CHAPTER 9

Conclusions

A. The merger situations

9.1. Under the terms of each reference and the provisions of section 69(1) and of section 75(2) and (4) of the Fair Trading Act 1973 we are required to investigate and report whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a merger situation in which section 64(1)(*b*) will be satisfied. Each reference requires us to exclude from consideration section 64(1)(*a*).

9.2. The assets of Johnson exceed a value of £15 million (see Table 5.4), and the condition set out in section 64(1)(*b*) is therefore satisfied.

9.3. By virtue of section 64(8) a merger situation qualifying for investigation exists if two or more enterprises have ceased to be distinct enterprises in the circumstances described in section 64(1). 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.

9.4. The offer by Sunlight to acquire the whole of the issued share capital of Johnson was made on 6 July 1982. The offer lapsed on a reference being made to the Commission, but it is clear that the acquisition of Johnson is still in contemplation by Sunlight. No formal offer to acquire Johnson has been made by Initial, but it is clear that acquisition of the whole of the issued share capital of Johnson is in contemplation by Initial.

9.5. We conclude that a merger situation qualifying for investigation will be created if the arrangements in contemplation for the acquisition of Johnson Group Cleaners PLC by The Sunlight Service Group PLC or those for the acquisition by Initial PLC are carried into effect.

B. The public interest

Competition and market shares

9.6. The business activities with which we are principally concerned in this inquiry are domestic and contract laundry, dry cleaning, linen rental, workwear rental and cabinet towel rental. Apart from dry cleaning, in which only Johnson is involved, the three companies concerned in the merger proposals, and other substantial companies, are to a greater or lesser extent involved in most or all of these activities. Together with dust mat rental, office and industrial cleaning, and the supply of industrial wipers and of a variety of washroom facilities (other than cabinet towels), they are sometimes regarded as constituting a single industry concerned mainly with textile maintenance. Sunlight referred to them collectively as the laundry and cleaning industry and Initial as the cleaning services industry.

9.7. The total United Kingdom annual turnover of this broadly defined industry is believed to be around £480 million, and the effect of acquisition of Johnson by Sunlight would be to increase Sunlight's share of it from about 5 per cent to about 14 per cent while acquisition by Initial would increase Initial's share from about 20 per cent to about 30 per cent. We consider below (paragraph 9.35) the effect of these increases on competition in the industry as a whole.

9.8. However, we take the view that, although there are clear relationships between these activities (for example contract laundry is to some extent an alternative to linen rental, and dry cleaning capacity is used both in retail dry cleaning and in workwear rental), for the purpose of assessing the effects of the proposed mergers on competition it is also necessary to consider separately the principal activities of the companies concerned.

9.9. Before doing this, however, we consider the argument, put to us by Johnson and others, that it is unrealistic to regard Initial as independent of, and fully in competition with, Advance. This argument, which is set out in paragraph 7.30, is that because of the BET shareholdings of about 80 per cent in Advance and 41 per cent in Initial[1] and because the Chairmen of both companies are also executive directors of BET, Initial and Advance should for competitive purposes be considered as part of a single group and their market shares should be aggregated. It was argued that because BET has the power to control and co-ordinate the activities of Initial and Advance it would be correct to assume that it does so. The effect of aggregating the market shares of Initial and Advance would be that these companies would have a share of the whole cleaning market of about a quarter, which would be increased to somewhat over a third if Initial acquired Johnson, and more particularly that their share of the cabinet towel rental market would be about two-thirds and would be increased by the acquisition to about 70 per cent. On this basis there might well be grounds for concluding that the existing market share, and resulting dominance in cabinet towel rental, should not be allowed to be increased.

9.10. BET told us 'there is no scope for BET to co-ordinate a joint approach by its interests in the cleaning services industry and, indeed, any such attempt would be totally contrary to BET's whole management philosophy'. We do not accept that there is 'no scope' for co-ordination by BET of the activities of Initial and Advance; on the contrary we think it is clear not only that BET has the power to co-ordinate in a formal way through Board decisions but also that co-ordination could come about through informal contacts between directors of the two companies. BET undoubtedly has the power as a shareholder in Initial positively or negatively to influence strategic decisions and, while it may be contrary to its philosophy to do so, it could in the future influence the general directions in which Initial and Advance should develop.

