

6 Conclusions

Introduction

6.1. We are concerned in this reference with proposals by Sligos SA (Sligos), a French subsidiary of the French state-controlled bank *Crédit Lyonnais SA* (*Crédit Lyonnais*), for the purchase of *Signet Ltd* (*Signet*), one of the two largest processors of payment card transactions in the United Kingdom. *Signet* is owned by four United Kingdom clearing banks, which have put it up for sale. The banks have reduced the tenders to two: those of Sligos and of *First Data Resources Ltd* (*FDRL*), which is ultimately owned by the United States company *American Express*. Sligos's bid was referred to the Commission by the Secretary of State, who stated in a press notice at the time that the implications of *Signet* coming under the control of a state-controlled company raised issues of public interest warranting investigation.

Terms of reference

6.2. Under the terms of the reference dated 24 October 1990 (see Appendix 1.1), and the relevant sections of the Fair Trading Act 1973, we are required to investigate and report whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a merger situation qualifying for investigation, in that enterprises carried on by or under the control of *Signet* will cease to be distinct from enterprises carried on by or under the control of Sligos. The reference also includes a condition, under section 64(1)(b) of that Act, that the value of the assets taken over exceeds £30 million. As will be apparent from Appendix 2.4, *Signet's* assets fulfil that condition. The reference excludes from our consideration the market share test in the Act.

6.3. Sligos told us at the beginning of our inquiry that it fully intended to continue with its bid for *Signet* if permitted to do so. At a late stage we were told that *Signet's* owners had decided to enter into detailed discussions with *FDRL*. If, however, they could not reach final agreement, they would wish to enter into similar negotiations with Sligos. Sligos confirmed to us, following this development, that it still intended to maintain its bid. We conclude that there are arrangements in contemplation by which enterprises carried on by or under the control of *Signet* would cease to be distinct from enterprises carried on by or under the control of Sligos. These arrangements, if carried into effect, would result in the creation of a merger situation qualifying for investigation. We have therefore to investigate and report on whether this merger situation may be expected to operate against the public interest.

Sligos and Signet

6.4. The main activities of Sligos are data processing and computer services in the banking, information technology, industrial, accounting and management sectors. It is a major provider of card processing services and consultancy services in France; it is also active in the provision of consultancy services in Germany and Italy. It is listed on the Paris Stock Exchange.

6.5. *Signet*, formerly *The Joint Credit Card Company Ltd* (*JCCC*), was established in 1970 by the three main shareholders, *Lloyds Bank*, *Midland Bank* and *National Westminster Bank*. Each of these banks now holds 30 per cent of the equity; the *Royal Bank of Scotland* owns the remaining 10 per cent. *Signet* is concerned today primarily with credit card processing (having been relieved by the shareholder banks in March 1989 of some important functions previously carried out by the *JCCC*: see paragraphs 2.33 to 2.35).

Card processing in the United Kingdom

6.6. The use of plastic cards of various kinds has developed rapidly over the past 20 years, and particularly in the last three or four, that is, during and following this Commission's monopoly inquiry into the supply of credit card services.¹ During that period, major building societies and a number of other credit card issuers have entered the market, some banks have offered credit cards which give effectively lower rates of interest (the annual percentage rate, or APR) and most card-issuing banks, including all the leading banks which had previously belonged to only one international payments system (MasterCard/Eurocard or Visa) have become members of both ('duality'). Competition has become particularly active over discounts paid by traders (the merchant service charge, or MSC). There has also been a rapid growth in the use of debit cards. Several new card processors have entered the market, notably three from the United States: FDRL, Electronic Data Systems Inc (EDS) (a subsidiary of General Motors) and General Electric Capital Corporation (a subsidiary of General Electric, which has purchased Welbeck Financial Services). These trends are expected to continue over the next decade, with particularly strong growth in the market for debit cards.

