

# 6 Conclusions

## **The merger situation**

6.1. Under the terms of the reference dated 20 September 1989 (Appendix 1.1) we are required to consider whether arrangements are in contemplation which, if carried into effect, would result in the creation of a merger situation qualifying for investigation as defined in section 64(8) of the Fair Trading Act 1973 (the Act) in that enterprises under the control of Desoutter Brothers (Holdings) PLC (Desoutter), incorporated in the United Kingdom, would cease to be distinct from enterprises carried on by or under the control of Atlas Copco AB (Atlas), incorporated in Sweden, and that (section 64(1)(b) of the Act) the assets which would be taken over exceed £30 million. The assets of Desoutter exceed £30 million (Appendix 3.5) and the condition set out in section 64(1)(b) of the Act is therefore satisfied. In view of the final paragraph of the reference, this finding precludes us from considering the test in section 64(1)(a) of the Act.

6.2. It is clear from evidence given to us during the inquiry (paragraph 5.3) that, if it is permitted to do so, Atlas intends to renew its offer for all the share capital of Desoutter.

6.3. We consider, therefore, that arrangements are in contemplation by Atlas for the acquisition of Desoutter which, if carried into effect, would result in the creation of a merger situation qualifying for investigation.

6.4. Consequently, we have to examine whether the creation of the merger situation which we have identified may be expected to operate against the public interest (section 69(1)(b) of the Act).

## **The events leading up to the merger**

### *Desoutter*

6.5. Desoutter is the largest United Kingdom supplier of pneumatic power tools. The Chairman and Sales Director are members of the Desoutter family which has substantial shareholdings giving it at present effective control of the company; but Desoutter told us that the level of the family shareholding had been eroded over time and might not be maintained in the future. By the autumn of 1988 the directors had become concerned that legislation might be introduced which would require a shareholding in Desoutter by the company's pension fund to be reduced. As a consequence, the ability of the directors to maintain their position in the future against a hostile bid would be at risk.

6.6. Desoutter's Chairman also told us that in his view, mainly because of the competition to be expected from a number of much larger multinational suppliers, but also because of the growing cost of research, Desoutter's position as a major producer of industrial power tools could not be sustained in the longer term. He considered that it was increasingly necessary for Desoutter to offer electric as well as pneumatic tools, and this was not possible for a company of Desoutter's size. If Desoutter remained independent, he was concerned that it would be unable to survive in its present form as a full-line producer of power tools.

6.7. In the spring and early summer of 1989 Desoutter, therefore, entered into discussions with a number of possible suitors. We were told that the Atlas bid was the best offer that was received because it was the highest cash offer for shares and also, in Desoutter's view, offered more autonomy than other bidders. We note that Desoutter's directors intended to 'buy out' a part of the business concerned with the production of pneumatic medical equipment.

6.8. Despite Desoutter's misgivings about the long-term future of the company, it is clearly a successful and profitable business at present. If the proposed merger were to be disallowed there seems little doubt from the evidence we have received that a further bid would be made from companies within or outside the pneumatic tool business and that some at least of the potential bidders might provide the type of additional security which Desoutter considers is necessary for the long-term prosperity of its business. In any event it appears evident that Desoutter is unlikely to remain independent.

### *Atlas*

6.9. Atlas is a long-established Swedish company which is involved in a number of businesses, many of which are associated with the production of equipment providing and making use of compressed air. We are concerned with one division of the business, the Industrial Technique, which manufactures and sells mainly pneumatic tools and is by far the world's largest producer of such tools.

6.10. Atlas has, within the last three years, purchased two firms in the same line of business: Chicago Pneumatic, a United States company supplying a wide range of pneumatic tools in many parts of the world, including the United Kingdom through its subsidiary Consolidated Pneumatic (CP), and Ets Georges Renault SA (Renault), a French producer of a small range of pneumatic tools which nevertheless has 20 per cent of the French pneumatic industrial tool market.

6.11. Atlas told us that its reason for making its offer for Desoutter was that the acquisition met a number of its strategic objectives in the field of industrial power tools. Buying Desoutter would provide the growth that Atlas needed if it was to continue to be a full-line supplier of industrial power tools. Atlas considered that there was a marked trend away from pneumatic and towards electric tools. Both Atlas and Desoutter were having to make heavy investments in R & D on electric tools (as well as on pneumatic tools) in order to meet today's competitive challenges. Atlas believed that both companies faced world competitors which were much larger and better placed to take advantage of the market trends such as Bosch, Makita and Black & Decker. Individually, Atlas and Desoutter could not hope to match those competitors with a broad range of products: they would be reduced to a niche role. By acting in partnership, Atlas considered that they could greatly improve the prospects for both companies. In particular, co-ordination of Atlas' and Desoutter's R & D would enable them to make more cost-effective use of their resources (spreading their R & D costs over a much larger volume of sales) and to develop a larger number of new or improved products.

