

# 6 Conclusions

## The merger situation

6.1. Under a reference (see Appendix 1.1) dated 24 April 1989 (made under sections 64, 68(4) and 69(2) of the Fair Trading Act 1973 (the Act)), we are required to investigate and report whether a merger situation qualifying for investigation has been created, in that enterprises carried on by or under the control of J B & S Lees Limited (incorporated in the United Kingdom) (Lees) have within the six months preceding the date of the reference ceased to be distinct from enterprises carried on by or under the control of Glynwed International plc (Glynwed). As regards the tests provided for in sections 64(1)(a) and (b) of the Act, the reference was made on the basis of the former, ie that it appeared that, as a result of such enterprises having ceased to be distinct, the condition specified in section 64(2) of the Act prevailed, or did so to a greater extent, with respect to the supply in the United Kingdom of hardened and tempered steel strip (H & T strip). This is generally known as the 'market share' test, although the alternative ('assets') test was not specifically excluded.

6.2. We are satisfied (see paragraph 3.1) that Glynwed acquired Lees from Quoteplan plc on 16 November 1988. Section 65(1) of the Act provides that any two enterprises shall be regarded as ceasing to be distinct enterprises if they are brought under common ownership or common control. We therefore conclude that enterprises carried on by or under the control of Lees have ceased to be distinct from enterprises carried on by or under the control of Glynwed.

6.3. We have taken supply of H & T strip in the United Kingdom to consist of the supply of H & T strip by a manufacturer to a customer who uses the strip to manufacture specialised products. We have included imports in this definition. Glynwed's acquisition of Lees raised its share of the supply of H & T strip in the United Kingdom. On Glynwed's estimates of the United Kingdom market, the combined Firth/Lees supply of H & T strip in 1988 was 84 per cent of total United Kingdom supply of H & T strip. Based on other United Kingdom manufacturers' figures for supply given to the Monopolies and Mergers Commission the combined Firth/Lees supply was 69 per cent (by volume) in 1988, amounting to 4,258 tonnes, and 64 per cent by value. Even if the definition of supply were widened to include some 2,300 tonnes of strip hardened and tempered by customers before conversion into end-products, the combined Firth/Lees share of total supply would have been 50 per cent in 1988 and therefore well above the 25 per cent required to satisfy the market share test. We therefore conclude that the condition described in section 64(2) of the Act is satisfied in respect of the supply of goods described in the reference and that the result specified in section 64(1)(a) has occurred. In accordance with the terms of the reference, this conclusion excluded any question of considering whether the assets test was satisfied.

6.4. We therefore conclude that a merger situation qualifying for investigation has been created. We have therefore to investigate and report on whether the creation of that situation operates, or may be expected to operate, against the public interest. Having regard to all the circumstances, and in particular to the nature of the supply of goods in the reference, we thought it right to concentrate our attention on the supply of H & T strip in the United Kingdom.

## **Background**

6.5. The hardening and tempering of steel involves heating cold-rolled steel to specified temperatures and quenching in liquid to improve its hardness and toughness. Strip to be hardened and tempered must have a content of at least 0.25 per cent carbon. H & T strip is not wider than 500 mm in the United Kingdom and can be as narrow as 4 mm. Most H & T strip is used to manufacture products such as saws, hand tools, cutting blades, springs and valves. Some is used with minimal further processing as cutting, scoring or scraping tools. Reflecting the variety of uses for H & T strip there is a wide range of combinations of width, thickness, hardness and toughness, as well as different proportions of carbon content, differing standards of polishing and dressing of edges, and possible addition of nickel and other alloys into the strip.

6.6. Total world production of H & T strip is not known but estimated output of the main producers in Western Europe, Sweden, the United States of America, Brazil and Japan is 146,000 tonnes per annum. The estimated total production of H & T strip by United Kingdom firms in 1988 was 12,500 tonnes, of which 6,739 tonnes were exported. Firth's share of the sales of H & T strip in the United Kingdom in 1988 was 58.4 per cent by volume, and Lees' was 10.7 per cent by volume. The combined share of 69.1 per cent represented 4,258 tonnes. By value the share was 63.5 per cent. In 1988 an estimated 560 tonnes of H & T strip were imported into the United Kingdom, mainly from France, Germany and Sweden, representing 9 per cent of the market by volume. Other United Kingdom suppliers accounted for 22 per cent. In 1988 Firth had exports of 5,144 tonnes and Lees 1,303 tonnes.

