

# 6 Conclusions

## **The merger situation**

6.1. Under the reference dated 19 September 1990 (set out in Appendix 1.1) we are required to consider:

- whether a merger situation would be created, in that enterprises carried on by or under the control of Imperial Chemical Industries PLC (ICI) would cease to be distinct from enterprises carried on by or under the control of Kemira Oy (Kemira), if the arrangements referred to in the reference were carried into effect; and if so
- whether the merger would qualify for investigation under one of the two tests specified in section 64(1) of the Fair Trading Act; in this regard the reference refers to the test specified in paragraph (b) of section 64(1) (the assets test) without excluding the test in paragraph (a) of that section (the market share test). We are, however, required to exclude one of these tests if we find the other satisfied.

6.2. As described in paragraphs 2.38 to 2.42, Kemira has agreed in principle to purchase ICI's business in the manufacture and sale of solid and liquid agricultural fertilisers in the United Kingdom. As shown in paragraphs 2.37 and 2.40, the value of the assets to be purchased exceeds £30 million. The assets test is satisfied and we therefore exclude the market share test.

6.3. We conclude that a merger situation would be created if the proposed sale proceeded and that the merger would qualify for investigation. We have therefore to consider whether this merger situation may be expected to operate against the public interest.

## **The companies and their fertiliser interests**

6.4. ICI is one of Britain's largest industrial companies. It has been involved in fertilisers since its formation in 1926 but this activity now represents a much smaller proportion of the group total than used to be the case. Following closures and rationalisation in recent years, ICI's United Kingdom fertiliser business (not all of which is part of the proposed merger) now employs some 2,000 people compared with the group total of 134,000 employees world-wide. In 1989 it generated a turnover of £527 million, representing 4 per cent of the group total of over £13 billion. The company has interests in fertiliser businesses abroad, mainly in Commonwealth countries, but these are separately managed and are not part of the proposed transaction.

6.5. ICI's United Kingdom fertiliser business comprises several related activities: the manufacture and sale of solid and liquid fertilisers (the activities which are the subject of the merger) with a turnover of £260 million in 1989; agricultural merchanting; and the manufacture and sale of ammonia and carbon dioxide. The main production sites are at Billingham, Severnside and Leith, with liquid fertilisers being produced at eight other, small sites. Merchanting is carried on by two subsidiaries, BritAg Industries Ltd (BritAg) and Scottish Agricultural Industries PLC (SAI), which deal in a wide range of other agricultural supplies besides fertilisers. Structurally the liquid fertiliser business is part of BritAg.

6.6. Kemira is a Finnish company operating through subsidiaries (the Kemira Group) in the chemical industry in 18 countries. In 1989 the Group's turnover was some £1.6 billion and it had some 16,000 employees. On both criteria it is approximately one-eighth the size of ICI. Unlike ICI, however, Kemira's major activity is fertilisers, which represented some 50 per cent of group turnover in 1989. The turnover of its United Kingdom fertiliser business in that year was £162 million.

6.7. The Finnish Government founded Kemira in 1920 to provide a secure domestic source of sulphuric acid and superphosphate fertilisers, and still owns 99.9 per cent of the shares. In the late 1970s Kemira took a strategic decision to expand outside Finland, particularly in the European Community. Its main subsidiaries outside Finland are located in the United Kingdom, Belgium, the Netherlands, Denmark, Sweden and the United States. The Group is now the second largest fertiliser manufacturer in Western Europe, behind Norsk Hydro. Its other principal activities are in agricultural and industrial chemicals, organic fine chemicals, paints and titanium dioxide. Apart from fertilisers Kemira's other United Kingdom interests are in paints. The combined turnover of Kemira's United Kingdom subsidiaries in 1989, at some £262 million, represented 17 per cent of the group total world-wide.

6.8. Kemira entered the United Kingdom fertiliser market as a producer in 1982 when it acquired a small company L & K Fertilisers Ltd, but its most important move came in 1988 with the acquisition of UKF Fertilisers Ltd (UKF), a substantial fertiliser manufacturer, as part of a wider transaction with UKF's owners, Dutch State Mines. Kemira has also made a substantial investment in the construction of a new ammonia plant at Hull. Kemira's main United Kingdom fertiliser interests now comprise a large integrated facility for the production of straight nitrogen (N), compound and blended fertilisers at Ince near Chester (the old UKF site); the ammonia plant whose output is currently shipped to Kemira subsidiaries elsewhere in Europe as a feedstock for fertiliser production there; three blending plants at Saxilby, Sharpness and Hillsborough (Northern Ireland); and a distribution company, Agtek Ltd, which deals in fertilisers and other agricultural supplies. In 1989 Kemira's United Kingdom fertiliser businesses made an operating loss (before interest and tax) of [ \* ] on sales of £162 million but provisional results for the first nine months of 1990 show an operating profit of [ \$ ] on sales of £128 million, compared with a loss of [ \$ ] sales of £121 million in the corresponding period of 1989.

## Background to the merger

6.9. The United Kingdom fertiliser industry in the 1980s was characterised by increased import penetration, growing overcapacity and, in consequence, downward pressure on prices. ICI told us that the profitability of its fertiliser business in the United Kingdom had been declining in real terms since 1981, moving into loss in 1986. In 1985 it had sales of 700,000 tonnes of nitrogen (700 ktN). At that time it operated from seven production sites (excluding the liquid fertiliser plants) and employed 7,000 people. By 1990 it had sales of 440 ktN per annum, operated from three production sites, and had 2,000 employees. In the interim period it had closed 23 plants making fertilisers or intermediate products and constructed three modern plants. Despite these changes, the business continued to make losses and early in 1990 ICI took the decision to divest it subject to the realisation of an acceptable price.

6.10. ICI told us that it contacted direct a number of companies which it considered were potential purchasers of the business, and employed a merchant bank to explore other possibilities. As a result of the responses to these feelers, ICI entered into negotiations with Kemira which culminated in an agreement in principle announced on 26 July 1990 that Kemira would buy ICI's solid and liquid fertiliser manufacturing business in the United Kingdom. The agreement includes the acquisition of the manufacturing facilities at Severnside and Leith and the eight liquid fertiliser manufacturing plants but Kemira did not wish to acquire the Billingham site nor the agricultural merchandising subsidiaries. ICI is seeking to sell the merchandising and industrial products activities to other parties and has announced the closure of the remaining fertiliser plants at Billingham.

6.6. Kemira told us that it was committed to the fertiliser industry and that the ICI acquisition fitted into its strategy of building up the strength of its Europe-wide fertiliser business. Although it faced the same market difficulties as ICI, it believed it was in a better position to meet them. Kemira expected to make the

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\* Figures omitted. See note on page iv.

acquisition profitable by realising efficiencies in manufacturing among its various plants and by spreading sales and overhead costs over a bigger turnover. It was not prepared to purchase the Billingham plants as these were old, inefficient and surplus to Kemira's requirements for manufacturing capacity. Their closure by ICI would itself bring United Kingdom capacity much more in line with demand.

6.7. Kemira said that it did not wish to extend its involvement in agricultural merchanting and had not therefore made a bid to buy SAI or BritAg (other than BritAg's liquid fertiliser business).

## **The use and production of fertilisers**

6.8. Fertilisers provide the three main nutrients which farmers need to enhance plant yields: nitrogen (N), the most important, phosphorus (P) and potassium (K). Fertilisers are supplied as straights, ie including only one nutrient, usually N; and compounds or blends which combine N, P and K or any two of them. The farmer's requirements vary according to the soil conditions, climate, season and the individual crop. A requirement for a particular combination of N, P and K could be met by successive applications of straights as well as by a single application of a compound or blend. There is also a high degree of substitutability between the different sources of the individual nutrients (though not between the nutrients themselves). Both straight and compound fertilisers can be supplied in liquid as well as solid form. Liquid fertilisers are an alternative to solids for those farmers who have invested in the specialised equipment needed to use them or who make use of the growing practice of hiring contractors to spread fertiliser.

