CHAPTER 8

Conclusions

The merger situation

8.1. Our terms of reference require us to investigate and report upon whether a merger situation qualifying for investigation, as defined in section 64(8) of the Fair Trading Act 1973, has been created by the acquisition by GUS of 29·99 per cent of Empire's shares. Such a situation would be created under section 64(1) of the Act if this acquisition had the effect of causing Empire to cease to be distinct from GUS and the assets of Empire exceeded £15 million.

8.2. We are also required to investigate and to report upon whether, if the full acquisition of Empire contemplated by GUS were carried into effect, that would constitute a merger situation as described in the Act. There are thus two merger situations to be considered.

8.3. In both cases section 64(1)(*b*) is satisfied, as it is evident from the published accounts of Empire that its assets exceed £15 million.

8.4. Under section 65 any two enterprises shall be regarded as ceasing to be distinct if one becomes able directly or indirectly to control or materially to influence the policy of the other, even though it has no controlling interest. This occurrence must, under section 64(4)(*a*), have taken place not earlier than six months before the date of the reference. GUS told us that it completed the purchase of 5 million Empire shares on 23 April 1982; and of a further 4·792 million on 5 May 1982; a total of 9·792 million shares representing 29·99 per cent of Empire's issued ordinary share capital. These acquisitions therefore took place within the qualifying period.

Full acquisition

8.5. We report later (see paragraph 8.41) on the situation created by the acquisition by GUS of 29·99 per cent of Empire's shares and deal first with the proposed full acquisition of Empire. Under section 75(2) we are required to proceed in relation to a prospective merger as we could proceed if it had taken place immediately before the reference. On 21 April 1982 GUS announced an offer to acquire the balance of the share capital of Empire. On 26 May this matter was referred to the Commission. Pending the outcome of our inquiry the offer has lapsed, but it is clear that the acquisition is still in contemplation by GUS.

8.6. We conclude that a merger situation qualifying for investigation will be created if the arrangements in contemplation for the acquisition of Empire by GUS are carried into effect.

The market

8.7. In order to assess any competitive effects of the proposed merger it appeared to us that we must first be satisfied that the mail order houses with which we are concerned operate within a distinct market or market sector. The characteristics of mail order were discussed in Chapter 2. We found that general mail order with sales of £2,373 million in 1981 achieved 5·8 per cent of the sales in that year of all retailers excluding food retailers. We estimate that the 1981 sales of the seven general catalogue mail order houses were about £2,220 million and those of the six agency mail order houses were about £2,140 million.

8.8. Mail order sales constitute a significant proportion of sales in some product groups. In 1980 13·2 per cent of all women's, girls' and children's wear was sold through mail order, 10·5 per cent of men's and boy's wear, 10 per cent of footwear, 16 per cent of household textiles and 12 per cent of sports goods, toys etc. In 1980 nearly half of their sales was in clothing and footwear and over 60 per cent was in products where their share of the total market was over 10 per cent (see Table 2.2). Although their sales represented only a small proportion of all retail sales it was apparent that they constituted an important source of credit for retail purchases.

8.9. It was put to us by GUS that mail order was in no way immune from competition from other types of retailing and was therefore not a distinct sector of the retail market. We accept the premise but not the inference. The sellers of all goods and services are in competition with one another for consumers' disposable income, but separate sectors offering these goods and services are still distinguishable. We accept also that some distinctions between different types of retailers have in recent years become less clear cut than they used to be, as traditional methods have been modified and credit in various forms has become more widely available. These changes have meant that some of the features of mail order may now be offered by some other types of retailer. The fact remains, however, that mail order companies, in particular the agency mail order houses, see themselves primarily as competing with one another and the competition with the High Street is less direct and less strong.

8.10. We found agency mail order's clearest distinguishing features in the particular methods of service which it was seen by its customers to offer:

- the customer is usually approached through an agent;
- the selection of goods is made from a catalogue in the home;
- the prices are inclusive of a fairly long period of credit;
- credit is made easily available for all purchases;
- delivery is quick and free; and
- the right to return goods is undisputed.