9.11. However, in their trading activities Initial and Advance appear at present to be as much in competition with each other as each is with other companies in the industry, and in considering in the following paragraphs the likely effects on competition in the principal activities of Johnson, Sunlight and Initial we do not aggregate the market shares of Initial and Advance.

[1] If Initial made an all-share offer for Johnson this would involve a reduction in BET's holding in Initial to around 30 per cent.

Laundry

9.12. In domestic and contract laundry Sunlight holds the largest market share with about 13 per cent of the market. Acquisition of Johnson, with a market share of about 2 per cent, would increase this slightly, but Sunlight's laundry activities are mainly in London and the South-East and in the Midlands while Johnson's are in the West Country and in Scotland. Initial's share of the laundry market is about the same as Johnson's, and acquisition by Initial would give the merged companies a market share of less than 5 per cent. The demand for laundry services has been declining for many years and, although the number of laundries has also declined, there are still numerous small independent laundries offering local competition. None of the companies concerned regards laundry business as an area in which it seeks to expand. We consider that neither of the proposed mergers would have any material effect on competition in this market.

Retail dry cleaning

9.13. Retail dry cleaning is Johnson's principal activity, and in 1981 this accounted for about two-thirds of the company's total United Kingdom turnover. Johnson is the largest dry cleaner in the country, with a market share of nearly a quarter; its principal competitor (though to some extent their shops are in different areas) is Sketchley, whose market share is slightly less than Johnson's, and competition also comes from a large number of smaller dry cleaners. Neither Sunlight nor Initial is in retail dry cleaning, and acquisition of Johnson by either company would not therefore change the market structure or have any immediate effect on competition in retail dry cleaning.

9.14. It was suggested to us by Johnson that if Sunlight acquired Johnson the financial pressure on it would then be such that it would be likely to dispose of or close a substantial number of Johnson dry cleaning shops, and that if this were to happen competition would be adversely affected since Johnson would be weakened as a competitor while Sketchley would become relatively stronger and, indeed, stronger absolutely to the extent that it acquired any of the Johnson shops disposed of by Sunlight. Sunlight provided us with forecasts to show that it did not in fact expect to be under financial pressure to dispose of Johnson trading properties in order to relieve its financial position; but even if it did so it is not in our view clear to what extent Sketchley's position would be strengthened, since properties could be sold to their managers or to independent operators, and we therefore think that the possibility of an adverse effect on competition in retail dry cleaning is no more than speculative.

Linen rental

9.15. Johnson's share of the linen rental market is about 6 per cent, while Initial's share is no more than about 2 per cent. We consider that acquisition of Johnson by Initial would have no material effect on competition or on potential competition in this market.

9.16. Sunlight on the other hand is the largest linen rental supplier in the country, with a market share of about a quarter. In the London area, which is estimated to account for about a quarter of the total United

Kingdom market, Sunlight's share is substantially greater than this, and the only other substantial linen rental operator in the London area is the Johnson subsidiary, James Hayes. If Sunlight were to acquire Johnson, it would thus acquire its principal competitor in the London linen rental market, in which it would then occupy a dominant position with about 70 per cent of the supply to London hotels with more than 10 bedrooms and just over 60 per cent of the total London linen rental market. Sunlight accepted that, on the face of it, its share of the London market could be a matter for concern, and we consider that the changed competitive position would indeed have implications for the public interest.

9.17. We need to consider how far competition would in practice be affected by the increased market share and dominance of Sunlight bearing in mind the nature of competition in the linen rental market and certain factors to which Sunlight drew attention. It argued that the significance of any increased concentration in the London linen rental market would be less than it might appear because many customers, particularly the larger hotel groups, could if prices or service became uncompetitive switch to owning their linen and laundering in on-premise laundries or in laundries (in other premises) owned by them, while smaller hotels and restaurants could use the considerable number of independent laundries that would welcome their business. Clearly on-premise laundries and contract laundering must to some extent be regarded as substitutes for linen rental since some hotels and restaurants do at present use these methods, and it may be that the use of on-premise laundries is growing. Nevertheless we consider that the competition provided by on-premise laundries and contract laundering must be limited. Many hotels would find it uneconomic to devote space and management resources to on-premise laundries, while many smaller hotels and restaurants would find that the limited facilities that they would be able to install would be inadequate to provide the quality of laundering they need. Moreover, to switch from using linen rental services could involve a significant investment in the purchase of a stock of linen and this might not always be a financially convenient option.

