6 The views of third parties

6.1. We sought views from competitors of Gillette and Wilkinson Sword, the investment companies involved in the transaction, retailers, trade unions and consumer bodies. This chapter summarises the evidence we received in response to our enquiries, and comments received from individuals.

MANUFACTURERS

Warner-Lambert

Operations

6.2. Warner-Lambert manufactures pharmaceutical and consumer products in 130 countries. Its consumer products section includes over-the-counter health care, confectionery and wet-shaving products, the latter being marketed in about 50 countries under the Schick brand name. Warner-Lambert said that wet-shaving products accounted for about 10 per cent of its total sales world-wide. In the United Kingdom it has a 2 per cent share in volume terms. The company considered the United Kingdom to be a major wet-shaving market in Western Europe and it was planning to increase its market share. Warner-Lambert told us that its main customers in the United Kingdom were large multiples and because of the high concentration in the market it focused on these major key accounts which represented about 60 or 70 per cent of its total sales. It also sold to wholesalers which acted as distributors to small independent retailers. It did not sell to small retailers. It was the company's policy not to enter into own-label products because of the high investment capital needed. Warner-Lambert said that world-wide it competed with Gillette and Wilkinson Sword in all three segments of the wet-shaving market.

The market

6.3. Warner-Lambert said that the United Kingdom wet-shaving market, with three major competitors, was highly competitive. At present no undue pressure was put on suppliers compared with other markets. Barriers to entry were very high because of the existing consumer brand loyalty and it took a long time and high investment to enter the market. Warner-Lambert told us that the main factors affecting market share were the manufacturer's expenditure on advertising support and technological development. Strength in negotiations with retailers was also important as it was essential to obtain shelf space in the multiple stores. Warner-Lambert said that there was little movement between the wet- and dry-shaving sectors. Within the wet-shaving market consumer loyalty was less strong in the disposable segment. The double edge blades segment was decreasing because these were favoured mainly by older people. There were no noticeable regional differences in demand for different types of shaving product: preference appeared to depend on the age of the population and their disposable income.

The transaction

6.4. Warner-Lambert said that it was approached by Swedish Match AB early in 1987 about the purchase of the Wilkinson Sword razors business from Allegheny which owned it at that time (see Chapter

2). Discussions took place between the two companies, but after consideration Warner-Lambert found that the consolidation necessary between the two businesses would be very difficult and it decided not to make the purchase. When approached in 1989 about the sale by Stora, Warner-Lambert still did not consider the purchase to be strategically appropriate or commercially viable, and declined to put in an offer.

Public interest concerns and anti-competitive effects

6.5. Warner-Lambert believed that the transaction would have anti-competitive effects on the wet-shaving products market which would be detrimental to small-scale manufacturers and damaging to the interests of consumers. In particular Gillette's equity interest in and creditor relationship with the consortium would, it believed, result in Wilkinson Sword's products presenting less competition to those of Gillette in the United Kingdom and the rest of the EC. Warner-Lambert thought that this would be the inevitable result of the Wilkinson Sword business of the consortium being limited to the EC without the benefit of world-wide sourcing, production and R&D and distribution synergies. In addition, Warner-Lambert believed that Wilkinson Sword would have difficulty in competing aggressively against Gillette as its shareholder, creditor and `partner' in the United Kingdom and the rest of the EC and would be completely eliminated as a competitor to Gillette in markets outside the EC. Warner-Lambert saw the EC aspects of the transaction as part of a policy of global acquisition and control by Gillette of Wilkinson Sword.

6.6. Warner-Lambert thought that the transaction would restrict competition from Wilkinson Sword in the following ways:

(a) Gillette was likely to have access to confidential technological and commercial information of Wilkinson Sword which would enable co-ordination of the two companies' respective manufacturing and marketing strategies.

(b) Gillette might be positioned as a full range, higher price supplier and Wilkinson Sword as a limited range, lower price double edge and disposable supplier so that each would dominate separate sub-markets. Further, given its enhanced market share and greater resource base, especially outside the EC and USA, as a result of the transaction, Gillette would have greater opportunity than at present to set prices at predatory levels if it chose to do so, possibly by means of parallel imports from the non-EC/US Wilkinson Sword businesses it would have acquired.

(c) Gillette's and Wilkinson Sword's advertising schedules could be co-ordinated so that their respective advertising campaigns would not take place simultaneously, thereby avoiding any mutual detriment as regards advertising strategy.

(d) Gillette's and Wilkinson Sword's respective in-store promotions might be timed so as not to compete or interfere with each other.

6.7. Warner-Lambert thought that Gillette would be able to exert pressure on retailers, with the result that retail selling space and retail inventory currently allocated to other manufacturers would be withdrawn. It thought that the company's enhanced market power could also be applied in the sourcing of steel. Warner-Lambert said that razor blade steel was supplied by three main suppliers and Gillette already purchased more razor blade steel than any other wet-shaving products manufacturer. It feared that Gillette would be able to exert strong pressure on the steel suppliers' prices and supply schedules and would be favoured by the steel suppliers at times when razor blade steel was in short supply.