6.7. In 1988 Glynwed's total turnover in all products was £840 million and operating profit £87 million. The Steel and Engineering Division's turnover was £247 million and profit £22 million. Firth's United Kingdom sales of H & T strip were £3,827,000 and profit £398,000, representing 0.46 per cent of total Group turnover. Lees' total turnover in 1988 was £21,583,000 and operating profit £3,685,000. United Kingdom sales of H & T strip provided £769,000 turnover and £89,000 profit, representing 3.6 per cent of Lees' total 1988 turnover. Glynwed referred to the very small proportion of Lees' turnover accounted for by H & T strip; moreover, H & T strip was the least profitable of all Lees' products, with the lowest value added.

## **Glynwed's reasons for the merger, and intended modus operandi**

6.8. Glynwed's motivation for the merger did not lie in Lees' sales of H & T strip, as we explain in paragraph 6.23. Its main interest in Lees was in its metal cutting bandsaw and bimetallic strip, which Glynwed did not manufacture and which accounted for 60 per cent of Lees' turnover. Glynwed told us that it is part of the general Glynwed strategy to keep operating units separate, and that Firth and Lees would continue to trade separately. Glynwed further argued that H & T strip prices would be unaffected by the merger. Glynwed also implied that the incremental market share resulting from the acquisition of Lees was small, and did not suggest that Glynwed's future competitive behaviour would be different from its past behaviour.

## **Adverse comments**

6.9. We received a number of adverse comments about the effect of the merger on the supply of H & T strip. Price rises were the most likely effect mentioned in our customer survey.

## **Competition issues**

6.10. It seemed to us that there were four main issues affecting competition: hardening and tempering of steel strip by customers, competition from other United Kingdom suppliers (and stockholders), competition from imports, and competition in the market for finished products (including imports of finished products) where a significant degree of competition would put pressure on Glynwed's customers to resist any excessive price rises for H & T strip.

## **Hardening and tempering of strip by companies**

### *Coil processing*

6.11. Glynwed argued that market share figures were misleading, because some companies (potential customers) choose to harden and temper untreated steel at the strip stage or the finished product stage. If Glynwed put up prices its customers could harden and temper at the strip stage, either in-house or through a subcontractor. About 2,000 tonnes of steel strip were coil processed (ie before conversion into end-products) by companies in-house in 1988. The minimum economic throughput for an in-house coil processing plant is in the region of 100 tonnes per year. We estimate that there are about 20 firms which purchase this amount of H & T strip, so that at least 100 firms would not have sufficient H & T strip requirements to make in-house coil processing economic. In addition to the 2,000 tonnes coil processed directly by companies, there were under 300 tonnes of subcontracted coil processing in 1988. Three hundred tonnes is only about 5 per cent of the total United Kingdom market for H & T strip. In our customer survey we asked whether untreated strip was an acceptable alternative to H & T strip in the sense that customers could themselves harden and temper at the coil stage. Of the 47 respondents to this question, none thought that it was.

### *Batch processing*

6.12. Glynwed also argued that customers had the alternative of batch hardening untreated strip to make their products. Glynwed said that there was no confidential know-how involved in the batch hardening and tempering process (other than is provided by the plant supplier) and plant could be bought off the shelf by any user of carbon steel strip to harden and temper should he so desire, that the cost of installing capacity is not high, and that customers had the option of using batch hardening subcontractors. However, the batch processing of products manufactured from untreated steel is an alternative to the purchase of H & T strip for some products only (see paragraphs 6.17 to 6.22). Some respondents to our survey said that they undertook batch processing. The smallest throughput of the in-house batch processors was 80 tonnes per year. As with coil processing this would rule out most H & T strip customers we estimate that over 100 would not have this required throughput. Of the 47 respondents to our survey question, nine firms said that the cost of batch processing, either in-house or through a subcontractor, was too high. Thirty-two said that their finished products were not suitable for batch processing.