9.18. Sunlight also argued that pressure on linen rental prices would be maintained because the larger hotel groups possess considerable buying power and are big enough to look after their own interests. However, we see little substance in this argument since large customers can apply pressure on prices, and indeed on service, only if there are alternative suppliers big enough to meet their requirements. The greater the concentration among suppliers to the London linen rental market and the greater the dominance of the leading supplier, the less effective the buying power of large customers is likely to be. There is, of course, the possibility of competition to existing suppliers from new entrants to the market but, although entry is relatively easy to companies already operating laundries, it would be unattractive in the present conditions of low profitability and we do not think that new entry could be counted on to prevent exploitation of the market.

9.19. Although we accept that the increased concentration in the London linen rental market that would result from acquisition of Johnson by Sunlight would not eliminate competition, we consider that competition both in price and in the quality of service provided would be significantly reduced.

9.20. In the rest of the country there would probably be little effect since Johnson's linen rental business outside London is concentrated in the west country, where Sunlight's business is minimal. It was put to us that Sunlight's dominance in the London area would have some effect in other parts of the country since a substantial proportion of provincial hotels are owned by the major groups which own hotels in London. However, we think that not much weight can be attached to this factor, since linen rental contracts are not necessarily negotiated centrally for all the hotels in a group, and in any case the major groups tend to prefer to have more than one supplier.

9.21. Our conclusion is that, although there might be little effect outside the London area, the effect of acquisition of Johnson by Sunlight on competition in the linen rental market within the London area would be adverse and substantial.

9.22. However, Sunlight told us that it wished to reduce its dependence on linen rental and that if it acquired Johnson it 'would be prepared to consider the sale of the James Hayes business should the Commission feel this to be desirable'. Disposal of James Hayes' linen rental business might eliminate the adverse effect on competition in the London area linen rental market, and it would be open to us to recommend that such disposal should be made a condition of acquisition of Johnson by Sunlight. We consider the relevance of this possibility below (see paragraphs 9.60 and 9.61).

Workwear rental

9.23. In the workwear rental market Initial is the leading supplier, with a market share of about a quarter. Other major suppliers are Sketchley with somewhat less than a fifth and Spring Grove with just over 10 per cent. Johnson's share is about 5 per cent while Sunlight's is about 4 per cent, and both these companies have in recent years been expanding their workwear rental business. Johnson in particular, which began to undertake this type of business in 1974, has now achieved national coverage and a turnover of about £6 million, of which about two-thirds was gained by internal expansion (the remainder as a result of the acquisitions of Kneels in 1978 and of James Hayes in 1979). Johnson told us it believed that, in spite of the present recession, the workwear rental market had considerable potential and it saw this as the principal area in which it intended to expand its business and increase its market share. Sunlight, though smaller than Johnson in workwear rental, and lacking national coverage, also told us that it had identified workwear rental as the principal area in which it intended to expand and that acquisition of Johnson would enable it to develop its business to the extent that it would be able to compete for the largest contracts which at present only the leading suppliers can undertake. Competition in the market would thus in Sunlight's view be enhanced.

9.24. Sunlight told us that the structure and organisation of the Johnson group, with emphasis on decentralisation and the maintenance of the local identities of its subsidiaries, while perhaps appropriate for domestic laundry and retail dry cleaning, were not appropriate for gaining business in workwear rental. However, we are satisfied that this is not correct. Johnson does in fact have the necessary organisation for seeking and negotiating national contracts and contracts negotiated centrally for more than one company in a group. Moreover, Johnson told us that since contracts with large companies are frequently negotiated by their local or regional managers, who prefer to deal with a local supplier, the decentralised organisation which Sunlight criticised had in fact been an advantage to Johnson in the expansion of its workwear rental business since 1974. In our view Johnson has the necessary financial and management resources and since, as we have said, it already has national coverage and conveniently situated facilities, we consider that it should, as an independent company, be able to continue to expand its business and provide increasing competition to the market leaders. Indeed, because of the substantial burden of debt that Sunlight would have after acquiring Johnson and because of the inevitable uncertainty surrounding its cash flow forecast to 1988 (see paragraph 9.44), we consider that Sunlight and Johnson together might be a less effective competitor than Johnson alone.