6.7. Signet has enjoyed, and still enjoys, a major share of the market. It owes this position to the fact that from its inception it was the appointed instrument for the credit card processing of three of the major English, and one of the major Scottish, clearing banks. (It should be noted that Barclays Bank (Barclays) is alone amongst the major clearing banks in carrying on all of its own card processing.) Signet's share of the total card-processing market remained roughly constant for the last four or five years until 1990, when it showed a significant increase. This was due largely to the wider distribution of Visa card processing (in particular of Visa acquirer processing, until then almost entirely carried on by Barclays). Signet may not, however, maintain its 1990 position, on account of the more rapid growth of the debit card, which it is more convenient for major card issuers to process themselves in-house, than to put out to third party processors.

6.8. Signet estimates that at the end of 1989, in the case of the issuer-processing market (ie processing of cardholder accounts) (Table 3.2), it was processing 47 per cent of credit card accounts, and 23 per cent of all card accounts (credit, debit, store and charge cards). Similarly, in the case of the acquirer processing market (ie processing of the accounts of merchants handling the cards) (Table 3.3) it was processing 63 per cent of credit card transactions and 39 per cent of all card transactions. About 96 per cent of its business in both these markets was with the four banks. These shares are large, whichever way one looks at them. However, it needs to be stressed that the market for processing services is in an important sense derivative, depending as it does on the business obtained by the enterprises marketing the cards and acquiring merchants to handle them. Moreover, while this situation is changing, in the sense that Signet is being set free to compete with other processors in the market, Signet is also going to be susceptible to the progressively fiercer wind of competition as its previous shareholder banks become free from their obligation to use the services of Signet itself, after their initial contracts with Signet expire. The latter factor stems from the terms which the banks intend to negotiate with the purchaser of Signet (see paragraph 6.11).

Reasons for the merger

6.9. Signet's shareholder banks told us that the increased competition in the payment card market over the past few years had been their main reason for deciding to sell the company. Following the developments described in paragraph 6.6, they were now competing with each other much more actively. The Signet joint venture thus became an anomaly. It was in any case unsatisfactory that the four shareholders were also Signet's principal customers. Signet was a support facility, with no profit-making incentive; consequently there was insufficient motivation to be efficient or to make more than minimal capital investment. Signet was consequently increasingly ill-equipped to provide a competitive service in

¹See the MMC *Report on the supply of credit card services in the United Kingdom*, published August 1989 (Cm 718).

the new conditions, although from 1989/90 Signet switched to a tariff basis of charge. The shareholders therefore decided that Signet should become a third party processor, providing services to all its customers, including themselves, on an arm's length basis. It was a logical consequence that the shareholders should disembarass themselves of the company altogether, if they could find a suitable purchaser.

6.10. Sligos for its part told us that its reason for seeking to acquire Signet was that it wished to expand its European business and ultimately to become a major card processing company in Europe. At present it carries on no activities in the United Kingdom. In this it differs from FDRL, the other contender for Signet, which has a very small share of the card processing market, and also hopes to expand. Sligos's business is primarily in the debit card sector, and is predominantly handled by electronic means (electronic funds transmission, or EFT). It thus contrasts with Signet's, which is largely in the credit card sector, and based more or less equally on paper voucher transmission and on EFT. The trend today is towards EFT.

The future of Signet

6.11. In disposing of Signet, the shareholder banks need to ensure that their own processing requirements continue to be met, since no third party processor exists at present to meet them in full. We recognise that the banks will be guided by the need to select a suitable purchaser, in terms of ability and experience, to carry on the business. The sale price will clearly be influenced by the business which the shareholder banks are able and willing to provide. The banks' intention is that, having jointly selected their preferred purchaser in principle, each should negotiate separately with it the terms of their future contracts with Signet. These will include an initial commitment period, probably of up to five years, as being the minimum necessary for the transfer of goodwill and for Signet to adjust to its new role and to the more competitive market. They will also specify that any increase in Signet's tariffs to the banks should be at a certain level below the prevailing rate of inflation. The shareholder banks are also likely to negotiate a diminishing proportion of guaranteed business to Signet over that period. Once Signet is sold, they expect it to be able to compensate for their own gradual but progressive withdrawal of business by work obtained from new customers, or, possibly, additional work for themselves. How far the banks withdraw business from Signet in the longer term depends on how competitive Signet becomes, in price and quality of service.

