4 The views of the main parties

4.1. Coats and Tootal gave written evidence to the Commission in a number of joint submissions. A separate hearing was held with each company followed by a joint hearing.

Background to the proposed merger

4.2. In 1984 and 1985 Mr Abraham Goldberg of the Australian Entrad Corporation Ltd built up a 29.9 per cent shareholding in Tootal and in 1985 made a full bid for the company. This was strongly contested and eventually rejected by Tootal's shareholders. Mr Goldberg and another Entrad director were subsequently invited to join the Tootal Board and in exchange Mr Goldberg agreed not to make a further bid for the company for two years and not to sell his shares without the consent of the Tootal Group Board. Mr Goldberg sold his shareholding in late 1985.

4.3. The parties told us that the possibility of a merger between them had been discussed on a number of occasions in the past. Towards the end of 1987, Coats initiated tentative discussions with Tootal on the possibility of a merger. Coats also told us that over the last few months of that year the company built up a 3 per cent shareholding in Tootal which it increased to 4.9 per cent by the spring of 1988. But the tentative discussions were not pursued by Tootal, which had a new management team and was only part-way through its strategic development plan.

4.4. By the middle of 1988 Tootal's restructuring was virtually complete. But, the company told us, it still faced difficulties as its activities were widely spread and lacked the necessary scale fully to support the high fixed costs of a truly co-ordinated international network. Nor, in Tootal's view, could it maintain adequate levels of research and development expenditure to keep up with the adoption of advancing technology by its competitors world-wide. Tootal accordingly began to explore possible alliances. Discussions took place with a possible European partner but proved abortive.

4.5. Towards the middle of 1988, discussions recommenced between Tootal and Coats, which had itself been entertaining a possible merger with a European partner. Both Tootal and Coats were convinced of the commercial logic of a merger between them and also of the need to be of one mind on the future strategy of the merged concern. Whilst these discussions were being pursued, Mr Abraham Goldberg announced that he had acquired a 9 per cent shareholding in Tootal (which he subsequently increased to 25 per cent). He proposed that Tootal should merge with his Australian interests on terms that would give Mr Goldberg a controlling 51 per cent interest in the resulting group. This proposal was rejected by the Tootal Board.

4.6. After his proposal had been turned down it became apparent that Mr Goldberg was a willing seller of his shareholding, at a suitable price. On 11 May 1989, the Boards of Tootal and Coats reached agreement on the terms of a merger and the following day Coats acquired Mr Goldberg's shareholding. This, together with the shares already held, gave Coats a 29.9 per cent holding in Tootal. On 7 June 1989 the terms of the recommended offer were sent to shareholders and on 26 June the proposed merger was referred to the Commission.

The merger in being

4.7. At present, pursuant to the order made by the Secretary of State at the time of the reference to the Commission, Coats is precluded from exercising 15 per cent or more of voting rights in Tootal. The parties told us that since Coats acquired its 29.9 per cent interest in Tootal there had been consultation and co-operation between them, specifically on the recommended offer to the shareholders of Tootal and the issuing of the Offer Document, and the preparation of joint submissions to the respective competition authorities in the United Kingdom, USA, EC and various other jurisdictions. There had also been limited exchanges of financial and related information at Board level. Representation by Coats on the Tootal Board had been neither sought nor offered. There had been no attempt by Coats to influence or control the affairs of Tootal.

4.8. The parties were asked about the position that might arise if the merger were not to proceed and Coats, contrary to its present intention, retained its shareholding in Tootal. Tootal said that in those circumstances it would expect to receive, and to agree to, a request from Coats for Board representation. Both parties accepted that this situation would enable Coats materially to influence the policy of Tootal. But Tootal told us that this would not, in its view, amount to control.

4.9. Tootal argued that there had always been considerable fragmentation of its share register. The institutional shareholders held shareholdings of between 0.5 per cent and 3.0 per cent each, and the composition of the register was such that approximately 75 per cent of the issued share capital was held in holdings of 100,000 or more and was registered in approximately 250 different names. Tootal also told us that the historical voting patterns displayed by Tootal shareholders at Annual and Extraordinary General Meetings showed that the Board of Directors exercised full control over the company. The votes cast by proxy in favour of various resolutions at recent AGMs and EGMs and votes cast in person at meetings had shown overwhelming support for the decisions of the Board.

4.10. Coats told us that if the merger were not allowed to proceed the company would be likely to dispose of its shareholding in Tootal. Coats also confirmed its intention to renew its offer for the rest of the Tootal shares if the merger were found not to be against the public interest.