9.25. For Sunlight the way to substantially increased workwear rental business and a significant market share would undoubtedly be eased by acquisition of Johnson. However, although Sunlight does not have the national coverage that it believes it needs to obtain a large volume of business, it does already cover a substantial part of the country and it should be able to increase its coverage, at least as a temporary expedient, by means of franchise arrangements as its Modeluxe subsidiary already does in its linen rental business. Both Johnson and Sunlight believe that the workwear rental market has substantial long-term growth potential and it should be possible for both companies to expand their business in competition not only with each other but also with the existing major suppliers.

9.26. Thus, although acquisition of Johnson by Sunlight would bring about no immediate change of much importance in the current competitive situation, it would have an adverse effect on potential competition since it would reduce the number of potentially strong competitors by one and would, in the absence of new entrants, be likely to lead to the industry becoming more concentrated than it would be otherwise. New entry is possible, but the cost is relatively high and it seems unlikely that new entry could be relied upon to provide effective competition.

9.27. Acquisition of Johnson by Initial would involve similar considerations. Initial's market share is already substantial, and although acquisition of Johnson would not increase this share greatly it would mean the reduction of the number of competitors by one as well as the elimination of a competitor, one of whose specific aims is to expand its workwear rental business and increase its market share.

9.28. It is our view, therefore, that because of the effects on competition, and in particular potential competition, in the workwear rental market it would be against the public interest if either Sunlight or Initial acquired Johnson.

Cabinet towel rental

9.29. The leading suppliers in the cabinet towel rental market are Initial with about 40 per cent of the market and Advance with about 24 per cent. There is a substantial number of other suppliers with much smaller market shares, among which are Johnson, whose share has been growing but is at present no more than about 5 per cent, and Sunlight, whose share is about 2 per cent. Our attention was drawn to the fact that paper towels and warm-air driers are to some extent alternatives to cabinet towels; but they are not acceptable substitutes in all cases and we consider that in assessing the effects on competition it is reasonable to regard cabinet towel rental as a separate category.

9.30. Acquisition of Johnson by Sunlight would in our view have no material effect on competition in cabinet towel rental. Because the merged companies' market share would still be very small, there would be no adverse effect; but for the same reason we do not attach much weight to Sunlight's argument that they would be 'better placed to market their product' and would 'represent a more credible alternative' to the market leaders Initial and Advance and that thus there would be a beneficial effect on competition. Johnson appeared to be confident that it could continue to expand its cabinet towel rental business and increase its share of the market on its own and without any assistance from Sunlight, and we see no reason why Sunlight should not increase its towel rental business without assistance from Johnson. Whether either company separately can become a major competitor to Initial and Advance must be a matter of speculation, but we do not think that a merger would offer a significantly greater chance of their doing so together.

9.31. Acquisition of Johnson by Initial would lead to some increase in Initial's market share and, although this increase would only be relatively small, we consider that, given Initial's already substantial share, there would be some detriment to the public interest if it were to increase it further by acquiring Johnson. Initial would in so doing be removing not merely a small competitor but a competitor whose share has been growing and who intends to increase it further, and would thus be reducing existing competition and also eliminating a possibility of increased competition.

Allegations of anti-competitive behaviour in relation to linen rental and to workwear and cabinet towel rental

9.32. There is one other matter relating to competition and concerning the companies involved in the proposed mergers. This is the allegations by Johnson, which we have described in paragraphs 2.21 and 2.29, of anti-competitive behaviour in the industry. There is no doubt that Sunlight and other companies, including on occasions Johnson but not Initial, have attended meetings at which prices for linen rental services were discussed with an intention in the minds of at least some of those present of achieving more profitable trading. Johnson told us that it did not wish to be involved in any collusive pricing arrangements that might result from these meetings, while Sunlight told us that it had an aggressive attitude to pricing and would never have committed itself to any anti-competitive pricing arrangement. In effect the attitude which both companies told us they adopted was essentially the same. In any event there appears to have been no significant effect on competition and pricing in the linen rental industry.

9.33. Secondly Johnson told us that Initial (but not Sunlight) was one of a number of companies that attended a meeting in July 1982 at which the desirability of adopting 'sensible' prices for workwear and cabinet towel rental was discussed. Johnson was represented at this meeting but, although a further meeting was arranged, Johnson did not wish to participate any further. Initial told us that the desirability of realistic prices was indeed discussed and accepted, but that no agreement on actual prices was, or could have been reached. Again, there appears to have been no significant effect on pricing in the markets concerned.