6.12. Atlas told us that it was also concerned to acquire a full-scale EC production base, with the potential for increased output, to give it a more assured position within the EC in the approach to 1992 and the Single Market. Desoutter was, in Atlas' view, well suited to that purpose. The acquisition would, we were told, also give some scope for improvements in manufacturing efficiency. Atlas believed that it could offer Desoutter new manufacturing techniques, computer systems, and expertise in inventory management, which would lower Desoutter's costs. In return Desoutter might be able to offer Atlas comparable benefits in other areas. Atlas considered that there would also be scope for an increase in the overall output of the group through co-ordination of production as between Desoutter's facilities and Atlas' existing power tool factories.

6.13. Atlas explained that it was its policy to pursue a multi-brand strategy, co-ordinating R & D and production but leaving group companies to operate as independent competitors in the development and sale of their own branded products. Atlas told us that it had pursued that strategy successfully with CP and Renault. The acquisition of Desoutter would further that strategy and Desoutter would be given, in common with other Atlas subsidiaries, a high degree of autonomy. It

would retain full profit and loss accountability and would continue to develop its own line of branded products and to compete actively in the market-place through its own independent sales and marketing organisations.

6.14. We consider the aims and possible effects of Atlas' strategy (paragraphs 6.39 to 6.44) after we have reviewed the United Kingdom market for industrial power tools.

## **The industrial power tool market**

6.15. The power tools with which we are concerned carry out a wide range of tasks in manufacturing, construction and maintenance sectors of industry. The tools, which are usually hand-operated but may be supported to reduce their weight (or, increasingly for some applications, controlled automatically), typically drill holes, fasten screws and nuts, rivet, and cut, shape and smooth metal and wood.

6.16. Power tools are used in many manufacturing industries as part of production lines for such diverse products as electronics, food processing, motor vehicles, aeroplanes, ships and oil rigs. In the construction industry they are found on all types and sizes of building sites and are used on a wide range of applications from fastening steel in the erection of major buildings to finishing and fitting-out work by craftsmen, such as electricians and carpenters. Power tools, sometimes with somewhat different specifications, are found in many large and small establishments concerned with the maintenance of aircraft, armoured and other vehicles for the armed services and motor vehicles where one of the most frequent applications is for the removal and replacement of wheel nuts.

6.17. Industrial power tools may be driven by electricity, mains and battery, or by compressed air (pneumatic) or to a small extent fluids (hydraulics). Atlas and Desoutter offer a small range of electric tools, mostly screwdrivers and other fastening tools, but in the main they are producers of pneumatic tools; even so, they have both contended that they operate in a broad market for tools generally, electric and hydraulic as well as pneumatic. In these circumstances they suggest that even after a merger the Atlas group will be only one of a number of major players in the United Kingdom and European markets competing with tools produced by many European, American and Far Eastern manufacturers which include Bosch (Germany), Ingersoll-Rand (United States) and Hitachi and Makita (Japan).

6.18. Other manufacturers of pneumatic tools and many distributors and users of power tools suggested to us that the Atlas and Desoutter view of the market did not take proper account of the circumstances in which many users of tools in certain segments of manufacturing and construction strongly preferred, or were restricted for a number of reasons to, pneumatic tools. The correct market was, it was suggested, the United Kingdom pneumatic tool market, and in that market, after a merger, the Atlas group of companies would dominate to such an extent that competition would be adversely affected. In addition, the continued ability of other producers to offer a competitive range of tools would be threatened.

6.19. We have looked carefully at these differing views of the breadth of the market for pneumatic tools and found that the extent of competition is determined by a number of factors including the technical specifications of tools, whether driven by electricity or compressed air, the nature of the industry requiring the tools and, in some instances, the existing facilities in particular manufacturing plants and the personal preferences of the engineering staff concerned.

6.20. It is apparent that in the area of fastening tools, particularly in relation to small screwdrivers, electric tools (mains and battery) and pneumatic products are available side by side and can therefore be said to be competing for broadly the same market. Many of the users we spoke to, however, stressed that the pneumatic fastening tools are more robust than their electric counterparts and, except for the applications where low voltage can be used, continue to choose pneumatic tools. For some types of tools, particularly the percussive range, pneumatic tools are virtually the only ones on the market.