## **Other United Kingdom supply**

6.13. Glynwed argued that competition was available from other United Kingdom suppliers. We noted that according to its competitors their supply in the United Kingdom in 1988 was 1,344 tonnes. This was five times the estimate given to us by Glynwed. Estimates given to us indicate that capacity in the United Kingdom is being increased. Although Glynwed considered that there were unlikely to be new entrants, there are no institutional or regulatory barriers to firms entering the market for the supply of H & T strip. One United Kingdom manufacturer offers the service of subcontracted hardening and tempering on plant used for its own production of H & T strip. Minimum orders can be as low as 25 kilos. Glynwed gave us a list of 18 firms which offer a batch processing service in the Midlands and Northern regions. There are three United Kingdom firms known to stock H & T strip. The estimated value of their sales in 1988 was about £300,000. There are also sales offices set up within the United Kingdom by overseas suppliers.

### *Imports*

6.14. Glynwed argued that H & T strip supplied by Firth and Lees could be obtained from continental European sources at equivalent net delivered prices and that, especially as a result of excess capacity in Western Europe, competition from imports was likely to increase. We noted that imports over the last five years had remained static at about 10 per cent of the market and that a substantial proportion had been in specialised areas not covered by Firth/Lees. Some customers referred to the higher prices of imported H & T strip. However, one of Glynwed's major customers in the hand tools

sector said that it could import H & T strip and saw no effect from the merger. Two French H & T strip manufacturers have recently established themselves as stockholders in the United Kingdom. A Swedish manufacturer also holds stocks. One of Glynwed's major customers told us that the French and Swedish companies' representatives make frequent calls. A German supplier has recently appointed a full-time United Kingdom representative.

### **Competition for finished products**

6.15. We received evidence that United Kingdom manufacturers of hand tools have faced substantial and increasing import competition in the last few years which puts pressure on them to obtain competitive input prices. Glynwed argued that this applies to the range of finished products. In paragraphs 2.40, 2.41 and 2.43 we noted the examples of power woodsaws, hand woodsaws and cutting knives and blades, where pressure on end-product prices may translate into pressure from customers for competitive prices for H & T strip.

### **The strength of competitive pressure**

6.16. Having considered competition in the supply of H & T strip in the United Kingdom it seemed to us that larger customers might be able to withstand any future attempts by Glynwed to increase prices excessively. Such customers could have recourse to in-house coil processing or, for appropriate end-products, batch processing. They could also obtain alternative supplies both from the United Kingdom and abroad. Smaller customers, however, might have more difficulty. For Firth/Lees' customers as a whole, 81 per cent by number accounted for only 16 per cent by value of purchases in 1988. One hundred and two out of a total of 126 customers each had purchases of less than £50,000 and, of those, 90 spent less than £20,000 each. Such customers were under-represented in the response to our customer survey.

### **End use of H & T strip**

6.17. We examined in detail the end use of H & T strip in the United Kingdom, based largely on Glynwed's original estimate of market size. Details are given in Chapter 2 (Table 2.4). (For reasons stated in paragraph 2.34 the estimates for the Firth/Lees share of individual sectors may be too high.) We have divided this business into three categories. In the first category there were five product sectors in which we believe the merger would have little effect, because the merger increased the combined market share of H & T scarcely, or not at all. These sectors were: automotive products, printers' rule, doctor blade, lawn-mower blades, textile industries. In total in 1988 H & T strip sales to these markets were estimated to be £2.4 million.

6.18. A second category consisted of band woodsaws and hand tools with H & T strip sales estimated at £1.2 million. In this category there was a substantial increase in market share brought about by the merger but imports were competitive. The market share for band woodsaws went up from 29 to 57 per cent. Imports, however, provided the whole of the remaining 43 per cent in 1988. A major Firth/Lees customer, who accounted for more than half of the Firth/Lees business in this area, said that in the very recent past imports from France as well as Sweden had become highly competitive on both price and quality. Sales of H & T strip for band woodsaws were estimated to be £887,000 in 1988.

6.19. For hand tools, with H & T strip sales of £355,000 in 1988, the merger increased Glynwed's share (based on 1988 supply) from 65 per cent to nearly 100 per cent. One of Glynwed's major customers in the hand tools sector said, however, that it could import H & T strip and that it saw no effect from the merger. Batch processing is also used by some firms in this sector.

6.20. The remaining, third category comprises products where the merger brings about some increase in market share, in some instances up to 100 per cent on Glynwed's estimation, where batch hardening is possible only in some cases and where competition from imports has been minimal. Total sales of H & T strip to this category were worth an estimated £1.5 million in 1988.

