

## 7 Conclusions

### **The monopoly situation**

7.1. We are required by our terms of reference to investigate and report whether a monopoly situation exists in relation to the supply of pest control services in the United Kingdom, and if so which provisions of sections 6 to 8 of the Fair Trading Act 1973 (the Act) apply and in whose favour the monopoly situation exists.

7.2. Section 7 of the Act is concerned with the supply of services and provides for what are usually described as 'scale' and 'complex' monopolies. A 'scale' monopoly under section 7(1)(a) or (b) may be found when at least one-quarter of the supply is by the same person or group of inter-connected bodies corporate.

7.3. We have shown in Chapter 2 that Rentokil Group PLC (the parent company) and Rentokil Ltd (the operating company mainly engaged in the group's United Kingdom trading operations), being members of one and the same group of inter-connected bodies corporate, provided in 1985 an estimated 61 to 64 per cent of the United Kingdom market for the supply of pest control services.

7.4. We have therefore concluded that a monopoly situation as defined in section 7(1)(b) of the Act exists in favour of Rentokil Group PLC and Rentokil Ltd (collectively referred to as Rentokil) in relation to the supply in the United Kingdom of pest control services as defined in the reference made to the Commission on 21 May 1986. The ground for this conclusion is that the market of that description in the United Kingdom is to the extent of 61 per cent supplied by members of one and the same group of inter-connected bodies corporate. Rentokil has accepted this conclusion.

### **The public interest**

7.5. Having established that a monopoly situation exists, we are required to consider whether any steps (by way of uncompetitive practices or otherwise) are being taken by the persons in whose favour the monopoly situation has been found to exist for the purpose of exploiting or maintaining the monopoly situation and, if so, by what uncompetitive practices or in what other way; whether any action or omission on the part of these persons is attributable to the existence of the monopoly situation and, if so, what action or omission and in what way it is so attributable; and whether any facts found in pursuance of our investigation operate or may be expected to operate against the public interest.

7.6. In considering these questions we have had particular regard to the following four matters:

- (a) whether, because of its strong position in the market and the lack of competitors of comparable size and resources, Rentokil is able to charge prices higher than would otherwise prevail and whether this is reflected in an unduly high level of profit;
- (b) whether, when faced with competition, Rentokil uses its dominant position in the market to reduce its prices selectively, thus defending and maintaining its share of the market and discouraging or preventing competitors from expanding their businesses;
- (c) whether Rentokil has reduced competition by refusing to supply a chemical, bromadiolone, which it imports under an exclusive agreement; and
- (d) whether the market is now insufficiently competitive and, if so, whether this lack of competition, and any ability of Rentokil to engage in the practices referred to above, result partly from its acquisition of competing suppliers of pest control services.

## **Competing suppliers of pest control services**

7.7. Competing suppliers of pest control services, some of which are operated by former employees of Rentokil, consist of a large number of very small firms catering principally for local markets and small customers, and a few larger firms which, they told us, were interested in acquiring a larger share of the market. Many competitors regard Rentokil as the major obstacle to their expansion and consider it either engages in, or is ready to engage in, unfair selective pricing in order to obtain or keep customers. Although many users of pest control services have a choice of supplier, Rentokil's dominant position and reputation mean that this choice is rarely exercised, so that Rentokil is in practice able to set its prices in a selective manner.

7.8. Rentokil contends that there is free competition in the supply of pest control services and that the market is such that it can not be dominated by any one undertaking; that the number of competing suppliers is increasing and has increased significantly since 1985, the year on which the Commission's market survey was based; and that some new entrants to the market are subsidiaries of well established and powerful companies with diversified interests and considerable resources, whom Rentokil regards as potentially major competitors. There is, indeed, one such company among recent entrants to the market, but it is too soon to assess its prospects of establishing itself and developing a significant market share. Other companies have tried in the past to provide an alternative national service to Rentokil's, but without success.