6.21. A number of users told us of their concern about the safety of electric installations. This may be a factor even when low-voltage tools, which reduce the risk, are available. Some users need compressed air lines for other purposes, and that will naturally bias the choice in favour of pneumatic tools.

6.22. In certain industries where it is essential to have the smallest possible size of tools, pneumatic products are at present the only real choice and major industries such as aerospace are for that reason mainly restricted to the use of such tools.

6.23. Atlas and Desoutter have told us that there have been considerable advances in the power-to-weight ratios of electric tools and that battery-powered tools have considerable advantages for some applications. We have noted these views and the circumstances in which both manufacturers now offer some electric tools. We have also noted that a number of users have switched in recent years from pneumatic to electric tools, for the most part in respect of small fastening tools. Others have, however, switched from electric to pneumatic tools and many, although they have looked at alternatives, continue to use pneumatic tools. We have also noted that electronic controls are allowing electric and pneumatic tools to provide users with a more accurate product.

6.24. Our survey (paragraph 2.20 and Appendix 2.2) suggested that electric and pneumatic tools are being used in a wide range of similar applications. For drilling and tapping, nearly 60 per cent of users were utilising both electric and pneumatic tools. But for two other applications, fastening and percussive tools, around 70 per cent of users only employed pneumatic tools.

6.25. Over the last ten years 39 per cent of the users responding to the survey had changed, either from electric to pneumatic or from pneumatic to electric. 37 per cent of respondents, however, told us that they would not consider changing. We also asked users whether they thought they would have problems in changing: 30 per cent envisaged problems, but 50 per cent did not.

6.26. This evidence from individual users and from our survey indicates the extent of change between electric and pneumatic tools and the willingness of many users to consider both types of tool. But the evidence also shows that for some users, sectors of industry and applications, pneumatic tools remain the preferred or only practical choice. (The same frequently applies to electric tools.) We have concluded therefore that it is necessary to take account of the effects of the merger on this distinguishable market for pneumatic tools.

## **The market for pneumatic tools**

6.27. Pneumatic power tools for the United Kingdom market are supplied by domestic and foreign manufacturers. Desoutter is the only domestic manufacturer supplying a reasonably full range of tools. It is also unusual in supplying three-quarters of its tools directly to end users through its own sales force, rather than through distributors. Foreign manufacturers (other than Ingersoll-Rand, which makes some tools in the United Kingdom) import their tools and sell them for the most part through distributors. In some cases (as, for instance, Atlas and Chicago Pneumatic) they have established marketing and sales companies in the United Kingdom, which deal partly through distributors. These companies, or their exclusively-appointed main distributors, may also deal directly with the largest end users.

6.28. Manufacturers range from such major participants in the United Kingdom market as Desoutter; Atlas; the American groups Ingersoll-Rand, Stanley, ARO and Dresser; CompAir, the second largest United Kingdom supplier; and the Japanese company Uryu; to some two or three dozen medium to small participants manufacturing in the United Kingdom (notably ATA, Thor and Trelawny), Europe, the United States and the Far East. Table 2.1 sets out the names of most participants.

6.29. The distribution system for pneumatic tools is complex. There are over 200 distributors of pneumatic power tools in the United Kingdom. Some are specialists, who generally limit themselves to pneumatic power, and are quite small. Others are distributors of a wide range of compressed air products as well as tools. There are also general engineering suppliers who deal in pneumatic tools as

a small part of their range. Distributors may market the tools of more than one supplier, especially on behalf of manufacturers who only do business in selected sectors of the whole range of tools (such as ATA's grinders and Trelawny's percussive tools). Distributors usually operate within a region, and may have an agreement which restricts their ability to sell other suppliers' tools within that region.

6.30. There are many thousands of end users, ranging from the largest concerns in the aerospace and vehicle assembly industries down to the smallest vehicle repair shop. Two specialist sectors, which absorb large numbers of tools, should be mentioned: construction companies employ pneumatic tools largely in steelwork erection; the 'automotive after-market' sector (vehicle maintenance and repair) uses them extensively for removing and attaching wheels and in body repair work. The latter is the cheaper end of the market. Far Eastern tools are used extensively here; many Western suppliers import tools and then sell them under their own brand names.

