6 Conclusions

The merger situation

6.1. Under the reference (made under section 64 of the Fair Trading Act 1973 – 'the Act') dated 14 September 1988 (see Appendix 1.1), we are required to investigate and report whether a merger situation qualifying for investigation has been created, in that enterprises carried on by or under the control of Bass PLC (of which one at least was carried on in the United Kingdom) have within the six months preceding the date of the reference ceased to be distinct from enterprises carried on by or under the control of International Thomson Organisation Ltd (ITOL). For this purpose, the reference specified the criterion presented in section 64(1)(b) of the Act, generally known as the 'assets test' – that is that the value of the assets taken over exceeds £30 million.

6.2. As was noted in paragraph 2.1, ITOL acquired Horizon Travel Ltd (Horizon) for £75 million from Bass PLC on 18 August 1988. We therefore conclude that enterprises carried on by or under the control of Bass PLC (that Horizon's activities are carried on in the United Kingdom appears from paragraph 2.9) have ceased to be distinct from enterprises carried on by or under the control of ITOL.

6.3. As appears from paragraph 2.19, the value of the assets taken over (ie those of Horizon) exceeds £30 million. Although the test provided for in section 64(1)(a) of the Act (generally known as the 'market share test') was not in this reference excluded from our consideration, we have thought it unnecessary to consider whether this too is satisfied in view of our conclusion as regards the assets test.

6.4. We accordingly conclude that a merger situation qualifying for investigation has been created. We have therefore to investigate and report on whether the creation of the situation operates, or may be expected to operate, against the public interest. The merger was completed in August 1988, about one month before the date of the reference; this period is clearly too short to show the actual effects of the merger and in the public interest context we are therefore concerned with whether the merger 'may be expected' to operate against the public interest.

The markets affected by the merger

6.5. Thomson Travel Group (Thomson)–a group of wholly-owned subsidiaries of ITOL–and Horizon are both operators of foreign air inclusive tours (AITs) from the United Kingdom, both operate predominantly charter airlines based in the United Kingdom, and each has its own chain of retail travel agents. We have therefore considered the effects of the merger on each of these three markets.

The market for foreign air inclusive tours (AITs)

6.6. Almost 10 million foreign AITs were taken from the United Kingdom in 1987, representing sales of over £2·5 billion. As is shown in Table 6.1, Thomson and Horizon are two of the three largest operators of foreign AITs from the United Kingdom.

TABLE 6.1 **Tour operators' shares of the AIT holiday market (of one or more nights), 1987**

Tour operator	*% share*
Thomson Group	30
ILG	14
Horizon	8
Redwing	5
Airtours	3
Grecian	3
Cosmos	2
Thomas Cook	2
Yugotours	2
Tjaereborg	2
Others	29

Source: See Table 3.11.

6.7. As shown in Table 3.12, the shares of Thomson and Horizon to some destinations are considerably above these overall percentages. For example, the two companies together accounted in summer 1988 for over 50 per cent of inclusive tours sold through travel agents to Spain – the most popular inclusive tour destination – and over 60 per cent of winter tours to Spain. The two companies also have higher shares of some regional markets within the United Kingdom, in particular over 50 per cent of air inclusive summer tours from the East Midlands (where Horizon accounts for almost 20 per cent of sales), and nearly 45 per cent of summer tours sold in the West Midlands. The share of winter tours from Birmingham and East Midlands airports is still greater.

Competition from other forms of holidays

6.8. AITs account for less than 25 per cent of holidays taken by residents of the United Kingdom. In the year to October 1987, almost 50 million holidays were taken by United Kingdom residents, about 20 million of which were taken abroad. Some 64 per cent of holidays abroad were taken as inclusive tours, the remainder as independent holidays. Of this inclusive tour segment, just over 80 per cent, almost 10 million, involved travel by air, the balance travel to or from the United Kingdom by sea.