6.12. Sligos told us that if it acquired Signet, it intended to run the enterprise like any other of its subsidiaries, that is, the company would have day-to-day management autonomy, being expected to make profits within a market which its management would understand much better than Sligos itself. Sligos did not expect to have to make any large capital investment; it would need to update Signet's software, but the resources existed within Signet to undertake that. There might in due course be some reduction in staff, which could be absorbed by natural wastage.

Competition: potential issues

6.13. Sligos has no presence in the United Kingdom market today. Its acquisition of Signet would not therefore represent any increase in market share, or any reduction in competition in the market in which Signet operates. Indeed, in so far as Signet will be leaving the somewhat protective environment of the four banks, ownership by Sligos-or indeed by any other enterprise independent of the card issuers and merchant acquirers-may be expected intrinsically to have a pro-competitive effect. We nevertheless put it to Sligos that the large share of the market with which Signet would start under its ownership might enable it by one means or another to achieve a dominating position, and to engage in anti-competitive practices, especially if it were able to take an unfair advantage of the fact that its own parent company was state-controlled. Before we consider this issue, we should take a closer look at the ownership and control of Sligos in the light of the views of the Department of Trade and Industry (DTI) about it.

State control: potential issues

6.14. The DTI suggested to us a number of propositions¹ against which the circumstances of any case involving state ownership or state control might be tested (see Appendix 4.1). 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 different from the normal commercial objective 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 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 will usually be immune from take-over and from take-over pressures themselves.

6.15. The 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.

6.16. We fully appreciate the importance which is attached by the 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 are among the relevant issues.² 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.

6.17. 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 Act. This provision requires the Commission 'to take into account all matters which appear to them in the particular circumstances to be relevant'. The subsection goes on to require the Commission 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.

6.18. It is the Commission'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 depend on an evaluation of all the relevant evidence against the background of the circumstances of the case in question.

¹These propositions, which have been put to the Commission in three other concurrent references raising issues surrounding the concept of state ownership or state control (British Aerospace PLC and Thomson-CSF SA, Crédit Lyonnais SA and Woodchester Investments plc, and Kemira Oy and Imperial Chemical Industries PLC), are addressed in paragraphs 6.16 to 6.18. There has been consultation among the group chairmen concerned with a view to approaching the propositions consistently in all cases. It will be noted that we as a group were also responsible for the inquiry into Crédit Lyonnais and Woodchester Investments.

²See, 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.

Sligos and state control

6.19. Crédit Lyonnais owns about 63 per cent of Sligos's shares, and another 8 per cent is owned by the public sector savings and investment institution, Caisse des Dépôts et Consignations. There is no other large shareholder. Crédit Lyonnais was itself nationalised in 1982, and today the French state together with other state agencies controls about 80 per cent of its capital and all the voting shares.

6.20. Sligos is managed, like any société anonyme, by its Président, assisted by an executive Comité de Direction, which he appoints. It also has a Conseil d'Administration, chaired by the Président, which exercises a supervisory and advisory role. Apart from the Président it is currently composed of five representatives of Crédit Lyonnais. All are appointed by the general meeting of shareholders. Sligos said that the membership could include representatives of minority shareholders, but for some years the latter had not availed themselves of the opportunity. The structure of Crédit Lyonnais is similar,¹ except that as a major enterprise under direct state control, its Conseil d'Administration is made up of 12 members appointed by the state (six from the business community and six from various departments of state), together with six elected representatives of the bank's employees. The Président is chosen from the representatives of the business community.

6.21. It is clear from the description in paragraphs 6.19 and 6.20 that Sligos is indirectly under state control and could be materially influenced by it. We asked both Crédit Lyonnais and the French authorities for their views on the implications of this.

6.22. Crédit Lyonnais pointed out that its acquisition policy generally was to leave a successful and established management team in place to continue running the business. This was its policy towards Sligos. It understood that Sligos intended to maintain Signet as an independently run company. Crédit Lyonnais acted only as an investor in Sligos, which also had to operate independently, not least because its principal competitors were amongst Sligos's own principal customers. If Sligos became insufficiently profitable, Crédit Lyonnais could consider possibilities such as restructuring or partial or complete disposal. Crédit Lyonnais told us that as a public sector company, it would need the Government's consent to dispose of its shareholding in a significant subsidiary, such as Sligos, outside the public sector. It gave us evidence that such consents were not infrequent. It also gave its opinion that the French Government was not likely in any circumstances to seek to intervene in Sligos's business, especially since it had no strategic importance, and the markets concerned were competitive and barriers to entry low. Crédit Lyonnais added that it had not consulted with or informed the French Government about Sligos's decision to bid for Signet.