9.34. If any agreements on pricing were made in either of the two sets of circumstances described, they might be registrable. This is a matter for the Director General of Fair Trading and if necessary the Restrictive Practices Court, and we are aware that particulars have already been furnished to the Director General. We have given some consideration to these matters because they were drawn to our attention by Johnson; but we do not think they affect the question whether either of the two proposed mergers may be expected to operate against the public interest, and we have not been influenced by them in reaching our conclusions on that question.

Competition in the textile maintenance market as a whole

9.35. As we have shown in Table 2.1, well over half the turnover of the United Kingdom textile maintenance market is at present in the hands of the six largest suppliers. While each of these companies tends to concentrate on different sectors of the market, the activities of all of them depend largely on the possession and operation of laundry or dry cleaning facilities, or both. To that extent the industry can be regarded as a single industry in which each of the major suppliers could develop its business in any or all of the separate sectors, and in which strength in one sector is likely to make it easier to acquire strength in others. Each supplier can therefore be regarded as a competitor, or at least a potential competitor, of all the others, and accordingly we think it is relevant to consider the existing degree of concentration in the industry as a whole and the effect of such further concentration as would result from either of the proposed mergers. In our view, with over half the market in the hands of six suppliers, elimination of Johnson (which as an independent company has the financial strength, the facilities and the resolve to be an effective competitor in the growth areas of the industry) would have an adverse effect on competition, and would be *prima facie* against the public interest. This consideration is relevant to both the proposed mergers, though the effect would be less marked in the case of acquisition by Sunlight. Acquisition by Initial would not only substantially increase the largest company's market share but would also give a single company (BET) the power to control more than a third of the total textile maintenance market.

Conclusions relating to competition

9.36. In the foregoing paragraphs we have identified certain adverse effects on competition which may be expected to arise from the proposed mergers.

These are:

(*a*) In the linen rental market acquisition of Johnson by Sunlight would result in a significant reduction of competition in the London area because it would increase Sunlight's dominance by eliminating its principal competitor (paragraphs 9.16 to 9.21).

(*b*) In the workwear rental market, since both Johnson and Sunlight aim to increase their share of this market, acquisition of Johnson either by Sunlight or by Initial would reduce the number of potentially strong competitors by one and would be likely to lead to the industry becoming more concentrated (paragraphs 9.23 to 9.28).

(*c*) In the cabinet towel rental market acquisition by Initial would increase Initial's already substantial share of the market, and by removing an existing competitor would eliminate a possibility of increased competition (paragraph 9.31).

(*d*) There would be increased concentration and a likelihood of reduced competition in the textile maintenance market as a whole (paragraph 9.35).

Management and efficiency

9.37. There have been accusations by Sunlight that the business of Johnson has been conducted in a way which has led to unsatisfactory returns being made on its assets, and argument on this subject has been conducted publicly by means of letters to shareholders from the Chairmen of both companies. In particular it was alleged by Sunlight that by failing to release the resources locked up in its property assets Johnson had failed to realise its full potential. Johnson told us that like other multiple retailers it required appropriate shops for its dry cleaning business and that it regarded these as an integral part of that business. Its policy was to purchase these shops wherever possible. They tended to retain their value despite inflation, and if they ceased to be required for trading purposes they provided ready access to funds (either by sale or as security for borrowing) for the development of the business. It is arguable whether the policy adopted by Johnson or the policy apparently envisaged by Sunlight would produce better results for shareholders, but in our view this is not a matter which affects the public interest.

9.38. We have examined the performance of Johnson and Sunlight (see Chapters 3 and 5) and also, for purposes of comparison, of Initial (see Chapter 4). We have set out in those chapters the earnings of the three companies for the five years to the end of 1981 (to 31 March 1982 in the case of Initial) expressed as pence per ordinary share, and their profits over the same period expressed as returns on capital employed, on shareholders' funds and on turnover. As Sunlight pointed out, Johnson's profitability, measured by reference to earnings per ordinary share and returns on capital employed and shareholders' funds, declined in 1980 and 1981, while Sunlight's and Initial's profitability increased. Johnson denied that these comparisons provided a valid indication of its relative efficiency. We considered all the detailed arguments submitted by Johnson in support of this denial, and in particular we have taken account of the fact that Sunlight's returns on capital and on shareholders' funds reflected high returns on its laundry business, in which the asset base had been substantially reduced by the sale and leaseback transaction referred to in paragraph 3.5, while Johnson's reduced returns for 1980 and 1981 reflected, *inter alia,* heavy capital expenditure in recent years which had increased its asset base. Also, as can be seen from Table 5.3, Johnson's profits before tax for the first half of 1982 were well up on those for the corresponding period in 1981.