6.31. Pneumatic power tools can be broken down into a number of categories (see paragraph 2.6). The largest of these is fasteners, which takes nearly 40 per cent of the market; it includes screwdrivers, nutrunners, wrenches and riveters. Abrasive tools (grinders and sanders) and tools for making holes (drills and tappers) take 17 per cent and 14 per cent respectively of the market. Percussive tools (needle guns, chipping hammers), cutting tools (saws, shears and nibblers) and lifting tools (hoists) make up most of the rest of the market. We understand that the great majority of users will buy the bulk of their tools in only two or three of these categories; in other words it is very unusual to find a business employing in substantial numbers pneumatic drilling and abrasive tools alongside percussive and fastening tools.

6.32. Owing to the complexity of the distribution system and the multiplicity of small importers, we have been unable to achieve any absolute certainty about the size of the United Kingdom market for pneumatic tools, but we are confident that sales in 1988 (including spares) were about £42 million. This is a little lower than the estimates provided to us by Atlas and Desoutter (paragraph 2.46), but in several specific cases where we had better information we have found evidence that their estimates were inaccurate. We have not ourselves made calculations of wider markets, such as the EC or world-wide market, but Atlas put sales of pneumatic tools in 1988 in the EC at £268 million and world-wide at £830 million.

6.33. On the basis of a market of about £42 million, Desoutter and Atlas had shares in 1988 of 19 per cent and 17 per cent respectively or 36 per cent combined. While this is slightly higher than Atlas' and Desoutter's estimate of the combined group's share (33 per cent), it is lower, often a great deal lower, than the estimates of a number of other interested parties (see paragraph 2.49). We find that the next highest share would be that of Ingersoll-Rand, at 12 per cent.<sup>1</sup>

6.34. We have also looked at Atlas' and Desoutter's joint shares in the various categories of tool described above. In the three main market segments, Atlas and Desoutter would have 38 per cent in the most important single segment, fastening (which accounts for 39 per cent of the total market). In the drilling and tapping segment (which accounts for 14 per cent of the market) a combined group would have 55 per cent, and in the abrasives segment (17 per cent of the market) 33 per cent.

6.35. We have also considered the matter of ease of entry into the pneumatic tool market in the United Kingdom. From evidence already quoted it can be seen that entry by way of setting up a production base in the country is quite uncharacteristic. We believe that to establish facilities on a greenfield site capable of manufacturing a full range of tools would today cost from £15 million to £20 million. A more practicable route would be to set up production facilities for tools for one sector of the market, or to assemble tools from components brought in from abroad. The commonest and least expensive method of entry is for an overseas manufacturer to find a distributor willing and able to market its tools, or in reverse for a new distributor setting up business to find foreign manufacturers willing to supply a range of tools for it to sell. This is the route by which many brands of Far Eastern tools, and several of European tools, have established themselves in the market.

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<sup>1</sup>Just over 14 per cent, taking account of its recent acquisition of ARO (paragraph 2.23).

6.36. We considered whether, through the acquisition of patent rights, Atlas and Desoutter might, if a merger took place, gain a significant advantage from their sales of oil-free tools (paragraph 2.11). From the evidence we have received from Atlas and Desoutter (paragraph 5.29) we are satisfied that neither company has any effective patents or patent applications in relation to their oil-free tools. We have also noted that other manufacturers are offering oil-free tools. More generally we have found no evidence that patents have been a significant barrier to entry in relation to the production of pneumatic tools.

6.37. We looked at a range of Desoutter's and Atlas' list and realised prices in the last three years in relation to the RPI and Producer Price Index (PPI) (see paragraph 2.43). Atlas told us that, because of its distribution arrangements, it was only able to give us list prices. The PPI for the period in question increased at a faster rate than the RPI, and in the main we found that both parties' rates of increase in the prices of the tools included in the analysis fell somewhere between the two indices.

6.38. We could not draw any conclusion from this evidence of prices. We asked manufacturers, distributors and users more generally about the nature of competition in the market. The range of views that we obtained suggested on balance that it might be somewhat less sharp than the competition currently prevailing in the market for electric power tools.

## **The effects of the proposed merger**

### *The operations of Atlas' subsidiaries*

6.39. Atlas told us that one of its main reasons for the proposed merger was to increase its share of the industrial tool market (paragraph 6.11). The purchase would be part of Atlas' overall strategy which has included in the past two years the purchase of two other manufacturers of pneumatic tools, Chicago Pneumatic and Renault. But in the view of Atlas, its policy of autonomy for subsidiaries which allowed its subsidiaries to compete with each other across the whole field of pneumatic tools without any centrally directed decisions on pricing would eliminate any possibility of reduction in competition. Atlas claimed that any attempt to consolidate the subsidiaries into one unified business by rationalisation and the denial of autonomy would deprive the group of a significant proportion of its business.

