

CHAPTER 7

Conclusions

A. The merger situation

7.1. Under the terms of the 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 for the acquisition of Fitch Lovell PLC by Linfood Holdings PLC which, if carried into effect, will result in the creation of a merger situation qualifying for investigation and in which section 64(1)(b) is satisfied—that is if the value of assets to be taken over exceeds £15 million.

7.2. As we have shown in Table 3.2 (see paragraph 3.46), the assets of Fitch Lovell exceed £15 million, and section 64(1)(b) is therefore satisfied.

7.3. By virtue of section 64(8) of the 1973 Act 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.

7.4. On 29 September 1982 Linfood announced its intention to make an offer to acquire the whole of the issued share capital of Fitch Lovell, and on 13 October 1982 a formal offer was made by Morgan Grenfell and Co Limited on behalf of Linfood. On reference of the matter to the Commission on 2 November 1982 the offer lapsed, but it is clear that acquisition of Fitch Lovell is still in contemplation by Linfood.

7.5. We conclude that a merger situation qualifying for investigation will be created if the arrangements in contemplation for the acquisition of Fitch Lovell PLC by Linfood Holdings PLC are carried into effect.

B. The public interest

7.6. Fitch Lovell is mainly engaged in the food trade, its principal activities being manufacturing and processing, multiple retailing, delivered wholesaling and cash and carry wholesaling. Linfood is not engaged in food manufacturing nor, since 1982, in delivered wholesaling; it is, however, engaged in cash and carry wholesaling and multiple retailing, and we consider that it is principally from the combining of on the one hand the cash and carry activities and on the other hand the retail activities of the two companies that any issues of public interest might be expected to arise. We also examine the likely effects of the merger on Fitch Lovell's wholesaling and manufacturing companies and on employment.

Cash and carry wholesaling

7.7. The likely effects of the merger in the area of cash and carry wholesaling can be disposed of relatively briefly and it is therefore convenient to consider these first.

7.8. Linfood is one of the four largest cash and carry wholesalers in the country, each of whom has a market share of 10 per cent or more and who together account for about 46 per cent of the market. Linfood estimated that its current share is under 12 per cent. Fitch Lovell's cash and carry operation is much smaller than Linfood's (less than 1.5 per cent of the market), and the increase in Linfood's share that would result from the merger would not therefore be significant. Indeed, since Linfood estimated that its share would only be increased from under 12 per cent to about 13 per cent and the share of the market accounted for by the four largest suppliers together would be increased only from about 46 per cent to about 47 per cent,¹ the merger would produce little change in the market structure or in the degree of concentration and could thus be expected to have little adverse effect on the existing competitive situation in cash and carry wholesaling. Moreover, this is particularly the case since for geographical reasons there is at present only limited competition between the cash and carry operations of Linfood and those of Fitch Lovell, Fitch Lovell's being mainly in the south-west where Linfood is thinly represented.

7.9. We consider that in cash and carry wholesaling the merger would not be likely to have any material adverse effect on the public interest.

The combining of the two groups' retail interests

7.10. In considering the possible effects of combining the two groups' retail interests we need to take into account the well-established fact that food retailing has in recent years become dominated by a small number of large and powerful grocery chains and that the market share accounted for by these chains appears to be continuing to grow. The extent of the continuing trend towards concentration in food retailing is indicated in paragraphs 2.5 to 2.7.

7.11. We also need to take account of the fact that in our 1981 report on Discounts to Retailers,² which was concerned *inter alia* with the discriminatory discounts and other terms which large retailers were increasingly able to obtain as a result of their buying power, we emphasised (paragraph 9.23) that, although discriminatory discounts had not in general been harmful to the public interest, 'this conclusion holds good only so long as there continues to be effective competition among suppliers and among retailers'.

7.12. In the course of our present inquiry it was represented to us that even since our 1981 report the trend towards concentration in the retail grocery trade had continued to such an extent that the buying power of the major supermarket chains was itself now against the public interest. This is a matter of importance and controversy, but it is certainly outside the scope of our present inquiry and we are not able to express a view on it in this report.

