CHAPTER 3

Raleigh's arguments and support of its distribution policy and supply criteria

3.1. Raleigh informed us that it accepted the facts stated in sections 1–6 of the OFT report. These sections cover (besides the background to the Director General's investigation) the companies, goods and brands concerned; the United Kingdom bicycle market; Raleigh's distribution policy and practices; and views of trade associations, manufacturers and retailers.

3.2. Raleigh disagreed, however, with certain analyses, projections and views given in section 7 of the report. In particular, it challenged the Director General's view (OFT report, paragraph 7.30) that the application of Raleigh's criteria for determining whether to supply bicycles to retailers was a course of conduct which, in terms of the Competition Act 1980, constituted an anti-competitive practice.

3.3. Raleigh, who put to us detailed arguments in relation to competition and to the public interest, prefaced these with introductory comments on some of its distribution criteria, ie on certain of the criteria identified at (*c*) of the reference (see paragraph 1.1 above). Raleigh argued:

(i) that the allocation of geographical areas, or the geographical limitation of dealership numbers in accordance with potential sales levels, was an essential part of all franchising, justified in order to develop loyalty, commitment and maximum selling effort, and was not unrelated to the criterion of credit-worthiness (which OFT had found generally acceptable);

(ii) that a reasonable expectation of 'loss leading' practices should be an acceptable ground for refusal to supply. (In the course of the inquiry, the question arose as to the meaning to be attached to the term 'loss leading' in the context of our consideration of Raleigh's distribution policy—see paragraphs 3.20 and 3.21, and 6.14 below.);

(iii) that facilities for technical advice, service and spare parts were interlinked and that, given their impact on consumer convenience and brand image, justified for manufacturers of many products a policy of selection of outlets where such facilities would be available. This applied *a fortiori* in Raleigh's case, where the product was a vehicle, with safety connotations;

(iv) that the last of the criteria listed in the Reference (which relates to commitment) need not be considered by the Commission as, in correspondence with Raleigh, OFT had confirmed that they did not suggest that Raleigh had in fact applied the commitment criterion in a discriminatory fashion.

Raleigh's detailed arguments

3.4. In its discussions with OFT in the course of the Director General's investigation, Raleigh found it impossible to separate the issues clearly into the two classifications of 'competition' and 'public interest'—the Director General being concerned with the former only. In its evidence to the Commission, Raleigh likewise considered it simpler and more effective to support its two main arguments together. They were:

(1) that (despite OFT's findings to the contrary) Raleigh's application of selection criteria for dealers was not an anti-competitive practice; and

(2) that even if it were shown that its practices were technically anti-competitive in terms of the Competition Act, they were demonstrably in the public interest.

3.5. Argument (2) reflects Raleigh's awareness that the Commission, in complying with the requirements of a reference under section 5 of the Competition Act, must—if they find that a relevant anti-competitive practice exists—address the question whether it operated or might be expected to operate against the public interest.

3.6. Raleigh advanced its arguments on a number of grounds:

(i) the desirability of any specialist products manufacturer, and Raleigh in particular, being free to adopt its own marketing policy and to select its outlets;

(ii) the importance of servicing arrangements for bicycle road safety; product liability considerations;

(iii) the likely reaction of Raleigh's dealers if it were forced to change its selection policy;

(iv) the state of competition in the bicycle market and the likely effect on competition of a forced change of course (especially if applied to Raleigh alone);

(v) financial considerations and the effect on Raleigh which it considered would follow from a forced change;

(vi) the inter-dependence of Raleigh's exports and home sales; and

(vii) the technology, investment and skills which could be jeopardized by a change of course.

Freedom to select outlets

3.7. Raleigh maintained that specialist products were often better retailed under a selective distribution system. A manufacturer's skilful choice of outlets was often one of his most effective means of competing (for example, in providing for technical service, in achieving the right balance of coverage and selling effort, and in promoting brand image and hence inter-brand competition). Raleigh contended that—provided it was not abused to maintain resale prices—a franchising system need not be either anti-competitive or against the public interest and that such a system had neither been objected to by the

Commission in their 1970 report on 'Refusal to Supply' (Cmnd 4372) nor been challenged under European Community competition law. Further, Raleigh drew our attention to the fact that, following protracted litigation in the United States involving Schwinn, an American manufacturer of up-market bicycles (and one whose distribution arrangements Raleigh considered very similar to its own), rulings by the United States Supreme Court had established that a selective distribution system did not necessarily contravene Antitrust legislation.