8.11. There are other features which distinguish agency mail order from competing forms of retailing, although customers will be less aware of them. Many of these differences arise from the timetable imposed by the need to select, order and price merchandise several months before it can be offered to the public, so as to allow time for the bi-annual catalogues to be prepared, printed and bound. This involves a high-risk and relatively long-term commitment in the face of possible changes in fashion and prices and subsequent stockholding and reordering problems; all of which deny mail order the flexible response to circumstances available to the High Street trader.

Techniques of warehousing and the picking and despatching of orders, the return and re-issue of unwanted purchases, the selection and administration of agents and the management of credit all require a combination of skills distinguishable from that required in other forms of retailing.

8.12. We noted also that Economists Advisory Group Ltd, in a study published in 1979, found that the gross margins of mail order houses were materially higher than those of variety and department stores (see paragraph 2.36). We conclude that in combination these various features make mail order a distinct sector of the retail market.

The public interest

8.13. While the chairman of Empire reiterated in the course of this inquiry his statement at the AGM on 2 June 1982 that he feels it in Empire's best interests to form a suitable association with a stronger company, it has not been put to us that the merger is essential as a rescue measure and we have not considered our conclusions in that light. Empire has told us that if the proposed merger does not go ahead it will continue the action it already has in hand to deal with the company's problems.

Potential advantages of a merger between GUS and Empire

8.14. Both GUS and Empire in their submissions to us explained the advantages that could be expected to arise for the parties. Empire's recent trading experience has undoubtedly been difficult—in which as a mail order company it is not alone—and it told us that in this situation it has been unable to generate profits sufficient to cover the investment needed to take full advantage of available technology and to maintain or improve its competitive position in the market.

8.15. Mail order businesses are dependent upon maintaining sales volume and it has been postulated that a substantial level of sales is required for an agency mail order company to be viable. The most obvious advantage arising from the proposed merger is that Empire would move from being the smallest agency mail order company to being part of the group of companies with the leading position in the market. The resultant benefits of scale may be reflected not only in the rationalisation of facilities and the application of technology but also in the generation of sales.

8.16. Empire needs to increase the volume of its sales, which in agency mail order is primarily a question of recruiting more agents. But such recruitment carries with it an increase in debtor balances to be financed and, particularly if conducted with urgency, a disproportionately increased risk of bad debts. It is in this area that Empire compares least favourably with GUS. Access to the GUS credit control system would, both Empire and GUS assured us, yield a significant improvement in the Empire debtor position.

8.17. GUS tells us that it is its policy to sell comparable goods at least as cheaply as any other mail order trader and that regular analyses of competitors' prices are used to ensure that effect is given to this policy. Empire would be in a position to benefit from the savings that can be obtained from larger purchasing, savings which GUS tells us it is its policy to pass on to customers. Some goods now found only in Empire's catalogue might with advantage be replaced by similar merchandise obtainable by GUS, while others might be taken up by GUS, in either case probably resulting in lower buying prices. Such rationalisation of purchases could make Empire more competitive and therefore increase its volume of business.

8.18. Other areas where integration with other GUS interests could be to the advantage of both companies include the transport delivery service and trading relationships with the Post Office, British Telecom, the banks and the National Girobank.

8.19. Throughout mail order new technology is seen as offering the best hope of containing operating costs but the application of such technology is necessarily a continuing and expensive process. GUS has already introduced systems which it could make available to Empire if it became part of the GUS group. Mention has been made of the suggested application of these systems to agent recruitment and credit control; GUS also sees advantage in applying them in due course to achieve substantial savings in Empire's warehouses, which it considers under-utilised.

8.20. Mail order catalogues, costing in the region of £3 to £4 each to produce, are a very expensive item and GUS, with its large requirements, is able to obtain keen prices. If adopted, the 'Noble Plan' to print the Empire catalogue under two names, would lead to an increase of some 400,000 copies in the print run, with consequent savings in the printing costs.

8.21. There are thus a number of benefits which may flow from the proposed merger. While accruing mainly to the parties, they would serve the public interest by enabling Empire to supply its customers more efficiently and at lower cost. But before coming to our conclusions on the public interest we must consider the possible detriments. To these we now turn.

Potential detriments arising from the merger

8.22. We have considered the potential detriments under two broad heads; first those that would be general effects on competition in this sector of the market as a result of the merger; and secondly those that might follow more particularly from changes to be expected in the trading practices of Empire.