6.9. The three principal nitrogenous materials used in the United Kingdom are ammonium nitrate (AN), calcium ammonium nitrate (CAN) and urea. AN is made by all three major manufacturers and also imported; supplies of CAN and urea are all imported. Urea is the most concentrated source of N but until the last few years it had been regarded as inferior to AN in application and hence was not manufactured in the United Kingdom as a fertiliser. All three products are made through a chemical process in capital-intensive plants which need to be run at a high level of capacity utilisation to be economic. The source of P is phosphate rock, which is imported either as a raw material or as a granulated material suitable for direct use as fertiliser, eg triple super phosphate (TSP). The source of K is also a mined material, obtained either from Cleveland Potash Ltd (Cleveland Potash) (the only United Kingdom source, which produces muriate of potash) or from abroad.

6.10. Combinations of N, P and K are supplied either as compounds or blends. Compounds are made by a chemical process which uses intermediate materials providing any two or all three of the nutrients and produces granulated compounds in which each granule incorporates the relevant nutrients in the correct proportions. Blends are made by a simple mechanical process which mixes finished straight products together in the appropriate proportions but the individual granules of each nutrient remain separate. Like plants for the production of straight N products, compounding plants are capital-intensive and require to be run at a high level of utilisation in order to be economic. Blending plants do not require heavy capital investment and do not need to be operated continuously as chemical plants do. Compounds have the advantage that the proportions of the nutrients are fixed whereas blends may vary or become separated, but the increasing use of blends indicates that their lower price has tended to outweigh the superiority of compounds in this respect.

6.11. Demand for fertilisers is seasonal. The main application of nitrogenous fertiliser is in the spring. There is a supplementary application, usually of low or zero N compounds or blends, in the autumn.

## **Structure of the United Kingdom market**

6.12. Farmers obtain most of their fertiliser needs from agricultural merchants or co-operatives. The merchants obtain their supplies from three sources: manufacturers, blenders and importers. There are overlaps among these categories. The three major manufacturers in the United Kingdom are ICI, Kemira and Hydro Fertilizers Ltd (Hydro Fertilizers) (a subsidiary of Norsk Hydro) which between them account for some two-thirds of the supply of nitrogenous fertilisers to the United Kingdom market, their approximate shares being 29, 18 and 19 per cent respectively. While most of their United Kingdom sales are derived from production in this country the majors (particularly Hydro Fertilizers) also import product.

6.13. The rest of the United Kingdom market is largely supplied by independent blenders and importers. The blenders are small suppliers-the largest having 3 to 4 per cent of the market-whose inputs come mainly from abroad or from Cleveland Potash. In order to provide a full range of fertilisers, blenders supply imported straights as well as their own blended products. They obtain their supplies from a variety of sources falling into two main categories: producers in the countries of export and intermediary traders, with some also coming from Hydro Fertilizers. Similarly imports of straights and compounds are obtained by merchants either from foreign producers or from traders.

6.14. Solid fertilisers account for around 93 per cent and liquids around 7 per cent of the United Kingdom market. Liquids are manufactured by a relatively simple process involving the dissolving or suspending of solid fertilisers in water. The largest supplier of liquids with around 60 per cent of the market is ICI via a division of its subsidiary BritAg called J W Chafer (Chafer). Chafer manufactures at eight small sites employing a total of 30 people and takes its main raw material (AN liquor) from ICI itself. Chafer comprises part of the package proposed for sale to Kemira. A small independent company has around 20 per cent of the liquids market with the remaining 20 per cent being shared among a number of suppliers.

6.15. Northern Ireland should be regarded as a market that is distinct from the rest of the United Kingdom market because of the handling and shipping costs involved in supplying it from Great Britain. (Since fertiliser is a relatively low value product transport costs are a significant proportion of the final price.) ICI has a 49 per cent share in an Irish fertiliser manufacturing company, Irish Fertilizer Industries Ltd (IFI), in which the Irish Government holds the other 51 per cent. This company is managed quite separately from ICI's United Kingdom business and is not affected by the merger. Kemira has a blending operation in Northern Ireland and exports materials to that company, as well as finished product direct to the Irish market, from England and from subsidiaries in other European countries.

6.16. Norsk Hydro is the biggest and Kemira the second biggest fertiliser manufacturer in Western Europe, with 18 per cent and 12 per cent of the European market respectively. Both have manufacturing subsidiaries in a number of European countries. ICI's European fertiliser business, by contrast, is largely confined to the United Kingdom and its share of the European market is 5 per cent.

## **Demand and supply**

6.17. After many years of strong growth the demand for fertiliser in the United Kingdom reached 2.6 million tonnes of plant food<sup>1</sup> in the mid-1980s and has been broadly static since.

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<sup>1</sup>Plant food is the nutrient content (N, P and K) of fertiliser products. On average plant food is approximately 39 per cent of finished product by weight: see paragraph 3.24.

TABLE 6.1 Fertiliser consumption in the United Kingdom ('000 metric tonnes of plant food)

<i>Year</i>	<i>Consumption</i>
1976/77	1,929
1977/78	2,009
1978/79	2,073
1979/80	2,235
1980/81	2,054
1981/82	2,301
1982/83	2,545
1983/84	2,617
1984/85	2,590
1985/86	2,524
1986/87	2,666
1987/88	2,484
1988/89	2,462
1989/90	2,511

*Source:* FMA for 1988/89 and 1989/90; FAO Yearbook *Fertilisers*, Vol 38, 1988 for all other years.

The change in the trend of demand was influenced by changes in the EC Common Agricultural Policy involving the imposition of limits (quotas) on the amount of certain products for which price support would be given and a reduction in some price support levels. As a result of these and other changes in agricultural policies, agricultural production flattened out and there has been some reduction in the total area of land under cultivation. Environmental concerns, particularly surrounding the level of nitrates in drinking water, may also have had some impact. Both these factors are likely to have a continuing if not increasing effect in depressing demand for fertiliser in the next few years. The industry expects demand in the United Kingdom to fall on average by around 1 per cent a year during the first half of the 1990s.

6.18. Although consumption has not so far fallen significantly, the change in trend had a profound effect on an industry which was used to steady growth and had continued to invest in anticipation of higher demand. At the same time there was a sharp increase in imports of fertiliser into the United Kingdom from 1982 as new sources of cheap nitrogenous products, notably in Eastern Europe and in oil- and gas-producing countries, became available. The low price of urea, and growing evidence that it was, after all, a reasonably efficient source of N (see paragraph 6.14), led to its increasing usage by farmers at the expense of domestically-produced AN, though cheap imports of AN were also an important source of competition. ICI's market share, which had been 50 per cent at the start of the 1980s, fell to around 40 per cent by 1985 as a result of direct import penetration, the growth of blenders using cheap imported materials, and an increase in the shares of the other two major manufacturers. In 1986 ICI sharply cut its prices in response to this competition. This had the effect of holding its market share for a while but its share fell steeply again from 1987 and it continued to incur losses. The other two major manufacturers, UKF/Kemira and Hydro Fertilizers, broadly maintained their shares in the second half of the decade at a time when their financial results were also adversely affected by market conditions (see Table 3.11).

6.19. Table 6.2 shows estimated market shares for the supply of nitrogenous products in 1989/90 (the fertiliser year runs from July to June).