6.40. As we have established in the previous section, if a merger took place the combined market shares of the Atlas subsidiaries in the United Kingdom would be about 36 per cent. In individual sectors of the market, notably so in drilling and tapping, the market share would be rather higher. In these circumstances the effectiveness or otherwise of the Atlas policy of autonomy for its subsidiaries could be an important factor in determining the extent of competition in the market if a merger took place.

6.41. Chicago Pneumatic, Atlas' first acquisition in this field, was only purchased in 1987 and Renault in 1988. There has not therefore been sufficient time to reach any judgment on the effectiveness of the policy, particularly as Chicago Pneumatic was, Atlas told us, trading at a loss at the time of the acquisition and has needed to be reorganised and redirected. We have, however, been able to consider a number of facets of Atlas' policy and their possible long-term effects. Atlas intends to control its subsidiaries by setting them annual targets, including profits. Provided the targets are met, the individual subsidiaries will be given, we were told, no particular directions in terms of ranges of their products or their sales policies and pricing. Capital expenditure will, however, be tightly controlled from the centre, and it is intended that R & D will be centrally co-ordinated to avoid duplication. This will involve individual subsidiaries concentrating on the development of particular types of tools and, probably at a later stage, the rationalisation of production, not only of parts of tools but also of particular completed tools, which may then be sold to the subsidiaries, perhaps with different housings or special features.

6.42. As a result of this policy it is probable that in the longer term the Atlas group of subsidiaries will be selling individually a wider range of products than at present. Some could be produced in the individual subsidiaries' factories; others could be manufactured by other subsidiaries and sold under the badge and perhaps general style of the individual company. Other products could be bought in, perhaps from the Far East on a group basis, and again sold by the individual subsidiaries.

6.43. We have no doubt that, at least for a period of time, the individual subsidiaries would maintain their own ranges of products and their pricing might, to some extent, be independent. A degree of competition would be possible between the individual subsidiaries since this would be to the group's advantage as it would increase the number of Atlas' products competing with the tools offered by other suppliers and add to the problems faced by new entrants. But, in the longer term, we do not believe that Atlas and Desoutter would be allowed to compete with each other for custom in the United Kingdom to the extent that their combined profits would be adversely affected.

6.44. We must also have regard to the reasonable expectation that at some time in the future Atlas might decide that it was uneconomic to maintain four separate subsidiaries producing pneumatic tools and might reduce the number of subsidiaries and thus brands of products. While we believe that for a time at least Atlas is likely to maintain Desoutter as a separate brand with a considerable degree of discretion in relation to the extent of its range of tools, its marketing methods and pricing policies, we consider that competition between Desoutter and the other brands owned by Atlas will in the longer term be different in nature and less effective than the competition which would have existed if Desoutter had remained independent of Atlas. We have taken this view into account in our consideration of the effect of the proposed merger.

#### *Competition in the pneumatic tool market*

6.45. As noted in paragraph 6.33, we estimate that if the merger were to go ahead the combined Atlas group would (on the basis of 1988 sales) enjoy a share of about 36 per cent of the market for pneumatic power tools, as against the Atlas group's 17 per cent and Desoutter's 19 per cent separately. Initially the nearest competitor (Ingersoll-Rand) would have a share of about a third of the new group's share<sup>1</sup> and other competitors would fall significantly behind that. No major competitor manufacturing mainly in the United Kingdom would enjoy more than a 6 per cent share. While all these figures must, for reasons we have given, be considered as broad approximations, it seems likely that a merger would bring about some loss in competition and some increase in Atlas' overall influence in the market. Atlas has claimed that it needs this influence to withstand the expected onslaught of competition from Far Eastern manufacturers; but the current shape of the market suggests to us that any such onslaught would be concentrated to a large extent in the electrical sector of the market. There are indeed Far Eastern manufacturers of pneumatic tools, but none other than Uryu has a significant share of the United Kingdom market, and the giants are all in the electrical field.

6.46. In considering the degree of the new group's influence, we have not only surveyed the market as a whole but have also broken it down in different ways. We have already noted that it is segmented into different types of tools. Of these, the abrasive and drilling segments each take about one-sixth of the market, and fastening tools more than a third. The new group would be particularly strong in the two latter segments (see paragraph 6.34). We have not been able to make any exact estimate of the new group's share in particular industries, but many witnesses have argued that its position in the aerospace industry, which is strongly committed to pneumatic tools, would be pre-eminent.