The merger in contemplation

4.11. Coats and Tootal told us that, by bringing together two groups with complementary skills and portfolios in both geographic and product terms, the proposed merger provided major opportunities internationally for improved marketing, production and supply of products, which would make the merged group a more effective competitor internationally, in particular with the large Japanese trading houses. The parties intended to develop further their international business in specific product areas capable of capitalising on linkages across the world between the various stages of production through to final markets. This would be combined with adding value, in marketing, design and in fast response technology and systems, initially focused on the developed markets, but with increasing penetration of the developing markets.

Coats

4.12. Coats told us that its overall supply strategy was to maintain a presence at each stage of textile production. This strategy, it believed, was the best way to enable Coats to understand and respond to the rapid rate of change in textile markets and in the competitive environment and technological advances. Coats did not itself produce all its requirements at every stage of production so that a certain amount of buying in took place at each production stage. Coats said that the group invested in modern production technology appropriate to its supply strategy though this was at its maximum in production stages closest to the final customer as these had the highest added value. This, Coats said, gave it more weaving than spinning capacity and more finishing and dyeing than weaving; maximum capacity was in facilities for making up products. Coats said that its capital investment in the United Kingdom had increased from some £46 million in 1986 to some £57 million in 1988 and that it had invested heavily in areas of high unemployment. Coats considered that its consequent structure was unusual compared with most other United Kingdom or international textile companies which concentrated mainly on one stage of production.

4.13. The company told us that the proposed merger represented the logical continuation of its current overall strategy as it had developed from the strategy that led to the 1986 merger between Vantona Viyella and Coats Patons. That merger brought together a group (Vantona Viyella) having broadly-based textile interests that were largely confined to the United Kingdom, with another (Coats Patons) having an extensive international presence. The proposed merger would take this process further through the complementary nature of Coats' and Tootal's products, geographic representation and skills so as to create a United Kingdom-based textile and clothing group of a scale able to hold its own against established global competitors. In particular Coats saw the merger as a means of:

— achieving lower costs and increased efficiency in its international thread business through the integration of the two groups' widely-spread operations throughout the world;

— gaining better representation in China and other parts of the Far East (where Tootal had a more established presence) which constitute the focal point for growth in textiles in key product areas, not only as export producers of what are largely commodity textiles, but also as local markets with longer-term growth opportunities;

— widening the scope of relationships and scale of operations in international sourcing, where Tootal had developed a range of flexible controlled sources for intermediate and finished products which were complementary to those established by Coats;

— gaining access to an additional pool of personnel skilled in international textiles, who were in limited supply; and

— by reason of the greater scale of the merged group's operations, increasing the capability for, and reducing the risks of, investment.

Tootal

4.14. Tootal told us that the merger of the three companies into the present Group in the 1960s (paragraph 3.46) was intended to produce a greater degree of vertical integration so as to strengthen the combined Group's position at all levels of production. By the late 1970s the Group had come to the view that this strategy was misconceived. The Group had found it lacked the flexibility to deal with the problems it then faced, notably rising competition from imports. Accordingly Tootal told us that throughout the late 1970s and early 1980s the Group undertook a major programme of rationalisation designed to change from a strategy of producing basic textile products to one concentrating on higher added-value products and exploiting the Group's international network of, in particular, thread operations.

4.15. Tootal told us that the proposed merger represented the means of achieving its own strategy of internationalisation and of overcoming the hurdles that it currently faced in achieving its objectives. In particular, Tootal was widely spread and lacked the scale necessary to support the high fixed costs of a truly co-ordinated international network in its key products: thread, fabric, clothing and specialised materials. Tootal was also hard pressed to maintain adequate levels of research and development to keep up with the adoption of advancing technology by its competitors world-wide. This advance was across much of its portfolio, in design, manufacturing and customer response. Moreover, Tootal considered that its geographic balance meant the company was overexposed to movements in the United States and United Kingdom markets, and such movements were likely to affect it both directly and indirectly. At the same time, the company had a number of gaps both in the broad skill base necessary to exploit its strength in the markets, and in its international sourcing and distribution network. Tootal said that, in all these respects, the proposed merger would permit the company's capabilities to be better exploited within an enlarged group with the resources to invest in technology, development and advanced equipment for design and manufacturing so as to enable it to compete still more effectively in the international markets.

Plans for the merger

4.16. The parties outlined their plans for the merged company in a number of areas.

Strategy

4.17. Most of the businesses of the merged group would have international competitors and so would be run on an international basis. Other businesses would have greater geographic focus, but would be capable of utilising international sourcing opportunities. The merged group would be largely a textile company operating in high value-added sectors, with geographic balance providing a means for reducing the impact of the cycles of demand. Management would need to concentrate the group on its core business. The Boards of the two companies were committed to agreeing and setting in motion a cohesive strategy for the merged group within six months of the merger taking place.