7.13. It is, however, relevant and, in the light of the emphasis in our 1981 report on the continuance of effective competition, particularly important

¹There is some uncertainty about the precise percentages (see footnote ² to paragraph 2.11) but this does not affect the point that the increases would be small.

²Discounts to Retailers', 13 May 1981, HC 311.

to consider the effects on competition of bringing together the Linfood and Fitch Lovell retail interests.

7.14. Clearly it is necessary to consider whether there might be adverse effects on competition in food retailing itself, such as might normally be expected to arise from a horizontal merger, or whether on the other hand there would be (as has been represented to us) an enhancement of competition resulting from the creation of a stronger chain better able to compete with the largest multiples. We shall also consider the point, made mainly by or on behalf of some food manufacturers, that the substantial buying power of retailers is already putting such pressure for improved terms on United Kingdom food manufacturing companies that they are earning insufficient profits and becoming unable to finance adequate investment in research and development and re-equipment, and that the merger would exacerbate this situation.

7.15. In spite of the large and increasing share of the food market held by the major multiples, and although there may be particular locations where competition is relatively weak because of the local dominance of a particular retailer, we have no doubt that in general the retail food trade is still a highly competitive business. In these circumstances we consider that adding Fitch Lovell's (ie Key Markets and David Greig) market share of less than 2 per cent (of the packaged groceries market) to Linfood's (ie Gateway, Dee and Carrefour) share of about 2 per cent is unlikely to have any material adverse effect on competition in the sense of enabling the combined group to exploit the market by, for example, increasing prices or failing to supply the range and choice of goods which the buying public would like. The combined group would have a higher share than 4 per cent in a few of the television regions. In only one case, however, would the share be significantly increased by the merger. In Wales/South West the combined group would have 9.7 per cent, but Linfood already has 8.9 per cent; in Anglia the combined group would have 5 per cent, but Fitch Lovell already has the whole of this share; in Tyne/Tees the combined group would have 4.9 per cent, but Linfood already has the whole of this share. The increase in regional market share would be other than trivial only in the South region, where it would be increased to 7.3 per cent as a result of Fitch Lovell's 4.7 per cent being added to Linfood's 2.6 per cent; but even here the combined share would be modest compared with the share of 45 per cent in this region held by the two largest chains.

7.16. Our view is therefore that the acquisition of Fitch Lovell by Linfood would have no material adverse effect on competition in food retailing.

7.17. We now consider whether the merger might on the other hand have some beneficial effect in that it might, as was suggested to us, enhance competition by creating a stronger chain better able to compete with the largest multiples. We have already referred (in paragraph 7.10) to the large and growing share of the food retailing market accounted for by the largest chains. The advantages enjoyed by these chains appear to be so great that it is likely that the trend towards concentration will continue and indeed could be speeded up as smaller chains and independent retailers

become progressively less able to compete. Although the trade is at present highly competitive, the ultimate result of the continuing trend might be the virtually complete concentration of the trade in the hands of a very small number of very large chains and the elimination of effective competition to them. We think that a merger which would strengthen the ability of middle ranking chains to survive and continue to compete, and which might even go some way towards redressing the balance between them and the largest chains, should not be prevented without good reason.

7.18. The argument put to us on this point, particularly by Linfood, was that while the strength of the merged group's retailing chain would certainly not be sufficient to reduce the market shares of any of the largest chains, or even to prevent some further increase in their shares, it would help to retard their continued expansion. In the present circumstances of continuing concentration some of the medium or smaller chains might not be able to survive unless they increased their strength by merger with other chains and thus became able to enjoy advantages such as more effective advertising (particularly television regional advertising), the ability to secure more favourable terms from suppliers, and greater ability to seek and obtain sites for new stores. To the extent that these advantages would flow to the merged group if Linfood were to acquire Fitch Lovell, this would, Linfood suggested, enable it to become a more effective competitor, particularly in those areas of the country where it would have a relatively high market share.