TABLE 6.2 United Kingdom nitrogenous fertiliser market, 1989/90: estimated shares of nitrogen content by primary manufacturer/importer

	%
<i>UK majors</i>	
ICI	29
Kemira	18
Hydro Fertilizers	19
Sub-total	<u>66</u>
<i>Importers</i>	
IFI	5
BASF	3
Grande Paroisse	2
Enfersa/FESA	2
Enimont	1
Others	<u>21</u>
Sub-total	<u>34</u>
	100

Source: FMA, ICI, Kemira.

6.20. As stated in paragraph 6.18, the independent blenders obtain their supplies of nitrogen mainly from importers but to the small extent that they import direct themselves they appear in Table 6.2 under 'Others'. An alternative way of looking at the market, which brings out the full role of the blenders, is to identify shares in the amount of fertiliser sold to merchants or direct to farmers: see Table 3.10.

### United Kingdom capacity and production

6.21. Import penetration in the early 1980s resulted in below-capacity working. By 1985 production of nitrogenous fertiliser by the majors, at 5.5 million tonnes of product, was around two-thirds of theoretical capacity. After 1985, with consumption flat and imports growing faster than exports, production fell to 4.1 million tonnes in 1989 and capacity utilisation fell further to 53 per cent, according to Nitrex and ICI estimates. Although as stated earlier (paragraph 6.9) ICI had closed a number of plants, the cuts in capacity lagged behind the fall in production. ICI therefore closed one of its two large AN plants at Billingham in June 1990 while Hydro Fertilizers closed its granulation plant at Immingham in July 1990.

6.22. Table 3.5 gives the breakdown of the majors' manufacturing capacity as it stood during the 1989/90 season and compares it with levels of production from the various plants in that year. Total capacity for AN and compounds (excluding ICI's mothballed compounding plant at Severnside) was 4.9 million tonnes of finished product while production was 3.5 million tonnes. The closures which have taken place since then have already cut capacity to 4.2 million tonnes. The closure of the remaining fertiliser plants at Billingham will reduce capacity further to 3.4 million tonnes, very close to the total production of AN and compounds achieved by the three majors in 1989/90.

6.23. Blending capacity is much less easy to define since the plants do not have to be, and are not, operated continuously. The majors produced almost 1 million tonnes of blends in 1989/90, while in 1987/88 (the latest year for which figures are available) the independent blenders produced an estimated 900,000 tonnes of blends as well as selling on some 260,000 tonnes of straight nitrogen products, largely imported urea and AN.

6.24. Kemira told us that it did not expect to keep the combined market share of 47 per cent which ICI and Kemira held in 1989/90, but estimated that its share would decline to perhaps 35 per cent as dealers sought to spread their purchases to avoid undue dependence on one supplier. Kemira envisaged that this loss of market share would be taken up partly by Hydro Fertilizers (whether from United Kingdom production or imports) and partly by blenders and other importers. Taking Kemira's forecast for United Kingdom consumption in 1991/92, at 6 million tonnes of finished product (equivalent to 1.44 million tonnes of nitrogen-see Table 3.20), a 35 per cent share would mean that Kemira was supplying 2.1 million tonnes of finished product to the United Kingdom market, of which perhaps 0.3 million tonnes would be blends. Since Kemira expects to continue serving the United Kingdom market very largely from

production in this country, these sales would allow Kemira's post-merger capacity for straights and compounds of around 2.4 million tonnes to be run at around 75 per cent utilisation. Kemira believes it could increase this rate close to the level it regards as optimal by making sales to the Irish market. If on the other hand Kemira retained the full share currently held by itself and ICI, it might have to import some product from sister companies in other European countries where it has spare capacity.

## **International factors**

6.25. Like the United Kingdom, other Western European countries have experienced growing import penetration and overcapacity in the 1980s, with a flattening of demand in the second half of the decade. Between 1985 and 1989 production in Western Europe outside the United Kingdom fell from 46 to 43 million tonnes of product, compared with capacity in 1989 of some 64 million tonnes, a level of capacity utilisation of only 67 per cent. Import penetration in the EC as a whole approached 50 per cent by 1988/89, much higher than for the United Kingdom alone, but more than half of this consisted of intra-EC trade. Capacity was reduced more slowly in the rest of the EC than in the United Kingdom but a number of closures have been announced in 1990. Continental European producers-many of which are state-owned-appear to have reacted to market trends by exporting vigorously to each other's home markets in an attempt to load their plants, albeit at low prices, and have only recently resigned themselves to cutting capacity.

6.26. The import pressure on Western Europe has come from two main sources: Eastern Europe and oil-producing countries. Eastern European producers have benefited from cheap supplies of natural gas from the USSR. Although their own consumption has grown rapidly, production rose even more strongly as the centrally planned economies saw exports of fertiliser as a valuable source of hard currency. According to the World Bank report of 1988 on *Price Prospects for Major Primary Commodities, 1988-2000* the Eastern Bloc's surplus of production over consumption rose from 3.5 million tonnes of nitrogen in 1980 to 5.8 million tonnes (over a quarter of total production in the region) in 1986 (see Table 3.19), the surplus being primarily exported to Western Europe in the form of AN and urea.

6.27. Many oil-producing countries have an even greater cost advantage than the Eastern European producers since the natural gas which they inevitably produce alongside oil has no local market and is often flared off. It thus has a very low marginal cost as a raw material for the production of ammonia and thence fertiliser. In the late 1970s and early 1980s a number of large plants for the production of fertiliser, particularly urea, were constructed in these countries, whose own demand for fertiliser is in many cases very low. Although much of the output of these plants has been shipped to other developing countries with large markets (notably China and India), substantial quantities were exported to Western Europe from the early 1980s.

6.28. However, the statistics on United Kingdom imports of fertilisers in the last three years (Table 3.9) show that the bulk of imports of all the main products (AN, CAN, urea and compounds) has come from other Western European countries. Eastern Europe is shown as a significant source of straight nitrogen but oil-producing countries feature relatively little. The Netherlands appears as a major source, however, and it is believed that the statistics include some supplies from outside Europe which are shipped to European ports, particularly Rotterdam, in bulk carriers and then transshipped in smaller vessels to the United Kingdom. ICI and Kemira further argued that imports which genuinely originate in Western European countries have themselves been stimulated by pressure on those markets from suppliers elsewhere.

6.29. The level and patterns of trade in fertilisers, as they have developed in the 1980s, have led the industry to see the main fertiliser nutrients as commodities where prices in individual countries are largely determined by world trends in supply and demand. The chart reproduced in Figure 3.4 shows how the United Kingdom price of AN has closely followed the Western European spot price for urea. Prices partially recovered following the imposition by the European Commission of anti-dumping duties on imports of urea from four oil-producing and four Eastern European countries in 1987, but the volume of imports has continued to grow. Domestic products tend to command a modest price premium over imports, which are more variable in quality.

## Prices, investment and profitability

6.35. United Kingdom prices for AN and compounds fell sharply between 1985 and 1987 as domestic producers led by ICI struggled to counter import competition. There has been a modest recovery in current price terms since then but in inflation-adjusted terms the price in the 1989/90 season was still more than a quarter below the level five years earlier (see Table 3.16).

6.36. Faced with this situation the United Kingdom manufacturers have taken vigorous action both by closing plants and by major investment programmes. Thus ICI has invested over £60 million in two modern ammonia plants at Severnside and £12 million in a new nitric acid plant at Leith. Kemira has spent £50 million on building its ammonia plant at Hull and a further £7 million on the plants it acquired from UKF at Ince. Hydro Fertilizers told us that it had invested around £100 million in new nitric acid and AN capacity at Immingham since 1985.