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<sup>1</sup>See footnote to paragraph 6.33.

6.47. It is fair to say that the opinions conveyed to us by different witnesses as to the effects that this situation might have on competition were various. Many witnesses, especially among the manufacturers, but also to a notable extent among distributors specialising in pneumatic tools, believed that Atlas would achieve a dominant position in the market. They evidently feared that, as a result, they would be put at a significant disadvantage. The market share estimates for a combined Atlas/Desoutter group that were cited were, however, greatly over-estimated. There were also a few manufacturers and distributors who took the view that the merger would be beneficial, and a number who were neutral.

6.48. As pointed out above, distribution arrangements for industrial power tools are complex. With a few exceptions, Desoutter's own salesmen market and sell its tools throughout the industrial market, but specialist distributors handle its automotive after-market tools. Atlas and CP use distributors for the greater part of their marketing and sales. Owing to their differing distribution arrangements, it is not easy to compare Atlas' and Desoutter's respective current practices and thus the likely effects of a merger.

6.49. No clear view at all of the competitive effects of the merger arose from our consultations with the users of pneumatic power tools. We heard a few voices firmly in favour, broadly on the grounds of economies of scale leading to lower prices, and against, because of market domination. Another group of users, including some very large purchasers of specific categories of pneumatic tools, said they were not concerned because they were satisfied that after a merger sufficient suppliers would remain to enable the users to ensure a continued competitive supply of tools. A final group simply indicated no interest.

#### *Domination of the market*

6.50. Both parties denied strongly that, even if we assumed a distinct pneumatic tool market, a merger could give the new group a position of domination. Desoutter said that a merger would not confer any significant market power on the new group. Its competitors were active in relation to all types of tool. Even where a merged group might at present have a large share of the market for a particular tool, or in a particular industry, many competing tools, sometimes electric but always pneumatic, were available. In these circumstances Desoutter considered that a combined group would not dominate the competition, nor would competitors be adversely affected or new entry deterred.

6.51. Moreover, Desoutter suggested that the merger would give rise to benefits for the public interest. These would arise through the greater resources available for R & D, through greater productivity arising from rationalisation of common components, and through the application of Atlas' experience in stock control. Finally, Desoutter would be able to continue to compete effectively in the world market, which, being largely export-based, it needed to do in order to survive.

6.52. Atlas argued on similar lines to Desoutter. There were enough suppliers competing in the market to ensure that the loss of one made no difference. Many of their customers were in large industrial companies, which had the incentive and ability to get what they wanted competitively. In practice these large companies were constantly exercising choice.

6.53. Atlas further claimed that specialist or 'niche' manufacturers and distributors had shown that they could still compete effectively with full-line suppliers. It gave us examples of the leading suppliers in the United Kingdom market of the main types of pneumatic tool, to demonstrate that in all sectors there was a wide range of competitors to Atlas and Desoutter, and that generally there was strong competition amongst the leading five manufacturers in each sector.

6.54. In the context of domination of the market, Atlas repeated its arguments about the continuing competition between Desoutter and the existing Atlas companies, and about the relationship of electric and pneumatic tools in the market. The existence of a single market in industrial power tools, electric or pneumatic, was, Atlas argued, reinforced by the growing tendency of suppliers, whether they supplied one or both types, to make comparisons between the two when seeking to promote any of their products.

### **The effect of the merger on the public interest**

6.55. If, as the parties have stressed to us, we were to look at the proposed merger in the context of a broad market for industrial power tools of every kind pneumatic, hydraulic and electric it would cause us little concern. The market share in the United Kingdom of a combined group, at about 12.5 per cent, is indicative of the wide range of competition, much of it from large industrial groups established on a world-wide basis. For reasons we have given (paragraphs 6.17 to 6.26) we cannot take that view. We consider that, in the situation we have found to exist at present, it is sensible to take as a starting point the United Kingdom market for pneumatic tools alone, where at the present time Atlas and Desoutter have roughly similar shares (17 and 19 per cent), and Ingersoll-Rand, the next largest supplier, has a market share of well over half that of those two leaders (12 per cent).<sup>1</sup> After a merger, Atlas and Desoutter together would virtually double their two individual shares, leaving Ingersoll-Rand as the second leading supplier with only a third of the combined group's share. That change of status alone remembering Atlas' own statement that it is seeking to increase its market share is enough to make us consider carefully the consequences of a merger. We believe, however, that in several respects, to examine the merger in terms of market share alone is a clear over-simplification.

