

7 Conclusions

The monopoly situation

7.1. Under the terms of reference dated 14 June 1990 (Appendix 1.1) we are required to consider whether a monopoly situation exists in relation to the supply in the United Kingdom of razors and razor blades intended, in either case, for wet-shaving use. If so, we have to consider, in respect of a matter specified in the reference, whether any action or omission, on the part of any person in favour of whom a monopoly situation exists, operates or may be expected to operate against the public interest. The matter specified is the giving of assistance to and the provision of finance for Swedish Match NV in or in connection with the acquisition of the Consumer Products Division (the CP Division) of Stora Kopparbergs Bergslags AB (Stora), including all transactions or arrangements entered into or proposed in connection with such assistance or provision of finance.

7.2. Total United Kingdom sales of the reference products during 1989 and sales by each supplier are shown in Table 4.4. It can be seen that Gillette UK Ltd (Gillette UK) supplied 60 per cent by value and 40 per cent by volume of United Kingdom sales. Given the relatively wide range in product prices and the existence of different types of razors and razor blades (disposable, systems, double edge), for the purpose of this inquiry we take market shares based on value to be the appropriate measure of the relative positions of the different suppliers in the United Kingdom market. If volume were used as the basis, Gillette UK's market share would still exceed 25 per cent. We conclude, therefore, that a monopoly situation exists, by virtue of section 6(1)(a) of the Fair Trading Act 1973 (the Act), in relation to the supply of razors and razor blades intended, in either case, for wet-shaving use.

7.3. Gillette UK is a wholly-owned subsidiary of Gillette Industries Ltd (Gillette Industries) which is itself a wholly-owned subsidiary of The Gillette Company of Boston, Massachusetts, the parent company of the whole group. The relationship between the three companies is such that we conclude that the monopoly situation which we have identified exists in favour of Gillette UK, Gillette Industries and The Gillette Company.

7.4. Although Biro Bic Ltd (Bic) has a market share of more than 25 per cent if measured by volume, its share, measured by value, is only 15 per cent. As we mentioned in paragraph 7.2, we consider value to be the appropriate measure of the relative positions of the different suppliers in this market, and we do not therefore find that a monopoly situation exists, by virtue of section 6(1)(a) of the Act, in favour of Bic. Moreover, if volume were to be regarded as the better basis, we do not consider that Bic's position would have any adverse implications for the public interest in respect of the matter specified in the reference as it took no part in the giving of assistance to and the provision of finance for Swedish Match NV in or in connection with the acquisition of the CP Division of Stora or related transactions and arrangements.

The companies involved

Gillette

7.5. The Gillette Company together with its subsidiaries (collectively referred to as Gillette) is the largest supplier of razors and razor blades in most of the world's major economies. Gillette products are marketed in almost every country in the world. It has large market shares in many major markets, including the United Kingdom. For example, measured by value it has a 64 per cent share in the USA and a 70 per cent share in France. In most other developed countries in which it sells its products, its market share is at

least 45 per cent by value. In some European markets (Norway, Switzerland and Denmark) and in some Latin American markets, such as Brazil, its market share, by value, is over 85 per cent.

7.6. Wet-shaving razors and razor blades are Gillette's core product line. In 1989 they accounted for world-wide sales of \$1,238 million and operating profit before corporate costs of \$429 million, representing 32 per cent and 62 per cent respectively of total group sales and profit. As well as manufacturing wet-shaving products, the Gillette group also includes Braun AG, a German company which manufactures and markets consumer electrical products, including dry shavers.

7.7. Gillette Industries is the holding company for Gillette's United Kingdom interests. It made a consolidated profit before tax of £16 million in 1989 on a turnover of £306 million. Its subsidiary, Gillette UK, manufactures and distributes razors and razor blades, toiletries (including shaving foam and gel) and writing instruments. It had a turnover in 1989 of £145 million, with profits before tax of £9 million.

7.8. As is explained in Chapter 4, there are three product segments within the wet-shaving market: double edge blades, systems razors and disposable razors. As is shown in Table 4.5, Gillette supplies each of these products to the United Kingdom market, but it is particularly strong in the systems sector, which has been growing relative to the other two sectors both in terms of volume and value.