(a) Effective competition

8.23. Section 84(1) of the Fair Trading Act 1973, in its guidance to the Commission as to the public interest, puts first among its requirements that we should have regard to the desirability:

'(a) of maintaining and promoting effective competition between persons supplying goods and services in the United Kingdom;'

It seems to us clear that where a dominant company in an already highly concentrated market or market sector further strengthens its position by acquiring a competitor, this may be expected *prima facie* to be inconsistent with the objective of maintaining and promoting effective competition in that market. Although each situation has to be considered on its own facts and merits, the legislative provision for referring mergers to the Commission for examination would seem to recognise that an increase in concentration or market power brought about by merger or acquisition differs significantly from one that results from the successful exercise of competitive skills.

8.24. In this case we have concluded (see paragraph 8.12) that mail order forms a separate sector of the retail market. The shares of general mail order sales (£2,373 million) and of general catalogue mail order sales (£2,220 million) in 1981 (not the same 12 months in the case of every company) were approximately as follows:

	General mail order %	*General catalogue mail order* %
GUS	37·0	40·0
Littlewoods	27·5	29·5
Freemans	12·5	13·0
Grattan	8·5	9·0
Empire	6·5	7·0
Others	8·0	1·5

The table shows the very high degree of concentration in mail order. There is moreover a marked disparity between the sizes of the companies concerned; the share of GUS with its two mail order houses, is one-third as large again as the company in second place, Littlewoods; which in turn is more than twice as large as Freemans in third place. If the five competing companies were to be reduced to four by a merger of GUS and Empire, GUS would emerge with a potential 47 per cent of general catalogue mail order, with the other three companies sharing 51·5 per cent.

8.25. We believe that this increased dominance by the leading company might be expected to affect the market significantly. GUS is already the market leader in agency mail order. On the evidence we have had it is relatively cost-efficient and the market is characterised by strong economies of scale. As already noted, it is also a market sector which substantial companies have found it difficult to enter (see paragraph 2.33), and some of the existing competitors are by no means as strong financially and in organisation as is GUS. The merger would increase GUS's strength as an agency mail order trader in several ways:

(i) giving it immediate access to more agents, thus incidentally widening the data base of the group's credit files;

(ii) adding to the group's turnover, allowing it to spread its fixed overheads across materially increased sales and giving it some increase in buying power; and

(iii) giving it access also to assets such as Empire's warehouses.

We see all this as substantially reinforcing GUS's competitive strength.

8.26. Thus the dominant company in the field would add to its ability to affect the trade of other mail order companies. It would be in a stronger position to set its prices at levels which enable it to make profits, but which could squeeze some of the more marginal traders. GUS says that it is not interested in acquiring market share *per se*. We accept this, but we could not expect GUS to refrain from taking steps on commercial grounds to maintain or increase its sales, which would put severe pressure on its smaller competitors. The merged company would start from a share of nearly half the market sector and its strength, resulting from its efficiency, superior buying power and economies of scale, may be expected to lead in time to a further weakening of its competitors; and thereafter perhaps to further structural changes. Such changes could be seen as strengthening the ability of mail order to withstand competition from other forms of retailing, but we believe that the public interest will be best served by maintaining and promoting effective competition between contending companies within this market sector. Such competition will also preserve the range of consumer choice in the mail order market.

8.27. We recall here our earlier report 'Discounts to Retailers' (HC 311 paragraph 9.34), in which we wrote:

> . . . We have referred to the fears which have been expressed that a handful of large multiples, buying on more favourable terms than their actual or potential competitors, might come to dominate the distributive trades to the disadvantage of suppliers and consumers . . . We consider that is is important to keep a particularly close watch on future mergers in the distributive trades.

8.28. The extent to which—and the speed with which—particular consequences may flow from this acquisition is unquantifiable; so too are the effects of future changes in the technology of mail order. But the situation appears clearly to us to be one in which, given that the GUS mail order companies start from such a strong position in the market sector, a further significant reinforcement of their competitive power through the increased market share resulting from the merger, must be expected to weaken the relative strength of their competitors in the field and thus to lead in time to a still greater degree of dominance. We conclude that the clear risk that the acquisition of Empire by GUS will have consequences adverse to maintaining effective competition in this sector of the market is a serious detriment.