3.8. Raleigh also said that a franchising system did not become anti-competitive or against the public interest if a manufacturer, especially in the face of fierce competition from other manufacturers, built up his brand to a dominant place in the market.

3.9. It was no accident, Raleigh suggested, that the dealership system had arisen in the case of cars, motor cycles and bicycles. This happened largely because these road vehicles were sufficiently specialised and complicated to lend themselves to being sold by specialist outlets.

3.10. Raleigh stressed its belief (which it said was shared by all manufacturers of 'up-market' bicycles) that a valuable brand image was developed and sustained by the selective distribution system. Raleigh's brand image had been built up hand in hand with the goodwill of its dealers. That goodwill was an important economic asset of Raleigh's.

3.11. To undermine the manufacturer's right to select outlets would, Raleigh suggested, distort competition. The distortion would be greater if that competitive method were denied to Raleigh merely because of its significant market share, while its foreign competitors remained free to continue to cultivate their up-market brand image, Raleigh having perforce to adopt what it saw as a down-market practice. That would be an artificial penalty on success.

3.12. Raleigh contended, moreover, that the Office of Fair Trading report exaggerated the degree and significance of Raleigh's dominance in the United Kingdom bicycles market. OFT recorded in its report, paragraph 7.3, that, in 1979, Raleigh's production of bicycles for the United Kingdom amounted to some 46 per cent of total sales in the market. Raleigh pointed out that (apart from the fact that in 1980 the corresponding figure was under 42 per cent) this was the market share of *all* brands of bicycle (including Carlton, BSA, Triumph etc) made by Raleigh, and that the corresponding figure for the Raleigh brand alone was, in 1980, just under 30 per cent.

3.13. In addition, Raleigh stated that the Raleigh brand was by no means dominant in the European Community market in bicycles which had become very much more integrated than it had been. This could easily be seen in the increasing intra-Community trade in bicycles and in customer awareness, at the top end of the market, of the range of European brands. It would, Raleigh suggested, be an artificial distortion of European competition to restrict the competitive methods open to one manufacturer because of its large share in its home market, especially as this could undermine the brand image of its products in Europe.

3.14. Raleigh stated that in 'free world' bicycle markets there were broadly two alternative methods of bicycle marketing and that its own need to select outlets was directly related to that fact. The two methods were:

(*a*) to produce to a low specification, competing primarily on price, selling through supermarkets, discount stores etc (often under stores 'own labels'); or

(*b*) to produce to a high specification, selling primarily through specialist bicycle dealers, with emphasis on quality and service and promotion of brand image and loyalty.

3.15. Raleigh, who in United Kingdom and export markets follows policy (*b*), said the two policies could not successfully be combined. In support, Raleigh referred to the experience of certain foreign companies in their home markets. In the Netherlands, where specialist dealers had about 80 per cent of the bicycle market, one Dutch bicycle manufacturer, which had traditionally sold only through dealers, had started also to sell through mass outlets. This manufacturer had, according to Raleigh, encountered a large drop in dealer sales, and had recently decided to revert to its former policy. In Canada, a manufacturer had made its premium brand, formerly available only to selected outlets, available to mass outlets. Subsequently it encountered severe financial difficulties.

3.16. Raleigh also cited the experience of Schwinn, a major American bicycle manufacturer (see also paragraph 3.7 above) which, having at one time sold through mass outlets, decided to move up market and developed a franchised dealer network. Its sales had subsequently increased.

3.17. The information supplied by Raleigh also indicated that substantial sales of bicycles through non-specialist retailers were achieved in various countries: in France, 60 per cent through specialist retail dealers, 40 per cent through non-specialist retailers; in Federal Germany, the market was said to split about 50/50 between specialist dealers and the rest. In the USA the shares were: specialist dealers 28 per cent, mass outlets 72 per cent (the three major United States bicycle manufacturers other than Schwinn sold through mass outlets).