Management

4.18. The prime responsibility for day-to-day management in the market-place would lie with operating units, including balance sheet and profit and loss responsibility. Operating units would be grouped within strategic business units (SBUs) which would be formed on the basis of a similar customer profile, a similar access to markets and a similar set of competitors. These SBUs would be the major focus for formulation of strategy. The managing directors of the operating units, in addition to being fully accountable for the performance within their units, would usually be members of their respective SBU boards, thereby being actively involved in setting the strategy and agreeing investment decisions and so on for the SBU as a whole. In principle there would be no further layer of management between the SBU and group management.

Rationalisation

4.19. There would be immediate opportunities for improving the returns of the business as a whole through the elimination of duplicated overheads, both centrally and within overlapping business areas, primarily in thread. Most of these overheads were non-manufacturing. There would also be the potential in the medium term to derive benefit through reorganising specific plants to concentrate production on specific products. At present, a number of the businesses were not internationally competitive and did not achieve adequate returns; the future of such businesses would be considered carefully during the strategy reviews after the merger.

Investment

4.20. A prime objective of the merged group would be to improve its cash-generating capability through improving returns and better management of working capital. This would enable the group to invest in modern capacity so as to be able to stand up to world competition. The two individual groups had invested heavily in the past few years but there had been significant investment over a much longer period by German, Italian, Japanese and Far Eastern manufacturers. The pace of technical change in terms of reducing response times and of significant improvements to quality requirements was accelerating. The cash flow improvements resulting from the merger would assist the businesses to keep abreast of these changes.

Expansion

4.21. Both groups had long-term expansion projects which would inevitably take time to come to fruition. These related either to introducing existing products, such as home furnishings and major clothing brands, into new markets, the initial targets being Europe, North America and Japan; or to developing new and related products in existing markets, largely associated with improvements in quality and service, for example in fabric supplied to the United Kingdom garment industry and in garments supplied to United Kingdom retailers. In particular, the merger would help to secure the success of projects already planned, such as the Tootal fabric finishing joint venture investment in Dundee.

Benefits of the merger

4.22. Both companies told us that the major United Kingdom-based international textile organisation that would be created by the merger would be better able to compete effectively throughout the world. They said that previous attempts in the 1960s and 1970s to rationalise the United Kingdom textile industry to create companies vertically integrated through from spinning to finished products had been unsuccessful. Coats and Tootal believed that today the most effective structure for a successful international textile organisation depended not on full vertical integration but on flexible integration combining external sourcing of low-cost materials with high added value in the United Kingdom and other developed countries. That required an extensive geographic spread to enable sourcing to be effected flexibly and the proper degree of control to be maintained over sources of supply. It also required substantial levels of downstream investment in the know-how, technology and plant required for the high added-value activities.

4.23. The proposed merger would permit these objectives to be realised. Because of Coats' and Tootal's complementary geographic spread the merged group would have the necessary comprehensive coverage of all major textile countries. The companies believed a strong local presence and intimate local knowledge were crucial for effective international sourcing, particularly in the developing countries. For example, Tootal maintained that it would have been unable to contemplate its recently-established blouse manufacturing venture in Malaysia had it not already had extensive local contacts through its presence as a thread manufacturer. Local presence was equally important in maintaining the quality of the sourced product, which required direct monitoring and control of each stage in the production process.

4.24. Dealing with the specific product areas in which they both operated the parties told us that in garments they would have a combined United Kingdom market share of 5 per cent. They considered that there would be opportunities to increase manufacturing efficiency and reduce overhead costs through rationalisation of the merged concern's activities in this area. Moreover, the garment operations should benefit from the improved and more closely controlled fabric supply made possible by the merger.

4.25. In fabrics the merged group would have a combined United Kingdom market share of 7 per cent. The parties believed that fabrics was a sector where United Kingdom suppliers had lost their position in world-wide competition, largely due to their failure to move up market, and had been replaced mainly by continental European and Japanese competitors. The parties said that the combined group could offer United Kingdom fabric customers improvements in quality and response time in high value-added areas to help them move back up market.

4.26. In household textiles Tootal and Coats pointed out that they operated in different sectors with a combined United Kingdom market share of 17 per cent. They said that there would be modest opportunities for increased efficiency through rationalisation of overheads, and enhanced marketing opportunities.

4.27. In non-woven fabrics Tootal had a United Kingdom and international business and Coats had no United Kingdom activities. The parties believed that the merger was likely to increase opportunities for investing in growth in selected sectors. For example, they said that there might be opportunities for further international expansion of production of fabrics for medical uses, based upon Tootal's recent United Kingdom investment in this field.