(b) Other possible detriments

8.29. Various interests among those supplying goods and services to Empire have put to us their apprehensions and have suggested possible detriments arising from changes in Empire's trading practices which might be consequences of the merger and we have given careful consideration to these matters.

8.30. A common fear of many of the small suppliers to Empire was that their relationship with that company was likely to be endangered by the rationalisation of purchasing likely to be required by GUS. Some suppliers are too small to bid for the size of orders which they expect GUS to require and thought that GUS preferred in principle to concentrate purchasing on a smaller number of suppliers than had been Empire's practice. (They were unaware of the 'Noble Plan'.)

8.31. GUS reiterated to us the assurance in its offer document that it would continue to operate the Empire business as a separate unit with a separate mail order catalogue. It also told us that its existing merchandising policies provide for the splitting of orders among relatively small suppliers, who in some fields can provide a greater flexibility of supply than larger firms.

8.32. We accept that this assurance was given in good faith, but we think that it cannot be open-ended and must be liable to modification in the light of commercial developments. Moreover, there is some evidence from the past to support the apprehensions of suppliers. As the range of goods offered by mail order companies is fairly similar and contains many well-known branded lines, it is inevitable that a lot of the same items from the same suppliers appear in all the catalogues. We understand that up to 30 per cent of the items in independent competing mail order catalogues may be identical. GUS told us, however, that in the last year 80 per cent of the items in Kays' catalogue have been identical with other BMOC catalogues, that this proportion had increased since the buying arrangements of the two companies were brought closer together two years ago and that some ten years ago the overlap was substantially less (see paragraph 7.14).

8.33. We think therefore that the overlap between GUS and Empire catalogues would be likely to grow materially over time, partly through the opportunities open to Empire management to buy more keenly from the same sources as supply GUS. We believe also that existing suppliers to Empire, while recognising the need to be competitive, have some grounds for feeling that this process would be taken to a point, in the interests of rationalisation within the group, where they would have fewer opportunities than now to compete for orders. While accepting that there is no necessary advantage in variety for its own sake, compared with keen prices, we conclude that in this case a degree of detriment would be involved both in the narrowing of the options open to consumers and in the possible loss of employment by existing suppliers. To the extent that orders might be diverted abroad for goods in which, on Empire's smaller scale of ordering, home suppliers could be competitive, there would be some detrimental effect on employment in the United Kingdom.

8.34. By increasing the buying power of the GUS group of companies, which is already considerable (see paragraphs 3.1 to 3.11), we believe the merger must also increase the bargaining strength of those companies in comparison with their suppliers of goods and services. We refer to paragraph 8.4 of our earlier report 'Discounts to Retailers' and the statement therein by manufacturers that the bargaining strength exerted by increasingly powerful retail organisations could leave suppliers with no alternative but to adopt a practice required of them.

8.35. It was put to us that there could be detriments to the future of the high quality gravure printing industry in the United Kingdom. The present situation is that the Empire catalogue is printed wholly in this country by Watmoughs (Holdings) PLC, of Bradford and Scarborough; and this work has been important as the nucleus of its output of high quality gravure printing. Most of the other mail order companies spread the printing of their catalogues among a number of printing firms, both here and on the continent. Advantage is seen in using more than one source, but it would be widely regretted if there were no capacity available in this country for high quality printing of this kind.

8.36. There is greater capacity for such printing on the continent and in recent years, with recession affecting demand for magazine printing and other work, some firms have had spare capacity which has enabled them to offer very favourable terms for printing British mail order catalogues, particularly because the timing involved enables them to take on this work after meeting much of their fixed costs from fulfilling local orders. The proportion of British mail order work carried out abroad has increased as a consequence and GUS now places almost all its mail order catalogue printing on the continent.

8.37. We were not asked to accept that British printers should be shielded from competition. Watmoughs in particular is well regarded as an efficient company with up-to-date machinery and excellent industrial relations. Given the advantages of proximity and flexibility it could be expected to retain a proportion of the work to be done for British mail order companies, even against the currently intense foreign competition. The fear has been expressed to us by the printing unions that in the event of a merger GUS might well seek to review the existing contract and that this could result in quickly moving the printing of the Empire catalogue to the continent. What is important to Watmoughs and for the future health of the high quality gravure printing industry in this country is that reasonable time should be given to adjust to any new market situation; and we should regard it as a detriment of the merger if this were not the case.