6.23. Crédit Lyonnais suggested that disposal of Signet by Sligos, if the former performed unsatisfactorily, would be a matter for the Sligos management itself, which would no doubt consult its Conseil d'Administration, on which Crédit Lyonnais is represented. Crédit Lyonnais noted, in connection with the possibility of Signet running into severe difficulties, that it had never provided loans to Sligos on any exceptional terms. It would not expect Sligos to act uncompetitively, and did not believe that it would be to Sligos's advantage to do so. It would be most concerned if Sligos appeared to be infringing any competition laws.

6.24. The French authorities made it plain that their attitude to Crédit Lyonnais's relationship with its subsidiaries, such as Sligos, would be that of any other shareholder. That would extend to a situation in which Crédit Lyonnais was considering how to deal with unsatisfactory performance on Sligos's part. The French authorities also pointed out that they had never intervened in the management of any enterprises in the payment card sector, and did not intend to. These businesses were conducted on commercial principles, and it was not to be envisaged that special treatment would be called for.

6.25. Sligos gave us a similar account of its relationship with its majority shareholder and with the state. Crédit Lyonnais's interest, it said, was in obtaining an adequate return on its investment, like any shareholder. It would be aware of major developments, generally after they had taken place, through its representation on the Conseil d'Administration. But it was not the practice of Crédit Lyonnais to intervene in Sligos's affairs. Sligos was not aware of any relationship, direct or indirect, between the state and itself.

¹The structure of Crédit Lyonnais and the nature of its relationship with the state is discussed in considerably more detail in the Commission's recent report on *Crédit Lyonnais SA and Woodchester Investments plc*, Cm 1404, January 1991.

6.26. It is very much a matter of judgment, rather than objective fact, to what degree this element of state control might be used to influence the behaviour of Sligos in the market and indeed to distort the market itself. While it is noticeable that none of the firms engaged in the card processing business in the United Kingdom expressed to us any concern at all on general grounds over the proposed sale of Signet to another card processor, two United Kingdom banks-Barclays and Bank of Scotland, both engaged in card processing themselves-expressed some fears that Sligos (in distinction to FDRL) might gain some unfair advantage if it were enabled to take longer-term decisions on pricing policy than a privately owned competitor; but neither provided evidence that Crédit Lyonnais would be likely to encourage Sligos to pursue policies of this kind. We nevertheless put to Sligos and to Signet and its shareholders a series of issues related to Sligos's status and Signet's position in the market, and the possible effect state ownership might have on them. We summarise their responses below.

6.27. We asked about the likelihood of the state-control factor causing distortion in the market, giving rise to uncertainty amongst competitors. The shareholder banks noted that the present level of Signet's market share was not a very reliable pointer, because of the likelihood of considerable expansion in the card processing market in the next decade, and Signet's relative weakness while it remained largely dependent on the business of the banks themselves. Competitors in this market were sophisticated and knowledgeable, and mostly had large financial resources. They were unlikely to be deterred by possible uncertainties in the market. Sligos also stressed the competitive nature of the market, and questioned what motive the French Government could have for insisting on Sligos pursuing non-commercial objectives. It was profit-driven and must take commercial decisions or fall foul of the stock market.

6.28. We asked about Signet's capability to indulge in predatory pricing, or to increase prices above the competitive level, if the merger went through. Sligos pointed out that its main customers could easily move their business in-house, and new third party processors could enter the market. Predatory pricing would not be in the best interests of its own shareholders, and high prices would violate the agreements intended to be made between Signet and the banks, which would restrict price increases to below the prevailing rate of inflation. The shareholder banks made similar arguments. We asked whether Signet, if acquired by Sligos, might be expected to use its resources inefficiently. Sligos claimed that its researches showed it (Sligos) to be efficiently run by comparison with its French competitors and with Signet. The banks pointed out that they had decided to dispose of Signet because they could not optimise the efficiencies of the business under the existing joint ownership/competing customer structure. However, an independent owner, especially if it was a dedicated processor, could make Signet more efficient and competitive. They believed Sligos to be a profit-driven enterprise with a strong financial record.