6.56. While, for the reasons we have set out, we cannot accept Atlas' view of the breadth of the market, we recognise that there are important sectors of it in which electric tools play a role, and can be regarded as being in competition. The concept of substitutability is a complicated one, and it does not seem practical to us to allocate precise areas where it runs or is absent. But we appreciate that it is a factor, variable as to type of tool and type of application, of which we must take account. In particular we are conscious that in fastening the biggest sector electric tools are making increasing inroads, especially in relation to screwdrivers. Furthermore, we have been impressed by the evidence of rapid development in technology, as a result of which the application of electronic control systems to both electric and pneumatic tools is likely in the next few years to increase the operational similarities of the tools and make the idea of substitutability more general and real.

6.57. We note also the two parties' assertion that we should pay heed to the highly internationalised nature of the market. We appreciate that both have to operate in European and indeed world markets, where their shares are less significant. Against that we need to balance the probability that a merger would give the merged group a stronger position vis-à-vis manufacturers generally in the world market, many of whom seek to compete in the United Kingdom market. That would accordingly improve Atlas' and Desoutter's position in relation to United Kingdom and other manufacturers active in the United Kingdom market.

6.58. As we have explained in paragraphs 6.41 to 6.44, we have been unable to accept Atlas' view of its subsidiary companies (Atlas itself, CP, Renault and Desoutter if it joins) competing to the same degree against each other as they must against the other suppliers. There is clearly advantage to Atlas in maintaining three or four separate brands with separate selling organisations. This may be carried through to the point of making three or four bids for a major contract. Realistically, however, there seem to be inevitable limitations on intra-group competition as soon as it touches the wider interests of the group itself.

6.59. Atlas has further suggested (paragraph 6.53) that rather than concentrate on overall market share, we ought also to pay attention to the situation in individual segments of the market, and the position in each of a range of different large and small suppliers. We agree that this is a useful

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<sup>1</sup>See footnote to paragraph 6.33.

approach. The fact that different full-line suppliers hold leading positions in different segmental league tables and niche operators by definition show up only in their own niches, but strongly there is an indication of a variety of competition.

6.60. We have considered in this context the position of a merged group in the larger segments of the market, in which (as we have noted in paragraphs 6.34 and 6.46) it would have particular strength. These segments are drilling and tapping, fastening and abrasives. In the case of drills, there are two main points to be made: one relates to competition from electric drills, the other to competition from other suppliers of pneumatic drills. In some parts of industry the automotive repair industry, for instance there has for many years been strong competition from electric drills; day-to-day interchangeability between electric and pneumatic drills is at its highest there. In other industries, notably the aerospace industry, the choice between electric and pneumatic drills rarely arises, and a merged group would have a very large share of the market. But that industry is strikingly unconcerned at the prospect of a merger. It has significant buying power; and there are also very powerful American manufacturers of pneumatic tools for aerospace, not now operating on a large scale in the United Kingdom, which could establish themselves more firmly.

6.61. In the fastening tool segment we find that Desoutter has been compelled by the competition to introduce an electric screwdriver as an alternative to its pneumatic model, and this has made rapid headway. In the area of impact wrenches, a combined group's strength would be offset by the fact that the great majority of these tools are imported from the Far East an option open to any supplier. In the area of abrasive tools there has been some interchange between pneumatic and electric tools and the successful entry of a niche producer, ATA. We believe therefore that in each case considered above, there is mitigation of the strong position that a merged group would have in important segments of the market.

6.62. We should, however, not ignore the fact that some of Desoutter's and Atlas' respective strengths tend to complement each other and that a merger would therefore give the Atlas group an enhanced position in virtually every segment of the pneumatic market. In addition, the parties themselves have stressed the opportunity for an enlarged Atlas group to improve the ranges offered by each subsidiary by means of internal sourcing.

6.63. How big an advantage a combined group would derive from this is hard to ascertain. On the one hand, a full-line supplier has the opportunity of using his sale of one type or range of tools to interest a distributor or end user in his other types or ranges. On the other hand, there is no evidence that the niche suppliers are at present losing out against full-line competitors and, as pointed out in paragraph 6.31, end users do not generally buy 'the range'.

6.64. There are also more definite advantages to the Atlas group in so far as it would have one of its subsidiaries, Desoutter, selling much of its enhanced range direct to users and two, or perhaps (if Renault's range is developed) three, ranges available through distributors.

6.65. We do not accept Atlas' submission that because of the group's policy of independence for its subsidiaries there will be no loss of competition in the existing market. Furthermore, we think that a merger may provide Atlas with competitive advantages. We must, therefore, consider the overall effects of the merger on the public interest.