6.8. Warner-Lambert estimated that Gillette controlled between 60 and 65 per cent of all intellectual property rights relating to wet-shaving products and thought that this was likely to enhance Gillette's R&D capability and its ability to develop new products. Warner-Lambert gave examples of areas where it believed that Gillette could benefit by access to Wilkinson Sword technology and it was concerned that Gillette would integrate this technology with its own when future business incentives persuaded it to do so. Because of the nature of these technologies, it said, this integration by Gillette would go undetected until its effects were felt by Gillette's competitors, and ultimately by the consumer. Warner-Lambert was also concerned that the Wilkinson Sword R&D facility at High Wycombe might be closed.

6.9. Warner-Lambert also thought that the arrangements between Gillette and the consortium for the division of the ownership rights in the Wilkinson Sword trade marks and the related contractual arrangements co-ordinating their market conduct in respect of Wilkinson Sword branded products constituted a vehicle for co-ordination of the commercial behaviour of Gillette and the consortium, at least in relation to the Wilkinson Sword branded products. It said that Gillette would, as a result, face less competition within the United Kingdom and EC markets and would be better able to control the markets to its own advantage as set out in paragraphs 6.6 to 6.8.

6.10. Warner-Lambert believed that the contractual obligation contained in the IP Agreement on Gillette not to make sales into the EC and the USA under certain trade marks and other Wilkinson Sword intellectual property might not be effective to prevent Wilkinson Sword branded products being supplied by Gillette within the United Kingdom and the EC (and in particular of the acquisition by Gillette of the non-EC/US Wilkinson Sword businesses) for two reasons:

(a) This term of the IP Agreement had the object and effect of restricting imports of wet-shaving products into the EC and therefore of restricting competition in the EC and of affecting trade between EC member states. As such, Warner-Lambert expressed the view that this contractual provision might well infringe Article 85(1) of the EEC Treaty so as to be void under Article 85(2) of the Treaty (especially if it involved an absolute prohibition on such imports). Gillette could therefore consider itself not to be bound by the provision, so as to be able freely to import Wilkinson Sword branded products into the EC to the detriment of the Wilkinson Sword business within the EC, possibly at lower prices than the Wilkinson Sword prices in the EC.

(b) Gillette would not be able to prevent distributors outside the EC to which it sold Wilkinson Sword branded products from reselling them within the EC, to the detriment of Wilkinson Sword within the EC. Furthermore, Warner-Lambert presumed, the actual contractual obligation on Gillette was not to make *direct* sales of Wilkinson Sword branded wet-shaving products into the EC and it could therefore be permitted under the IP Agreement to sell such products to a distributor that intended to resell them into the United Kingdom or EC. Indeed, many distributors (based outside the EC) might wish to purchase Gillette and Wilkinson Sword branded wet-shaving products from the same source outside the EC and USA, namely Gillette. It was, therefore, in Warner-Lambert's view, very likely that such indirect sales by Gillette of Wilkinson Sword branded products would be made following the transaction into the United Kingdom and the EC, to the detriment of the Wilkinson Sword businesses within the United Kingdom and the EC.

Warner-Lambert said that the acquisition by Gillette of the non-EC/US Wilkinson Sword businesses was therefore likely to have damaging effects on the Wilkinson Sword businesses in the United Kingdom and the EC, and affect Wilkinson Sword's ability to compete effectively with Gillette in those countries.

Possible influence by Gillette on Swedish Match NV

6.11. Warner-Lambert thought that the various contingent rights and entitlements which Gillette had acquired gave it the ability now, notwithstanding that its equity influence might be non-voting, materially to influence the policy of Swedish Match NV. It said that most of the significant contingent rights covered one-off events and the significance was not necessarily whether they were exercised but what they might prevent happening. For example, Gillette had pre-emption rights to acquire the whole of the Wilkinson Sword business if the consortium decided to sell and Warner-Lambert said that the consortium might decide that it did not want to sell to Gillette and would therefore keep the business. This might mean that it was prevented from expanding. Warner-Lambert said that the other particularly significant type of pre-emption rights were those which applied if the consortium were to be listed on a stock exchange, in which case Gillette would have the opportunity to acquire voting shares and thereby increase its holding in the equity of both companies. Again, Warner-Lambert said, this could influence the consortium not to go for a listing.

6.12. Warner-Lambert also thought that the fact that Gillette was the only company directly involved in wet-shaving products in the consortium meant that Gillette would make suggestions to other consortium members as to how the business should be run and, in view of Gillette's experience, they would be likely to take note of what it said.

6.13. Warner-Lambert also suggested that because MGTC, the sister company of MCC, one of the participants in the consortium, was Gillette's lead bank and the two companies had a long-standing commercial relationship, their commonality of interest would continue and they might be operating as associated persons within the meaning of section 77 of the Act.