6.9. We regard AITs, however, as a distinct market. One survey which we have seen suggests that the large majority of those on package tours have not taken an independent holiday within the previous five years; another survey confirms that the majority of people on inclusive tours have a strong preference for such holidays. The proportion of holidays that are independent also varies significantly by destination (see, for example, Table 3.7); in some resorts, it is difficult or uneconomic to make independent arrangements.

6.10. On the other hand, the availability of other forms of holiday can be expected to impose some constraint on the prices that can be charged for package tours. In forecasting air traffic, for example, the Department of Transport estimates that a 1 per cent increase in air fares will lead to a reduction in demand for air travel of between 1 and 1.5 per cent; although the Department of Transport does not separately identify package tours, we were told that other organisations have assumed a similar responsiveness of demand for AITs to price. However, the present level of prices for AITs, and the recent reduction in these prices, would appear to result mainly from competition between tour operators, rather than from other forms of holiday.

Competition between tour operators

6.11. Before the merger the three largest companies – Thomson, ILG and Horizon – together accounted for over 50 per cent of AITs operated from the United Kingdom, and the 40 largest companies for about 85 per cent of the market. Although there has been some concentration and consolidation amongst the larger operators, the total number of tour operators licensed by the CAA has increased from 473 in 1978 to 703 in 1988. Despite the importance of the larger firms, the market sustains a considerable number of smaller firms which are able to specialise on particular destinations, or types of holiday.

6.12. Barriers to entry into tour operating are very low. Tour operators contract for hotel accommodation and aircraft seats, which together account for some 80 per cent of costs; these can be arranged through agents or brokers. Sales within the United Kingdom are carried out by travel agents on a commission basis; overseas representative services can also be supplied by local agents. The costs of entering the market are therefore low, and accommodation and aircraft seats are generally readily available.

6.13. It was argued to us that there were significant economies of scale in tour operating, such that smaller firms could not be expected to offer effective competition to the larger tour operators. Thomson clearly intends that the merger with Horizon will yield cost savings, and another tour operator also referred to the scope for reduced costs from such a merger – but these savings may reflect increased efficiency as much as economies of scale as such.

6.14. As discussed above, about 90 per cent of costs – of aircraft seats, hotel accommodation and retail sales – are 'bought in', with little scope for economies of scale other than through purchasing power. In our previous report on foreign package holidays,[1] we suggested that economies of scale in buying transport and hotel accommodation could be achieved at sufficiently low levels for the small specialist operators to be competitive. The evidence we have seen during this inquiry tends to confirm this impression. Economies of scale in purchasing hotel accommodation would, for example, seem available to the specialist operator concentrating on a particular resort, as well as to the larger tour operators which have a leading market share at a number of resorts. It would seem probable that some advantages do accrue to the larger companies: some companies, for example, serve a range of destinations and thus insure against the risk of particular areas losing their appeal. However, we have not seen sufficient evidence to suggest that scale economies, at least beyond a small minimum size of operation, are such as to prevent smaller firms or new entrants from offering effective competition to the larger tour operators in the particular markets in which they may choose to operate.

6.15. Although most smaller operators and new entrants concentrate on 'niche markets', some companies have built up and retained a share in the mass market in the last ten years; the relative stability in the composition of the larger companies (to which the Commission referred in their previous report) may itself partly reflect the efficiency and strength of competition between the major tour operators.

6.16. Recent competition between tour operators has been intense. Most consumers show little company or brand loyalty in choosing an inclusive tour, but are highly sensitive to differences in prices. The evidence we have seen suggests that relatively small differences in price can therefore lead to a large shift in sales and market shares to the tour operator offering the lowest price. The tour operators in turn closely monitor their competitors' prices, and may revise their own brochures if prices are drastically out of line. Consumers also appear willing to consider alternative destinations. Hence increases in prices to particular destinations can lead to a loss of business in favour of other resorts, as occurred when Spanish hotel rates were increased in 1985. The sensitivity of consumers to relative prices may also partly explain the lack of any significant relationship between Thomson's market share of particular resorts and its profitability in serving them (see paragraph 3.23).