4.28. In sewing thread, the integration of the two groups' activities world-wide would, they said, make possible significant savings in the costs of manufacture, distribution, working capital and overheads. In the United Kingdom it would be possible to rationalise production without reducing product range, by specialisation of particular activities at particular plants so as to increase efficiency and reduce working capital requirements. Rationalisation would also be possible in distribution and administrative and support activities. Larger improvements in efficiency would be available in overseas markets where both groups had operations, while in markets where neither was present the merged group would be better placed to effect penetration (for example, in the emergent thread markets of Central America and parts of South-East Asia). Overall, the parties thought that the complementary geographic spread of the two groups would bring about a more comprehensive coverage, Coats having specific strengths in South America, Southern and Central Europe and India, where Tootal had little or no position, and Tootal being well established in the Far East, North America and Scandinavia.

4.29. A further benefit the parties saw in merging their thread operations would be through optimisation of the merged group's world-wide grey thread sourcing facilities. Their merged thread operations would also make more widespread and effective use of technology so that the merged concern could make more rapid, and more effective, progress, particularly in the areas of colour physics; new thread dyeing technology, new continuous filament thread developments and better lubrication methods.

4.30. In industrial trim the companies pointed out that the merger would bring together Coats' zip interests with Tootal's interlining business in a common distribution system offering industrial customers a comprehensive range of trim products, and would enable the merged group to increase the quality of service to its customers. In consumer craft there would be scope for rationalising distribution, reducing costs and increasing the level of service to retailer customers.

4.31. The parties also argued that another benefit of the merger would be a more soundly- based United Kingdom textile industry. They pointed out that some 25 per cent of their combined United Kingdom sales (excluding non-textile sales) constituted sales of input materials to other United Kingdom manufacturers. By enabling the merged group to increase its efficiency in fabric sourcing, fabric finishing and dyeing, and in the supply of thread and industrial trim, the proposed merger would assist these customers in achieving quicker response rates. The parties also believed that the enlarged group, with its commitment to quick response and to techniques such as team working, should constitute a catalyst for change towards the quick response concept in the United Kingdom industry as a whole. Moreover, the more effective international sourcing that the merger would make possible would help to make those customers more competitive.

Effects of the merger on competition

4.32. The parties told us that the only areas in which, in their view, the merger's effect on competition would need to be considered were in industrial trim and consumer craft products; specifically industrial thread and domestic sewing or consumer thread. In other product areas where both Coats and Tootal were active they said that their respective activities were largely complementary, market shares were low and there was substantial existing competition, including extensive international competition.

Industrial thread

4.33. On the basis of 1988 sales the combined United Kingdom market share of the merged concern in industrial thread would be 42 per cent (Coats 18.6 per cent and Tootal 23.6 per cent). But in the view of the parties there were a number of factors denying such a market share any real market power. They pointed in particular to the many existing effective competitors both producing in the United Kingdom and importing from overseas who offered comparable quality, range of product and service. The United Kingdom producers included successful United Kingdom companies such as Oxley as well as subsidiaries of major overseas suppliersDMC and American & Efird. In addition other European suppliers were becoming increasingly active in the market: Belgian Sewing Threads of Belgium and Amann of Germany (which had recently appointed a United Kingdom agent)both of them using low-cost grey thread from international sources. There were also other Far East-based suppliers, such as Gunzetal, which were active in the United Kingdom. The parties further argued that it would be feasible for these and other suppliers to meet a significant part of any customer's requirements through imports. They instanced Tootal's present arrangements to supply thread to the important Portuguese market.

4.34. Secondly, the parties said that their customers could, and did, dual or multiple source their thread supplies, were sensitive to thread costs and had, and would continue to have, a more than adequate choice of alternative suppliers. The parties believed it was likely that one consequence of the proposed merger would be that customers would switch part of their requirements to other suppliers so as to maintain multiple sourcing, and so would reduce the merged group's market share. The parties also pointed to the availability of spare capacity among existing suppliers to meet such demand and to provide a safeguard against anti-competitive behaviour by the merged group. The parties provided us with their detailed estimates of this spare capacity.

4.35. A third factor which, in the parties' view, would limit the effect of the merger on competition in the supply of industrial thread was the low barriers to new entry into this industry: low-cost thread could, they said, be imported as finished product; there was extensive grey thread production capacity world-wide; costs of investment in dyeing and finishing in the United Kingdom need not be great and were likely to decline with newer technologies. The parties also pointed to the ease of entry by acquisition of United Kingdom companies as in the case of DMC and American & Efird.

4.36. Fourthly, the parties believed their world-wide position in industrial thread (with an estimated combined market share of 16 per cent) brought with it no additional market power in the United Kingdom. The two groups' world-wide positions represented, they said, the aggregation of sales in a great many individual countries, in each of which they were subject to effective actual or potential competition.

4.37. In all these circumstances the parties believed that the proposed merger would not be expected to reduce the effectiveness of competition in the supply of industrial thread in the United Kingdom.