6.37. Despite these efforts ICI continued to incur losses: its solid fertiliser manufacturing and wholesaling business made operating losses of over [ \$ ] a year in 1987 to 1989. Kemira made an operating profit of [ \$ ] in 1988 but a loss of [ \$ ] in 1989 on its United Kingdom fertiliser business. Those, however, were the years in which it acquired, and then reorganised and invested in, the UKF business: results for the first nine months of 1990 show a significant improvement (see paragraph 6.8). Hydro Fertilizers made operating losses of [ \$ ] to [ \$ ] a year in 1985 to 1987 but achieved an operating profit of [ \$ ] in 1988 and [ \* ] in 1989 as the benefit of its investment programme came through. Nevertheless the company decided to close its compounding plant at Immingham in July 1990.

6.38. Information on the independent blenders is inevitably less precise than on the major manufacturers because of the number of companies involved and their generally small size. ICI told us that both the number of blenders and their combined output had risen substantially since 1986. The established companies in the blending business have been consistently profitable in recent years.

## Market prospects

6.39. As noted in paragraph 6.22, United Kingdom demand for fertiliser is forecast to fall by around 1 per cent a year over the next few years. A similar picture is expected in Western Europe as a whole. In developing countries by contrast demand is forecast to rise as farmers increase their intensity of application of fertiliser in an attempt to keep pace with the demand for food from rapidly growing populations. The World Bank study of 1988 (see paragraph 6.31) foresaw a strong recovery in world prices in the early 1990s because this growth in demand, especially in China, would outstrip growth in capacity.

6.40. The urea market has indeed been firmer in 1990 but this may be a temporary change, partly in response to events in the Middle East. Looking ahead, a number of important developments will affect world fertiliser markets. While the impact of these cannot be predicted with any certainty, the overall effect is likely to be a reduction in the current oversupply to Western Europe and an increase in prices. The main developments are as follows:

- (a) Eastern European countries will, from January 1991, have to pay the world price in hard currency for their supplies of oil and gas from the USSR. This will involve a significant increase in the cost of their main feedstock. Unless they are able to achieve a marked improvement in efficiency, Eastern European producers may find that some of their capacity will be uneconomic in future. Nevertheless these countries will continue to need to earn hard currency and are likely to see the export of fertilisers, where they have substantial installed capacity and a proven ability to achieve exports, as an important means of achieving this. But it is unlikely that they will be able to keep their prices as low as hitherto, particularly given that the European Commission will be vigilant for signs of dumping, and an increase in prices will inhibit their ability to penetrate Western European markets.

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\* Figures omitted. See note on page iv.

- (b) 1990 has also seen a number of measures to close down and rationalise fertiliser production capacity in Western Europe. It is too soon to be able to assess the full consequences of these moves but they should bring capacity more into line with production.
- (c) Iraq's invasion of Kuwait in August 1990 has cut off supplies of ammonia and urea from both countries, created wider uncertainty about the future of Middle East output, and caused turbulence in world oil and gas prices, affecting both raw material and transport costs for the fertiliser industry.
- (d) The eventual outcome of the GATT (General Agreement on Tariffs and Trade) Uruguay Round negotiations on agricultural price support will have an important influence on demand in the developed countries, particularly the EC and North America: if subsidies are sharply reduced, a fall in agricultural production and hence in demand for fertilisers would be the expected result. On the other hand if the negotiations were to succeed they would contribute to an increase in prosperity in developing countries, leading in turn to higher demand for imported food and/or fertiliser. For the moment the prospects are uncertain given that the negotiations have recently been suspended.

## **Public interest issues**

6.30. The next section considers whether the merger may be expected to operate against the public interest. The main issue is whether the merger would reduce competition in the United Kingdom market for agricultural fertilisers. We also consider the implications for production, employment, research and development (R&D), and product support. Finally we consider the implications of Kemira's ownership by the Finnish Government for these various issues.

## ***Competition***

### ***Background***

6.31. The market we are concerned with is the supply of chemical agricultural fertilisers, whether in solid or liquid form, in the United Kingdom (but see paragraph 6.20 concerning the position of Northern Ireland). The bulk of the market is in nitrogenous fertilisers, ie those containing nitrogen, whether or not in combination with the other nutrients.

6.32. For some years the structure of the United Kingdom market for agricultural fertilisers has consisted of three manufacturers each with a substantial market share and a number of other suppliers, including importers, with much smaller shares. Within this broad structure the main developments in the 1980s were the replacement of two of the major manufacturers by Kemira and Norsk Hydro and a big fall in the share of the market leader, ICI, from 50 per cent to below 30 per cent. In the early 1980s the other major manufacturers gained share at ICI's expense, as did importers; in the second half of the decade ICI lost more of its share primarily to imports (whether supplied to the market direct or via independent blenders) while the other two manufacturers broadly maintained their share (see Table 3.11). Prices fell sharply in the mid-1980s as a result of import competition and the three major manufacturers have all faced difficult trading conditions in recent years. These developments have been paralleled in other Western European countries. Penetration of Western Europe by low-priced imports from outside the region, which has now reached around 18 per cent, has caused low capacity working and exerted a powerful downward pressure on prices.

6.33. Thus the position reached by 1989 was one of substantial overcapacity in Europe, resulting in highly competitive conditions. These conditions have developed over a number of years. But there are indications that the strength of import competition will diminish in future (see paragraph 6.40). Against this background we have to consider the likely effects of the merger in changing market conditions.

### *Extent of present competition*

6.34. At present there is strong competition among the suppliers to the United Kingdom market. The three major manufacturers have two-thirds of the market and there is competition among them, and against importers, to maximise sales to merchants in order to achieve the high levels of capacity utilisation which are essential to the economic operation of their costly chemical plants. The blenders, with their access to cheap imported materials, are estimated to have doubled their sales in the last few years despite the overall lack of growth in the market. The merchants, who are the conduit whereby the majority of fertilisers reach the farmer, obtain supplies from different sources typically including at least one source of blends and imported straights. The three largest merchants, accounting for about a quarter of the market, have accounts with all three of the majors as well as sourcing elsewhere. Merchants are thus readily able to adjust the volume of their purchases from each supplier according to market conditions. Kemira submitted evidence of a survey it carried out in 1989 of customers whose business it had lost between 1987/88 and 1988/89: this showed that among 100 farmers 49 had switched to imported AN and urea while 39 had switched to ICI or Hydro Fertilizers.

6.35. The evidence on prices also bears witness to highly competitive conditions both between United Kingdom manufacturers and imports and among United Kingdom manufacturers themselves. ICI as market leader cut prices sharply in 1986/87 in an attempt to maintain sales in the face of import competition and obliged the other two major manufacturers to follow suit. Kemira said that despite basing its price lists partly on competitors' prices and on market conditions, it was rarely able to achieve its list prices and the maximum discount allowed to its sales force usually became the norm. ICI said that it was unable to price its products by reference to production costs. ICI's traditional practice had been to publish a price list covering the whole of the buying season, structured so as to reduce the seasonal pattern of demand, but price competition had prevented it from doing this since 1983/84. The great majority of respondents to our survey of merchants said that price competition was quite keen or very keen and that there was not much differentiation between brands.

