be internationally competitive in terms of both the prices of its blanks and the quality and characteristics required in overseas markets.

190. We attach little importance to the consequences for the balance of payments of an increase in imports of lens blanks if UKO is allowed to remain an independent company. The added value of finished lenses is far greater than that of blanks and therefore any savings in imports which might result from Pilkington preventing UKO from purchasing certain types of blanks from overseas suppliers is likely to be more than offset by the resulting reduction of UKO's ability to export finished lenses. In any case Pilkington's sales of ophthalmic glass to UKO in the year ended 31 March 1976 totalled only about £1.7m (see table 5 in Chapter 2) and we do not consider that the effect on the balance of payments of UKO obtaining part of its requirements overseas would itself be serious.

191. We find it difficult to assess the possibility mentioned by UKO that entry by Pilkington into mass lens manufacture might jeopardise its sales to some overseas customers. Co-operation in technical matters between glass makers and lens makers is normal and desirable, but this may involve the disclosure of technical information and we had evidence pointing to the fact that for this reason an independent lens maker would be reluctant to buy from a glass maker whose association with a lens maker was unduly close. The evidence is inconclusive but we think that there is some risk that the merger might impede Pilkington's efforts to market its ophthalmic glass overseas.

192. The effects of the merger on the United Kingdom balance of payments are complex and difficult to forecast. On balance we think that there is a risk of adverse effects, chiefly resulting from a lessening of competitive pressure on Pilkington.

Effect on prescription ^{houses} charges

193. There was some apprehension on the part of prescription houses that the merger might have an adverse effect on the supply of lenses to prescription houses. It is important to prescription houses that they should be able to supply their own customers without any undue delay, since if they fail to do so they are liable to lose business to their competitors. It was thought that in circumstances of shortage, such as there have been in recent years, UKO would be bound to give preference to its own prescription houses at the expense of independents. The merger, by increasing the number of prescription houses to which UKO could be expected to give preference, would exacerbate this situation. We also considered what effect UKO's recent acquisition of BAO's lens factory at Kidwelly would have in this context. BAO has prescription house subsidiaries accounting for about 5 per cent of the total business done by United Kingdom prescription houses; but UKO is not acquiring these. However, with the withdrawal of BAO from mass lens making UKO becomes the only mass lens manufacturer in the United Kingdom, and the possibility of discrimination in favour of UKO's, and (if the merger takes place) Pilkington's, prescription houses becomes greater, as does the adverse effect of any such discrimination on independent prescription houses.

194. Although UKO told us that it did not discriminate in favour of its own prescription houses either in price or in service, we accept that the possibility of discrimination against independent prescription houses and in favour of prescription houses owned by Pilkington and UKO is a potential detriment of the merger. UKO's prescription house interests account at present for about 10 per cent of the total business done by United Kingdom prescription houses and Pilkington's for something under 5 per cent, and the merger would make the group the largest prescription house organisation with the possible exception of Dollond & Aitchison (which supplies only its own retail outlets).

Effects on management and employees

195. UKO believed that the merger would have an adverse effect on the management of the company. Pilkington intends that if the merger takes place, there shall be two UKO representatives on the board of the Optical Glass Division as well as Pilkington representatives on the UKO board, and that managers and directors of UKO shall be represented on the Optical Holdings Board (see paragraph 126). Moreover UKO told us that it understood from Pilkington that Pilkington would 'more or less' leave UKO management alone for two years. Nevertheless UKO believed that some of its executives would be likely to feel that their opportunities would be reduced if UKO became a division of Pilkington, or that there would be a different, and more bureaucratic, style of management which they would find uncongenial. UKO believed that some of its key executives would therefore leave the company if the merger took place, and that this would exacerbate any difficulties which might arise from incompatibility of personalities in senior management. We think that the merger would have some disruptive effect on the management of UKO; any merger, especially if contested, tends to have this effect in the short term. We do not, however, believe that in the longer term such disruption would necessarily continue or be severe enough to be weighed against the merger.