7.19. In considering the claim that the greater retailing strength of the merged group would be an advantage to the public interest in the way suggested, we need to take account of the argument put to us by Fitch Lovell that the Linfood and Fitch Lovell retail outlets are so different that they could not efficiently be managed together. This argument, which we have set out in paragraphs 5.23 to 5.26, is briefly that the individual Key Markets stores are in the main bigger than those of Gateway (under whose Managing Director Linfood intends to put them) and that they have fundamentally different trading strategies, Key Markets providing a wider range of goods and services and being designed to attract the one-stop shopper, and Gateway tending towards limited range discount stores.

7.20. Fitch Lovell did not say that the difficulty of managing chains of stores which differed in the ways it claimed Gateway and Key Markets differed would threaten the viability of the merged businesses, but it did claim that the difficulty was such that if combined they could not be operated efficiently and that therefore they would be a less effective competitor.

7.21. It is correct that the Key Markets stores are on average a good deal bigger than those of Gateway, and that Key Markets has a higher proportion than Gateway of large stores and Gateway a higher proportion than Key Markets of small stores; but we do not see much significance in this since the size range of all Linfood's retail outlets, even without Carrefour, is not materially different from the size range of the Key Markets stores. There are differences between the two chains in the range of goods and services and the proportion of own label goods offered; but there are also

differences in the range of goods in the stores within each group; and we do not think that the differences between the chains would prevent their being successfully operated within a single group. Moreover, Linfood denied that any of its stores could correctly be described as a discount store, and we agree that none is a discount store in the generally understood sense of a store with a small but varying range, of a few hundred lines, presented in a simple way and sold at prices appreciably lower than the normal retail prices. If Gateway were discount stores it would be expected that their prices would be generally lower than those in Key Markets stores, but on the basis of limited information supplied to us by Fitch Lovell itself this does not appear to be the case.

7.22. We do not therefore accept the argument that the merged retail chain would be prevented from realising its full potential strength and effectiveness as a competitor by problems of management arising from Gateway and Key Markets being put together. The two chains are no doubt not identical in character or in their trading strategies, but on the facts put before us we see no reason for concluding that Linfood, retaining most of the existing management of Key Markets, could not successfully cope with any problems that might arise from bringing the two businesses under the management of a single group, and develop them into a stronger and more effective competitor than either is at present.

7.23. However, even if all the advantages which Linfood claimed would result from the merger were to be fully realised, we think that any benefit to the public interest could hardly be more than marginal. The problem for the public interest presented by concentration in food retailing does not arise from the medium-sized or smaller chains but from the largest. We do not think that the merger could do much to retard the growth of the largest chains; but it would do something to improve the prospect of the maintenance of some competition to them. If Key Markets is to be sold there may be some advantage from this point of view in its being acquired by Linfood. Prevention of the merger, on the other hand, would do nothing either to retard the growth of the largest chains or to reduce the difficulties now confronting the others.

7.24. Similar considerations apply to the argument that some United Kingdom food manufacturers are earning inadequate profits because of pressure from retailers for more and more favourable prices and terms. To the extent that there is an imbalance of bargaining power between manufacturers and retailers this results primarily from the dominant position and the great buying power of the largest retail chains. We have no doubt that the merged group would seek to use any additional retail buying power to obtain more advantageous terms from suppliers; but compared with the buying power of the largest chains the retail buying power of Linfood and Fitch Lovell combined would not be great.

7.25. The merged group would have substantial wholesale interests as well as increased retail interests and, if purchases for the wholesale and retail interests were aggregated for the purpose of negotiating terms, the balance of buying power could be significantly altered. The merged group would then become in terms of sheer buying power the fourth largest food buyer in

the industry, with only Sainsbury, Tesco and Asda being larger; thus the merged group would have greater buying power and presumably therefore better buying terms than any of the other multiple retailers and any of the other multiple cash and carry operators. The potential effect on food manufacturers of such increased buying power is obvious. However, if the merger would, as we have said in paragraph 7.23, do something to improve the prospect of the maintenance of some competition with the three biggest chains, it seems that this can only be at the cost of some increase in the buying power of the merged group.