Bic

Operations

6.14. Bic is a wholly-owned subsidiary of the French company, Société Bic SA. The parent company has subsidiaries and associates world-wide and Bic, itself, has subsidiaries in Australia, New Zealand, Ireland and Sweden. Although Bic has some autonomy it is ultimately controlled by Société Bic. In the United Kingdom Bic's main products are ball-point pens (its original product), disposable lighters and, since 1975, disposable razors. Bic told us that the company had always aimed to produce high volume, low priced, functional items and when it entered the market the other two principal manufacturers had approximately 47 per cent of the market each.

6.15. Initially Bic had difficulty in selling its razors to the large retailing chains in the United Kingdom even though it was already selling them pens and other products, because each unit of its product would give retailers a much smaller unit of profit than the sale of its competitors' products. The other manufacturers were also able to offer a wide range of products across which they could produce promotional agreements and campaigns. Bic offered to give the product free for two months to one major retailer but its offer was refused and for the first few years it sold direct to small independent chemist chains and small retailers and produced what was then innovative packaging for the cash-and-carry section of the trade. Bic gained a fairly significant share of the market and eventually the larger retailers were under pressure from their customers to sell Bic's product. Bic set up an agency agreement with a toiletries company, allied its razors with the company's range of hair care products and thus sold to major retailers. Bic's aim was always to provide a better quality product at the lowest available price and although in the last few years it had launched a higher priced disposable razor it had no intention to move from the lower end of the market.

The market

6.16. Bic told us that there were three main factors affecting market share: price; quality; and product support. It thought that it would be very difficult for a new manufacturer to enter the market unless the company was already in the toiletries market and was able to persuade the major retailers to take its product. Even then, it would be extremely difficult for a company with no credibility in the razors market to gain entry at the top end of the market. Bic said that large retailers' own brands had increased their share of the market in recent years and it was mainly from this area that it thought that new entrants would come. A manufacturer which had gained entry by making retailers' own brands might at a later stage introduce its own brand. Bic said that its sales of razors by volume had increased every year but one since entry and there was no evidence to suggest that they would not continue to increase.

The transaction

6.17. Bic told us that it first became aware of Stora's intention to sell its CP Division in 1989 when Stora contacted Société Bic SA in France. Discussions took place between the two companies and a bid was made by Société Bic SA. In Bic's view it was unlikely that Gillette would make the investment without having some control or influence over the affairs of Swedish Match NV and in view of Swedish Match NV's relatively poor performance it thought that the transaction was strategic rather than financial. Bic thought, for example, that Gillette might influence Wilkinson Sword to sell at the bottom end of the market, thereby competing directly with Bic, and, in its view, restricting its profit margins and in the long term weakening its position. At the same time Gillette would be selling at the top end of the market where it had no competition. Bic also feared that the transaction might result in the exercise of pressure on retailers to restrict or eliminate shelf space allocated to Gillette's and Wilkinson Sword's competitors and because the two companies' combined usage of steel would give them over 50 per cent of the world market it was concerned that they would have preference when blade steel was scarce, to the detriment of the competitors. Bic also thought that the trans-action gave Gillette access to a wider spectrum of advanced technology.

Personna UK

6.18. Personna UK told us that it had been operating as a company in the United Kingdom since 1986 and its sales had increased substantially within the past two years. It told us that `everybody in the trade' saw the transaction as a take-over by Gillette and considered that there would have been no logical reason for it to take part in the financing of Swedish Match NV unless it was to gain control of Wilkinson Sword. Personna UK believed that the transaction posed a significant threat to competition in the United Kingdom market because it would eliminate one of the major suppliers. It thought that Gillette would have the ability to command an even greater percentage of retail shelf space and dominate all potential co-operative advertising opportunities, making it difficult for other suppliers to remain competitive by promoting new or existing products. Personna UK also said that with its dominant market share Gillette would have the ability to dictate pricing.

COMPANIES INVOLVED IN THE TRANSACTION

Lazards

6.19. Lazards told us that its connection with Swedish Match AB went back many years and had included in the past Board membership. Discussions with Gillette about Wilkinson Sword had extended over the past three years, in particular at the time when Wilkinson Sword previously changed hands.

Background to Lazards' involvement

6.20. Lazards said that it originally contacted Gillette after seeing a report on the Stora announcement of its divestment in the *Financial Times* of 8 June 1989. At that time Lazards offered to act on behalf of Gillette should it wish to acquire Stora's CP Division and Gillette confirmed on 7 July 1989 that it wished to retain Lazards' services for this purpose. Lazards said that initially its role was to advise Gillette as to the strategy it should follow in bidding for the division, the value of the division and the obstacles that might be encountered. Subsequently, after Gillette's initial offer had taken it into the second round of the auction, Lazards advised Gillette as to the structuring of the transaction and the introduction of equity participation and loan finance, and then advised the equity group through to the signing of the Stock Purchase Agreement. Lazards said that MSI confirmed that the CP Division must be sold as a whole. Lazards discussed this with Gillette and also pointed out the probable EC competition problems if it were to retain the Wilkinson Sword business in the EC. It made a presentation to the Gillette Board on the possibility of structuring the transaction in the way that it ultimately occurred.