3.18. Raleigh traded, and had traditionally traded, at the upper end of the bicycle market—predominantly through bicycle dealers and up-market departmental stores. About 15 years ago, in difficult commercial conditions, Raleigh also started trading (but under brand names other than Raleigh) with catalogue mail order houses. These now accounted for about a fifth of Raleigh sales. This move had created hostility among Raleigh's specialist dealers (see paragraphs 3.40 and 3.41 below) although Raleigh told us that, for various reasons (one being that the mail order houses were not present in the High Street), its dealers did not now regard catalogue mail order as a direct competitor. Nevertheless, even now there remained an undercurrent of dissatisfaction among dealers because Raleigh sold through catalogue mail order houses.

3.19. Raleigh stated that because it had built up over the years a reputation for excellence, value, convenience and safety, its cycles being built to a high specification, with emphasis on quality and reliability, it was extremely important that nothing should be done to remove from the public's mind the firm association between the Raleigh image and high quality. Selling to discount stores would undermine the Raleigh brand image both with consumers and with its other retailers.

3.20. In Raleigh's view, it was not uncommon for discount stores to sell goods as 'loss leaders'. This term lacked precision but Raleigh suggested that its essence was selling goods at an artificially low price—although not always or necessarily at an actual loss—in order to attract customers into the shops to buy other goods. Raleigh considered that this type of practice set in the public's mind an artificially low price, especially if there was heavy local advertising. Other retailers could not match these prices, therefore they would switch to selling other goods or give up servicing. Raleigh would be reluctant to start supplying a retail organisation if Raleigh suspected that the practice was likely to occur.

3.21. Raleigh also argued in this connection that it was justified in refusing supplies to discount stores competing only or mainly on price because of 'the different general pricing levels that must obtain' as between such outlets and dealers presenting bicycles in a specialist way round the year and providing technical service. This was not only not anti-competitive but was actually in the public interest because of benefits to consumers in respect of the quality and variety of goods and services available.

3.22. In its supporting argument, Raleigh pointed out, first, that there was keen price competition in bicycle retailing in the United Kingdom, made keener by the efforts of foreign competitors, by the large number of outlets and by the spread of outlet types and, secondly, that there was competition on level of service, availability to the customer, year-round presence in the market and presentation of the right image. Raleigh, who did not think it anti-competitive to seek to preserve existing specialised and technical distribution channels by trying to maintain 'general price levels consistent with the provision of good service but with keen price competitive retailing' within those channels, emphasised the difference between this and resale price maintenance, which it did not practise.

3.23. Raleigh also cited a European Court precedent (the *Saba* case—No 26/76 ECR 1977 p 1875) as acknowledging that price competition did not constitute the only effective form of competition or that to which absolute priority must in all circumstances be accorded.

3.24. Raleigh told us it tried to insist where it could that technical service facilities were available to the customer and to encourage a general level of shop service which kept the Raleigh brand as up-market as possible. Discount stores, Raleigh contended, generally had no technical expertise or facilities for pre-sale checking and provided no guidance to the customer. Raleigh was sceptical of any undertaking by discounters to provide such facilities or upgrade their general level of shop service partly because, in Raleigh's opinion, such stores had no real commitment to bicycle retailing.

3.25. Unlike established bicycle dealers, discount stores, Raleigh argued, would in some cases only take and stock bicycles at certain times of the year and in others would at non-peak periods reduce floor space—and hence selling effort—devoted to bicycles. They might also be interested only in the leading models, so that the total sales exposure of the Raleigh range would (in such outlets) be severely restricted. This would contrast with the practice of dealers who had a greater identity of interest with Raleigh and could be regarded by Raleigh as very much an extension of its own sales force.