196. It was represented to us by one of the trade unions concerned that the prospects for UKO's shop floor workers were good as long as the company remained independent, but they might be less secure if the company were acquired by Pilkington. In so far as the company would be weakened as a result of acquisition, as UKO maintained would be the case, the position of its employees would be correspondingly worsened. There was also some apprehension that the apparent policy of Pilkington (implied by a statement to UKO shareholders about the narrow geographical spread of UKO's activities) of spreading its manufacture widely around the world might be applied to UKO and that this would reduce employment opportunities in the United Kingdom. In particular, senior shop stewards and trade union members at UKO's Lurgan factory felt that this implied that the Lurgan factory might be closed on geographical grounds. They expressed considerable anxiety that, while employment was reasonably secure as long as the Lurgan factory was of central importance to a relatively small company, employment would be much less secure if the factory were part of a larger company with more widely spread international interests. They drew attention to recent closures or partial closures in Northern Ireland by other international companies. They also feared that if UKO were acquired by Pilkington this might damage long-standing satisfactory industrial and personal relations with UKO management.

197. Pilkington claimed that it had a record of good industrial relations and of 'proved and real concern for the welfare of its employees', and argued that because the merger would strengthen the company its effect would be to enhance the security of employment of both UKO's employees and Pilkington's. Pilkington told us that it had no present intention of closing the Lurgan factory, and we accept this assurance; moreover closures by large companies of factories in Northern Ireland which have taken place appear to have been mainly as a result of a lack of orders, whereas lens making is a growth industry.

CONCLUSION

198. While we do not exclude the possibility of benefits to the public interest arising from the merger, we consider that there is a greater probability of detrimental consequences and that these outweigh any potential benefits. We therefore conclude that the proposed merger of Pilkington and UKO may be expected to operate against the public interest. The particular effects, adverse to the public interest, which in our opinion it may be expected to have are—

- (1) a risk that Pilkington may not give sufficient priority to the immediate needs of the British mass lens industry (paragraph 173),
- (2) a risk that Pilkington may not give sufficient priority to the development of plastic lenses (paragraph 174),
- (3) the reduced likelihood that the British ophthalmic glass industry and the British lens industry will remain competitive internationally if UKO ceases to be an independent company in a position to exert pressure on Pilkington (paragraph 184),
- (4) the risk of increased prices for blanks and lenses (paragraph 185),
- (5) the risk of adverse effects on the United Kingdom balance of payments (paragraph 192),

(6) the risk of discrimination against independent prescription houses (paragraphs 193 and 194).

199. We are unable to recommend any actions which would remedy or prevent the adverse effects mentioned and we therefore recommend that the merger should not be permitted.

E L RICHARDS (*Chairman*)

G F ASHFORD
(Subject to note of dissent)

ROGER FALK

T P LYONS

CAROLINE MILES

S A ROBINSON

Y LOVAT WILLIAMS (*Secretary*)
13 January 1977

Note of dissent by Mr G F Ashford

200. I am unable to agree with my colleagues. In my opinion the risks of detrimental consequences following a merger are slight and are largely balanced by the possible detrimental developments which might occur in the absence of a merger. If a merger does take place, in my opinion technical progress is likely to be faster than without a merger.

201. The following are my comments on the risks referred to by my colleagues in paragraph 198.

Risks in the event of a merger

202. *Paragraph 173.* In my opinion, there is little justification for the suggestion that because Pilkington attaches importance to long range research there is a consequent danger that it will give insufficient priority to more immediate requirements of the British mass lens industry.

203. *Paragraph 174.* I agree that in view of Pilkington's traditional interest in glass there is a slight risk that the development of plastic lenses may be delayed.

204. *Paragraph 177.* I do not agree that if vertical integration takes place glass making interests are likely to take precedence over the lens making interests of UKO. If Pilkington acquires UKO it will approximately treble its investment in the ophthalmic lens industry. Pilkington is prepared to pay a

substantial price for UKO because it regards UKO as an efficient company, presumably with good prospects. I have been unable to identify any evidence suggesting that Pilkington would be so foolish as to neglect its expensive acquisition.