Structuring the transaction

6.21. Lazards told us that it was approached by Procuritas, which had recently been founded with the backing of Swedish institutions, which wished to be involved in any leveraged buy-out of the CP Division. Lazards believed that the Swedish Match AB management had been approached by Procuritas to participate in a leveraged buy-out but management declined to do so at that time and suggested that Procuritas contact Lazards. According to Lazards the idea of a management buy-out came out of necessity because of Stora's requirement that the division be sold to one buyer only, and the competition problems that would result if Gillette subscribed for 100 per cent of the equity. Therefore Lazards sought a way of reducing Gillette's involvement which led to the participation of financial equity providers as distinct from commercial equity funds. Its view was that a leveraged structure would be needed for the transaction because the internal rates of return to the equity providers were insufficient with any unleveraged structure to meet financial institutions' requirements.

6.22. Lazards said that Gillette gave it a free hand in choosing which banks to approach on the deal. It knew MGTC was Gillette's lead bank which it had known for many years. MGTC responded enthusiastically and consequently underwrote both the senior debt and the non-Gillette portion of the mezzanine debt. Lazards also stated that Gillette's commitment in loan equity and mezzanine funds helped it to persuade MGTC to participate in the process because Gillette was at the outset quite clearly the driving force in the transaction. It was MGTC which recommended ICG to be the agent for the mezzanine debt.

The transaction

6.23. The institutional mezzanine providers, ie except Gillette, wanted an interest rate of LIBOR plus 4 per cent plus a right to participate in 2 per cent of the equity. Later ICG negotiated a further 2 per cent which was ceded by Gillette bringing the latter's percentage down. In addition, when the final net asset value was raised in November Gillette was most anxious that the deal should not fall through due to insufficient funding, and this led to Lazards' proposal of a vendor note which was eventually and reluctantly accepted by Stora.

6.24. Lazards said that the strategy was to finish up with a consumer products company based in Europe which could be floated or sold, subsequently returning to the equity providers the internal rate of return they expected of over 30 per cent. The financial projections indicated that this figure would be achieved by the end of five years on the estimated value on disposal of the shares which was based on multiples of earnings before interest and tax. Lazards told us that Gillette, with its experience of the razor market and operating margins in Europe and elsewhere, gave Lazards advice in assessing what margin increases and enhancement should be capable of being secured at Wilkinson Sword. Later, in discussion with Swedish Match AB management, Lazards gained confidence that the margin projections Lazards felt were necessary (in the region of 25 per cent compared with the current 9 to 10 per cent) were achievable. MGTC reduced (`took a haircut') both the forecasted margins of the Wilkinson Sword business and the disposal values although Gillette's margins were significantly higher than 25 per cent. Lazards confirmed that the satisfactory sale of the matches and lighters businesses and the improvement of the margins to a 25 per cent level were both important to the success of the new company.

The outcome

6.25. Lazards' only continuing involvement with Swedish Match NV was as an adviser with a specific mandate to find a buyer for its global matches and lighters operations. This was being done jointly with Schroders. Lazards was emphatic that the other equityholders were not relying on Gillette's presence to ensure their ultimate exit from the company and that they knew that the business could not rely in any way on support from Gillette. Given the decision to `ring fence' Wilkinson Sword Europe Lazards' view was that it would be wholly inconsistent for the other equityholders to believe Gillette could suddenly come to their rescue and acquire Wilkinson Sword Europe.

6.26. Lazards confirmed that Gillette's acquisition of the non-EC businesses was very important in its getting involved in the transactions. Lazards said that Gillette had long-term plans to penetrate the less developed markets of the world, and it recognised the need for a second brand name for this purpose. Lazards saw the use of Wilkinson Sword by Gillette in non-EC areas as an alternative rather than a second grade product.

The future

6.27. Lazards thought that a stock market listing of Wilkinson Sword was highly unlikely because of the way the pre-emption structure operated and because of the higher value that would be realised by a trade sale. If the company's growth prospects now were very good indeed the shareholders would be likely to raise new money to foster more rapid growth so that their investment became more valuable two years hence. If the growth prospects were not so good there would be a wish to maximise the current price of exit in which case it was likely that a trade sale to a major company agreed between all the shareholders would be the outcome.

6.28. Lazards said that it did not consider that Gillette's option to interpose a buyer of its choosing would have any effect on the conduct of the company or its planning. However, it would affect the process of exit because `no one likes pre-emption rights whoever holds them'. Lazards said that Procuritas had indicated that it would waive its rights over the matches and lighters businesses if Lazards sold them on a global basis.