6.66. We have summarised the two parties' own opinions of the benefits that would accrue from a merger in paragraphs 5.23, 5.27 and 5.28. Atlas concluded that they would lead to a more competitive situation, in the sense that efficiency would improve and production expand in a merged group, enabling the parties to compete more effectively. Accordingly, Atlas claimed, the merger would operate positively in the United Kingdom public interest. Desoutter's view of the benefits, not

dissimilar in themselves, led it to the conclusion that it needed a partner that understood its business and could provide synergy of the kind offered by Atlas. Absorption into a conglomerate was unlikely to produce the necessary investment to allow effective competition to be maintained. A merger would enable the business to continue to grow, and to meet the increasing competitive challenges.

6.67. This, Desoutter claimed, would benefit the United Kingdom public interest in that it would enable the business to survive as a competitor, permit its significant export earnings to continue and expand, so helping the balance of payments, and maintain Desoutter as a significant employer of skilled and semi-skilled people.

6.68. We are not inclined to take these statements of the public interest in the merger at face value. They appear to overstate the coincidence of public interest and the self-interest of the companies concerned by a considerable margin. But we would concede that the merger could maintain employment in Desoutter's factories and should lead to improvements in its productivity, stockholding, R & D and international sales effort. This is all to the advantage of the British engineering industry.

6.69. The bearing of the proposed merger on the United Kingdom public interest seems to us finely balanced. We are concerned that most of the parties' direct competitors are (as often happens with agreed acquisitions) against the merger; so are many distributors. The combined group would have a rather high share in some important segments of the market. The present level of competition may not be as intense as the parties have claimed; this might leave room for Atlas to exploit its market position at least in dealing with smaller customers, and to use its power through unfair pricing to squeeze the smaller suppliers in the market.

6.70. Atlas has steadily increased its market share in the United Kingdom by offering a good product sold through effective distribution, backed up by effective central support. It could be argued that it would be better for the public interest if Atlas were to continue to compete for market share as spiritedly as it has hitherto than to increase it by acquisition.

6.71. On the favourable side of the balance, we have taken into account the marked lack of concern amongst the users of pneumatic power tools, large and small, at the prospect of the merger. The small minority of objectors amongst the users, like the suppliers who have objected, tended to have a grossly inflated idea of the market shares that Atlas and Desoutter currently hold. From the evidence we have obtained from nearly every supplier to the market, while the combined group will undoubtedly hold a strong position in some sectors, there are also effective competitors in the market. If a merged group sought to abuse its position, the other suppliers would have the opportunity of increasing the competition by introducing products from their own sources in the United Kingdom or overseas or by buying products from other overseas manufacturers for sale under their own brand names. We understand that the Japanese industry is currently overstretched on delivery dates on certain products, but this is likely to be only a temporary shortfall. Meanwhile the number of small competing suppliers, especially from Europe and the Far East, is remarkable. Their numbers may grow further, and we have no evidence of frequent failures in the industry. The track record of these niche suppliers is good, and we expect them in general to continue to hold their positions, especially in circumstances in which multi-sourcing is common.

6.72. We have also had regard to possible developments affecting competition between electric and pneumatic tools. The potential benefits from the application of electronic controls to industrial power tools are evident, and the more so as the control systems are perfected and made more widely applicable. While they can be applied to electrical or pneumatic tools, the former seems a more natural process. These and other developments may be expected to continue to reduce some of the disadvantages that have hitherto attached to the use of electric power tools in some roles. Growing

interchangeability of pneumatic and electric tools should go some way to eliminating the reduction in competition which we have accepted the merger might bring about.

### **Conclusions on the public interest**

6.73. We have considered the probable effects of the proposed merger between Atlas and Desoutter on the public interest. We consider that there will be some reduction in the existing competition for the supply of pneumatic tools in the United Kingdom and that Atlas may gain some competitive advantage from the merger over its competitors.

6.74. We have, however, taken into account the extent and number of competitors in the market for pneumatic tools, the continuing and significant opportunities for niche suppliers and the existence of an increasing potential for competition from electric tools. On balance, we do not consider that the reduction in competition is likely to be such that the merger may be expected to operate against the public interest.

6.75. In view of this finding, it follows that the proposed merger between Atlas and Desoutter should not be prevented.

H H LIESNER (Chairman)

F E BONNER

R O DAVIES

P K R MANN

L A MILLS

S WAINWRIGHT

S N BURBRIDGE (Secretary)

19 December 1989