9.39. We do not feel justified in drawing from the statistics a conclusion that Johnson's business has not been efficiently managed or that it has failed or, if left as a separate entity, would fail to achieve adequate returns on its assets. Accordingly we conclude that the performance of Johnson does not give rise to any issue concerning the public interest.

9.40. As we have already mentioned in paragraph 9.24, a further criticism by Sunlight of Johnson management is that Johnson is not organised in a way which will enable it to develop from being essentially a retail dry cleaning business so as to achieve really effective expansion into rental business. However, the general direction in which the business of Johnson is likely to go is not in itself a matter which concerns the public interest. The public interest would be involved if we took the view that Johnson was unlikely ever to be more than a negligible competitor in the rental field, in which case its elimination as an independent competitor would be of little consequence. It is clear from what we have said in paragraph 9.24 that we do not take this view. Thus, although there may well be argument as to the most appropriate form of organisation for Johnson, this is a matter which by itself does not affect the public interest and on which we do not need to reach any conclusion.

9.41. One of Johnson's arguments in opposing acquisition by Sunlight was that the changes in organisation that Sunlight would undoubtedly make, including imposition of a divisional structure, would involve a period of conflict that would be damaging to the business since it would seriously affect the morale, loyalty and effectiveness of the management and the workforce. We accept that there would be friction and disruption arising from changes in organisation and differences in management style, and we recognise the difficulty which the top management of Johnson would have in accepting changes which, as they would see it, would mean the negation of deeply felt and sincerely held views on the proper way to manage the business. Sunlight, on the other hand, was confident that any problems arising in this context could be resolved without serious difficulty. Its interest would be in the success of the business, as it has been with previous acquisitions it has made, and while there might be some short-term damage to the business we doubt whether in the longer term there would be any adverse effects such as would amount to a public interest detriment.

Financial effects

9.42. A major part of Johnson's opposition to acquisition by Sunlight stems from its belief that, after acquisition of Johnson, Sunlight would be under severe financial strain, with a burden of debt that it could reduce only by selling off Johnson properties, including some trading properties, and that it would not have, or be able to raise, finance necessary to develop and expand the business. Johnson on its own, on the other hand, is in a strong financial position, with a substantial bank of non-trading freehold properties which can either be sold to raise finance or be used to facilitate bank borrowing.

9.43. Sunlight denied that it would be under any financial strain or that it would be unable to finance development and expansion of the business without disposing of Johnson trading properties. Much of the argument turned on the level of gearing that Sunlight would have after acquiring Johnson, and this itself depended on the value that should be put on Johnson's properties.

9.44. Even if account were taken of Johnson's properties at their current cost values, the gearing of a merged Sunlight/Johnson group would still be high. This would not in itself be a factor operating against the public interest. The public interest is, however, concerned in the question whether the pressure on the merged group to reduce its borrowing (particularly bearing in mind that the Midland Bank loan is to be repaid in five years) and improve its debt/equity ratio might inhibit the development of its business and thus make it a less effective competitor in the dry cleaning and textile rental markets than Johnson would be if it continued to exist as a separate entity. We have examined a cash flow forecast until the end of 1988 provided by Sunlight (referred to in paragraph 7.63) which indicates that this will not be the case. However, although the assumptions on which the forecast is based may not be unreasonable, we think there must remain some doubt whether the merged group's high gearing immediately after the merger would in fact be reduced in the way that Sunlight forecast. This doubt arises not only from the inherent difficulty of forecasting as far ahead as 1988, but also because much would depend on the success of the group's trading in the first year or two after the merger had taken place.