4.38. We also put to the parties a suggestion by a third party that the merger would be anti-competitive in that in operating a world-wide network of companies Coats would, for example, be able to use Tootal's source of very cheap Chinese grey thread to undercut other United Kingdom suppliers of thread to whom this source was not available. In response the parties told us that Tootal's source of grey thread from their existing joint-venture plant and that under construction in China was fully committed to Far East markets and was not imported into the United Kingdom. They also said that other United Kingdom suppliers had access to and made use of sources of grey thread at prices comparable to those applying to thread from Tootal's Chinese joint ventures.

4.39. The parties also commented on the supply of corespun thread (a polyester filament covered with cotton or spun polyester to give `sewability') much used by garment manufacturers. It had been suggested that the merged company would have 60 per cent of the United Kingdom market in corespun. The parties provided their own estimate for their 1988 market share which was slightly below this at 57 per cent (24 per cent Coats and 33 per cent Tootal).

4.40. The parties pointed to the many possible sources for this thread. International producers of grey corespun thread included American & Efird, DMC, Ti-Caro, Barbour, Lipasa, Saha Union, Frame, Wegberg, Schoeller, Otto, Leuze, BSU, Circeo, Legnano and the China National Textiles Import and Export Corporation. The parties also argued that corespun thread was not a separate market since corespun was, in their view, interchangeable with other threads in respect of virtually all its end uses and was, in fact, being widely substituted by garment manufacturers with, in particular, spun polyester. They gave as an example Hong Kong where spun polyester was introduced in 1974 by a competitor at prices about a quarter of the price of corespun. It was thought at the time that spun polyester could not match the sewability and quality of corespun. This belief had proved unfounded. Since that time, the parties told us, there had been considerable progress in improving the quality of spun polyester (not least by Coats and Tootal, who were progressively replacing their corespun sales with spun polyester) which had resulted in the virtual disappearance of corespun in Hong Kong.

4.41. We put it to the parties that some United Kingdom manufacturers, particularly garment makers, found it necessary to continue to use corespun, many having found substitutes unsatisfactory due to frequency of breakages in sewing and inadequate quality of the finished seams. The parties said in response that this was partly a tribute to the success of their sales staff in promoting corespun's undoubted technical advantages, especially when it was first introduced. They also said that some machines used in high-speed sewing in the United Kingdom were not as finely adjusted as those used elsewhere. The parties reiterated their belief that increasing use would be made of the cheaper polyester thread in the United Kingdom in the future and that in consequence their combined share of corespun sales would not adversely affect competition in the industrial thread market.

Domestic sewing thread

4.42. The parties agreed that as a result of the merger they would have a 55 per cent share of the United Kingdom market in this thread used mainly in the home for sewing. They pointed out that this thread was not manufactured in the United Kingdom and was imported along with other consumer craft goods; the thread came from the parties' respective overseas affiliates at, we were told, arm's length prices. The parties acted effectively as distributors and were in competition with many other distributors.

4.43. The parties told us that the merger should not result in a reduction in consumer choice of domestic thread. They intended that the merged group would continue to offer the range of consumer thread currently available. It was also their intention to continue to operate separate sales forces.

4.44. The parties also drew our attention to the distinction in the current market situation between branded and unbranded thread. In the supply of branded thread, there was effective competition from the Gütermann group, which operated mainly through 12 major wholesalers and which offered very competitive terms to both retailers and wholesalers. There was also the prospect of increased market penetration by Metrosene, the brand name of Amann, which was well established in other parts of the EC, as well as by American & Efird and by DMC which already had its Dunlicraft distribution subsidiary in the United Kingdom.

4.45. Coats has a 20 per cent shareholding in the Gütermann group (see paragraph 3.6) and we questioned the parties on the effect this might have on competition with the merged group in the United Kingdom domestic thread market. The parties said that there was strong competition for both Coats and Tootal from Gütermann in domestic thread and they expected this to continue after the merger.

4.46. The parties told us that branded thread was sold mainly through department store groups and specialist outlets, often from display cabinets which they supplied and kept stocked. But this market was under attack from the growth of sales of unbranded or promotional (`promo') thread which had already had a significant impact on the supply of branded thread. Although branded threads at present accounted for a high proportion of the market there was strong price competition from the unbranded threads and minor brands. `Promo' threads were principally made from spun polyester compared with the traditional cotton sewing thread, giving them a substantial price advantage. When they were first introduced, `promo' threads were only offered in a limited range of colours but this range had been extended as the sales of the thread increased. They had captured a significant share of the market in the United States and were making progress in West Germany, Denmark and Australia. The parties also told us that `promo' threads as a growth trade were attracting new suppliers seeking to enter the United Kingdom market.

4.47. In the light of the situation as they described it the parties believed that their 55 per cent combined share of the United Kingdom sales of domestic thread of some £10 million would not be economically significant. In particular they argued that this market was small, declining and highly contestable, and that therefore the merged concern would be unable to exercise any market power.