7.26. The evidence before us was that wholesale and retail purchases are not generally aggregated at present, and neither the food manufacturers who responded to our invitation to express views on the merger nor their representative bodies referred to the possibility of such aggregation. Eight food manufacturers opposed the merger, but none of them did so specifically on the ground that additional buying power would result from the aggregation of retail and wholesale purchases. Others were neutral or did not wish to make any comment, and others again shared the view expressed by the Food Manufacturers' Federation that in spite of increased buying power the merger would on balance be beneficial (see paragraphs 6.10 and 6.20 *et seq*). We consider there is some validity in the point made by the Food Manufacturers' Federation that a stronger cash and carry operator might be good for independent retailers, and to the extent that more favourable prices or terms secured by the merged group's cash and carry operation were passed on to independent retailers this would help the latter to continue to survive in competition with larger retailers.

7.27. Taking account of all these factors, we do not consider that the merger would be against the public interest because of any adverse effect of increased buying power on food manufacturers. In any event, even if there is at present an undesirable imbalance of bargaining power to the disadvantage of food manufacturers, we do not think that to prevent the merger would do anything to redress it.

Possible distortion of competition

7.28. Fitch Lovell drew our attention to the possibility that, after acquiring its manufacturing companies, Linfood might not operate a policy of strictly arm's length trading between the manufacturing and the wholesaling and retailing companies. If this were to be the case the manufacturing companies might discriminate in price in favour of intra-group customers to the competitive disadvantage of other wholesalers and retailers, and the wholesaling and retailing companies in the group might be required to buy from the group's manufacturing companies to the competitive disadvantage of other food manufacturers. However, it is by no means inevitable that this should happen, as is shown by the fact that Fitch Lovell itself, though vertically integrated in food manufacturing, wholesaling and retailing, has not traded in this way. We see no reason why Linfood should do so, and we accept its assurance that its policy is that intra-group trading should be at arm's length, and that purchases from present suppliers of Fitch Lovell or supplies to present customers of the manufacturing and wholesaling businesses would not be arbitrarily restricted.

The effect on Fitch Lovell's manufacturing and wholesaling interests

7.29. Fitch Lovell said that it considered the most important issue to be the severe adverse effects which the merger would have on its manufacturing and wholesale interests (paragraphs 5.19 to 5.22). It told us that it believed that Linfood was interested primarily in acquiring the Key Markets retail chain and that after the merger it would be likely to dispose of the present Fitch Lovell manufacturing companies. This view seems to have been the result of a lack of understanding or failure of communication between the two companies during the period leading to the bid by Linfood. We have no need to take a view on precisely how this came about; but we are satisfied that Linfood in fact wishes to expand into food manufacturing and that its intention, if the merger takes place, is to retain and develop the Fitch Lovell manufacturing companies.

7.30. However, that is not the end of the matter since Fitch Lovell told us that, for the reasons set out in paragraph 5.20(a) and (b), it had become convinced that food retailing was incompatible within a single group with food wholesaling and food manufacturing because of the damage that could be done by retailing competitors ceasing to buy or reducing their purchases from the wholesaling or manufacturing companies. We have no doubt that action of this kind has in fact been taken against Fitch Lovell specifically as a means of influencing its policy and limiting the effectiveness of its competition. We also have no doubt that Fitch Lovell, in order to protect the business of its manufacturing and wholesaling companies, has on occasion felt obliged to compete less aggressively than it would have liked.

7.31. Fitch Lovell told us that for these reasons it had already taken a decision to separate its retailing and manufacturing interests and was seeking a purchaser for Key Markets. The company said that, whatever Linfood's intentions might be Linfood would if the merger took place find itself subjected to a greater intensity of the same pressure from retailing competitors and would sooner or later find it necessary to dispose of the delivered wholesaling and manufacturing companies.

7.32. Linfood told us that its Board had considered this point because of the specific warning given to it by Fitch Lovell, but had decided that there were good reasons for disregarding the warning (see paragraph 5.11). It is possible that Linfood may be underestimating the difficulties which might arise; we consider, however, that Linfood would not necessarily react in the same way as Fitch Lovell has, and would offer stiffer resistance.