9.45. Sunlight would not only have the disadvantage of taking over a company much bigger than itself; it would also be taking over one in whose main business, retail dry cleaning, it has no experience. Though we do not attach the same importance to this factor as Johnson did in its arguments against the merger, we think that it does involve risk of damage to the business in the short term. There are other factors involving the same risk of probably short-term damage, such as the friction and disruption, already referred to in paragraph 9.41, which would arise from imposed changes of organisation and from differences in management style, and the disruption that might be expected from the closing of plants and from the loss of some of Johnson's head office staff.

9.46. Factors such as these are not critical considered individually: taken together they do in our view cast doubt on Sunlight's optimistic view of the prospects for the merged group. We also need to take account of the undoubted fact that immediately after the merger the group would have about £13 million of additional short-term debt and thus be less strong financially than Johnson is now. We do not take the extreme view put forward by Johnson that the group would in effect not be financially viable; on the other hand we foresee, at best, no advantage to the public interest and, at worst, the risk that the group's ability to expand and develop the business would be restricted and that it would thus be a less effective competitor than Johnson would be on its own.

9.47. No specifically financial considerations would arise on an Initial/Johnson merger first because Initial appears to be unlikely to have to resort to significant borrowing to finance the acquisition, and secondly because it appears to have adequate funds available to it to fund any foreseeable likely developments within the merged business.

Employment

9.48. Johnson argued that acquisition either by Initial or by Sunlight would result in substantial numbers of job losses. In the case of acquisition by Initial, Johnson said that:

> Either Initial would follow its existing policy of long-range trunking from a small number of processing centres, in which case it would close a large number of Johnson works, leaving perhaps only one in Scotland, one in Wales and one in the West Country. Alternatively, it would throw its policy of recent years into reverse and start using Johnson's works providing local coverage throughout the country for its processing, in which case Initial would have to make wholesale redundancies in its transport fleet and distribution network.

9.49. Initial denied that redundancies would arise in either of these ways, and made the general claim that since its aim in making acquisitions was always the development and expansion of the company acquired, the probability was that the merger would result in increased employment. In particular, its plans for expansion in the workwear rental area following acquisition of Johnson would lead to greater throughput in the Johnson retail dry cleaning shops and thus protect shops which might otherwise have to close. Neither side offered any detailed estimates of the losses or gains which it claimed could be expected, no doubt because, in the case of Initial, it had not made any detailed examination of how the two businesses might be put together, and in the case of Johnson because little information was available to it on this point.

9.50. In our view it is unlikely that the merger would take place without there being some rationalisation either of plants or of distribution. We are unable to say when this might happen or what it might amount to, but clearly there is the possibility of some redundancies that would not occur in in the absence of the merger. Equally we are unable to say how far there might on the other hand be increased employment as a result of development of the business, that would not occur in the absence of the merger; but we do not consider that it is likely to be significant.

9.51. We think therefore that it is not possible to predict any significant effect on employment, either adverse or beneficial, from acquisition of Johnson by Initial.

9.52. The likely effects on employment of acquisition by Sunlight are different. Johnson claimed, for reasons which we have set out in paragraphs 7.79 to 7.81, that this would lead to almost 1,000 redundancies. Sunlight on the other hand considered that there would be only about 400, and it also argued that about half of these could not properly be regarded as resulting from the merger.

9.53. We believe that Sunlight's estimate is the more realistic since, unlike Initial, Sunlight had definite plans for rationalisation of the businesses, which were unknown to Johnson but were described to us in some detail. These involved the closing down of certain Johnson and Sunlight plants; and Sunlight estimated that these closures, together with about 60 redundancies at management level, would result in a net loss of about 200 jobs. The remaining 200 job losses envisaged by Sunlight would result from closure of Johnson dry cleaning shops which it expected would be found to be making inadequate profits; and it was these job losses which Sunlight argued should not be considered to be a result of the merger on the ground that the shops might be, indeed ought to be, closed by Johnson in any case. It may well be that Sunlight is mistaken about the profitability of Johnson shops and it can only be a matter of speculation at this stage whether Sunlight would in fact close Johnson shops that would not be closed otherwise, and if so how many. We think it likely, however, that Sunlight would adopt a more rigorous approach after the merger than Johnson does now, and that therefore there probably would be some closures or disposals that would not take place otherwise. We cannot, however, estimate how many job losses (if any) this would involve, particularly as some jobs would be preserved by shops being taken over by other businesses.

