

## CHAPTER 6

### Views of the main parties

#### **BET's views**

##### *Reasons for the bid*

6.1. BET told us that, with the introduction of a new management team in the recent past, it had developed a new strategy to concentrate on its key businesses, viz those which were perceived to have growth potential and operated in areas which BET knew well. The acquisition of the remaining shares in Initial was part of that process. The new strategy involved greater head office involvement in the affairs of BET's subsidiary companies. After the proposed acquisition BET's executives would seek to ensure that BET's objectives were reflected in the annual plans of Initial as of other operating subsidiaries. Initial would become subject to the detailed monthly financial reporting procedures for subsidiaries within the BET group and there would be a significant degree of more informal contact. BET also planned to integrate some of the activities of Advance and Initial (see paragraphs 6.4 and 6.5) and argued that its present 42 per cent shareholding was not in itself enough to enable it to carry through its full intentions in this respect given the two different bodies of shareholders involved.

##### *Benefits of the merger*

6.2. BET thought that a number of commercial benefits would flow from the merger and that some of these would also be benefits to the public. There was scope for cost savings by rationalising some of the activities of Advance and Initial. BET expected annual savings of around £2.7 million after three years, the largest potential savings being in administration, processing, data processing and rural distribution.

6.3. BET expected that combining Initial's and Advance's warehouse facilities to some extent would be possible and thought that the merged group might reduce the amount of stock on hand by common holding of many items. It said that a combined approach to purchasing, training and engineering work might yield some economies of scale.

6.4. To maintain the two separate brand images of Advance and Initial separate fleets of vehicles would generally be kept for door-to-door distribution to customers. The trunking of large vehicle loads between distribution branches and processing plants, which is already done on a large scale by Initial, was likely to offer scope for integration and re-routing and possibly the use of bigger vehicles. Integrated trunking would be an essential feature of specialised processing arrangements but would not produce economies as important as those to be made on processing.

6.5. BET said that it would make more efficient use of the processing facilities of the merged group by integrating the work of Advance and Initial in the most suitable plants and trunking textiles in bulk loads large enough to justify specialised handling of each type of article. This was

expected to make savings of up to 10 per cent in the cost of processing and the employment of specialist operatives would result in higher standards. These measures could help to retard the decline in the cabinet towel market by competing more effectively with other forms of hand-drying.

6.6. BET said that if these economies produced a reduction in costs, its object would be to stabilise prices and compete more effectively with other operators and with substitutes on the basis of better value for money.

#### *NHS contracts*

6.7. The more efficient organisation of Advance's and Initial's processing capacity would increase the private sector's capability to launder NHS textiles by:

- (a) releasing substantial units of capacity to be dedicated to the specialised requirements of the NHS; and
- (b) ensuring that such capacity was made available near the hospitals concerned when NHS contracts had been obtained.

6.8. BET told us that only a very small proportion of the potential market for NHS laundry had been taken up by the private sector. Companies had tendered on a marginal cost basis and were using spare capacity in laundries to carry out the work. It thought that such small-scale spare capacity was largely taken up and if substantial contracts were to be gained new capacity would have to be found. BET did not think that any company would lay out the capital cost of providing laundries on a greenfield basis in the near future because of insufficient return and political uncertainty about privatisation. This view of investment was likely to change only as mutual confidence was established between the private sector and the NHS on the basis of greater experience of laundry contracts, but the combined business base of Advance and Initial would spread the risks associated with investing in large NHS contracts.

6.9. The enlarged group would have considerable experience in hospital work overseas and BET thought it would be able to compete for NHS contracts of viable size against both 'in-house' facilities and other undertakings. The latter would probably consist of large companies like Sunlight and the co-operative societies and also smaller firms with premises conveniently close to hospitals. BET saw substantial savings to the public purse.

#### *Financial effects*

6.10. The merger would strengthen both Advance and Initial financially, enabling them to seek to expand both at home and abroad and to accept the risks of providing new plant for NHS work if and when the level of contracts gained made this necessary. BET thought that the separate operations of Advance and Initial in the United States of America could be co-ordinated to achieve cost savings, while a joint investment strategy would allow more effective use of broader based financial resources for expansion in that market.

#### *Research and development*

6.11. BET told us that research and testing of new products was carried out for both Advance and Initial separately by their jointly-owned company,

Strattwell, which also did similar work for outside companies. In the merged situation work done by Strattwell would be for the benefit of the group as a whole and wasteful overlap between separate Advance and Initial projects would be eliminated. Artificial barriers between different lines of research could be removed and product innovation would be encouraged.

#### *Effects of the merger on competition*

6.12. It is only in the textile maintenance market that the activities of BET, through its subsidiary Advance, overlap with those of Initial. The various sub-sections of the market with the market shares of Advance, Initial and other main competitors are shown in Table 2.1. BET pointed out that the table necessarily excluded those users in both the private and public sectors who had their own laundry and dry cleaning facilities and owned their own linen. BET concentrated on the effects of the merger on workwear, cabinet towel and dust mat rental with some reference to ancillary rental and said there would be no significant effect on market shares of industrial wiping cloths and linen rental.