3.26. The taking of bicycles only on a seasonal basis, and the lack of long-term commitment, ran counter to the need to have factories working at high capacity continuously throughout the year. Moreover, the output must be distributed promptly to avoid stocking costs. Raleigh needed outlets which bought throughout the year, to even out seasonal effects on the market and possible major swings in consumer demand.

'5 Star' dealers

3.27. Raleigh supplied us with a description of, and details of certain developments concerning, its '5 Star' dealers, who sell exclusively bicycles made by Raleigh. Raleigh, who told us it had been increasing the number of '5 Star' dealers, and that it had 186 of whom 120 were fully operational, stated that it realistically expected to reach 200 in the next few months, with little prospect of any significant increase beyond that figure.

3.28. Raleigh stated that it hoped, but had no guarantee, that the expanded network would increase its total sales. It was natural to expect that an increased percentage of total Raleigh bicycle sales would go through '5 Star' dealers when the scheme was fully operational but the shift would be to a degree more apparent than real because newly appointed '5 Star' dealers would usually have been selling Raleigh bicycles anyway. The total number of units going through '5 Star' dealers was likely to remain a small percentage of Raleigh's total sales in the United Kingdom bicycles market (about 13 per cent in 1980).

Servicing of bicycles and road safety

3.29. It was important to Raleigh that a Raleigh bicycle should be regarded as a safe and reliable road vehicle. This image, Raleigh maintained, was reinforced if the bicycle was sold through a specialist outlet which provided technical services much as a garage did when selling a car. In effect, Raleigh offered a package—a bicycle package with service for road safety—and this had implications for the price.

3.30. While Raleigh knew of no relevant statistics, it believed that accidents were caused by inadequately serviced bicycles, and that it was important that dealers checked bicycles before passing them to the customer and had stocks of spare parts to enable them to do repairs and for sale, particularly as a high proportion of all bicycles sold were intended for use by children.

3.31. Raleigh acknowledged that some purchasers of Raleigh bicycles, notably those who bought from mail order houses, had to rely, for servicing or for spares, on the Raleigh Service Dealer network (described in the OFT report in section 4.7). No changes in the service dealer network were planned other than the continued effort to improve geographic coverage. Raleigh considered it important, from the road safety and public interest aspects, that there was this service base up and down the country (although, Raleigh added, there was sometimes a marked reluctance among dealers to service bicycles bought from discount stores). Raleigh cited the support expressed by the Royal Society for the Prevention of Accidents for the view that, from a road safety aspect, bicycles should be sold only through dealers providing technical service.

3.32. As further evidence for its concern about road safety, Raleigh pointed out that it ran technical training courses for dealers on the servicing and maintenance of bicycles and that a senior Raleigh executive was Chairman of the International Standards Organisation Committee dealing with bicycles from both a technical and a safety aspect.

3.33. Moreover, Raleigh foresaw an increasing risk of costly litigation, given the growth of consumerism and the possibility that stricter liability would be imposed by law, affecting manufacturers whose goods had been put into circulation in a defective state. Raleigh argued that it would be lacking in judgement and commercial foresight not to insist, as far as possible, that its dealers provided service facilities.

3.34. In Raleigh's contention, if it were forced to supply discount stores this would lead to widespread reduction of the number of, and in competition between, dealers offering servicing facilities to the public, for two reasons:

(1) many dealers would abandon service in order to compete on price alone on the ground that they could not compete on price while maintaining their service base; and

(2) other dealers would be forced out of business, reducing the number of outlets available to provide service.

3.35. Although Raleigh conceded that, in the longer run, it was possible that new providers of service—at a price—would eventually emerge, this would take a long time to bring about and there would be considerable difficulties in the meantime.

Reaction of specialist dealers to a change of course

3.36. Much of Raleigh's business went through specialist bicycle dealers—relatively small 'bicycle shops' whose primary income came from selling and servicing bicycles. Over the years, Raleigh had carefully built up the goodwill of its dealers, regarding them as a very valuable asset in its crucial home market.

