

4 Views of the main parties

4.1. BCI and Myson each submitted written evidence and each attended a hearing to discuss issues put to it by the Commission.

BCI

Benefits arising from the proposed merger

4.2. BCI told us that there were two principal ways in which the proposed acquisition of Myson would bring benefits. Firstly, the merger of the gas boiler activities of its Potterton subsidiary with those of Myson would, by releasing resources, enable the merged group to cope more successfully with the market developments that were expected in the next few years. With the creation of the single European market in 1992, higher safety standards would have to be met and this would require substantial expenditure on the development of boilers to meet these standards and on new tooling for their production as well as increased expenditure on training of installers. A merger would allow duplication of effort to be eliminated, costs of research and product development would be spread over a larger volume of production, and there would be other economies of scale. A merger would also allow rationalisation of certain functions, such as purchasing, selling, warehousing, transport and distribution. With the passage of time and in the process of product development there would also be opportunities for the rationalisation of the product range.

4.3. Secondly, there was in future likely to be a trend towards integrated central heating systems, with the constituent parts designed, produced and supplied by the same manufacturer. Myson manufactured a range of central heating products not made by Potterton: radiators, pumps, valves, and towel heaters. The merged concern would be better able to develop integrated systems. BCI expected that the merger would lead to improvements in the production and marketing of Myson products by the enlarged home products division of BCI.

4.4. BCI believed that the above benefits could be obtained without giving rise to effects adverse to competition or to consumer choice.

4.5. In respect of gas fires, BCI said that the benefits would be less marked as the merger would take it into this market for the first time. In BCI's view this was a static market that was not particularly attractive to new entry other than by acquisition. However, BCI believed that Myson's range of gas fires would fit well, in terms of technology and product development, within BCI's home products division. Through its New World gas cooker business, BCI already had well-established sales links with British Gas; the New World brand name also enjoyed greater consumer awareness than Myson's Main brand name.

4.6. Taking all these factors into account, BCI believed that there was a strong case for allowing the proposed merger to proceed.

BCI's present shareholding in Myson

4.7. BCI accepted that, if the present restriction on voting rights was lifted, its present holding of 29.5 per cent of Myson's shares would give it the ability materially to influence the policies of Myson. BCI said that the shares had been purchased merely as a first step in the process of acquiring the whole of the issued share capital of Myson. It was a declaration

of intention to acquire the company; BCI never intended to use that shareholding to influence Myson otherwise than in the context of a full bid.

The market for residential gas boilers

4.8. BCI said that the United Kingdom market for domestic gas boilers was very competitive and highly dynamic. There were a number of factors which made competition robust enough to safeguard the interests of the consumer after the merger:

- (a) There were several manufacturers of domestic gas boilers in the United Kingdom, each with a sizeable share of the market. Besides Potterton and Myson, Baxi, Glow-worm and Stelrad were all major producers of gas boilers. Each had great experience in domestic water heating and space heating.
- (b) There were also several other smaller manufacturers in the United Kingdom and a number of well-known companies based in continental Europe had entered the United Kingdom market. These continental manufacturers had enjoyed substantial home markets (particularly for combination boilers), and strong positions in those markets. Many of the new technologies and products, such as fabricated heat exchangers and the combination boiler, had been pioneered by these continental competitors.
- (c) The major distributors of gas boilers in the United Kingdom had considerable buying powers. They were neither owned, nor controlled, by any of the manufacturers. Nor, to BCI's knowledge, were there any exclusive arrangements between major distributors and manufacturers. In addition to the main distributors, there were a large number of smaller 'second line' distributors.
- (d) The consumer looked to installers of central heating systems for advice on the choice of boiler type and model. The number of installers in the United Kingdom was estimated to be in excess of 50,000. Most installers shopped around to secure prices and products to meet their requirements.
- (e) Success in the market-place depended in large measure on the development of new types of boilers and on improvements to existing models, and this stimulated competition. For example, Glow-worm and Stelrad (like Potterton and Myson) now manufactured combination boilers in response to competition from the Continent, and Stelrad had also introduced a condensing boiler to meet the challenge of environmental concerns. Baxi had developed new lighter-weight cast-iron technology which was used in its new fanned wall-hung boiler.
- (f) There were no significant barriers to entry to the United Kingdom market.
- (g) There was competition between domestic gas boilers and heating systems using other fuels.

BCI believed that only the first of the above factors would be affected by the proposed merger, and then only in the technical sense that the number of large suppliers would be reduced from five to four.

The effect of the proposed merger on competition

4.9. BCI believed that, across the whole range of gas boilers, the merged company would have a share of around 29 per cent of the United Kingdom market – half as much again as any of the remaining three major suppliers. Nevertheless, BCI believed that the increase in concentration and the larger share of supply would not enable the merged company to restrict or distort competition by virtue either of its absolute size or of its size relative to its established United Kingdom competitors. If, for example, the merged company raised its prices to the trade, distributors could switch to other suppliers, who would have no difficulty in meeting the demand.