### *Prospects for competition if merger proceeds*

6.36. The combined market share of ICI and Kemira is currently around 47 per cent. Kemira argues that on past experience the share of the merged operation could be expected to fall, and forecasts that its share would level out at around 35 per cent. Kemira argues that this would present no threat to competition in view of the pressure from imports, which would continue to set prices and constrain the behaviour of domestic manufacturers. It is unarguable, however, that the acquisition of the market leader by one of only two other large manufacturers would tend to reduce competition in the United Kingdom market. Kemira would be the new market leader. Unlike ICI it is already making operating profits despite having only recently digested the acquisition of UKF and would appear to be in a stronger position than ICI has been to exercise a degree of control over the market. Since price is the main determining factor (though with United Kingdom production commanding a premium over imports on account of greater reliability of quality) it seems to us that Kemira could set out to retain something much closer to the 47 per cent share which it and ICI hold now. While the parties argued that combined market share had fallen following two previous mergers during the 1980s, the circumstances of each case inevitably vary and we do not think great reliance could be placed on these precedents. Indeed if import competition were to slacken it is possible that Kemira could achieve a 50 per cent share. With four mainly modern plants and its strength in other Western European countries too, Kemira would be in a much better position than ICI was when it held a similar share ten years ago.

6.37. A further difference compared with the past is that if the merger were to proceed the number of major manufacturers would be reduced from three to two. Hydro Fertilizers currently holds some 20 per cent of the market. Hydro Fertilizers could be expected to take advantage of any failure by Kemira to hold on to ICI's share: the company told us that it expected to be a beneficiary of the merger in this way and that it could raise its United Kingdom-based capacity by 20 per cent within 12 months. The market shares of the two remaining majors would be likely to be at least 60 per cent and possibly, depending on imports, nearer the 75 per cent of the market that the three major manufacturers had until the last two years. The rest of the market is served by a number of companies with much smaller shares (see Table 6.2). In present

conditions there is little prospect of new entrants to manufacturing, as opposed to blending, in the United Kingdom. We therefore expect that this new market structure would continue for the foreseeable future.

6.38. We have received no evidence that Kemira and Norsk Hydro have colluded in the fertiliser business in the past and have no grounds for thinking they might do so in the future. But it is not necessary to postulate collusion in order to imagine that competition between them might be less than fierce if they were free of outside pressures. Since both companies have made losses at some stage in the second half of the 1980s and regard prices as having been at uneconomic levels, they believe that prices need to rise if they are to earn an adequate return on the investments they have made in the industry. A reduction in imports would have a dual effect in facilitating such a rise, by reducing direct pressure on prices and by enabling the United Kingdom manufacturers to approach full capacity utilisation, thus diminishing the incentive on them to price keenly. It is noteworthy that a majority of respondents to our survey of merchants believed that the merger would be likely to lead to an increase in prices (see paragraph 3.71), although the larger merchants thought it would have no effect. Almost a third of respondents also believed the merger would make fertiliser supplies less reliable. BASF PLC (BASF) took the view that there would be less competition and thought it might have some difficulty in obtaining adequate supplies from Kemira (see paragraph 5.32).

#### *Other parties in the market*

6.39. In considering the possibility of Kemira exercising market power if competitive pressures ease we have to consider the relative strengths of other parties. Although following the merger there would be two suppliers with large shares of the United Kingdom market and a large number of others with much smaller shares, some of the others are substantial companies. They include the other four of the big six Western European manufacturers (Grande Paroisse, BASF, Enimont and Enfersa). BASF told us that it saw the United Kingdom market as important and had been concerned to keep a foothold in it, despite its unprofitability, against the time when conditions improved. But none of these companies has manufacturing capacity in the United Kingdom and the handling and shipping costs involved in exporting from their continental plants restrict their ability to compete against efficient local producers. Moreover, reductions in capacity (see paragraph 6.40(b)) will reduce the tendency for continental producers to supply product to the United Kingdom market at prices covering marginal costs only.

6.40. The blenders are not large companies and some of them have entered the market only in the last few years. They have succeeded in competing effectively, in their various geographical niches, with the majors' output of compounds and blends. While they have a number of advantages (see paragraph 3.44), however, the key to their success is the supply of low-priced imports. The durability and commitment to the fertiliser business of some of these companies must be open to question if supply conditions become harder.

6.41. Some very large companies (Bunge, Cargill, Conagra) are involved in the import trade from outside Western Europe and are a powerful competitive force in current market conditions. Fertilisers are only a small part of their business, however, and as trading companies they respond to, and act as a conduit for, market forces originating elsewhere.

6.42. Concerning distribution, while Kemira told us that it was seeking to enter into agreements with all ICI's dealers, it believes there are too many dealers in the market and that this makes for disorderly conditions. Its plans for the future of its United Kingdom fertiliser business include the revision of distributor contracts, vigorous enforcement of their terms and conditions, and the rationalisation of distributors and sales channels. Again a number of respondents to our survey expressed concern that the merger might leave the smaller merchants vulnerable to a supply squeeze. Two companies which gave evidence to us, one small manufacturer and one blender, said that they had experienced a refusal to supply them by Kemira following previous acquisitions which it had made. Kemira said that in one case (supplies of urea from a company it had acquired in the Netherlands) it had ceased to produce urea, while in the other (supplies of AN from the former UKF) it had been acting in accordance with a policy of selling to the most profitable markets.

6.43. The merchants vary widely in size and strength, from subsidiaries of multinational companies to small, local companies and co-operatives. Their ability to resist pressure from the major manufacturers varies correspondingly. Because of transport costs there is a degree of regional differentiation in market shares according to the location of the majors' manufacturing plants, while in each area there is also competition from typically one or two blenders and from imports. This situation has little effect on the market at present because the three majors and the importers have been eager to maximise sales everywhere despite variations in the profitability of sales because of transport costs. As noted above, however, some small merchants expressed fears of being squeezed as a result of the merger, although the large companies generally saw no detriments arising for them. The merchants' trade association, the United Kingdom Agricultural Supply Trade Association Ltd (UKASTA), took a favourable view of the merger.

6.44. Merchants, however, share an interest with suppliers in seeing an orderly market and, within reason, higher prices. The ultimate consumer is the farmer. The National Farmers Union stressed the economic difficulties which farmers were facing and the difficulties which higher fertiliser prices would cause them. It said that there was already pressure for price increases from suppliers and expressed the fear that the merger would facilitate such increases.

6.45. ICI and Kemira argued that the idea of Kemira exercising market power was theoretical, since competition from Hydro Fertilizers and a wide range of importers would prevent it. While Kemira naturally would like to see higher prices it would be unable to bring this about. Its plans for making a commercial success of the acquisition depended on improving efficiency and reducing unit costs. In this way Kemira would have a strong and profitable United Kingdom manufacturing base for competing against imports. ICI argued that the United Kingdom was well integrated into the Western European market as a whole and that the merger would not result in any loss of competition among the big six European producers. ICI had been unable to exercise market power when it held over 50 per cent of the United Kingdom market in the early 1980s, and competition had increased considerably since then.

#### *Prospects for demand and supply*

6.46. Some elements of the current, highly competitive market conditions are likely to persist. There is a consensus that demand in Western Europe will fall slowly over the next few years though opinions differ as to the rate of fall and whether there may be a levelling out or upturn from the mid-1990s (see paragraphs 3.88 to 3.90: the eventual outcome of the GATT round will be relevant here).

6.47. As to conditions globally, the World Bank's view in 1988 was that the balance between world supply and demand would tighten in the early 1990s. Information we received from Fertecon about world ammonia capacity, taken together with the World Bank's projections for fertiliser production, also suggested that the extent of world overcapacity in fertilisers would reduce. While the situation is difficult to assess, the balance of factors listed in paragraph 6.40 points to an expectation that overcapacity will fall and import prices will rise. In view of the diversity of sources of imports and the amount of surplus capacity in Europe (both Western and Eastern), an immediate change in the current situation of oversupply to the United Kingdom market would appear unlikely. On the other hand at the global level overcapacity is the relatively small difference between two large quantities, *viz* world supply and demand. If, as the industry contends, a relatively modest volume of imports into Western Europe can have a disproportionate effect on prices, a similarly modest fall in imports might do the same.