Swedish Match NV and Wilkinson Sword

7.9. Wilkinson Sword Ltd is the principal operating company for the Wilkinson Sword businesses (which are referred to as Wilkinson Sword) in the United Kingdom. It has been marketing razors and razor blades in the United Kingdom since the turn of the century. Until the 1960s it was confined mainly to the United Kingdom but subsequently became active in a number of other markets including EC countries, Australia, New Zealand, Japan, USA, Canada and Brazil.

7.10. By the mid-1970s, Wilkinson Sword accounted for nearly half the volume of blades sold in the United Kingdom, almost all of which were in the traditional double edge segment. Since then, with the growth of systems razors and the introduction of disposable razors, its branded share has fallen to 18 per cent (or 17 per cent by value). Wilkinson Sword is the major supplier of own-label products, accounting for around 70 per cent of total own-label sales in the United Kingdom. Wilkinson Sword had a turnover in 1989 of £26 million, on which it made a loss before tax of £2.2 million.

7.11. The ownership of the Wilkinson Sword wet-shaving business has changed hands a number of times in the last 20 years. It was acquired in 1973 by the British Match Corporation Ltd (British Match), in which a Swedish company, Swedish Match AB, had a 33 per cent interest. British Match then changed its name to Wilkinson Match Ltd (Wilkinson Match). In 1978 Swedish Match AB sold most of its holding to Allegheny International Inc, which acquired the remainder of the share capital of Wilkinson Match two years later. In 1987 Wilkinson Match was sold again, this time back to Swedish Match AB. In May 1988 Swedish Match AB was itself acquired by Stora, a leading forestry products company, with world-wide sales of wood pulp, newsprint, fine papers, packaging, paper and board and other wood-based products. In July 1989 Stora decided to dispose of its CP Division, which consisted of the matches, disposable lighters and Wilkinson Sword wet-shaving and toiletries businesses which had previously been the main part of Swedish Match AB. It was this sale which gave rise to our inquiry.

The market for wet-shaving products

7.12. Hair removal products can be divided into three basic types: wet-shaving products (razor blades and razors); dry-shaving products (electric razors); and depilatory products (hair removing creams, etc). As Table 4.1 shows, in 1989 consumers in the United Kingdom spent about £160 million on various hair removal products. About half of this expenditure was on wet-shaving razors and razor blades. The rest was on dry shavers (or electric shavers) and various depilatory products. The wet-shaving market is an important market, affecting a large proportion of the adult population.

7.13. Dry-shaving and depilatory products are not considered by most wet shavers to be close substitutes for wet-shaving products, and from the evidence we received it was clear that wet-shaving can be regarded as a separate market.

7.14. As paragraph 4.9 describes, the wet-shaving market has three product segments: (a) double edge blades; (b) systems razors; and (c) disposable razors. There are three main suppliers to the United Kingdom market: Gillette, Wilkinson Sword and Bic, which together supply (including own-label supplies) about 95 per cent by value and 94 per cent by volume. Each of them is particularly strong in a certain market sector. In value terms, Gillette supplies over 80 per cent of the systems sector, Wilkinson Sword about 70 per cent of the declining double edge sector and Bic over 32 per cent of the disposables sector (behind Gillette at 44 per cent). In volume terms, Bic has the largest share of the disposables sector, at over 40 per cent.

7.15. Total United Kingdom sales by each supplier during 1989 are shown in Table 4.4. We have already noted that consumers spent over £80 million in 1989 on wet-shaving razors and razor blades. Using manufacturers' net selling prices, sales of wet-shaving razors and razor blades amounted to about £56 million in 1989. Of this, Gillette's share was about 60 per cent, Wilkinson Sword's about 20 per cent (including about 3 per cent for its sales of own-label razor blades) and Bic's about 15 per cent.

7.16. In volume terms, a total of about 4 million razors and 594 million razor blades were sold in the United Kingdom in 1989. Of the blades, some 40 per cent were sold by Gillette, 30 per cent were sold by Bic and 23 per cent were sold by Wilkinson Sword (including own-label sales). Including razors slightly increases the shares of Gillette and Wilkinson Sword.