6.13. BET told us that after the merger there was bound to be some breaking down of the separateness of Advance and Initial in the market place; they would be able, for example, to see each other's customer lists. They would not compete against each other for NHS contracts and there would be a combined national accounts group.

#### *Workwear*

6.14. BET said that the workwear market share of Advance was about the same as that of Johnson and recalled the Commission's objections to the merging of Initial's share with Johnson's in the 1983 report. It thought that the potential growth of Johnson in workwear was a major factor in that case whereas Advance's market share had been relatively static for several years. Sketchley and Pritchard each had more than twice the share of Advance and would be able to compete effectively with the merged group. Initial's share was mainly at the heavy industrial end of the market and Advance's at the light 'High Street' end and entry to the sector was easy. Only about one-third of the 28 per cent combined share of Initial and Advance would be at the lighter end of the market.

#### *Cabinet towels*

6.15. BET urged that cabinet towel rental should not be regarded as a discrete market but treated as a part of the hand-drying market which included also hand towels, paper towels and warm air dryers. BET produced figures for the hand-drying market showing £60 million for cabinet towels, £50 million for paper towels, £18 million for warm air dryers and £5 million for hand towels. The group's combined share of this £133 million market would be 31.7 per cent as against 63 per cent for cabinet towels alone.

6.16. BET had initiated a market research exercise within the hand-drying market and submitted the results in support of its contention that cabinet towels should be regarded as part of this market, not as a separate market sector. BET claimed that the research showed that customers perceived the hand-drying market as a single entity. There was a high awareness of

cabinet towels, warm air dryers and paper towels as alternative forms of non-domestic hand-drying, and the last few years had seen significant movement from cabinet towels in favour of the other two methods. About 17 per cent of those who responded to the survey reviewed the type of hand-drying facilities installed at least once a year, 14 per cent of the sample reported that they had changed facilities or added a new type of facility in the last two years, and 19 per cent of the sample had changed supplier within the last two years. The majority of those who had changed supplier or method of drying in the last two years said that price was the main consideration. Of those who had not changed supplier in the last two years, 36 per cent reported that they would consider changing for savings of as little as 1 to 5 per cent. BET said that the market was highly price-sensitive.

6.17. Data produced by BET indicated that on an average 'cost per dry' basis paper towels were marginally more expensive than cabinet towels at the lowest level of use and warm air dryers were substantially cheaper than either. At higher levels of use the same pattern held but the differences in cost were much greater; cabinet towels were 35 per cent cheaper than paper towels but averaged nearly three times the cost of warm air dryers. There was a range of prices within each category. The most expensive paper towels were about double the price of the cheapest but the range of prices for warm air dryers was narrower. Cabinet towel prices were quoted for Sketchley and Advance only, the former being the cheaper by about 12 per cent for small customers and 30 per cent for larger ones.

6.18. The data supported BET's view that warm air dryers were the cheapest form of hand-drying. BET told us that paper towels varied in quality and cost and many were probably wasted in practice, but the lower-priced ones used economically were no more expensive than cabinet towels. It made a point of the difference between Advance towels where customers were supplied from a common stock and Initial towels where each customer had towels allocated to him marked with his initials and said that this distinction would be maintained if it acquired Initial. Separate brand names would be supported by competing sales forces but there would be a combined national accounts group.

6.19. BET said that the hand-drying market was a mature one with little prospect of further growth and that the cabinet towel market was shrinking. It told us that in the United States of America paper towels held about 75 per cent of the hand-drying market and warm air dryers some 10 per cent and that it feared a similar scale of penetration in the United Kingdom. BET saw all three methods as substitutable one for another and a need for cabinet towels to compete with substitutes on a 'value for money' basis rather than purely on price. BET said that competition had also been growing in the cabinet towel sector itself as a result of recent acquisitions.

6.20. BET thought that any enterprise, big or small, having laundry facilities could enter the cabinet towel market without much trouble or expense and said that some local laundries had done so to fill up spare processing capacity. It ascribed the fact that market shares of national and local concerns had not varied much in recent years to lack of incentive to go into a mature market with little growth potential. It appeared that

major companies had concentrated on the sector of the overall rental market which they had found suited them best. BET said that any attempt by the merged group to exploit a dominant market share to increase prices would not only bring in many local competitors but increase market penetration by warm air dryers and imported paper towels.

6.21. Keen competition had kept prices down and the relatively high return on capital in this sector of the market was due to low capital outlay in a dwindling market rather than high profit margins. BET did not think that cabinet towel prices could be raised as much as 5 per cent without significant loss of market share and said that Advance's prices had fallen 3.4 per cent in real terms between 1979 and 1984.