## **Pricing and profits**

7.9. We have considered whether Rentokil has pursued a policy of generally overcharging its customers; whether its dominant position in the market has enabled it to discriminate between customers in setting prices; whether it has engaged in selective price cutting to defend that dominant position; and whether by these practices it has succeeded in limiting the growth of its competitors.

7.10. No other supplier has been able to mount a successful challenge to Rentokil's dominance in servicing major national contracts. Some have tried in the past but none has persisted, and most of those which made the attempt have either been bought out or have withdrawn from the market. Likewise, no other supplier has been able to reduce Rentokil's market share. None has established a comparable scale of operations, although some competitors are now trying to extend their coverage to a wider area.

7.11. The cost of pest control services is usually insignificant in relation to a consumer's total expenditure. Many consumers prefer, therefore, to use Rentokil, with its established reputation, rather than a competing and less well-known supplier, even if the latter quotes a lower price. Should the competitor's service prove to be inadequate, the damage to the consumer's reputation and goodwill may well be disproportionately large in relation to the cost saving.

7.12. These factors help to reinforce Rentokil's dominant position and give it a considerable degree of freedom to charge its customers what it likes within the somewhat loose constraint of what they would regard as value for money. As a result, many smaller customers are charged much higher rates than larger customers; and the differences between rates for large and small customers tend to be much greater than might be expected to occur in conditions of normal competition.

7.13. One feature of Rentokil's pricing which our inquiries have revealed is that the first year charge to a new customer, which includes the initial treatments of any existing infestation, continues to form the basis of the charge for subsequent years when only routine service visits are normally necessary. Rentokil told us (see paragraphs 3.17 and 5.7) that it regarded a level of charges that allowed for more than routine visits as incorporating an element of insurance against possible re-infestation. (Under the terms of Rentokil's standard contracts no extra charge is made if its serviceman is called on to deal with such problems.) We also found cases where new customers were quoted higher prices than they should have been according to Rentokil's instruction to its surveyors, and where this incorrect quotation was not corrected.

7.14. In spite of Rentokil's explanations, the fact remains that its prices are high enough to allow it, when it feels the circumstances warrant such a course, to cut its prices drastically to counter competition. A number of its competitors have complained that it does, in fact, cut prices to obtain or keep business; two examples are given in paragraphs 3.33 and 3.35. The low prices charged to certain customers serve to corroborate these complaints.

7.15. Some customers may benefit, at least in the short run, from Rentokil's selective price cutting policies. On the other hand, if Rentokil were not able to reduce its prices to some of its customers, it might lose their business to its competitors whose businesses would as a result prosper. Consumers would then benefit from there being more alternatives to Rentokil than at present, leading in time to a reduction in prices generally. As paragraph 3.27 shows there is a tendency for Rentokil's contracts to be priced above, rather than below, 'list price'. Thus, of the local contracts we examined at branch B under 1 per cent by value were charged at 'list price'. Over two-thirds of contracts by value were charged above 'list price', and under one-third were charged below 'list price'. Over half were in fact charged 30 per cent or more in excess of 'list price', but less than one in ten were charged 30 per cent or more below 'list price'.

7.16. We believe that the practices we have described have brought about Rentokil's high profitability and have enabled it to cut its prices selectively. Its profits, as instanced by its 28 per cent return on turnover and its 92 per cent return on capital employed, are higher than they would be in conditions of normal competition. In our view, the extent of Rentokil's differential charging and price cutting exceeds the discounts that might normally be allowed to larger, and more alert, customers. These practices inhibit the development of competition.