3.37. Raleigh represented that, if it were forced to supply discount stores, the value of its image would be dissipated and it would lose much of its dealers' loyalty and goodwill. Many would desert Raleigh both out of a feeling that Raleigh had deserted them and in an attempt to convert to more profitable business. Raleigh had built up its good will on the basis that it was pursuing the policy of producing to a high specification and selling through specialist dealers. Dealers had entered into joint advertising ventures on that basis and might feel that they themselves had helped to build consumer loyalty to the Raleigh brand.

3.38. Raleigh argued that the OFT report underestimated (at its paragraph 7.21) the probable reaction of Raleigh dealers and that more than 10 per cent of them would drop its bicycles if there were a change of distribution policy.

3.39. Such a reaction by dealers would be understandable because (apart from their feeling of being let down) they would face what they would regard as predatory selling, widely advertised in the local press, at reduced prices made possible by omission to carry the less profitable services and parts base. Customers would go to the dealer and ask his advice on sizing and other technical points before moving on to the mass outlet and purchasing there or trying to force the dealer down to the same price. Heavy discounting by one outlet could possibly affect many dealers within quite a large radius.

3.40. Raleigh also does not sell to direct mail order organisations but about 1965 the decision to sell to major catalogue mail order houses was taken. According to Raleigh, this was at a time of reduced demand for bicycles and when catalogue mail order, as an emerging form of trade, was beginning to take volume from the established retail trade. Catalogue mail order houses were not in the High Street and did not compete directly on price with bicycle dealers, nor did Raleigh supply mail order with cycles under the Raleigh brand—see also paragraph 2.16. Nevertheless, Raleigh's decision affected its trading relationship with, and at first sales to, its dealers (see paragraph 3.18 above). Dealers' allegiance had had to be carefully re-cultivated over the years. Moreover, the Raleigh Service Dealer network had had to be established, among other things, to service mail order bicycles, as some dealers had shown reluctance to service such bicycles.

3.41. If discount stores obtained the right to be supplied with bicycles of the Raleigh brand, then catalogue mail order houses, who at present receive the BSA, Phillips and Sunbeam brands, would claim it too. This would further drive away Raleigh dealers and renew their old resentment.

3.42. As indicated in paragraph 3.15 above, Raleigh also cited the experience of a Canadian and a Dutch manufacturer both of which had experienced a drop in sales when they changed their distribution policy.

Competition and effects of forced change

3.43. Raleigh contended that OFT had ignored or misjudged the possible adverse effects on competition at both manufacturing level (where OFT accepted that Raleigh's trading practices did not appear to restrict or distort competition) and at retailing level if Raleigh were forced to change course. Raleigh did not believe that it could operate both marketing policies (*a*) and (*b*)—see paragraph 3.14 ff above—and considered that, for reasons touched on in paragraph 3.52 below, a forced change of distribution policy could even put Raleigh out of business. This would sharply reduce competition among United

Kingdom bicycle manufacturers and would result in even more imports, besides reducing competition at the retail level.

3.44. Even if Raleigh could survive a change of distribution policy, it believed that OFT were wrong in holding that probable subsequent structural changes in the retailing sector would, in the long run, be likely to enhance competition (OFT report, paragraph 7.28). Raleigh argued, first, that a number of retail outlets would go out of business with a resultant reduction in the number of retailers' independent price-setting decisions and a loss of consumer choice as to variety of bicycles and service, secondly, that many retailers would drop service (see paragraph 3.34 above) and, thirdly, that there would be 'a great increase in concentration at the retailing level, with a corresponding fall in consumer choice'.

3.45. Thus, Raleigh argued, retail competition would be reduced not enhanced by a forced change, and that Raleigh would sell fewer bicycles through fewer outlets, stocking fewer models. As to the prospect that, by beginning to sell to discount stores which now relied largely on imports for their supplies of bicycles, Raleigh could greatly reduce the level of those imports and substitute sales of its own machines, Raleigh argued that the reduction of imports through the discount stores would be counter-balanced by an increase in the number of imported bicycles sold through dealers.

3.46. Even if it were shown that there would be a fall in the general retail price of Raleigh bicycles as a result of a changed distribution policy, Raleigh submitted that the accompanying structural changes in the retail bicycle trade—leading to loss of jobs among small retailers and of opportunities for young people for training as bicycle mechanics—would not be justified in the public interest by what, in Raleigh's view, would only be a marginal, and probably temporary, increase in consumer welfare.