6.17. The extent of competition in the market is, we believe, shown by the price and market share performance of Thomson Holidays over the last two years. In 1986 Thomson Holidays reduced prices in real terms by about 15 per cent below those prevailing in the previous year, when demand had been static. As a result, its market share increased from 17 per cent to 25 per cent; and the overall level of the market was also expanded. In 1987, Thomson Holidays pursued a similar low margin/high volume strategy, but this was matched by

[1]Cmnd 9879 – *Foreign Package Holidays*, September 1986.

other firms in the industry; although there was a substantial increase in overall market size, the market share of Thomson Holidays declined by about 2 per cent. For summer 1988, Thomson Holidays initially announced increased prices, giving higher margins, but was out of line with its competitors and in the pre-Christmas booking period lost over ten percentage share points compared with the same stage of the previous year. It therefore relaunched its brochure with more competitive prices and regained market share. Market shares have therefore shown considerable volatility, and have fluctuated both between the market leaders, and between the larger and the smaller operators in the industry.

6.18. Competition has resulted in significant price reductions in real terms over the last four to five years and a deterioration in margins (see Table 3.14). The greater degree of competition in the United Kingdom market also in part explains the considerably lower prices for inclusive tours in the United Kingdom compared with those elsewhere in Europe, and the unattractiveness of the United Kingdom market to other European operators. The failure of the major United Kingdom operators to enter the Continental market in turn seems to be explained by the fact that in some countries the inclusive tour business is less developed, and in others is highly concentrated among a small handful of vertically integrated enterprises.

The effect of the merger on AITs

6.19. As is apparent in Table 6.1, the merger would remove the second largest competitor to Thomson, and (on the basis of 1987 figures) increase Thomson's share of AITs from about 30 per cent to about 38 per cent. We have therefore to consider whether the merger may be expected to result in a significant reduction in competition in the supply of AITs, with adverse effects on price, choice, or standards of service. The acquisition of such an increase in market share by Thomson, the market leader, clearly deserves our close examination.

6.20. Although Horizon was the third largest tour operator and – as Thomson agreed – made its contribution to the competitive process, it cannot be regarded as a strong competitor. It attempted unsuccessfully to compete on quality, rather than price, and given its recent financial performance, it would clearly have had difficulty in maintaining its independence in the present competitive environment. Most of the £75 million paid by Thomson for Horizon is accounted for by the value of the Orion airline, with little value attached to the tour operation business. Although we do not discount the possibility that Horizon could be acquired by another United Kingdom or European tour operator, we cannot regard the merger of Thomson and Horizon as making a significant impact on the present highly competitive market for AITs. Competition with Thomson will continue to come from both the larger and the numerous smaller operators in the industry, and from new entrants into the industry.

6.21. Among the larger tour operators, ILG in particular has been an effective competitor. It is, however, possible that larger tour operators would welcome some lessening of the present price competition in the market, and would follow any attempts by Thomson to increase price. Thomson may again attempt to do this (although unsuccessful when it attempted to increase prices in its 1988 brochures), irrespective of whether the present merger proceeds. However, we believe that competition, and potential competition, is by no means confined to that between the largest tour operators. We believe many smaller operators could readily expand their scale of business if it was attractive to do so. The fluctuations in market share over the last few years show the willingness of consumers to compare prices, and ensure that they obtain value for money: any attempt by Thomson unreasonably to increase prices, to reduce availability or choice of holidays, or to lower standards of service would risk a significant loss of share to the other firms in the industry.

6.22. We also believe that it is very easy to enter this industry (see paragraph 6.12); new entrants have indeed been attracted in considerable numbers despite recent poor profitability. Any attempt by Thomson to abuse its market position by raising prices and margins would, we believe, further encourage new firms into the industry.