7.17. Prices of razor blades vary considerably according to type. The cheapest are the disposable razors, for which the retail price at a major retailer in September 1990 ranged from 7 pence each for single blade disposables to 17 pence for twin blade swivel disposables, with Bic's new Microglide being priced at 15½ pence per razor (see Table 4.8). The retail price for double edge blades was about 12 to 16 pence each. The highest priced blades are the systems blades. The retail prices for these varied from 23 pence each for the regular fixed blades to 32 pence for Gillette's Contour Plus blades. Prices for Gillette's new Sensor blades have been set above the price range for other systems blades, with a retail price per blade of just over 43 pence.

7.18. There has been only limited volume growth in the market in the last few years, but there has been a growth in value terms partly due to a move from the cheaper, disposable varieties to the systems models. As paragraph 4.19 and Table 4.8 show, price increases in recent years have been considerably above the rate of inflation. The companies told us that this was mainly in order to recoup increased advertising costs and also, in Gillette's case, in part a result of a deliberate policy to narrow the differential between disposables and systems and hence encourage the use of systems razors. Gillette accepted that it acts as a price leader in this market. From the evidence it seems that price competition in the systems and part of the disposable razor segment (where there are only two major suppliers) was already less than vigorous before the transactions we are considering.

7.19. The razors currently marketed in the United Kingdom under Gillette and Wilkinson Sword brand names are listed in Table 4.11. Both companies supply a full range of razors (except that Gillette does not market a single blade disposable razor). Bic operates only in the single blade disposable sector, where price is very important. Thus, of the three main suppliers to the United Kingdom market, Gillette and Wilkinson Sword offer broadly similar product ranges.

7.20. The rest of the United Kingdom branded market is supplied by Personna International UK Ltd (Personna UK), part of American Safety Razor Co (American Safety Razor), by Sterling Four Blades Ltd, the United Kingdom distributor for Harbans Lal Malhotra & Son Ltd (Malhotra) through its Supermax brand, and by Warner-Lambert Company (Warner-Lambert), through its Schick brand. In 1989 they accounted for 5 per cent by value and 6 per cent by volume of sales, including own-label supplies.

7.21. A number of retailers sell own-label products, notably The Boots Company PLC, Safeway plc, Sainsbury plc, Superdrug Stores PLC and Tesco PLC. As mentioned in paragraph 7.10, Wilkinson Sword is the major United Kingdom supplier of own-label products accounting for around 70 per cent of sales. The other major supplier is Personna UK. Own-label sales have increased in importance in the last ten years and are thought now to account for about 7 per cent (by volume) of the United Kingdom market.

7.22. The development, testing and ultimate launch of a completely new product can be a lengthy process, often taking many years. In addition to the development of completely new products, the companies may from time to time modify their existing products. In Appendix 4.3 we have drawn together what appear to be the major product developments in earlier years, together with a more detailed list of the developments in recent years. As the table shows, Gillette, Wilkinson Sword and Bic have made a number of major product innovations in this market.

7.23. There are a number of practical barriers to anyone wishing to gain entry to the United Kingdom market. These barriers are in two broad categories: production and marketing. There are significant costs involved in setting up a production facility capable of producing a competitive volume of output (see paragraph 4.45). Research and development (R&D) costs can be high (see, for example, paragraph 4.46). The other major obstacle to marketing new wet-shaving branded products in the United Kingdom is the cost of promoting and advertising them. For example, Gillette budgeted to spend about £8 million on advertising and promoting Sensor in 1990 in the United Kingdom alone. The strong loyalty that consumers have to their current brand and shaving product adds to the promotional barrier. Also, a limited number of national retail chains account for a significant proportion of sales of razor blades, and creating a promotional package that may persuade them to give shelf space to a new brand is not easy, and can be expensive. (Bic told us that when it first tried to enter the market it offered its product free for two months to one major retailer but its offer was refused, even though it was already supplying it with pens and other products.)

7.24. There are about 12 major manufacturers of wet-shaving products supplying the developed world: Gillette, Swedish Match NV (Wilkinson Sword), Warner-Lambert (Schick), Bic, Malhotra of India, Prago Union Vyrobce Kovopol NP of Czechoslovakia, Leninets and Mostoglamesh both of the Soviet Union, Permatik Celik Sanayi Anonim Sirketi of Turkey, Alexandria Blade Co of Egypt, Kai Company Ltd/Kaijirushi of Japan, and American Safety Razor (see paragraph 4.51 and Appendix 4.4). Of these, only the first four have any significant market share in the EC.