6.21. Of this total we estimated that £832,000 related to products springs and presswork, and cutting knives and blades where market share increased significantly and batch processing was suitable only for some products.

6.22. A further estimated total of £687,000 related to items where Glynwed's acquisition of Lees significantly increased its market share for products power woodsaws and hand woodsaws where batch processing was not used in the United Kingdom, although Glynwed told us of a firm in the USA which batch processed hand woodsaws. There is evidence that in the markets for both these end-products there is considerable competition from imports which translates into competitive pressure on H & T strip.

### **Arguments for the merger**

6.23 The main benefits of the merger as a whole were seen by Glynwed as lying not primarily in H & T strip but in the development and increase in product range of its specialist steel strip business. Glynwed was particularly interested in Lees' metal cutting bandsaw and bimetallic strip, which were not the focus of our reference. The merger would allow Glynwed to compete effectively in the world market for this specialist steel strip. There would be benefits in purchasing, in the pooling of technical expertise to improve manufacturing efficiency, in a reduction in selling and distribution costs to allow further penetration of export markets, and an expected increase in employment. These arguments applied also to the narrow area of H & T strip. Glynwed told us that the merger would not reduce customer choice; production would continue in the present Firth and Lees factories with their existing autonomy and brand names. One stockholder saw the merger as increasing the combined firm's ability to compete with H & T strip imports. A suggestion by customers in favour of the merger was that the combined firm would be able to compete effectively in the market for thin H & T strip (below 0.25 mm thickness). Both the British Independent Steel Producers Association and the Iron and Steel Trades Confederation were in favour of the merger.

### **Conclusions**

6.24. The merger took Glynwed's share of H & T strip supply in the United Kingdom from 58 per cent to 69 per cent (by volume) and from 53 per cent to 64 per cent (by value). We examined what we saw as the main competition issues. Excessive price rises could make it increasingly worthwhile for larger customers themselves to harden and temper at the strip and, where appropriate, the finished product stages. On the other hand, as we noted in paragraphs 6.11 and 6.12, the ability for smaller customers to harden and temper is strictly limited. As to competition from other United Kingdom suppliers, we note that three other manufacturers had 22 per cent of the market by volume. There are also stockholders. There is also one firm which offers a strip processing service, and many firms which offer batch processing services. There are therefore alternative sources of supply of H & T strip to a fair degree. Imports of H & T strip have not increased much in volume in recent years, and are largely of higher-value, fine strip. Nevertheless H & T strip capacity abroad, accompanied by an expected increase in, in particular, European trade, suggests that the potential exists for imports to the United Kingdom to increase if Firth/Lees acted uncompetitively. We noted that in some products, notably hand tools, pressure on H & T strip prices is also imposed by competition (including imports) at the finished product stage. We also noted that United Kingdom producers are competitive in overseas markets, and the argument by Glynwed that the merger would assist exports.

6.25. Our analysis (paragraphs 6.17 to 6.22) of sectors of supply in the United Kingdom suggested that H & T strip sales of £2.4 million were unaffected by the merger because the acquisition of Lees scarcely altered Glynwed's market share. In two sectors, representing a further £1.2 million where market share increased significantly as a result of the merger, there was evidence that imports were regarded by major customers as competitive. We felt some concern about the remaining sectors, representing some £1.5 million of sales. The larger part of these showed a significant increase in market share but there remained at least for some customers the alternative of batch hardening by themselves or by subcontractors. The remainder, representing £687,000 of sales in 1988, concerned two types of woodsaw where market share increased significantly but where batch processing was not used in the United Kingdom although we were told that an American firm used batch processing for hand woodsaws. We felt some concern for small customers, some of whom had told us that even before the merger the market was weakly competitive on price. However, we conclude that the possibility of monopolistic abuse in some very limited areas is sufficiently offset by the potential for smaller H & T customers to obtain more material from United Kingdom and other sources, using, for example, stockholders and the United Kingdom sales offices of continental European suppliers, if Glynwed were to raise prices excessively. Furthermore, we noted that the end-product markets for hand woodsaws, power woodsaws and cutting knives and blades were competitive and could be expected to exert some pressure on H & T strip producers to offer that material at competitive prices.

6.26. We conclude that the merger between Glynwed and Lees does not and may be expected not to operate against the public interest.

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