6.48. If import pressure eased, Kemira would be in a position to exercise market power in pricing and distribution arrangements and we believe it would do so with a view to raising the return on its assets. The impact of transport costs would further enhance its power in certain parts of the country: see paragraph 6.54. The existence of a duopoly with possibly up to 75 per cent of the United Kingdom market, held by the two leading suppliers to the Western European market as a whole with (following the merger) a combined share of perhaps 35 per cent of that wider market, would exacerbate this risk. Both Kemira and Norsk Hydro have built up their shares through acquisition as well as investment in fixed assets and may continue to do so, although the strong element of state ownership among the other large manufacturers may restrict the scope for this. Again if imports from the rest of the world into Western Europe were to fall after capacity had been cut, the market structure could become heavily weighted against consumers and Kemira

and Norsk Hydro would be in a position to exert significant influence over developments in prices and supplies.

6.49. The new market structure which the merger would bring about would be significantly less conducive to competition than the present structure. We believe that over time it could be expected to lead to prices higher than would result from a normal level of competition and to a reduction in choice in the supply of fertilisers manufactured in the United Kingdom, which command a price premium over imported products. We also believe that a continuation of the present strength of competition based on imports cannot be counted on. If this pressure eased, the detriments we see arising from the merger would be magnified and brought forward in time.

### ***Production and employment***

6.50. ICI and Kemira argued that the merger, together with ICI's closure of Billingham, would enable Kemira to operate its existing plants and those at Leith and Severnside close to capacity. This would substantially reduce unit costs and greatly improve the prospects for the continuation of this capacity in the face of import competition. They argued that the most likely alternative to the merger would be the ultimate closure of ICI's plants and a potential loss of a further 540 jobs-300 at Severnside, 150 at Leith, 30 at the liquid fertiliser sites and 60 in ICI's headquarters organisation-on top of the 640 jobs which were already due to go as a result of the closure of the Billingham plant.

6.51. An assessment of the extent of the benefits which the merger would bring for United Kingdom production and employment would depend on a judgment as to what would happen if the merger did not proceed. This is an issue we return to later but it inevitably is a matter for informed speculation. What we can say, however, is that the merger would have no adverse effect on production and employment and might have some benefits because of Kemira's potential ability to achieve efficiency improvements. Kemira told us that it intended to operate the plants it would acquire from ICI for the foreseeable future. We accept that Kemira has a long-term commitment to the fertiliser industry and would seek to make the best use of the capacity but it cannot be ruled out that market conditions-which Kemira can be expected to react to on a European basis-might cause it to close down one or other of its United Kingdom plants before long, with Leith the most vulnerable.

### ***Research and development and product support***

6.52. A number of witnesses expressed concern to us about the future of R&D into fertilisers if ICI were to withdraw from the market, particularly given the company's considerable research efforts in the past. ICI told us that the losses it had incurred in fertilisers had led it to cut severely its R&D work. It was in the process of closing part of its agronomic research establishment in Berkshire and this would go ahead regardless of the merger. The Ministry of Agriculture, Fisheries and Food had agreed to take over a long-term research project into the leaching of nitrates into water supplies.

6.53. Kemira has a major commitment to research in fertilisers. While this is primarily based in Finland the company had a number of projects under way in the United Kingdom and was supporting work led by others. It also provided much more support to its farmer customers, for example in replacing any supplies which fell below acceptable quality, than was available in respect of imported supplies.

6.54. We consider that, in view of Kemira's commitment to the fertiliser business, a major increase in its United Kingdom market share could be expected to lead to some expansion of its R&D programme here. Since Kemira will in any case have a substantial presence in the United Kingdom, however, we would not attach a great deal of weight to this prospect.

## *State control*

### *Potential issues*

6.55. This reference, like three others which were under investigation concurrently with it, raises a set of issues beyond the normal competition criteria. These are issues surrounding the concept of state ownership or state control of at least one of the enterprises involved.

6.56. The Department of Trade and Industry (DTI) has suggested to us a number of propositions against which the circumstances of any case involving state ownership or state control might be tested (see paragraphs 5.3 and 5.4).<sup>1</sup> These proceed from the basic assumption that state control inevitably distorts the natural condition of the market. State-controlled companies, the argument runs, are likely to behave in a fundamentally different way from other companies because the state as a shareholder is unlike private enterprise shareholders. The state may have objectives distinct from the normal commercial objectives of maximising the financial return on a shareholder's investment. State-controlled companies do not face the threat of financial failure, they are not financially accountable in the same way as a quoted company, and they may have access to cheaper forms of finance. Because their objectives (or actions) may not be, or may not be perceived to be, strictly commercial, their behaviour is apt to be unpredictable by the normal standards of the market-place. This creates uncertainty among companies operating in the same area. To the extent that competitors in the private sector adjust their own behaviour as a result of the involvement of a state-controlled company, there may be a misallocation of resources in the market leading to overall loss of efficiency in the production of the goods or services concerned. In the case of acquisitions by foreign state-owned companies, the state concerned might be seeking to control a sector of the economy in order to pursue some objective inimical to the national interests of the United Kingdom. Furthermore, in addition to the distortion of the product market, the market for corporate control will be adversely affected, because state-controlled companies themselves will usually be immune from take-over and from take-over pressures.

6.57. DTI further argues that, taken together, these possible consequences lead to a general presumption that acquisitions by state-controlled companies are likely to have adverse effects on the public interest unless there are offsetting benefits.

6.58. We fully appreciate the importance which is attached by DTI to these propositions and the possible consequences suggested. We accept that, in some investigations including the present one, these and other matters arising in connection with state control may be among the relevant issues.<sup>2</sup> As regards some merger situations qualifying for investigation, the fact of state control, taken alone or in conjunction with other relevant facts, might indeed be the basis of a conclusion that the creation of the situation operated or might be expected to operate against the public interest.

6.59. Nevertheless, we are unable to accept that we can look at these matters in terms, as has been suggested, of a general presumption. Our approach to the public interest, or to any aspect of it, is governed by section 84(1) of the Fair Trading Act 1973. This provision requires the MMC 'to take into account all matters which appear to them in the particular circumstances to be relevant'. The subsection goes on to require the MMC to have regard to the desirability of five specific matters or objectives. The language of the subsection appears to us to exclude any presumptions, whether of fact or of law.

6.60. It is the MMC's duty to approach each case according to its facts. Whether any particular issue, including as to state control, arises, and the weight to be attached to it for the purpose of section 84(1), will

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<sup>1</sup>These propositions, which have been put to the MMC in the three other concurrent references mentioned in paragraph 6.66, are addressed in paragraphs 6.69 to 6.71. There has been consultation among the Group Chairmen concerned with a view to approaching them consistently in all cases.

<sup>2</sup>See, for example, the discussion of conclusions-paragraphs 8.111 *et seq*-in the report on the merger situation of *The Government of Kuwait and The British Petroleum Company plc*, Cm 477, October 1988.

depend on an evaluation of all the relevant evidence against the background of the circumstances of the case in question.

### *State ownership of Kemira*

6.61. We received a considerable amount of evidence on the question of the ownership of Kemira by the Finnish Government. This came primarily from Kemira itself, the Finnish Government and DTI. We also questioned ICI closely on the subject and sought the opinion of other parties in the fertiliser industry.