7.33. Fitch Lovell argued that the wholesaling and manufacturing companies, if they had to be disposed of, would be likely to be sold to and absorbed in 'large national or semi-national businesses', in which case rationalisation might lead to their disappearance as 'regional businesses and separate regional sources of employment'; alternatively disposal might result in some of them 'possibly falling under foreign control' (see paragraph 5.21).

7.34. We do not think it is possible to make any confident prediction about these matters. It is uncertain whether Linfood would have to dispose of any businesses; if it did so it is uncertain who would acquire them; and, whoever acquired them, it is uncertain whether there would be undesirable

consequences. In view of this chain of uncertainties it is impossible to conclude that there would be a probable detriment to the public interest in this connection.

The effect on employment

7.35. Some concern was expressed to us by the trade unions (see paragraphs 6.6 and 6.7) that the merger might lead to some loss of employment, particularly as they believed that Linfood had no experience or expertise in food manufacturing or specialist wholesaling. We do not share this anxiety, since the relevant Fitch Lovell businesses would be taken over by Linfood as going concerns under their own management and we see no reason why they should not prosper under Linfood control; and in that event their development and expansion could result in increased employment.

7.36. The unions were also apprehensive that following acquisition of the Key Markets chain, which they believed to be operating more profitably than Gateway, Linfood would close some of its less successful stores and thus jobs would be lost. However, we are satisfied that Linfood has been successfully carrying out a policy of improving the profitability of its stores where this is necessary and thus generally of avoiding closures. Since the Key Markets chain is to change hands in any case, the possibility of closures arises whoever acquires it, but it is unlikely that there would be more than two or three closures if it is acquired by Linfood.

7.37. If the merger takes place Linfood would be likely to dispose of a few of the miscellaneous businesses of Fitch Lovell which are unrelated to the main activities. These would probably be sold as going concerns, just as Fitch Lovell itself has recently disposed of its animal feed compounding company (see paragraph 3.28), and we see no reason why there should be any loss of employment.

7.38. In our view any job losses would be primarily the consequence of rationalisation of administrative functions of the two companies. They would not necessarily involve redundancies. The number would be likely to be small, they would not all take place immediately, and would in our judgment be of less importance than the generally better prospects for employment in the group as a whole which would result from the merger. In this connection we note that it was stated in the offer document of 13 October 1982 that 'The Board of Linfood believes that job opportunities for management and staff of the two groups will be enhanced'.

7.39. As regards pension and other rights of employees it was stated in the same document, 'Linfood assures Fitch Lovell group employees that their rights will be safeguarded and that their conditions of employment, including pension rights, will not be adversely affected by the acquisition'. We have no reason to doubt that this assurance would be implemented.

Conclusion

7.40. We have found that the merger would not be likely to have any material adverse effect on competition either at wholesale or retail level (paragraphs 7.7 to 7.16), that in so far as there is imbalance between the

bargaining power of food retailers and of their suppliers the merger would not materially aggravate it (paragraphs 7.24 to 7.27), that the effect of the merger on Fitch Lovell wholesaling and manufacturing companies is unpredictable and that even if they were sooner or later disposed of the consequences would not necessarily be against the public interest (paragraphs 7.29 and 7.34), and that the merger would probably not have any significant adverse effect on employment (paragraphs 7.35 to 7.39). On the other hand we think that the merger might, by creating a stronger retail chain, marginally enhance or at least tend to preserve competition in food retailing and that this possibility would not be likely to be prevented by any management problems arising from the bringing together of the two retail chains (paragraphs 7.17 to 7.23).

7.41. We conclude that the arrangements in contemplation by Linfood PLC for the acquisition of Fitch Lovell PLC may be expected not to operate against the public interest.

J G LE QUESNE (*Chairman*)

P GOLDMAN

C M MILES

L A MILLS

N L SALMON

N E D BURTON (*Secretary*)

18 April 1983.