Consumer craft

4.48. The parties told us that apart from domestic thread and hand-knitting yarns there was very little overlap between them in consumer craft. Tootal's consumer craft business consisted of distributing a range of bought-in haberdashery items, such as zips, ribbons and buttons. This business overlapped with the craft business of Coats only in small sales of a variety of goods; zips, for example.

4.49. The parties also pointed out that about 25 per cent of Tootal's consumer craft business was accounted for by a single range of haberdashery items sold to Woolworths under the Sew `n' Care label. Woolworths constantly monitored performance of product categories within its stores and placed great emphasis on price, whilst at the same time providing an important benchmark for other retailers' prices.

4.50. The principal source of competition for both groups was the wholesale trade. The wholesalers were substantial businesses frequently offering a wider range of merchandise than the two companies. Apart from thread (and zips, pins and needles from Coats) the wholesalers tended not to purchase from either Coats or Tootal, but to compete directly with both for the custom of retailers. The parties contended that this ready availability of alternative sources of supply for retailers ensured that the merger would have no adverse effects on competition in the supply of consumer craft goods.

4.51. The parties suggested that the merger would have no adverse effect on competition in the supply of own-label hand-knitting yarns. Neither company was in direct competition with the other in hand-knitting yarns, so the merger would create no increased market power. Coats, whose hand-knitting yarns business was Patons & Baldwins, principally manufactured branded hand-knittings under the Patons, Jaeger and Copley names. Tootal, on the other hand, manufactured mainly own-label hand-knittings through its subsidiary, Greenwoods. The parties told us that the total United Kingdom market in hand-knitting yarns had declined substantially since 1986, contrary to industry expectations, falling from £300 million to about £230 million, of which the own-label share was about 10 per cent. As a result there was, in their view, substantial overcapacity in the knitting yarns industry generally with current United Kingdom balling capacity estimated to be approximately twice the level of demand. There was also extensive excess capacity elsewhere in Europe with a large number of alternative suppliers such as Sirdar and Emu and two privately-owned companies Ramsden and Spectrum. There were, in addition, a large number of smaller United Kingdom suppliers.

4.52. The parties assured us that they had no intention of ceasing to supply own-label products following the merger. The business was successful and Tootal had recently invested in order to provide a flexible own-label service to customers. There would be no advantage to the merged concern in ceasing to supply own label: own-label customers would be unlikely to increase their purchases of branded products.

Shirts

4.53. Coats and Tootal submitted that in this area there could not be any real concern about the increased market share of the merged group. They pointed out that the shirt market was heavily penetrated by importsby about 80 per cent according to DTI estimatesso that their share of something over 40 per cent of the United Kingdom shirt manufacturers' share of the market would not adversely affect competition. Moreover, competition was intense with much of the business being under contract to the large retail groups which exerted considerable pressure on prices.

4.54. The parties also argued that in branded shirts there could be no increase in market power as Tootal's only branded shirt business was in its Trutex childrens wear. Moreover, in the supply of contract shirts Tootal's business was entirely dependent on the long-run requirements of Marks & Spencer.

4.55. We put to the parties the concern of one of their competitorsa United Kingdom shirt manufacturerthat the merged group would have a very powerful position in the market for branded shirts (as opposed to the contract market of shirts made for the major retailing store groups). This competitor was particularly concerned that the merged group could use this position to redress any reduction in demand from its contract shirt customers by stimulating demand for branded shirts by pricing at very low levelspossibly lower than production costs. The competitor further alleged that Coats had previously done this on occasion. In response the parties pointed out that in their view the dominant pressure on shirt prices came from imports. The parties maintained that while their shirt prices had to be as competitive as possible in this difficult market, imported shirt prices were the key factor in determining their shirt- pricing policy. They also provided at the Commission's request detailed figures on the make-up of their production costs and their selling margins for both branded and contract shirts which they said refuted any suggestion that they had been selling at uneconomically low prices.

4.56. Coats and Tootal saw the following benefits arising from the bringing together of their shirts businesses:

— greater overall employment security through the transfer between the parties of technology and work practices such as team working and also through the sharing of broader sourcing skills and resources associated with the merger;

— the creation within the group of a reliable demand for shirting fabric which could support the investment made in shirting fabric production by Coats in Lancashire and by Tootal in Dundee, again assisting employment and the balance of payments; and

— the maintenance of a degree of skill and commitment to shirtmaking in the United Kingdom.

Effects of the merger on exports and imports

4.57. Coats and Tootal believed that the merger would operate to the benefit of the United Kingdom balance of payments. By improving the competitiveness of the United Kingdom production base in garments and fabrics, particularly through quick response principles and international sourcing of intermediate goods from the most competitive sources, the merger should reduce the level of imports of finished goods. The parties also believed that the merger should eventually lead to an increase in the level of exports and that, through the enhanced profitability of international activities resulting from the merger, the United Kingdom would also benefit from an increased flow of dividends and other remittances.