**Possible effect on the maintenance of a national service and on research**

7.17. Rentokil argued that if competition developed to such an extent that there was a substantial contraction of its turnover its ability to offer a national service and to maintain a research programme might be prejudiced. We do not think, however, that the loss of such a national service, even if it did occur, would adversely affect those large firms that favour 'multi-sourcing' or regionalising their purchases as a matter of policy, sometimes inviting competitive tendering. Moreover, there is no shortage of pest control suppliers providing services on a local or regional basis. If there were some growth among these suppliers at the expense of Rentokil, it should not necessarily detract from the latter's level of service or its ability to conduct research. Indeed, Rentokil itself told us (see paragraph 5.14) that it could meet competition from companies nearer to its own size without being materially threatened.

**The supply of materials**

7.18. We considered Rentokil's refusal to supply to other pest control companies the rodenticide bromadiolone, which it imports under an exclusive arrangement. A complaint about this was made to us by another supplier of pest control services, and we invited Rentokil's views. Rentokil told us that there were a number of satisfactory alternative branded products of the same group of compounds as bromadiolone. Any of these would be a satisfactory, although more expensive, substitute. However, it added that it regarded the exclusivity of bromadiolone as of little significance and it will now be ready to supply this rodenticide to competitors. If this is done there will be no need to pursue this matter further. The Office of Fair Trading would no doubt investigate any further complaints.

7.19. We also received some complaints about Rentokil's refusal to sell to other suppliers of pest control services a number of pesticides apart from bromadiolone. We investigated these complaints and established that in most cases the products were available via wholesale or retail sources. There were two in-house products of its own formulation which Rentokil does not supply to others, although the active ingredient will now be available for others to include in their own formulations.

**Acquisitions**

7.20. Rentokil said that its present policy is to expand by organic growth and that growth through acquisition had been of minor significance. Some of its past acquisitions were, however, clearly designed to reduce competition or to frustrate

potential competitors (see paragraph 4.8). While the firms concerned were not large when they were acquired, some of them might have grown, or have been acquired by other competitors intent on growth.

7.21. The best, perhaps the only, hope for the growth of vigorous competition in this industry lies in the growth by acquisition of one or more substantial businesses which can establish a national reputation and therefore mount a significant challenge to Rentokil's market dominance. We therefore consider that the need to encourage healthier competition in the supply of pest control services makes further acquisition of its competitors by Rentokil in general undesirable. Any competing businesses which come on the market should preferably be acquired by firms other than Rentokil. We note that section 76(a) of the Fair Trading Act 1973 imposes on the Director General of Fair Trading a duty to take all such steps as are reasonably practicable for keeping himself informed about actual or prospective arrangements which may constitute or result in the creation of merger situations qualifying for investigation. The Director General's task could be facilitated if an undertaking were given by Rentokil to notify him of any proposed acquisitions by it of other pest control businesses.

## Conclusion

7.22. Rentokil has established a dominant position in the pest control market. This gives it freedom to fix its prices largely unconstrained by competition. For example, in certain cases it charges high prices, as is shown by our inquiries into a number of its pest control contracts (see paragraph 3.27). This is also confirmed by Rentokil's pest control profitability figures, whether these are measured by reference to its return on sales or to its return on capital employed. However, when Rentokil encounters competition, its high margins enable it to defend its position by selective price cutting. The customer is not told how the amounts charged to him relate to the cost of carrying out the work. The adverse effects are, first, that the prices paid by many customers for their pest control services are higher than they would be in conditions of normal competition and, secondly that the choice of suppliers is unduly limited, particularly for customers who require a national service. We find that these differential pricing practices operate against the public interest.

**Remedy** 7.23. The remedy that we propose against the charging of high prices is that Rentokil should provide the customer with more information. We recommend therefore that Rentokil should be required to:

- (a) accompany every quotation for pest control services with a written statement specifying the estimated number of hours to be spent on the work, the hourly charging rate, the total labour charge and the estimated charge for the chemicals and other materials to be used; and
- (b) give every contract customer each year a statement showing the actual number of hours spent on the contract, the hourly charging rate, the total labour charge and the charge for the chemicals and other materials used.

J G LE QUESNE (*Chairman*)

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17 December 1987