6.29. We asked whether the size and market power of Sligos and Signet might be expected to deter competitors from challenging the joint enterprise. Sligos claimed that the two businesses were largely complementary, one chiefly processing debit cards, the other credit cards, and that the minimum efficient scale of operation was small in relation to the size of the market. The shareholder banks did not consider that economies of scale conferred a great competitive advantage, especially since the principal competitive market-place in the next few years would be amongst fairly small card issuers, relative to the size of the banks themselves. Also, development was likely to be in the direction of individual product functionality, quality and range of service provided by processors; this would further reduce the significance of economies of scale. The market power of the combined enterprise was not such as to deter potential competitors.

6.30. We asked for comments on the relevance of the market for corporate control on the issues before us. The shareholder banks suggested that its importance lay in the spur to efficiency provided to management by the threat of take-over; this force could not bear upon the banks themselves in the case of Signet which was not publicly quoted and was too small. Consequently if Sligos should be considered bid-proof by virtue of its indirect state ownership that was not in itself a public interest detriment, since the sale to Sligos would involve no change. The banks were, however, concerned that if they were denied the possibility of selling to Sligos, their intention to consider competing bids would be frustrated, and it was possible that they would be denied the opportunity of selling to the enterprise that they considered best suited to meeting their requirements, whichever it might be. Sligos put the same argument to us.

Public interest considerations

6.31. We are satisfied that Sligos's motives for wishing to acquire Signet are purely commercial. In the context of developments in the European Community (EC), it is a natural objective for Sligos to expand into an EC country where payment cards are a considerable and growing element in the economy. It would have been odd if Sligos had not entered the competition when the shareholder banks put it up for sale.

6.32. We recognise that the decision to compete for Signet is one that Sligos itself would be competent to take, without direction from its parent, still less the French authorities. It would be natural, nevertheless, and in no sense untoward, for Sligos to consult Crédit Lyonnais before going ahead, and for Crédit Lyonnais to endorse the move, as they both did.

6.33. We accept that Crédit Lyonnais's primary interest in Sligos is that its investment should be profitable. It told us that its general target for subsidiaries, of an annual rate of return on investments, currently of 15 per cent, applied to Sligos. That approach would extend to the proposed acquisition of Signet. By extension, though in a very small way (Sligos's importance in this scale being so slight), one can suppose that the French authorities would be concerned that Sligos's acquisition of Signet should contribute to the profitability of Crédit Lyonnais.

6.34. It is conceivable that, if in the future the investment in Signet proved detrimental to Sligos's balance sheet, Crédit Lyonnais could intervene and impose certain requirements. But it is in practice hard to imagine that before that point was reached the Sligos management would not have received enough danger signals to begin to formulate plans to retrieve the position itself-and no doubt to put them to Crédit Lyonnais through the Sligos Conseil d'Administration for approval.

6.35. We state these hypotheses simply to clarify our opinion of the likelihood, and the limits, of state-motivated intervention in Sligos's affairs. In fact we believe that Sligos has the capacity to manage Signet soundly in any likely market conditions. We do not foresee circumstances in which the French authorities, or Crédit Lyonnais, or Sligos, would be likely to need or to want to depart from their normal policies of leaving their respective subsidiaries to manage their respective businesses day to day without interference.

6.36. Consequently, we see no reason to expect that Sligos would follow policies likely to distort the United Kingdom market or to create uncertainty among competitors. Even if this were possible, it does not seem realistic to us to suppose that in this sector of business it would be worth the French authorities' trouble to cause the necessary action to be brought about. Nor (in different circumstances) would they be likely to respond with capital injections or other means to a request to facilitate Sligos in a strategy, for instance, of predatory pricing. On the contrary, we believe that, if Signet's business under Sligos's ownership was running into trouble, Crédit Lyonnais-and, still more, the French authorities-would be most reluctant to step in with any assistance that could not be justified on the standard financial criteria prevailing in the private sector.