Possible influence

6.29. Lazards told us that in its view, Gillette did not participate in any way in Swedish Match NV's activities and strategies. Apart from the pre-emption rights its view was that Gillette did not influence Wilkinson Sword at all other than as a competitor in the market-place. However, the negotiations on the interim Supply Agreement had become very difficult and Lazards had offered to mediate; the competitive tension between the personnel at Wilkinson Sword and Gillette remained as strong as ever and if anything, had increased since the transaction had been consummated. Lazards thought that, if Gillette had to withdraw, there would be parties which would take the mezzanine and others which would take the equity, but that markets had deteriorated and Gillette would probably have to accept a discount. Lazards told us that the Gillette PIK mezzanine debt which did not carry a cash coupon (interest) was unusual in the United Kingdom and it had not itself previously done a deal with these characteristics. The PIK debt instrument is commonly used in the US leveraged buy-out market.

Procuritas

6.30. Procuritas, a Danish company founded in 1987 with its main offices in Copenhagen, initiates, structures and arranges financing for management buy-outs related to the Nordic region. It has made three transactions to date, of which the Swedish Match NV transaction is the largest.

Background to Procuritas' involvement

6.31. Early in 1990 Procuritas established a buy-out fund (the Fund) known as Procuritas MBO Invest Consortium which would provide the equity to invest in future transactions while Procuritas acted as its management arm. However, the Fund was not established at the time of the Swedish Match NV transaction and Procuritas made arrangements with two potential investors in the Fund to have options on behalf of the Fund to purchase the equity represented by SEK 37.9 million of the two investors' total SEK 100 million investment in the equity in Swedish Match NV. In addition it was agreed that the Fund, when created, would have the opportunity to acquire the whole of Procuritas' own SEK 12 million investment. (Procuritas told us that it was still considering whether the Fund would acquire any of the equity in Swedish Match NV.) In June 1989 Procuritas contacted Swedish Match AB to see if it was possible to arrange a buy-out.

The management of Swedish Match AB suggested that Procuritas should get in touch again when the views of potential industrial buyers were known. Procuritas knew that Gillette had expressed interest in purchasing Swedish Match AB and, rather than compete with it for the acquisition, in July 1989 it contacted Gillette to propose a management buy-out. Procuritas told us that it had the following reasons for doing this: it did not want an outright purchase by Gillette to preclude the possibility of a management buy-out; it hoped that the participation of an industrial company would improve its own standing with Stora; it believed that Gillette had the financial sophistication and capital strength to be involved in the buy-out; and it hoped that it would be possible to divest assets to Gillette to reduce acquisition costs. Procuritas said that it had not planned which part of the business should be disposed of.

The transaction

6.32. After discussions with Lazards Procuritas reached an agreement with Gillette that Gillette and a group of Scandinavian investors would acquire Swedish Match NV in a leveraged transaction. Procuritas thought that the main benefit arising from its involvement as a shareholder was that it would enable it to influence the policy of Swedish Match NV to reflect the goals which Procuritas hoped to achieve. These were firstly to complete the sale of all or some of the matches and lighters businesses so as to realise a capital gain and thereby reduce acquisition debt in Swedish Match NV; and secondly to improve the operations of Wilkinson Sword to achieve greater efficiency in manufacturing and in the allocation of marketing costs and to develop competitive products. Procuritas felt that this could be achieved by closing plants, reducing corporate overheads, improving Wilkinson Sword's product mix and introducing a single form of packaging for use in EC markets.

Procuritas' contact with the other parties

6.33. Procuritas said that it had had little contact with the other investors, apart from the Scandinavian ones with whom it had met to discuss the progress of the disposal plan and review the performance of Wilkinson Sword and the progress of the anti-trust proceedings. In addition, it said, the Managing Director of Procuritas as a non-executive director of Swedish Match NV had regular contact with other directors (including a representative of MCC who attended Board meetings of Swedish Match NV as an observer) and had been involved in policy matters discussed at Board level, on behalf of all shareholders. Procuritas said that it had been involved with Swedish Match NV as a representative of the Scandinavian investors in matters related to the disposal plans. It told us that since the first closing date in December 1989 there had been no contact between Procuritas and Gillette. Procuritas did not envisage having to seek trade advice from Gillette.

Possible influence

6.34. Procuritas thought that as a customer Gillette would be unable to influence the policy of Swedish Match NV, but it thought it possible that in the long term, as a creditor, it could have influence. Although ideally Procuritas would have preferred Gillette not to have pre-emption rights it did not think that these rights would cause problems. Procuritas saw its eventual exit as a listing on a stock exchange. Its main aim was to realise adequate return on its investment and in order to do this it expected to retain the equity for three to five years. Procuritas was unable to comment on whether Gillette's involvement with Swedish Match NV could have an effect on the competition between Gillette and Wilkinson Sword.

Morgan

6.35. Morgan is incorporated in the State of New York, USA. Its banking interests are dealt with by its subsidiary MGTC and equity matters are covered by another subsidiary, MCC. As noted in Chapter 3, both subsidiaries were involved in the Stora transaction.