8.38. It was put to us, particularly by UAPT, that it was a detriment that the position of CCN (the wholly-owned subsidiary of GUS in the business of supplying credit information) would be strengthened by the proposed merger, which in its belief had already led to Empire becoming a customer of CCN. However, other mail order companies unconnected with GUS have started using CCN and this does not support the assumption that, but for the contemplated merger, Empire would have used another agency. Thus while the concentrated nature of the market for credit information and the vertical integration between CCN and GUS might have implications for competition policy, we did not find that the prospective merger of GUS and Empire affected this situation and we did not therefore pursue the matter further.

Summary

8.39. GUS is the dominant company in a distinct sector of a market which is particularly difficult to enter and which is already characterised by an unusually high degree of concentration. A material increase of market share by acquisition would increase GUS's power to influence prices and to weaken its competitors, reducing effective competition and making a further increase in concentration more likely. The increased bargaining power inherent in this situation could exert an undue influence on suppliers of goods and services, some of whom could be expected to suffer from the rationalisation of sourcing flowing from the merger. We acknowledge that the points set out in paragraphs 8.15 to 8.20 are such as could sustain the competitive strength of Empire, but in our view the detriments we have noted outweigh the potential advantages.

Conclusion

8.40. We conclude that the proposed merger 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 those summarised in paragraph 8.39.

The current merger situation

8.41. We have described above the situation arising from the full acquisition of Empire. We now consider whether the current holding by GUS of 29·99 per cent of Empire's shares constitutes a situation qualifying for investigation, for which it must be established that this holding gives GUS the power, in the terms of section 65 of the Act, 'directly or indirectly to control or materially to influence' the policy of Empire.

8.42. GUS put it to us that the provisions of the Companies Act 1980 with regard to insider dealings meant, in its experience, that managements and shareholders are now extremely cautious about giving preferential treatment or regard to particular shareholders. GUS also told us that while, if it were so minded, it was likely it could succeed in securing the election of its candidate to the Empire board, this could not be guaranteed; and even if it were achieved such a director would be bound to act in the interests of shareholders generally.

8.43. We acknowledge these points; but we believe that a shareholding of this size in the hands of the acknowledged leader in the field would enable the holder, should it believe that its interests so required, materially to influence the policy of a company. Moreover, we understand that Empire's shares are widely distributed, with no other holding representing more than 7 per cent of the total share capital. We note also that in earlier reports[1] the Commission have reached similar conclusions in comparable situations.

8.44. We consider therefore that in the six months ending 26 May 1982 GUS became able directly or indirectly to control or materially to influence the policy of Empire and that a merger situation qualifying for investigation was thus created.

Conclusion

8.45. We think that it is undesirable that so powerful a shareholder as GUS should be in a position materially to influence the policies of another competitor such as Empire; and in particular to influence Empire against alternative courses of action or associations which it might wish to consider. It seems to us also that this shareholding could indirectly act as a deterrent to other parties who might wish to form an association with Empire. On these grounds we conclude that the current merger situation may be expected to operate against the public interest.

Recommendations

8.46. Dealing first with the proposed merger, we are unable to recommend any action which would prevent the adverse effects which we consider

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[1]Lonrho Limited and Scottish and Universal Investments Limited and House of Fraser Limited, 261; and Eurocanadian Shipholdings Limited and Furness, Withy and Company Limited and Manchester Liners Limited, 639.

would be likely to arise and we therefore recommend that the merger should not be permitted.

8.47. We have commented upon the adverse effects which we think will result from the merger situation already created and for the purpose of remedying or preventing these adverse effects we recommend that GUS should be required over a period not exceeding two years to reduce its holding of Empire's ordinary shares to less than 10 per cent of Empire's issued ordinary share capital and that meanwhile it should be permitted to exercise voting rights only in respect of shares representing less than 10 per cent of the issued ordinary share capital of Empire.

ALAN NEALE (*Chairman*)

J G ACKERS

N L SALMON

R G SMETHURST

R STEPHEN

N E D BURTON (*Secretary*)

17 November 1982