Thus any attempt by the merged company to raise prices would cause a significant loss of business. It would not make commercial sense. Nor, in BCI's view, could the merged company act as a price leader, forcing prices up in the industry generally to the detriment of consumers. The rivalry in product innovation, the buying power of each of the large merchants and the threat from continental European manufacturers eager to increase their participation in the United Kingdom market would ensure that any experiment in price leadership would be short-lived and ineffective.

4.10. BCI said that any attempt by the merged group, by virtue of its size, to drive competitors out of the market by deliberately reducing prices would also be self-defeating, if only because of the financial strength and staying power of the leading United Kingdom suppliers. In any case the move would succeed only if the merged company could raise its prices monopolistically when its United Kingdom competitors had been driven out or made ineffective. The presence in the United Kingdom of continental manufacturers ready to expand their sales, combined with the ease of entry for other manufacturers, made this an implausible strategy.

4.11. BCI argued that what was true for gas boilers in the aggregate was true for any particular type of gas boiler. While the merged company would have some 35 per cent share of the supply in the United Kingdom of floor-standing domestic gas boilers, BCI did not think this would give rise to consequences adverse to competition. Similarly, with wall-hung domestic gas boilers, where BCI estimated that the merged company's share would be about 43 per cent if combination boilers were excluded or about 34 per cent if combination boilers were included, BCI did not expect any effects adverse to competition.

4.12. BCI stressed that there was a considerable degree of product substitutability between different types of boilers – and indeed between gas boiler systems and other systems (some using fuels other than gas) performing similar functions. BCI also pointed out that a manufacturer experienced in other boiler technology, for example oil-fired boilers, was well placed to develop domestic gas boilers. Moreover, a manufacturer of one variety of domestic gas boiler would not find it difficult to introduce another variety. The scope for substitutability between one type of boiler and another, and one supplier and another, was such that the different boiler types could not be considered as being in distinct product markets. This was particularly true in respect of wall-hung boilers; virtually all combination boilers were wall-hung and condensing boilers, which were expected to have a significant impact on the market in the future, would generally be wall-hung.

4.13. On the question of whether oil or solid fuel boilers offered competition to gas boilers, BCI said that it was insufficient to look simply at the issue of product substitutability between boilers fuelled by gas and those fuelled by oil or coal. Other possibilities included central heating systems using electric storage heaters, or individual room heaters (gas or electric). The consumer had a wide choice. Factors outside the control of the gas boiler manufacturer could have an impact on the competitive position. A rise in the price of gas compared with other fuels (notably electricity) would adversely affect the total sales of gas boilers. Similarly, technological developments in heating systems using other fuels would intensify competition facing gas boiler manufacturers. There had, for example, been a recent increase in sales of electrical systems which reflected in part the development of compact electric storage heaters.

The impact of the proposed merger on employment

4.14. BCI told us that it was difficult to predict accurately the effect of the proposed merger on employment. There would be some rationalisation of the product range, as existing products became due for replacement or upgrading, but this would be a slow process, spread over a number of years. This rationalisation would tend to reduce the numbers employed. On the other hand, more employees might be required for in-house manufacture of cast-iron heat exchangers for Myson boilers (although this could be offset by the modernisation of the foundry at Warwick which could follow a merger), and of fabricated heat exchangers for Potterton boilers. To remain competitive in a technologically developing business, the merged company would find it necessary to invest more in research and development and in the training of central heating

installers; this would also require more employees. On balance, BCI expected there to be a slight reduction in the total number of employees in the combined business. Much of this was expected to come from natural wastage.

Effect of the proposed merger on research and development

4.15. BCI said that Potterton and Myson together would be better placed than each separately to meet the higher safety and environmental standards expected in the United Kingdom as a result of European Community harmonisation. It would also be better placed to fund the substantial expenditure required to design, develop and supply more complex products and integrated systems. Benefits would also arise from the avoidance of duplication in research and development, and from the spreading of research and development costs over a larger volume of production. The qualified people required for research and development were in short supply in the United Kingdom—especially those with gas engineering qualifications. In the merged company skilled resources could be more flexibly deployed across a wider range of products. The result would be a better range of future products.

MYSON

Reasons for the proposed merger

4.16. Myson said that it was clear, from its discussions with BCI, that BCI's prime interest in Myson stemmed from its desire to widen its activities in the central heating market with products manufactured by Myson, ie radiators, pumps, valves, fan convectors and towel warmers. BCI's and Myson's strengths were largely complementary, both in the market-place and technically. By combining with Myson, BCI would be better placed to compete with its continental rivals.