Background to Morgan's involvement

6.36. Morgan informed us that the opportunity for MGTC to become involved in the transaction arose because the bank had acted as banker and creditor to Gillette. However, MGTC's participation in this transaction was simply that of a lending bank and no merchant banking or advisory services to Gillette (or any other party) were provided. From its perspective the transaction offered the opportunity to earn substantial fees and an attractive margin on the credit exposure. MGTC stated that it maintained an arm's length position from Gillette throughout the negotiations. The fact that Gillette, with its knowledge of the markets concerned, was prepared to commit itself to investing in the buy-out was regarded by MGTC as an important factor in its ability to syndicate the senior debt facilities. However, in MGTC's view, Gillette's continued presence as an equity investor was not regarded by the banks and institutions concerned as necessary to the longer-term success of Swedish Match NV. MGTC said that the reason why it put forward MCC's name as a potential equity investor was based on normal commercial principles, ie the opportunity to put some business in the direction of another company in the Morgan group. However, MCC's decision to take an equity stake in Swedish Match NV was made independently on the basis of its own investment criteria. Morgan argued that the agreements had been structured throughout so as to ensure that Gillette did not obtain the ability to exercise any influence, whether direct or indirect, over the commercial policy of Swedish Match NV. Also it maintained that Gillette and/or any successor had no influence on any matter of any impact until such time as the institutional lenders of the mezzanine facility (and therefore also the senior lenders) had been fully repaid and even thereafter Gillette's rights were significantly restricted.

6.37. MGTC informed us that its first involvement was on 23 October 1989 when Lazards, acting as adviser to Gillette, contacted MGTC's New York branch to discuss a leveraged transaction involving Gillette and a consortium of financial investors in the acquisition of the CP Division. Having analysed the information provided by Lazards and Stora, MGTC conducted sensitivity analyses on management's cash flows and held a detailed conference with Mr Rossi as Chief Executive Officer of Swedish Match AB to discuss the asset disposal programme. MGTC said that at the beginning of November 1989 Lazards and Gillette expressed concern about the ability of the lead arranger to raise sufficient equity for the transaction from Scandinavia in time for the commitment deadline. It was then that MGTC suggested Lazards met with MCC to see whether the transaction was of interest to it. According to MGTC the main financing problem which caused Stora to be concerned that the deal would not close in a timely manner was insufficient equity backing coupled with high price. As noted in Chapter 3, this was solved by Stora reluctantly agreeing to accept an SEK 300 million subordinated note in lieu of a corresponding amount of cash, generally improving the credit from a banking perspective.

The transaction

6.38. MGTC expected to derive the following benefits from the transaction:

(a) fees for arranging and underwriting the senior and subordinated debt financing for the transaction;

(b) an attractive lending margin on the credit exposure outstanding to Swedish Match NV;

(c) mandates to advise Swedish Match NV on the sale of some of its non-core businesses;

(d) ultimately, the opportunity to refinance the transaction as debt was paid down and the credit quality of the transaction improved;

(e) greater perception in the European market of the bank's ability to underwrite and syndicate complex cross-border leveraged transactions; and

(f) an opportunity for a sister company (MCC) to acquire a stake.

6.39. MGTC told us that when the transaction was introduced to it separate companies were envisaged for the razor business and for the matches and lighters businesses. MGTC asked for them to be merged into one company because, as senior debt provider, it wished to have recourse to all the assets in the event of any problems. MGTC said that it originally underwrote both the senior debt and the institutional mezzanine debt. It then contacted ICG, mezzanine debt specialists whom it already knew. ICG committed for a portion and MGTC arranged co-underwriters for the other amounts. ICG was appointed agent for the whole mezzanine debt. Morgan said that representatives of Gillette were present at their documentation meetings with Lazards `as often as not'.

6.40. MGTC stressed that it paid great attention to the operating margins forecast for the razors business and eventually accepted that Wilkinson Sword could increase them significantly in six to seven years' time. The primary reason given for this improvement was the withdrawal from non-European international markets which were costly and concentration on investment in markets where it had significant share such as West Germany and the United Kingdom. Other reasons were harmonisation of pricing and rationalisation of packaging and promotion. When asked about the structure and timing of the management team MGTC said that the team was in place before it became involved in the transaction.

6.41. MCC said that it had a considerable amount of negotiation and discussion with various parties as to what the arrangements would be for the operation of the company after buy-out took place. It could take only 5 per cent of the voting securities (due to a US Federal Reserve constraint on bank investment in non-banking business). MCC sought to compensate for this by taking a large share of non-voting securities. MCC said that the new company had been set up in the Netherlands for tax reasons and for organisational reasons.

The future

6.42. MGTC said that in European terms the transaction would be regarded as very highly leveraged but that this was not unknown in the USA. It was confident about the early disposal of the match and lighter assets which would bring the amount of leverage down dramatically in the first 12 to 18 months. MCC said that it had undertaken similar transactions. MGTC expected to disengage totally within the next five years when the commitment to provide working capital ended. However, if the asset sale realised more than US $300 million then Wilkinson Sword could pay down the working capital provided for the razor business earlier if it so wished. MCC likewise expected to exit within five years following a successful asset disposal and achievement of the planned improvement in Wilkinson Sword margins. It would be looking to leave as little equity in the business as possible consistent with prudence and the ability to secure adequate financing. MCC said that it considered this to be an important investment and took a close interest in it. It attended Swedish Match NV Board meetings as an observer.