6.23. Similarly, we do not believe that Thomson would be able to exploit its higher share of those particular destinations, or types of holiday, where its own operations and those of Horizon are at present concentrated (as discussed in paragraph 6.7). Attempts to increase prices in particular resorts would be likely to cause customers to look elsewhere for their holidays, or attract other firms in the industry into these resorts. We also doubt whether Thomson would be able to exploit those regional markets in the United Kingdom where its share would be significantly increased as a result of the merger: any significant price increases in these regions could both attract increased competition from other operators or cause consumers to travel to airports outside their region to obtain lower cost holidays.

6.24. A number of tour operators expressed to us the somewhat different concern that in the short run Thomson could intensify price competition, causing the withdrawal of a number of its main competitors, and leading in the long run to a more substantial reduction in competition and adverse effects on price, choice, availability and standards of service.

6.25. In support of this argument it was suggested that Thomson had recently reduced both the overall level of its prices, and its prices in particular resorts, apparently to match, or undercut, those of its competitors; and that its prices at several resorts were now below the cost either of its competitors or, by implication, of Thomson itself. It was suggested that other tour operators lacked the financial resources of the scale available to Thomson, and that some of these operators could not continue in effective competition or might have to withdraw completely from the market if present losses continued. Thomson assured us that it did not target other operators' successful holiday ventures on such a loss-leader basis.

6.26. Our concern is whether, as a result of the merger, Thomson is more likely to pursue such an anti-competitive strategy, and whether such a strategy is more likely to succeed. Given Horizon's recent poor financial performance, we do not believe that the merger increases Thomson's ability or its incentive to behave in the predatory manner feared by some of its competitors. If Thomson were to pursue such a strategy – which it could attempt even if the merger were not to proceed – we also doubt whether it could be successful. Even if major competitors were to withdraw from the market, it would be difficult for Thomson subsequently to raise prices, without suffering a rapid loss of market share.

6.27. Given therefore the intensity of competition between the existing firms in the industry (see paragraph 6.16), and the potential competition from new entrants into the industry (see paragraph 6.22), we do not expect the merger to result in a significant reduction in competition in the market for AITs from the United Kingdom. Nor therefore do we believe that the merger will be the cause of increases in price, reduction in choice, or deterioration in the standards of service of AITs.

The market for leisure travel by air

6.28. Britannia, the subsidiary of ITOL, and Orion, the subsidiary of Horizon, are respectively the largest and fifth largest charter airlines in the United Kingdom. As shown in Table 6.2, together they account for some 35 per cent of the charter traffic of United Kingdom airlines and some 29 per cent of all charter traffic to and from the United Kingdom (including charter airlines). Both airlines also have significantly higher shares of charter traffic at

Birmingham and East Midlands airports. However, there is competition not only between charter airlines, but also between scheduled and charter airlines, both for the business of inclusive tour operators and for 'seat-only' passengers. The combined share of Britannia and Orion of all holiday visits abroad by United Kingdom residents (including scheduled flights) is some 21 per cent.

TABLE 6.2 **Airline shares of charter and leisure traffic, 1987**

per cent

	Shares of all charter traffic on UK airlines	*Shares of all charter traffic to and from UK*	*Shares of air holiday visits abroad by UK residents*
British Airways Group	13	11	18
Britannia	28	23	17
Dan-Air	20	16	10
Monarch	11	9	7
Air Europe	7	6	4
Orion	7	6	4
Other	14	29	40

Source: See Tables 3.17 and 3.18.