9.54. In general it can be argued that there would be some gain to the public interest from rationalisation of the business in spite of the job losses involved, since it should lead to greater efficiency through a reduction in total costs and perhaps elimination of some excess capacity. But we consider that any gain to the public interest in this way would be outweighed, not only by adverse effects on competition which we have considered above, but also by the adverse effect on the public interest, in present conditions of high unemployment, of lost jobs, especially as some of these would, we believe, be likely to occur on Merseyside where unemployment is already exceptionally high.

9.55. We therefore conclude that the adverse effect on employment is a detriment to the public interest, though, since the numbers involved would not be very large, we should not regard it as of sufficient magnitude to lead us to conclude, in the absence of other factors, that the merger would be against the public interest.

Conclusion

9.56. We have identified certain detriments in connection with competition in the case of the proposed acquisition by Initial and in connection with competition and employment in the case of the proposed acquisition by Sunlight. In the absence of any benefits to the public interest we should regard these as grounds for concluding that both acquisitions would be against the public interest, particularly as, in the case of acquisition by Sunlight, the detriments have to be seen against a background of uncertainty about the merged group's prospects and hence its ability to be an effective competitor (see paragraphs 9.44 to 9.46).

9.57. It is therefore relevant to consider whether there are any benefits to the public interest which should be weighed against the detriments we have identified. In our view the only advantages claimed for either merger which could properly be regarded as benefits to the public interest are that Johnson and Sunlight together would become a more significant competitor in workwear and other rental business than either company would separately, and that Johnson and Initial together would, as a result of the development of new areas of rental business that would then be possible, be able to provide greater employment than either company would separately. However, it will be apparent from what we have already said on these points that we regard both of these claimed benefits as too speculative to be given any weight against the detriments we have identified. If Johnson were, or were to become, a weak company unable or unlikely to offer effective competition to the major suppliers in the various markets concerned, there would be less reason for preserving its independence and there might, indeed, be some advantage to the public interest in its becoming part of a larger group. But on the evidence available to us this is not the view we take of Johnson's present situation or of its prospects.

9.58. We conclude therefore that both acquisition of Johnson by Sunlight and acquisition of Johnson by Initial may be expected to operate against the public interest, the particular effects adverse to the public interest being:

in the case of acquisition by Sunlight

the adverse effects on competition summarised in paragraph 9.36(*a*), (*b*) and (*d*),

and the adverse effect on employment as described in paragraphs 9.52 to 9.55,

in the case of acquisition by Initial

the adverse effects on competition summarised in paragraph 9.36(*b*), (*c*) and (*d*).

9.59. We considered whether there might be any action we could recommend which might remove the effects adverse to the public interest.

9.60. As we have already pointed out in paragraph 9.22, the adverse effect on competition in the London linen rental market of acquisition of Johnson by Sunlight might be eliminated if the linen rental business of James Hayes were disposed of. This would be of relevance only to the London linen rental market and would have no bearing on the other adverse effects. Nevertheless, we considered the possibility. Since the merger is opposed by Johnson it would not be practicable to insist on disposal of this business before the merger took place, and it would therefore be necessary for the Secretary of State to seek an undertaking from Sunlight that it would dispose of it after the merger had been completed. Sunlight might well be willing to give such an undertaking, but we think that it might have difficulty in implementing it. The London linen rental market is not at present an attractive market to be in, and we think there is substance in the view expressed by Johnson (see paragraph 7.32) that a potential buyer of the business would see a history of losses and low prices as a result of competition with Sunlight and so would be unwilling to purchase the business without some assurance that it was likely to be profitable; and such assurance could come only from Sunlight and since, to be satisfactory to the purchaser, it would have to amount to an agreement not to compete, it would frustrate the purpose of disposal. Moreover, an undertaking by Sunlight to dispose of the James Hayes business would not bear on its customers, and there would be no certainty that they would in fact transfer their custom to a new owner of the business.

9.61. We are unable to recommend any action which might remedy the adverse effects either in the case of acquisition by Sunlight or in the case of acquisition by Initial.

9.62. We accordingly recommend that neither the proposed acquisition of Johnson Group Cleaners PLC by The Sunlight Service Group PLC nor the proposed acquisition of Johnson Group Cleaners PLC by Initial PLC should be permitted.

M S Lipworth (*Chairman*)

P Goldman

R M Goode

L Kelly

C M Miles

B C Owens

N E D Burton (*Secretary*)

16 March 1983