6.37. We therefore consider that Sligos constitutes no threat to the United Kingdom market by virtue solely of its state control through Crédit Lyonnais. We note that that was the precise ground of the Secretary of State's reference (see paragraph 6.1), the rider being added that Sligos's being under the control of a state-controlled company merited investigation in the context of the fact that the sale of Signet would lead to the creation of the largest third party processor in the United Kingdom. We have considered what implications that fact has for the public interest.

6.38. As explained in paragraphs 6.6 to 6.10, the market has developed considerably, especially in the last two years. The unlocking of the business of the four shareholding banks, to whomever Signet is sold, will add considerably to its incentive to be competitive. Many individual developments have already contributed to this trend, eg the four banks each taking on its own business of merchant acquiring, hitherto the responsibility of Signet; the growth of duality, whereby card issuers have become members of both Visa and MasterCard/Eurocard; the rapid growth of debit cards, including the introduction of new systems such as Switch; and the entry into the market of several new processors.

These and other recent developments have given customers sufficient freedom of choice between in-house and third party processing, and the ability to change readily from one to the other (see paragraphs 3.19, 3.25, 3.26 and especially 3.28), that the card-processing market must realistically be treated as a single integrated one. Although for the smaller customer in-house processing is a less practicable option, there are not two distinct markets, in one of which Signet would have an advantage.

6.39. Signet is by no means guaranteed prosperity in this competitive environment, especially as it has hitherto been unaccustomed to competition. It will have to look for new business for which other powerful enterprises will be competing against it, and may have to seek openings outside card processing. The high margins enjoyed until recently by card businesses, especially those of the banks, have been drastically shorn; as the shareholding banks themselves told us, the average MSC has dropped from around 2.2 per cent on retailers' credit card turnover to about 1.5 per cent since the advent of duality. Just as Barclays lost a significant share of the business when the other large banks joined Visa, so Signet will have to fight to retain its volume of business if as seems to us likely the four banks gradually reduce their commitment. If indeed, after the initial contracts with Signet are ended, any of them withdraw much or all of their custom, and take it in-house or to a third party processor, Signet will be hard pressed to maintain its position.

6.40. We have considered whether the acquisition would give Sligos any particular advantages. At first sight, the fact that it operates largely in the field of debit cards, and Signet in that of credit cards, might be thought to be important. But the two operations do not seem to complement each other in a significant way: the actual processing is much the same in both cases; also Signet already does a small amount of debit card business, and will inevitably be looking for more as the debit card's popularity increases.

6.41. We would not expect Sligos to benefit significantly from economies of scale, chiefly because, according to both parties, a processing business has to be in quite close contact with its customers, so there is little likelihood of amalgamation of facilities. If any synergy arose from the merger, we would expect it to be in the area of research and development, where the United States competitors are large enough to hold their own, as indeed are Barclays and the other big British banks. Economies of scale are also less important where the customers (card issuers particularly) are of modest size.

6.42. It is feasible to enter the market on quite a small scale, as shown by the recent initiatives of FDRL and EDS. Even at the larger scale, entry does not require major investments; exit costs can be low, as much expenditure can be recovered. Moreover technology has developed rapidly in the last two decades to make processing power and capacity available at lower cost. All these factors need to be taken into account in measuring the barriers to new entry. In sum, we do not consider that new entrants are likely to be significantly deterred from entering the market by such barriers as exist.

6.43. The ultimate response to any threat to competition from Sligos, after acquisition of Signet, is the ability of major customers—such as notably the four shareholder banks—to take their custom in-house, or to another independent processor. This course is not to be undertaken lightly: we were told that a transfer of custom might take at least a year to complete, and the inevitable upheaval could cause a deterioration in customer service. But it is plainly a feasible response. It is also relevant in this context that the business done by Signet for the four banks is only somewhere between 5 and 10 per cent of their total comparable processing requirement (ie the banking transactions which they handle themselves in-house).