6.29. As noted in the Commission's previous report on the proposed merger between British Airways and British Caledonian[1], there is considerable overlap between scheduled and charter services on some routes. Most of the capacity on charter flights is sold to tour operators and used as part of an AIT, but about one-quarter of charter airline seats are used by passengers who make independent arrangements for their accommodation (although the seat price may include a voucher for nominal accommodation). Conversely, up to 50 per cent of capacity of scheduled aircraft can be sold to tour operators for use on inclusive tours; and scheduled airlines compete directly for leisure passengers through various types of discounted fares. Some airlines operate both scheduled and charter services and switch aircraft between scheduled and charter flights. About three-quarters of inclusive tour passengers are, however, carried on United Kingdom charter airlines, a further 14 per cent on overseas charter airlines, and the balance on both United Kingdom and overseas scheduled airlines. Independent holidays are more evenly distributed between United Kingdom and foreign scheduled airlines and the United Kingdom charter airlines, but with a lower share taken by overseas charter airlines.

6.30. As shown in Table 6.2, Britannia and Orion together carry about 21 per cent of all United Kingdom leisure passengers who travel abroad by air (but the share would be significantly lower in terms of passenger-miles or revenues). It would, however, seem reasonable to regard the requirements of tour operators for chartering capacity as distinct from those of individual passengers. Britannia and Orion together account for a higher proportion of United Kingdom air passengers on inclusive tours – about 29 per cent. Unlike most other charter airlines, most of the capacity of Britannia and Orion is used by their associated tour operating companies: in 1987 about 75 per cent of seats on Britannia flights and 66 per cent of seats on Orion flights were used by the Thomson and Horizon tour operating companies respectively.

6.31. The charter airline industry is characterised by relatively low barriers to entry. Although a licence to operate charter services is required from the Civil Aviation Authority, the regulatory controls are not regarded as restrictive for new charter airlines; aircraft are readily available second-hand, or on lease. There has therefore been a significant number of new entrants to the industry but several firms have also left the industry. Six new United Kingdom charter airlines have started operating in the last two years, and about a dozen United Kingdom charter airlines are now in operation, in addition to Britannia and Orion. Within the last three years, several overseas charter airlines have also begun to supply capacity to United Kingdom tour operators and we have been told that in the last few months others have started to compete for tour operators' business. Charter airlines, unlike scheduled airlines, are also able

[1]Cm 247 – *British Airways Plc and British Caledonian Group plc*, November 1987.

readily to enter new routes, being licensed to operate charter services between any airport in the United Kingdom (other than Heathrow) and any airport in Europe. The only significant barriers to entry arise from congestion at some airports, notably at Gatwick; Britannia and Orion combined account, however, for only some 19 per cent of charter passengers at Gatwick, less than Dan-Air, and only slightly more than Caledonian (the charter arm of British Airways).

Effect of the merger on the air leisure market

6.32. Some smaller tour operators expressed the concern to us that, as a consequence of the merger, Thomson would be in a position to increase charter rates, or reduce the availability of seats for independent tour operators. One charter airline also suggested that, although the present merger was not expected to cause difficulties, the trend to concentration in the tour operating business could distort competition to the detriment of independent charter airlines.

6.33. There is at present strong competition for the business of tour operators from about 12 other United Kingdom charter airlines, as well as overseas charter operators, and scheduled airlines. We do not expect that the acquisition of Orion, which does relatively little business with third parties, would significantly reduce competition, or the alternatives available to tour operators. Any attempt by Thomson or other main operators to increase prices or reduce seat availability would also attract different new entry into the industry. The ease of entry would also constrain the ability of Thomson to increase rates on particular routes where, as a result of the merger, it may initially have a relatively high market share.

6.34. We do not therefore expect the merger to operate against the public interest in the United Kingdom air leisure market in general, or more specifically in the supply of aircraft seats for inclusive tour operators.

6.35. We also, however, considered one related aspect of the airline charter operations of Britannia and Orion – namely whether the vertical integration between the airlines and the Thomson tour operating activities puts Thomson at a significant competitive advantage. As discussed in paragraph 3.41, there may be a number of advantages in vertical integration between a charter airline and a tour operator.