#### *Dust mats*

6.22. BET accepted that the market shares of Advance and Initial combined would be significant but saw little risk to the public interest. It said that dust mats were largely a 'discretionary' product in that there were other methods of preventing dirt from being carried into premises or into clean areas from dirty parts of such premises. There was keen local competition and good growth potential in this sector of the market. Advance had promoted a dust mat for use in locations where appearance was important which did not compete with other types of dust mat. The proposed merger could not be expected to have an adverse effect on competition or choice.

#### *The textile rental market as a whole*

6.23. BET said that the merger would have no adverse consequences for competition in the textile rental market as a whole. It did not think that strength in several sectors of the market would give any tangible economy in distribution costs although towels and workwear, for example, might sometimes be carried by the same vehicle and there would be some integration of distribution to rural customers.

6.24. However, BET argued that the integrated textile rental market was not a useful tool for market analysis because rental was a means of financing the access to a product and did not differentiate between the services provided by competing products. A rental definition also ignored large areas of competition from products owned by the consumer, eg a warm air dryer or workwear garment owned by the user competed with equivalent rental items.

#### *Effects on employment*

6.25. BET said that the merger would entail some loss of employment in administrative functions and estimated some 120 job losses over a period of three years. It would seek to find alternative employment for any employees affected and to phase out some jobs by natural wastage but the possibility of redundancies could not be ruled out. The prospects of workers in the plants would be improved, however, as increased NHS work should maintain present levels of staffing. Without the merger redundancies in plants operating below capacity might well arise. Greater job security might

stem from the strength of the merged group in the market. BET pointed out that cabinet towel rental was labour-intensive, whereas competing products such as imported paper towels and warm air dryers were not.

### **Initial's views**

6.26. Initial generally agreed with BET as to the benefits to be expected from the proposed merger and its probable effects on competition. It told us that if the relationship between the two companies after the merger was looked at in terms of managers rather than directors, the management of Advance and Initial would end up working together much more closely and there would be cross-fertilisation at all levels without the difficulties and constraints that presently existed. The expectation would be that direction would be given in areas of uncertainty by BET on advice and in the light of papers submitted by management. It added that it had already adopted a policy of using specialised plant for different items such as towels and garments using long-distance trunking to make up large enough loads of each item where necessary. It thought that the merger would enable it to apply this policy more widely and effectively. Initial saw this trend as essential to the future growth and success of the industry quite apart from its effects on the ability of the merged group to tender for NHS work.

6.27. On the basis of present joint cost figures for Advance and itself, Initial thought the proposed merger might result in annual savings of £6.9 million mainly in the areas of processing, distribution and marketing. Spare capacity in Initial's plants was about 18 per cent on a single shift basis and Initial said this figure could be very substantially increased by working additional shifts and/or installing extra equipment.

6.28. Initial thought that the merged group should see what NHS contracts it could win before deciding the pattern of plant and distribution rationalisation because the convenient location of plant in relation to hospitals was crucial. NHS linen stocks were geared to a much quicker turn-round than rental companies commonly achieved.

6.29. Initial said that at the light end of the workwear market it specialised in protective clothing while Advance concentrated more on styled garments where appearance was important. Light workwear rental was also in competition with cheap imported garments which could be washed at home. Initial estimated that there were about 2 million wearers of rented workwear in the United Kingdom, with a potential total market of 10 million. With the possibility of more frequent changes of garment and increased numbers of wearers, it felt that there was great scope for growth in this sector and that the merger would not have any adverse effect on competition within it. Initial thought that even a slight upturn in the economy could increase sales at the heavy industrial end of the workwear rental market.

6.30. Initial supported the case made by BET for considering a 'hand-drying' or 'washroom services' market instead of a cabinet towel rental market and agreed with all the views which BET had expressed on the subject. It told us that the cabinet towel rental market had declined significantly since 1981 and indicated that some adjustment had been inevitable because cabinet towels had been over-sold in an unusually high

penetration of the United Kingdom market. Initial laid particular stress on its provision of initialled towels which distinguished it from Advance and from all other competitors, including small local laundries. Initial's market was largely among smaller customers and its types of cabinets and billing systems were different from those of Advance.

6.31. In the dust mat rental sector Initial said that small local companies competed with national operators. Initial had been early in the field, but many others were now coming in, attracted by ease of entry and large potential expansion.

6.32. Initial argued that the merger would have no material effect on competition in the textile maintenance market, apart from workwear, hand-drying and dust mat rental. In these three sectors adequate and effective competition would remain and it did not attach much importance to possible distribution economies from the merged group's substantial share in all three, although it would look at integrating delivery in the more remote areas of the country. It told us that Initial Services Division mostly made deliveries with a variety of items on the same van. It would also be possible to carry different brands on the same vehicle; this had already been done very successfully within Initial.

6.33. Initial did not expect any adverse effect on employment in the short term and hoped to arrange any changes of function without the disturbance of lay-offs and re-employment. In the longer term it hoped to see benefits in terms of price, quality of goods and services and efficiency translated into growth with a consequent increase in employment. Any incidental job losses in administration, transport and stock control might be offset by increased operational employment. Some changes of job might have to be accepted but pay and conditions would not be adversely affected.