205. *Paragraph 184.* In my opinion there are two reasons why it is unlikely that the British lens industry will be less internationally competitive if UKO ceases to be an independent company in a position to exert pressure on Pilkington. The first reason is that Pilkington for a number of years has exported approximately 45 per cent of its lens blanks to a number of countries, including Japan. Pressures will continue to be applied by Pilkington's major overseas customers. The second reason is that the organisation proposed by Pilkington will ensure that its Optical Glass Division continues to be under pressure from UKO. Pilkington has never suggested the merging of its Optical Glass Division with UKO into a unitary organisation. It has stated that the business of UKO will be maintained and developed as an identifiable entity under its present management, with the support of the Pilkington group, and that there will be no essential change in the responsibilities of the boards of UKO or the Optical Glass Division. There will be cross membership between the two boards; on the UKO board there will be two directors from the Optical Glass Division Board, and on the Optical Glass Division Board there will be two directors from the UKO board (see paragraph 126). In my view, particularly taking into account the personalities of the UKO directors, this will be a highly practical arrangement for maintaining the necessary pressures on the Optical Glass Division. This organisation may well produce solutions more in accordance with the public interest than might result from the economic pressure which could be exercised by UKO in the position of sole United Kingdom customer. From the technical point of view, the proposed organisation should assist in optimising and accelerating research and development carried out by UKO and the Optical Glass Division. UKO can continue its short term developments with some assistance from the Optical Glass Division. The Optical Glass Division may well be carrying on longer term research, but under pressure from UKO not to forget short term considerations.

206. *Paragraph 185.* If there is a merger and the present Price Code ceases to operate, and Pilkington raises the transfer price of lens blanks to UKO, and neither DHSS nor any other Government department investigates the costings of making lens blanks, then I agree that the price of mass lenses used in the National Health Service may be increased. In my opinion it should be possible for some Government department to investigate the costings of lens blanks.

207. *Paragraphs 193 and 194.* I do not agree that the possibility of discrimination in favour of UKO's and (if the merger takes place) Pilkington's prescription houses becomes greater. UKO has stated that as a matter of enlightened self-interest it gives preference in times of shortage to independent prescription houses, and that its prices to independent prescription houses are the same as to its own (see paragraph 154). Pilkington has stated that it saw no case for integrating beyond the field of lens manufacture, or for expanding into the prescription house field and that it was against its policy to give subsidiary companies preferential terms through transfer prices (see paragraph 129). While

it is always possible that UKO might change its policy with or without a merger, I can see no evidence that the likelihood of this occurring is increased if a merger does take place.

Risks in the absence of a merger

208. Recently, UKO has become the sole manufacturer of mass lenses in the United Kingdom. This means that it will be virtually the sole United Kingdom purchaser of Pilkington's lens blanks. This gives UKO very substantial power which could be so exerted as to reduce the existing low profitability of Pilkington's Optical Glass Division to a point where it would be difficult for it to afford its present high level of expenditure on research and development. Pilkington has stated that in any industry in which it operates, it will always maintain adequate research and development. It has never suggested the possibility of having to abandon the manufacture of lens blanks; nevertheless it appears that a rather precarious situation could emerge as a result of the exercise of UKO's buying power. It is also possible (as Pilkington has suggested) that UKO may be taken over by another company who may or may not be makers of lens blanks.

Technical advantages of a merger

209. I agree with my colleagues that it is regrettable that the two companies find difficulty in keeping each other informed on technical developments (see paragraph 172). I do not agree that there are no real barriers. It appears that UKO's relationship with Bausch & Lomb, and UKO's fear that Pilkington may manufacture mass lenses will continue to constitute a substantial barrier inhibiting co-operation. If the merger does take place this barrier will be eliminated and in my opinion innovation is likely to be accelerated and made more effective.

210. The following are examples of the benefits which might arise from closer collaboration. If Pilkington is developing a new glass or improved tolerances with an existing glass, uninhibited discussions at the early stages of the development would be likely to minimise problems and maximise economies both at the blank making stage and at the mass lens making stage. Each company has informed us of new developments which it hopes to complete in two to five years' time. Economies from these developments would be maximised if the two developments are designed to fit into each other. In the case of one major development being undertaken by UKO assistance from Pilkington's greater engineering resources might well shorten the time required for completion of the development.

Conclusion

211. In my opinion the risks of detrimental consequences following a merger which have been enumerated by my colleagues are unlikely to occur, particularly taking into account the organisation proposed by Pilkington. In the event of no merger taking place, there is a possibility of other detrimental developments. If a merger does take place, there will be faster and more effective technical progress, resulting in a stronger British ophthalmic lens industry.