6.44. The four banks have argued that it is of special significance that they themselves, Signet's vendors, are its predominant users as well, and likely to continue in that position for up to five years, though on a declining scale. On this argument, they are likely to act as a brake on any non-commercial practices. In principle, we consider that they can be relied upon to sell to a bidder who will not run Signet in a way that is harmful to their interests. Other things being equal, there is advantage in the four banks being free to make arrangements for the sale of Signet on a competitive basis. But we would not put it higher than that, since the interest of the shareholder banks is not necessarily the public interest.

Conclusion

6.45. While Signet has undertaken a large proportion of all card processing carried out in the United Kingdom, it has not been able, owing to the status of its shareholders, to take wider advantage of its competitive potential hitherto. While Sligos could bring a freshly competitive approach as a new owner, it would add nothing to the market share position, since it plays no role in the United Kingdom market today. Indeed, it is possible that, if Signet continues to be occupied for a prolonged period in meeting the processing needs of the present shareholder banks, though probably on a declining scale, the merger will have a very limited discernible effect on the United Kingdom market or on market shares. However, a change in the market share position will be likely only if Signet improves its efficiency to such an extent that it is superior to the main processors who will clearly strive to obtain that business. In that case, the market will be more competitive and Signet-and probably others-will have become more efficient.

6.46. We recognise that, since Sligos would be taking on a much more influential role in the market by acquiring Signet than Crédit Lyonnais in the case of Woodchester Investments plc, any interference would be of greater significance. However, as we found in that case (which was a case of direct acquisition by a state-controlled company), there is no evidence that the French Government intervenes in the affairs of Crédit Lyonnais in such a way as to distort the United Kingdom markets. *A fortiori*, we would not expect any interference, indirectly, in the United Kingdom activities of Sligos.

6.47. Competitors in the market have raised only theoretical possibilities of Sligos being able to engage in unfair practices, by virtue of its indirect state control. We do not consider that Sligos would have the market strength to benefit from such practices. In any event there is the constraint of United Kingdom and EC legislation. Equally, we would not expect Sligos to have any freedom to operate inefficiently on account of state control; nor would we foresee any likelihood of an inefficient use of economic resources on a broader scale, through misallocation brought about by state intervention imposed for non-commercial purposes. Sligos itself has told us that its policy is to give its subsidiaries autonomy of day-to-day management.

6.48. The processing market is in any event an increasingly competitive one, as shown by the continued growth in the number of processors, and not least by the entry in the past two or three years of three of the largest American processors-FDRL, General Electric Capital Corporation and EDS. It is also noteworthy that these companies have all made the initial entry on a comparatively small scale. Exposure of the shareholder banks' requirements to other processors will represent an important increase in competition. Additionally, customers, especially the larger ones, have the option, if they object to Signet's policies under Sligos, to take their business in-house.

6.49. It does not appear that Sligos/Signet will derive economies of scale from the merger, of a kind or degree to give it significant advantage over its competitors. While the cost of entry to the market constitutes some barrier, it is not so high as to be likely to deter major firms in the financial sector, especially as competitors can enter initially on a small scale and much of the investment could be recouped if an entrant wished to change its mind and withdraw. We do not consider that, with or without state control, Sligos would be able to exploit its position.

6.50. We have considered whether the market for corporate control is likely to be reduced in this instance, on the ground that Sligos, as a subsidiary of a state-controlled enterprise, is bid-proof. We note that, in the context of the United Kingdom market, the position of Sligos-being a French company-is less relevant than that of Signet. We believe that, if the question of the disposal of Signet arose, both Sligos and Crédit Lyonnais would treat the matter as a normal commercial transaction. If state approval were required for the disposal of Signet, we do not consider that it would be withheld. In practice, the likelihood also appears to be that if Crédit Lyonnais wished to dispose of Sligos and could show that it was in its clear commercial interest to do so, it would be able to obtain the state's approval for it. The market for corporate control would not therefore be likely to be reduced in any important sense by the merger.

6.51. For all the above reasons, we conclude that the proposed merger may be expected not to operate against the public interest.

H H HUNT (*Chairman*)

C C BAILLIEU

C M BLIGHT

F E BONNER

S N BURBRIDGE (*Secretary*)

28 January 1991