The market for residential gas boilers

4.17. Myson said that although it accounted for about 11 per cent (by value) of the market for residential gas boilers and Potterton about 16 per cent, past experience of mergers in the industry suggested that the combined group would supply significantly less than the 27 per cent suggested by those figures. Myson believed that, based on previous experience of mergers, the combined share would eventually settle at between 22 and 25 per cent.

4.18. Myson said that there was very substantial competition in the supply of gas boilers. For example, Baxi, Glow-worm and Stelrad had market shares in the range of 15 to 18 per cent. Worcester, a major supplier of oil boilers, had been growing rapidly and had achieved the largest share in the supply of gas combination boilers. Trianco Group Ltd, the largest United Kingdom manufacturer of oil boilers, had also entered the gas fabricated wall-hung boiler market and back-boiler market. Myson added that in the past three years there had been rapid import penetration and importers had obtained some 18 per cent by value of the supply of gas boilers. Other large continental companies with appropriate products were waiting on the sidelines.

4.19. Myson pointed out that there were no significant barriers to entry into the supply of gas boilers. There were no patent or approval barriers, and anyone wishing to enter the business could readily obtain heat exchangers, burners, controls and sheet metal work from other manufacturers. New entrants also had ready access to distributors, both local and national.

4.20. Myson also pointed out that the four leading national distributors purchased about 60 per cent of gas boilers, and the largest eight purchased about 80 per cent. These distributors were powerful, sophisticated buyers; they had low brand loyalty and used their ability and strength aggressively to obtain the best value for money. Past experience suggested that these merchants would seek to have the best terms currently offered by Potterton or Myson applied across the whole product range of the merged companies. This would have a depressing effect on

prices. Myson said that, in spite of the very wide range of its products sold through the distributors, it had no exclusive distribution agreements; nor, as far as it was aware, did any other manufacturer. Myson considered it highly unlikely that any such agreements could or would be negotiated by gas boiler manufacturers with their distributors.

4.21. Myson also drew attention to the role of gas central heating installers of whom there were tens of thousands. They shopped around between merchants who had, accordingly, to stock a wide range of boilers from all the major manufacturers.

4.22. With regard to the large market share which the combined companies would have initially for particular types of gas boiler, Myson pointed to the high level of substitutability between one type of boiler and another and to the rapidly developing technology. This was illustrated by the arrival in 1970 of wall-hung boilers with cast-iron heat exchangers, and the subsequent increase in market share of these boilers at the expense of the less flexible free-standing boilers; the advent in 1980 of lower-cost wall-hung boilers with fabricated heat exchangers; and the rapid advance of wall-hung combination boilers from 1985 onwards. The partial resurgence of wall-hung boilers with cast-iron heat exchangers between 1985 and 1987 also illustrated the effect on market share of technical innovation in cast-iron heat exchangers, led by Stelrad. It had been a characteristic of the years since 1970 that innovation by one company was quickly followed by competition from the other major suppliers, who generally brought out a competitive model within two or three years. Condensing boilers would, over the next five years, make an impact on the wall-hung and free-standing boiler markets and markedly affect present market shares.

4.23. Myson said that too much weight should not be placed on manufactures' shares in sub-markets for the different types of boilers mentioned above. Although widely used in the trade, such categories merely reflected the chronological order of boiler development. It would be equally logical—or even more logical—to classify boilers by type of flue (chimney, unfanned balanced flue, fanned balanced flue etc) since this was the major factor that often influenced the siting and choice of boiler.

4.24. Myson suggested that a manufacturer with a large share of the boiler market (or a segment of it) would still be vulnerable to competition. For example, Baxi's 60 per cent or so share of the back-boiler market had not discouraged other companies from entering that market.

4.25. Myson said that manufacturers also faced competition from heating systems based on other fuels. Gas was no longer the cheapest fuel for central heating. Oil was cheaper to use and the market for oil-fired boilers, which had declined during the oil crises, was now showing signs of recovery. Electricity was now only marginally more expensive than gas and electric central heating was cheaper to install. The development of higher insulation standards requiring smaller heating inputs was also making electric central heating more acceptable.

4.26. Myson argued that, with such strong competition in the market, the proposed merger would have no adverse effects on price, quality or consumer choice.

Effect of the proposed merger on research and development

4.27. Myson said that without a knowledge of Potterton's research and development activities it could not speak with authority on the likely effect of a merger on research and development. Myson stressed, however, the importance of maintaining adequate resources especially in terms of trained personnel, not just for the development of boilers, but to keep abreast of new technologies and the use of new materials. The alignment of United Kingdom standards on gas boilers

with the present European Community proposals would require additional technical effort by United Kingdom suppliers. At present, Myson had to select its new projects with care. The merged company would be able to spread its research and development over a greater volume of sales, and would be able to make more efficient use of trained research personnel who were in short supply.

Conclusion

4.28 Myson said that for all the above reasons a merger would not be against the public interest.