6.62. Kemira argued that there were many other ways besides direct state control for governments to intervene in industry. The argument that state ownership was undesirable of itself, because it introduced distortions and uncertainties into the market-place, was not persuasive because the motives and behaviour of private sector companies also varied widely. Kemira pointed out that the Treaty of Rome was neutral towards state ownership and that the European Court of Justice had rejected the argument that the very existence of state monopolies was incompatible with undistorted competition. State ownership was therefore neither a necessary nor a sufficient condition for establishing the existence of behaviour which could distort competition. It was necessary to look at the actual conduct of individual state-owned firms in order to evaluate this.

6.63. In its own case, Kemira operated within the same legal framework as companies in the private sector in Finland. Its financial relationship with the Government was transparent and it received no subsidies beyond those which were available to privately-owned companies on the same terms. Kemira operated entirely as a commercial business and the Finnish Government had not sought to use its shareholder rights to pursue industrial policies of its own. The Government looked for a normal return via dividends on its investment in Kemira.

6.64. We put it to Kemira that while the Finnish Government did not formally guarantee Kemira's borrowings, the company had an advantage in the amounts and terms on which it could borrow because of the implied state backing. We also suggested that Kemira's profitability was lower than would be normal for a commercial concern. Kemira argued that its credit rating in the money markets, which was lower than the Finnish Government's, showed that it was viewed as a commercial concern on its merits. Kemira regarded its high gearing as a disadvantage and had secured the Government's approval for a flotation of 25 per cent of the company when stock market conditions permitted. Because of the high gearing its profitability should be assessed before interest payments: at that level its returns had been comparable with those of other leading European chemical companies. Kemira argued that its behaviour in the United Kingdom fertiliser industry showed that its aim was to operate efficiently and make profits. While conditions in the market were difficult, fertilisers was a core business for Kemira: the company believed that with the investments it had made and the position it had established in Western Europe as a whole (in contrast to ICI) it was in a position to operate profitably despite the difficulties.

6.65. We also asked Kemira about arrangements affecting the Finnish fertiliser market (of which Kemira holds a 98 per cent share) which DTI had drawn to our attention and which appeared designed to inhibit imports. Kemira maintained that a requirement for imports to be approved by a state institute had not proved a problem for importers. Strict limits on the cadmium content of fertiliser, which had benefited Kemira because it had access to a source of phosphates in Finland which was low in cadmium, had been eased following representations by the European Commission. Kemira had also now terminated an agreement it had previously had with a number of central purchasing organisations in Finland (not state-owned) that they would sell no fertilisers other than Kemira's.

6.66. The Finnish Government confirmed that its state-owned companies operated under the same legislation as the private sector and enjoyed no advantages by virtue of their state ownership. The management of many state-owned companies was pressing for them to be privatised and the Government was preparing a Bill to enable state ownership to be reduced below the current 75 per cent statutory minimum, and below 50 per cent subject to parliamentary approval. The Ministry of Trade and Industry (the Ministry) had a representative on Kemira's Supervisory Board and received a regular flow of information on the company's financial performance. The Ministry was also given advance information on significant investment projects but did not play an active role in evaluating them. In the case of the

proposed acquisition of ICI's business Kemira had sent a two-page letter to the Ministry describing the proposal in summary terms and the Ministry had been content with this information.

6.67. We questioned the Finnish Government's representative about requirements which might be imposed on state-owned companies under guidelines for their operations issued by the Finnish Council of State. We were told that the Government sometimes asked state-owned companies to help deal with difficult employment problems by, for example, delaying plant closures. The companies were not obliged to comply but usually did so, and in that event were compensated by the Government for the extra costs incurred. No such requests were thought to have been made of Kemira in recent times.

6.68. As to the implied backing of the Finnish Government for its state companies' debts, we were told that there had been cases where the Government had been obliged to inject fresh equity capital when companies had got into difficulties but in principle it was possible for a state-owned company to be made bankrupt.

6.69. ICI also argued that it was necessary to examine individual cases rather than draw any general inference from the fact of state ownership. State ownership had long been a feature of the chemical industry in a number of European countries but the behaviour of state-owned companies in these countries had varied. ICI shared the view that state ownership could not be regarded as uniquely importing behaviour into the market-place which differed from the norm. ICI's decision to leave the fertiliser industry had not been influenced by the extent of state ownership of other European fertiliser companies. ICI regarded Kemira as an efficient, commercial organisation whose decision to acquire ICI's United Kingdom business was explicable by reference to commercial considerations.

6.70. BASF, which would be the last large European fertiliser company in private ownership if ICI left the market, told us that in its experience many state-owned companies had in the past been heavily subsidised but that in recent years state companies had operated like privately-owned companies on the basis of fair competition. Most other parties from whom we took evidence did not express concern at the prospect that the two remaining large fertiliser manufacturers in the United Kingdom would both be state-owned, although some regretted that neither would be in United Kingdom ownership.

6.71. We accept that Kemira operates within a legal and structural framework which requires it to follow sound business principles and constrains the Government's ability to intervene in its affairs. We believe the Finnish Government's general approach is not to use its state-owned companies (which have been in state ownership for many years) as a means of pursuing industrial policies but to see them act commercially and make profits. There are some indications that affairs have been arranged to Kemira's benefit in its home market in the past, even though those arrangements have now been dismantled (see paragraph 6.76). We have seen no evidence, however, that the Finnish Government has sought to influence Kemira's overseas activities, although it must have endorsed the company's policy of overseas expansion. Nor do we believe that Kemira's intentions in the merger are other than commercially motivated.

6.72. The financial aspects of Kemira's state ownership have conflicting implications. On the one hand we believe state ownership does put Kemira in a better position to borrow than it would be in as a privately-owned company. The Finnish Government has moreover been prepared to accept returns on some of its equity investments which were lower than private investors would look for (see paragraphs 5.7 and 5.17). On the other hand injections of new equity capital by the Government have been relatively small and the high gearing which has resulted is a handicap in times of high interest rates. A flotation of part of the company would change the context for Kemira's operations, though not fundamentally if it were confined to the 25 per cent for which approval has been granted. At present we consider that state ownership could have some effect in enabling Kemira to sustain lower profitability than it could as a privately-owned company, though this effect will be strictly limited as long as interest rates remain high.

6.73. This factor could exacerbate the detriment to competition which we consider would result from the merger in that Kemira could afford to wait longer than an equivalent private sector company for conditions to improve without itself having to retrench, or could choose to keep prices down for a period if competitive pressures eased thus enhancing its market share and position of dominance. In other respects we have concluded that state ownership does not in this case represent a threat to the public interest. Indeed paradoxically Kemira's commitment to fertilisers and ability to endure difficult conditions strengthens the merger's potential benefits for United Kingdom production and consequently for employment.

## **Conclusions and recommendations**

6.74. We conclude that the merger would reduce competition in the United Kingdom market for agricultural fertilisers. Kemira, already the third largest supplier to the United Kingdom market, would acquire the largest supplier and become market leader. Its market share following the merger cannot be predicted with certainty but could be well over 40 per cent. With modern, efficient production facilities in the United Kingdom and a strong position in Western Europe as a whole, Kemira would be well placed to exploit this market leadership (see paragraph 6.47). It would, with Hydro Fertilizers, be part of a duopoly holding at least 60 per cent and possibly (depending on imports) up to 75 per cent of the market with other suppliers having small shares and little prospect of new entry in manufacturing (see paragraph 6.48). We do not consider that this market structure would be conducive to the maintenance of a high level of competition (paragraphs 6.49 and 6.60). The strength of other parties in the market varies and some would be in a vulnerable position in the changed market structure (paragraphs 6.50 to 6.55). We believe that this reduction in competition will lead over time to adverse consequences in the form of prices above what would be expected in normal competitive conditions. There would also be a reduction in choice in the supply of fertilisers manufactured in the United Kingdom. Because of transport costs these adverse consequences would be increased in particular parts of the country (paragraph 6.59).