Effects of the merger on employment

4.58. The parties said that the proposed merger would create opportunities for rationalisation of the activities of the two groups, which would provide greater efficiency internationally and permit substantial economies to be achieved. The parties estimated that the net savings realisable would be substantial, greatly strengthening the merged group's ability to undertake the investments required to maintain and increase its competitiveness in the international markets in which it would be operating.

4.59. The parties told us that opportunities for rationalisation would arise primarily in the thread business and primarily overseas, where the two groups had duplicated facilities in a number of countries, with one or the other of them tending to have the more established presence.

4.60. The parties said that there would also be scope for rationalisation within the United Kingdom but the two groups were not at present able to formulate definite plans. But on the basis of current information they considered that the net reduction in the number of jobs in the United Kingdom as a result of the merger was likely to be around 500 out of a total United Kingdom workforce in the merged group of some 44,000. This reduction would take place over a period of two years. Natural wastage would be expected to account for much of that reduction, the balance being dealt with by way of redundancy. In relation to any particular measures proposed, the merged group would consult the appropriate trade unions, as had been the practice of each of the two groups in the past.

4.61. The parties told us that they believed the merger's greater long-term significance for employment in the United Kingdom was the fact that it would increase job security for the workforce of the two groups by creating a merged group that would be a more effective international competitor in its chosen product sectors, with greater resources for investment. Over time they expected that the merger would lead to the creation of new jobs particularly through the eventual substitution of imports and the creation of new export opportunities, especially to the rest of Europe. For Tootal, the merger would also remove the risk of a possible break-up of the Group, with consequent loss of jobs that might result if Tootal were to be acquired by an alternative bidder.

Possible remedies

4.62. We invited the parties to put forward views on possible remedies for any adverse effects which the Commission might consider to arise from the issues we had raised with them. Specifically on the industrial and domestic thread businesses we sought the parties' views on the possibility of divestment of the United Kingdom industrial and domestic thread businesses of Tootal, the divestment of the United Kingdom domestic thread business of Coats and the divestment of Coats' shareholding in Gütermann. We also invited the parties' views on a possible assurance or undertaking on the continued supply of own-label yarns and the possibility of divestment of part of the proposed group's shirt business.

4.63. The parties told us that they believed the proposed merger would operate to the benefit of the United Kingdom public interest, and that there would be no consequences of the merger that called for remedies.

4.64. On divestment of Tootal's industrial and domestic thread businesses, the parties considered that it would not be practicable to separate the whole of that business (ie English Sewing Ltd (ESL)) from the rest of the activities that currently comprised Tootal's international thread business, and any requirement for such a divestment would have far-reaching implications for the proposed merger.

4.65. The parties told us that some 42 per cent of ESL's production through its spinning, dyeing and finishing facilities was exported principally to Tootal's overseas thread subsidiaries. Neither the dyehouse nor the spinning mills could be considered economically viable if throughput were reduced by 42 per cent. Accordingly, any divestment that de-integrated the United Kingdom production units from the overseas Tootal thread businesses would be likely to involve the closure of those units. Whilst it would be possible for such a separate ESL to continue to operate, sourcing grey and finished thread from elsewhere, that would be at the cost of some 1,000 or more jobs in the United Kingdom. For example, if ESL were acquired by a United Kingdom company without international distribution capability sufficient to take up ESL's current exports, the most likely course of action would be for it to close the spinning mills and most of the dyehouse, buying in grey thread and using commission dyeing capacity within the EC. A few dyeing machines and the newer winding machines would probably be moved to a very much smaller operation somewhere in the United Kingdom to service ESL's United Kingdom requirements. If ESL were acquired by one of the companies which had international distribution capabilitysuch as American & Efird, DMC, Amann or Gunzetalit was unlikely that they would wish to substitute ESL's United Kingdom production for their current international sourcing. Such a purchaser would be more likely greatly to reduce the scale of ESL's United Kingdom production operations.

4.66. The parties considered that if, as an alternative, the merged group disposed only of ESL's brands and distribution operations, the mill and dyehouse facilities could not be maintained to service only their present export customers. Again, the United Kingdom production facilities would have to be closed and the export business supplied from elsewhere within the merged group.

4.67. The parties further took the view that disposal of ESL would be likely to give rise to substantial problems in relation to the brands that ESL currently used in the United Kingdom, as these were major brands (particularly Polyfil) used by Tootal internationally. A brand- licensing arrangement might be possible but it would be unlikely to be satisfactory either for the purchaser of ESL or for the merged group, since both would be free to supply, at least indirectly, under the same brand throughout the EC.