6.36. Although vertical integration is common, most tour operators use airlines with which they are not in association for all or the bulk of their business. Thomson itself uses airlines other than Britannia for about 30 per cent of its requirements. It told us that it dealt with Britannia on an arm's length basis, and that its tour operating companies would not pay a higher rate for chartering seats from Britannia than they could obtain from other airlines, and, for a similar set of conditions and commitments, the rate charged by Britannia to Thomson and Portland Holidays would be similar to that charged to independent tour operators. The figures we have seen tend to confirm this. Given therefore the competitive nature of the charter airline market, the tour operators which are not vertically integrated would not appear to suffer a serious competitive disadvantage as a result. We do not therefore believe that the vertical integration between Thomson and its airline subsidiaries will constrain the development of effective competition with Thomson following the merger, or operate as a barrier to entry into either the tour operating or airline charter markets.

Retail travel agents

6.37. In total there are about 2,900 travel agents in membership of ABTA, with about 7,300 retail outlets in the United Kingdom. Lunn Poly, a subsidiary of ITOL, at present operates about 500 retail outlets in the United Kingdom, including the 17 Horizon Travel Centres already transferred to it. The acquisition of the 17 Horizon Travel Centres has only a negligible effect on Thomson's share either of all sales through retail travel agents, or more specifically of sales of inclusive tours.

6.38. It has, however, been argued to us that since Thomson will account for almost 40 per cent of AITs, it will be in a stronger position to distort competition between travel agents, and hence between tour operators. It was, for example, suggested that Thomson could concentrate retail sales of its package holidays on its own outlets, or other preferred outlets; that it could ensure that preference was given to its products over those of other tour operators; or even that it would be in a strong enough position to exclude other operators' products from some agencies. In part, however, this reflected a general concern about the trend towards vertical integration between tour operators and travel agents, and in particular about the development by Thomson of Lunn Poly.

6.39. Lunn Poly at present accounts for a similar proportion of sales of Thomson's holidays as of sales of inclusive tours generally, and we do not believe that it would be to Thomson's advantage to concentrate sales on Lunn Poly, nor that it would be more inclined to do so as a result of the merger with Horizon. Were it, however, to do so, there are many alternative products to which travel agents could turn, and indeed the suggestion was made to us that smaller tour operators could benefit from travel agents wishing to reduce their dependence on Thomson.

6.40. Similarly we do not believe that the acquisition of Horizon increases Thomson's influence over travel agents. The suggestion was, however, made to us that Thomson already attempted to exert undue influence over some travel agents by, for example, withholding supply of brochures. Such action is, we believe, likely to have as damaging an effect on Thomson as on travel agents but, should Thomson attempt to abuse its position in this way, we believe that there is sufficient scope for action under the Fair Trading Act or the Competition Act to safeguard competition.

6.41. A further suggestion put to us was that, as a result of the merger, Thomson would be in a stronger position to influence the travel agents' choice of computer reservation systems. The installation of such systems by smaller, independent travel agents is still at an early stage of development. We recognise that there are various routes that future development could take, and that Thomson's position in the industry will give it a significant influence over the choices that are made. However, we do not consider that there are sufficient grounds for believing that the acquisition of Horizon may of itself put Thomson in a position to distort either the choice of system to be installed, or the operation of the system, in such a way as to put other tour operators at a disadvantage.

6.42. We do not therefore believe that the merger may be expected to operate against the public interest in its effects on travel agents.

Conclusions

6.43. We have considered the effect of the merger on foreign AITs, on leisure travel by air including charter flights, and on retail travel agents. We have also considered the implications of vertical integration between these sectors. These markets are at present characterised by strong if variable growth, extensive competition, and continued entry by firms new to the industry. We do not believe that the merger will sufficiently reduce competition as to cause any adverse effects on price, choice or standards of service in any of these sectors.

6.44. We conclude that the creation of the merger situation qualifying for investigation, which we have identified, may be expected not to operate against the public interest.

D G Richards *(Chairman)*

M E Beesley

Robert Clayton

M R Hoffman

C A Unwin

R Young

S N Burbridge *(Secretary)*

8 December 1988