6.75. A continuation of import competition in its present strength would inhibit the extent of these adverse consequences, though it would not in our view prevent them. But we expect competition from imports to slacken and such a change would magnify and bring forward the detriments we have identified (paragraph 6.60). The circumstances of Kemira's state ownership which we have described (paragraphs 6.72 to 6.83) could exacerbate the position because they enhance the company's ability to withstand competitive pressures until conditions become more favourable to it and could further enhance its market leadership (paragraph 6.84). There might be benefits in terms of increased production and employment in the United Kingdom as a result of the merger as described in paragraphs 6.61 and 6.62 but we do not consider that these benefits would be sufficient to outweigh the harmful effect of the merger on competition.

6.76. We conclude that the merger situation we have identified may be expected to operate against the public interest.

6.77. We are therefore required to consider what action, if any, should be taken for the purpose of remedying or preventing these adverse effects. Such action would need to be directed against the reduction of competition which the merger would cause. Outright prohibition of the merger is the most obvious possibility. But we have also considered whether there may be remedies short of prohibition which would meet our concerns about competition in a satisfactory way, and as recounted in paragraphs 4.92 to 4.107 we discussed a number of possibilities with the main parties.

6.78. ICI told us that it would be likely to close down its United Kingdom fertiliser business altogether if the merger were prevented. In view of the losses which ICI has incurred and the overcapacity which currently prevails, this possibility is real. Closure of the remaining business would entail the loss of 540 jobs and capacity totalling some 1.4 million tonnes. On the other hand it would enable all other players in the market to compete for ICI's share with the spoils going to those who competed most effectively. This would be clearly preferable in competitive terms to Kemira's being able to acquire ICI's business as a going concern, complete with customer lists, trade marks and other elements of goodwill, and thus to step into ICI's shoes.

6.90. Although no parties other than Kemira and Norsk Hydro were prepared to buy ICI's business when it was put up for sale, ICI told us that another producer had discussed a joint venture on terms which ICI, with the prospect of selling out completely, was unwilling to consider. ICI told us that if the merger were turned down it would look quickly for another buyer but expected that Norsk Hydro would be the only interested party; [  
] *Details omitted. See note on page iv.*

6.79. We questioned ICI closely about its plans should the merger be prevented and examined internal company documents. In January 1990 ICI had examined the various options which were in principle open to it, including continuation of the current mode of operation, asset renewal, closure, acquisitions, divestments and joint ventures. It concluded in favour of divestment, subject to the realisation of a satisfactory price. Continuation of the current mode of operation was seen as the best fall-back option, if satisfactory divestment did not prove possible, since the business was forecast to generate a positive cash flow for a number of years forward. As long as this situation continued there was no case for closing the business.

6.80. ICI pointed out that these decisions had been taken nearly a year earlier and said that the prospects for its fertiliser business had worsened in the meantime. If the merger were prohibited the company would have to review its options afresh on the basis of up-to-date information. The company's representatives thought it likely that, leaving aside a possible sale to Norsk Hydro, the review would this time conclude in favour of closure, but not necessarily of the full business in the immediate future.

6.81. We put it to ICI that since the January 1990 review it had decided to close Billingham and that this would improve the business's financial position. ICI agreed that this was so but argued that the improvement, after taking account of the loss of gross margin on sales currently supplied from Billingham which it would no longer have the capacity to meet, would be small. The company told us, however, that it had not prepared up-to-date forecasts on which decisions as to the future of the remaining business, following the closure of Billingham, could be taken if the merger did not proceed.

6.82. We further put it to ICI that it had recently invested over £60 million in modern, energy- efficient ammonia production at Severnside incorporating new technology which the company had developed. ICI agreed that it would be difficult to achieve the aim of licensing the technology to other parties if the only plant using the technology were to be closed and said that this would be a factor in considering the timing of any future closure of Severnside.

6.83. ICI did not present detailed, up-to-date information to us showing the projections on which it would base its decision if the merger were prohibited. The company was unable to be precise about the options which would face it then, or the timing of closures if that were the chosen option. Our view is that while parts of its remaining business might close fairly soon and complete closure might ultimately follow, prohibition of the merger would not result in the closure of all ICI's plants in the near future. Other possibilities might well be opened up in those circumstances which would be more beneficial to competition in the United Kingdom fertiliser market than would the merger. Even if ultimate closure were the consequence, we consider that that would not outweigh the adverse consequences of the merger for competition.

6.84. As the complete closure of ICI's business would have adverse effects for production and employment, we have considered whether remedies short of outright prohibition might be found which would avoid complete closure while sufficiently addressing our concerns about the merger's effect on competition.

6.85. Among the possibilities short of prohibition which we considered, exclusion of Severnside would be tantamount to outright prevention since that plant is the heart of the deal. Exclusion of Leith would be likely to lead to the plant's early closure. Since we do not believe a third party would be prepared to buy it, this course would be likely to reduce capacity without significantly detracting from Kemira's strengthened position in the market.

6.86. The liquid fertiliser business was profitable last year and would be likely to find a buyer who, because of the economics of producing liquid fertilisers, need not be a major fertiliser manufacturer. This business represents some three to four percentage points of ICI's 30 per cent market share. The parties acknowledged that the manufacture and sale of liquid fertilisers was a discrete activity and could be treated separately from the manufacture of solid fertilisers. Its exclusion would preserve some competition but would not make a material difference to Kemira's market power.

6.87. The exclusion from the acquisition of ICI's trade marks, which are long established and well recognised in the industry, would inhibit Kemira's ability to step into ICI's shoes and would strengthen the position of its competitors. While ICI considered that in current market conditions the brands were not of great value, Kemira saw them as an essential feature of the purchase of a going concern whose exclusion would require reassessment of the whole agreement. They were particularly concerned about the possibility of the names being sold to a third party. But Kemira's main concern was that the exclusion of the brand names would cause confusion in the market: it argued that as a remedy it would not have a significant impact. While we believe that exclusion of the names would hamper Kemira in its efforts to hold on to ICI's market share, we do not see this remedy as adequately meeting our concerns about the merger's effect on competition.

6.88. We also considered whether undertakings should be sought from Kemira which would give some assurance that the benefits which the merger would have for production and employment in the United Kingdom would continue. Kemira indicated to us that it would be prepared to undertake to give six months' notice of closure, to the appropriate Government department, of its intention to close or dismantle plant where this would represent a permanent reduction of its capacity to make nitrogenous fertilisers of 25 per cent or more below present levels. Six months is probably not much longer than the normal lead time for the closure of a substantial manufacturing facility so we did not consider that such an undertaking would be sufficient. Even if Kemira were prepared to give an undertaking that it would continue to operate the Leith and Severnside sites at a normal level of production for at least two years, say, from the date of their acquisition, and give at least six months' notice to the Secretary of State of its intention to close either plant at the end of that period or thereafter, we do not consider that these benefits for production and employment would be sufficient to outweigh the detriment to competition that we have identified.

6.89. We therefore conclude that remedies short of outright prohibition would not be adequate to offset the adverse effect on the public interest which the merger would cause. We therefore recommend that the merger should not be permitted.

M S LIPWORTH (*Chairman*)

A G ARMSTRONG

K S CARMICHAEL

A FERRY

S N BURBRIDGE (*Secretary*)

28 December 1990