4.68. The parties told us that they believed Tootal's domestic thread business could only be divested along with Tootal Craft as a whole. Since this was a distribution business which relied on bought-in goods divestment was possible, but Tootal Craft was currently dependent for its supplies of domestic thread on Tootal's plant in Sweden. This in turn obtained the grey thread used for domestic thread manufacture from the Lisnaskea mill in Northern Ireland. If that relationship were to be continued with the new owners of the divested Tootal Craft business, it would need to be under a long-term supply agreement, the effect of which would be to leave the Tootal Craft business materially under the control of the rest of the merged group. If, on the other hand, the divested Tootal Craft were to source its thread from elsewhere (for example from France, if it were acquired by DMC), then that would put at risk the viability of the Swedish plant, and would also reduce the loading of the Lisnaskea mill, putting jobs at risk there. Moreover, if the divested business were to sell domestic thread under the Sylko brand, a licence for this purpose would be required, particularly if the name were to be applied to products from a different source (and possibly made to different specifications) as compared with the product marketed under the Sylko brand elsewhere in the world.

4.69. On disposal of Coats' shareholding in the Gütermann group the parties said that the company was already, and would remain, an effective competitor to the merged concern in the United Kingdom, particularly in the domestic thread market. Nevertheless the parties appreciated that while Coats remained a shareholder in Gütermann it might be said, in the parties' view mistakenly, that Gütermann would not be an aggressive and independent competitor. Coats told us that it had no objection in principle to disposing of its shareholding in Gütermann provided only that it was recognised that a reasonable time-scale would have to be allowed to effect the disposal. Coats' holding in Gütermanna family-controlled groupcould not be equated with a holding in the United Kingdom public listed company where stock was readily marketable. The parties said they were confident that such a disposal would dispel fully any remaining doubts that might persist about the degree of competition between the merged group and Gütermann.

4.70. Both parties told us that they regarded the possibility of divestment of Coats' consumer craft and/or thread businesses (and indeed the divestment of those businesses of either party) as considerably more draconian than concerns about the share the merged group would have of the United Kingdom domestic thread market warranted, particularly if Coats' Gütermann shares were to be disposed of. They had already indicated that it would not be feasible to dispose of Tootal's domestic thread business separately from the craft business as a whole, since thread sales formed so substantial a part of the total sales. In contrast, Coats told us that it had pursued a somewhat different strategy in relation to its own craft business which aimed to absorb the overhead costs of its distribution business over a much wider range of consumer craft products sourced from within the Coats group and from elsewhere. This was well illustrated by the fact that turnover from sales of domestic thread accounted only for some £1.8 million of the total turnover of £15 million of Coats' Leisure Craft business. Of this £1.8 million some £1.5 million was attributable to sales of two major United Kingdom brands, Drima and Supersheen.

4.71. In the parties' view it was more feasible to divest the Coats interests in domestic thread than those of Tootal, although it had to be recognised that those interests did not constitute a discrete business. The parties believed it would be unreasonable to require the divestment of the craft business as a whole, since the vast majority of it constituted products in respect of which there was no concern about the market share of the merged group. The parties suggested that disposal of the domestic thread part of Coats' craft business might be along the lines of:

(a) the grant of a long-term United Kingdom trade-mark licence to use the trade-marks Drima and Supersheen, but not Coats' name, in respect of the main domestic thread brands (although these brands were not utilised exclusively in the United Kingdom, it was not anticipated that licensing of the Drima and Supersheen brands in the United Kingdom would involve major EC problems);

(b) the disposal to the licensee of existing stocks of domestic thread, together with the retail display cabinets, normally supplied and stocked by Coats; and

(c) if necessary, conclusion of a supply agreement between Coats and the licensee, on an arm's length basis, at least for an initial period.

The result would be the withdrawal of Coats from cabinet thread sales, leaving the new operator as an effective competitor.

4.72. In addition the parties said that if they were required to dispose of the Coats domestic thread business along the above lines, it might be necessary to review the present intention to maintain separate consumer craft businesses within the merged concern, since that intention was in turn based primarily on the maintenance of separate domestic thread businesses.

4.73. On the possibility of an assurance or undertaking in relation to the continued supply of own-label yarns, the parties explained that it was their intention to continue in this business. Accordingly, although the parties believed that no adverse consequences to which such an undertaking need be directed would arise from the proposed merger, they would be ready to give such an undertaking subject always to economic viability.

4.74. In response to the Commission's suggestion of the possibility of divestment of the proposed group's shirt businesses, the parties said that the only relevant respect in which the merger would change the structure of the shirt manufacturing industry would be to combine Tootal's contract shirt activity with the existing Coats shirt businesses. Tootal's contract shirt business was entirely dependent upon the custom of Marks & Spencer so that there would be no effective increase in the merged group's market power. Moreover, any requirement for the divestment of the parties' respective shirt businesses would deprive the merged group of the opportunity of realising the benefits foreseen as arising from the merger (paragraph 4.56).