6.43. Both MGTC and MCC maintained that they saw nothing to show that Gillette had the ability directly or indirectly to influence Swedish Match NV's policy. However, they were concerned that when the equity players decided the time was right for exit that it would be possible to clear the `mechanical hurdles' of the Gillette or Scandinavian investor options as rapidly as possible. In the event that the shareholders wished to float the company and Gillette exercised its pre-emption right by paying the equivalent amount, Morgan said that it was always happier to make a complete exit rather than a piecemeal exit which was the case with a flotation and therefore this would suit Morgan. Morgan's preference was in any case for a trade buyer.

6.44. MGTC considered that Wilkinson Sword would compete vigorously with Gillette. On the other hand it felt that if Gillette was not subject to competition constraints, neither lenders nor equityholders would be concerned about Gillette having more involvement in the Wilkinson Sword business. MGTC said that whereas all divisions of Swedish Match NV were currently ahead on revenue, the company had a negative cash flow when interest payments were taken into account; this was expected to change when the asset disposals had been made. However, when the rolled up interest was taken into account there was an increasing operating deficit.

ICG

6.45. ICG was set up in February 1989 with an initial capital of £200 million raised from nine institutional shareholders who had put up £45 million of share capital, the remainder being lent by a syndicate of banks. ICG invests only in the mezzanine or intermediate capital layer of transactions which are leveraged. Its investments vary from buy-outs through development and expansion capital to employee share ownership plans and off-balance-sheet structures. It invests as a principal and will syndicate the portion it does not wish to keep itself. The average size of its investment is about £5 million to £6 million.

Background to ICG's involvement

6.46. ICG first become aware of Stora's intention to sell the CP Division when it was contacted by Morgan on 6 November 1989 which was looking for specialists prepared to take on the mezzanine risk.

The transaction

6.47. ICG said that it underwrote some 40 per cent of the institutional mezzanine debt funding for Eemland's purchase, amounting to £18 million, and shared the risk as co-arranger and co-underwriter with MGTC which had initially underwritten the whole mezzanine debt. Later MGTC syndicated most of its part to Orix Europe Ltd (Orix) and Copenhagen Handelsbank. ICG was also aiming to syndicate about two-thirds of its share and had partially achieved this. ICG also subscribed for equity loan stock under two classes (`C' and `D'), the latter class for its original allocation and the other for the extra 2 per cent of equity it managed to obtain from Gillette following the late stage negotiations. ICG said that it expected the mezzanine debt to be refinanced within three to five years. It and other institutional equity providers would be wanting an exit in four to five years' time. ICG told us that the thrust of the transaction came from Lazards acting on Gillette's behalf and that was where it understood the deal to have originated.

6.48. ICG told us that it did not have any dealings with Stora direct and only one telephone call to Gillette. Its contacts during the transaction were always with those running the deal, mainly Lazards and Morgan (the Gillette call concerned the proportion of equity ICG was to obtain). ICG confirmed that it was present at many negotiations at Slaughter and May when the leveraged buy-out arrangements were being made mainly to ensure that its own interests were protected. It also said that Gillette often attended bank and lender meetings. It did not know any of the management before the transaction but did carry out an assessment of them and of the business.

The future

6.49. ICG said that it was very good to have an industrial trade partner who knew the business in such transactions. In this case Gillette was appropriate and looked to be the only long-term player in the equity of the transaction. ICG said that the current negotiations for the disposal of the matches and lighters businesses were of major importance to it because Swedish Match NV took over the responsibility for this disposal and ICG would not receive repayment of its investment until funds had been generated by this second sale. ICG was convinced that, provided the sale of the matches and lighters businesses was completed satisfactorily, the remaining (ie Wilkinson Sword EC/US) business would be profitable. It said that it would be attractive to retain the Gillette PIK loan and the Stora loan note in place for as long as possible because the Gillette interest would become an intolerable burden on the company after a time. In regard to the most likely exits, ICG said that there was the prospect of a viable stock exchange float in Frankfurt or Dusseldorf of the Wilkinson Sword core business. A trade sale was also a possibility. At exit ICG felt that Gillette might well endeavour to procure an independent third party to buy the shares if the other equity investors sought to sell to a competitor of Gillette. As ICG understood it, if the equityholders wanted to exit and sell to any third party, they could overcome any potential restrictions due to Gillette's pre-emption rights by requiring it to match the price. ICG said that Procuritas' rights applied only to matches and lighters and would no longer be relevant when the disposal was completed.

6.50. ICG said that it had entered the transaction on the basis of advice on the extent to which Gillette could lawfully be involved in the transaction. ICG pointed out that the $6.4 million for buying back the US business from Gillette was only payable after the Stora loan note was repaid.