Raleigh's trading situation

3.47. TI Raleigh Industries Limited and its subsidiary TI Raleigh Limited comprise the United Kingdom part of the bicycle division of Tube Investments Limited. (The overseas bicycle companies which were previously subsidiaries of TI Raleigh Industries Limited are now held separately by Tube Investments Limited.)

3.48. Raleigh stated that, until recent years, the overseas subsidiaries depended heavily on Raleigh United Kingdom for their supplies of both bicycles and parts. With or as a result of what Raleigh described as the decline of United Kingdom competitiveness, those subsidiaries had largely become independent operations, manufacturing or sourcing on a world-wide basis for themselves. Moreover, direct exports from the United Kingdom to other parties had fallen. The very large United Kingdom factories had thus become underloaded and there had been many redundancies.

3.49. The effect of these worsening conditions of trade on Raleigh's financial situation has resulted in serious losses in 1979 and 1980. A summary of the consolidated trading results, including external sales, based on the published accounts prepared under the historical cost convention, for the five years ended 31 December 1980 is set out at Appendix 2, together with a summarised version of the consolidated balance sheet as at 31 December 1980.

3.50. [Details omitted. See note on page iv.]

3.51. Raleigh was devoting effort to increasing its sales in Europe, to reductions in its overhead cost structure, and to concentration and modernisation in its two main factories in Nottingham and Birmingham (with closure of factories elsewhere). Thus, the future of Raleigh UK now depended heavily on the sales volume it could obtain in the United Kingdom market, from which was derived about 67 per cent of the total gross contribution of TI Raleigh Limited.

3.52. At an early stage of the inquiry, Raleigh told us that it estimated that if it were to supply discount stores it could lose up to one-third of its annual bicycle sales through other outlets, which, based on 1980 figures, could amount to over 200,000 units valued at over £12 million, as well as substantial sales of toy bicycles through the same outlets. It estimated that its sales through new outlets might be no more than 40,000 units. (The estimated sales loss from existing outlets—of possibly 33 per cent—was thought by Raleigh to be the most likely outcome, a minimum possible loss of 20 per cent and a maximum of 50 per cent having been considered.) Raleigh subsequently informed us that, because of worsening market conditions, it could not produce a realistic current estimate of the net loss of sales of bicycles if its distribution arrangements were changed.

Exports and their dependence on home sales

3.53. Although its exports had declined in recent years, Raleigh was still probably the world's largest exporter of bicycles (some £30 million in 1980). In addition, invisible exports—royalties and technical fees—were growing, reflecting an increase in technology licensing. Raleigh's exports and its United Kingdom sales were interdependent. When United Kingdom demand was seasonally slack, production for export could be slotted in so as to achieve a more even level of production. Whether for home or for export markets, bicycles required similar materials and components, the same production methods and factory routeing, and the same managerial and technical support.

3.54. Thus, production for home and export markets was integrated to optimise the use of Raleigh's Nottingham factories. Raleigh stated that, if its United Kingdom sales fell significantly, none of the export trade could be salvaged. Income from invisible exports and technology agreements would also wither in the absence of continuing technological development on offer from the United Kingdom.

Raleigh's investment and technological innovations

3.55. Raleigh claimed to have been, over a number of years, in the forefront in developing engineering processes, eg powder metallurgy, cold flow press work, swarf compaction and aluminium alloy forging. Recently it introduced the Raincheck brake block, an acknowledged contribution to bicycle safety. The company's manufacturing plant had been modernised with the support of grants under the Selective Investment Scheme. Raleigh stated that, when the modernisation programme, which had involved heavy capital expenditure over the last five years (£4 million in 1980), was complete, in about two years time, Raleigh would have made significant gains in productivity.

3.56. Raleigh submitted that it was not in the public interest that its export trade, its investment in plant, technology and skills (or the contribution it and its employees make to Nottingham's industrial and civic life) be put at risk by a forced change in its distribution policy.