RETAILERS

Boots

The market

6.51. From its own knowledge of the market, and using Audits of Great Britain information, Boots estimated that the total sales of razor blades in the United Kingdom amounted to approximately £57 million. About 21 per cent of this, or around £11.5 million, was through Boots. Boots regarded the shaving market as a very important part of its core business. It told us that the total shaving market was divided into 30 per cent dry shaving and 70 per cent wet and this had been fairly consistent over the years. Within the wet-shaving market there appeared to be growth in disposable razors and systems at the expense of double edge blades (although these still accounted for 10 per cent of the market). Gillette and Wilkinson Sword between them accounted for about 90 per cent of the market with Schick, Personna and retailers' own brands making up the remainder. Boots said that Gillette's new Sensor accounted for seven out of ten of the razor systems currently being sold and Boots' own brand accounted for 4 per cent of its sales. It thought that Gillette's size, world-wide representation and consistent management gave it a considerable advantage over Wilkinson Sword whose frequent change of ownership and lack of funds were ongoing problems.

Marketing and sales promotion

6.52. Boots said that it had total choice in what it marketed and there was no pressure apart from the effect of brand leadership. The allocation of shelf space was determined by sales volume, relative profitability for Boots and sales growth. Although space was allocated for the Sensor launch (on the basis of expected growth and higher margins) Boots did not allow permanent point of sale promotional material as a matter of policy.

Market entry

6.53. Boots said that consumers were very loyal to a particular brand name, making it difficult for new suppliers to enter the market. In order to make an impact on users potential entrants would need to spend a large amount on advertising. Even then Boots was doubtful whether a new supplier would gain entry, particularly at the top end of the market. An entrant into the disposable razor sector was more feasible but essentially Boots regarded the whole market as a closed shop at present.

The transaction

6.54. Boots told us that because Gillette, Wilkinson Sword and Bic were the only strong companies in the market it would regard a combined Wilkinson Sword/Gillette as detrimental to retailers and therefore ultimately to the consumer. At present Boots had some negotiating strength but if the two companies joined forces this would be weakened. Because in the razor systems segment there were no other products currently marketed in the United Kingdom to substitute for those of Gillette and Wilkinson Sword and because customers expected to see their products in Boots stores it would be forced to continue buying them regardless of cost. Boots had received no formal notification of the details of the transaction. It would be very concerned if Gillette and Wilkinson Sword were to operate as one but it understood that the intention was to continue to operate as two completely autonomous units. Boots thought that even though Gillette's shareholding was non-voting its significant financial stake could have an effect on the United Kingdom wet-shaving market through co-ordination between the two companies on pricing, product lines and advertising.

Asda

6.55. Asda told us that for the year ended April 1990, of its total sales of razors and razor blades Gillette accounted for 46.5 per cent, Wilkinson Sword 13.5 per cent and the remainder were BiC, Personna and own brand. It said that in that year and previously Gillette did not appear to act in a monopolistic way and that there was active competition between the two companies.

Tesco

6.56. Tesco said that Gillette was a strong dominant market leader with Wilkinson Sword very much a secondary force. It did not think that the transaction would have a materially adverse effect on the present situation.

Sainsbury

6.57. Sainsbury said that its own-label sales accounted for about 13 per cent of sales within its own stores. This had grown from 10 per cent during the last year. It said that a reduction in the number of suppliers in the wet-shaving market was likely to lead to a loss of competitiveness overall and it was clear from the figures that Wilkinson Sword was under considerable pressure. It said that the participation by Gillette as a shareholder and creditor in the financing of Swedish Match NV could lead to a situation where Wilkinson Sword reduced its R&D factor to a point where it was not capable of sufficient product development to defend its market position. It was also possible that there would be less competitive pressure on prices. Such a situation would be to the detriment of the consumer as well as retailers.

The Retail Consortium

6.58. The consortium told us that there was no strong or widespread own-brand activity in the wet-shaving market. It said that given the high market shares of Gillette and Wilkinson Sword there was a real fear that the effects of the transaction would be anti-competitive. It feared that the companies would operate as one and consumers would suffer as there would cease to be realistic price competition.

TRADE UNIONS

Manufacturing Science Finance (MSF)

6.59. MSF said that over the last decade 40 per cent of manufacturing companies in the North-East of England had closed as a result of mergers. As the Wilkinson Sword factory employed over 400 people in this area MSF was concerned that the production capacity might be absorbed into a larger group and transferred to Gillette's factories.

A Wilkinson Sword employee

6.60. An employee who had worked at the Cramlington factory for 22 years during which time he had been an AEU representative wrote on his members' behalf expressing concern as to whether agreements made with Stora would be transferred to Swedish Match NV. He also said that in the past it had been agreed that production would be shared 50:50 with the Wilkinson Sword factory in Solingen and over the last four months there had been a significant reduction in production and consequently the loss of 65 jobs. He, too, was concerned about the possible closure of the factory.

CONSUMERS

6.61. The National Consumer Council and the Consumers' Association did not wish to make any comments on the reference.

6.62. A member of the public from the North-East of England wrote to us expressing concern about the transaction which he thought would increase Gillette's influence and lead to a loss of competition in the industry.