7.25. In sum, therefore, this is a market in which there are few suppliers and in which there are a number of practical barriers to anyone wishing to achieve entry to the United Kingdom market as a manufacturer of razor blades and razors. Distribution channels do not encourage new entry and strong consumer loyalty makes entry by new producers more difficult. There are no close substitutes for wet-shaving products. Gillette is not only the largest United Kingdom supplier of wet-shaving products but is also by far the largest supplier in most developed countries. It is particularly strong in the systems sector of the market which is the fastest growing and the most profitable sector. Although Bic competes effectively in the disposable sector, Wilkinson Sword is Gillette's only significant competitor in the United Kingdom across the whole range of wet-shaving products and its only effective competitor in the systems sector.

The transactions giving rise to the reference

7.26. The sale by Stora of the CP Division took place on 20 December 1989. It took the form of a highly leveraged buy-out, financed by a consortium of banks and finance houses and Gillette. Some members of the CP Division senior management took small equity stakes. The vehicle used for this purchase was then known as Eemland Management Services BV (Eemland), a Dutch company which had been incorporated in February 1988, but had not previously traded. In April 1990 Eemland changed its name to Swedish Match NV. In October 1990, after the disposal of the matches and lighters businesses, it announced its intention to change its name again, this time to Wilkinson Sword NV. The consideration payable to Stora was SEK 3,930 million (\$627 million) of which SEK 300 million (\$48 million) was in the form of a non-interest-bearing loan note.

7.27. The transaction and its financing are described in more detail in Chapter 3. About SEK 348 million (\$56 million) was provided by various forms of equity (ordinary voting shares) and quasi-equity (convertible loan stock) capital, and \$595 million was provided by debt financing, including the Stora loan note. In addition, Swedish Match NV received \$72.3 million from The Gillette Company for the sale of the non-EC shaving businesses, although \$6.4 million subsequently became repayable as Wilkinson Sword reacquired the US businesses. The total funds of some \$723 million covered the consideration payable to Stora, plus working capital requirements, fees etc. 22 per cent of the 'equity' was represented by the ordinary shares subscribed for by a group of Scandinavian investors, together with small holdings by Morgan Capital Corporation (MCC) and members of the CP Division senior management: these carried all the voting rights in the company. The rest of the 'equity' capital was in the form of non-voting convertible subordinated unsecured loan stock, which was in effect equivalent to non-voting equity. Part of this, equivalent to 22 per cent of the total equity, was provided by Gillette UK. It was originally to have been 24 per cent but Gillette ceded 2 per cent to the Intermediate Capital Group (ICG) to ensure that the deal proceeded. A further 24 per cent was provided by MCC and the remainder was provided by various other financial institutions (see Table 7.1 and Appendix 3.2).

7.28. Of the \$595 million of debt, \$409 million was senior debt, ranking ahead of the mezzanine debt and syndicated by the Morgan Guaranty Trust Corporation (MGTC). \$300 million of this senior debt was expected to be repaid by 31 December 1991 out of the proceeds of sales of the matches and disposable lighters businesses, and the balance of \$109 million was in the form of a revolving credit facility with a final maturity at the end of 1994. Institutional mezzanine debt of \$69 million was provided. Most of this was syndicated by ICG and MGTC; the balance was provided by Copenhagen Handelsbank. A further \$69 million of mezzanine debt was provided by Lustrasilk International UK Ltd (Lustrasilk), a subsidiary of Gillette Industries. (This was subordinate to the institutional mezzanine debt, in that it is not to be repaid until after the institutional mezzanine debt has been repaid.) Finally, there was the non-interest-bearing loan note to Stora for the equivalent of \$48 million, which was subordinate to the Gillette mezzanine debt. This loan note is, however, immediately payable if the Gillette mezzanine debt is fully repaid or renegotiated or a dividend distribution is made.

7.29. The equity and debt structure is summarised in Table 7.1.

TABLE 7.1 Swedish Match NV equity and debt structure

	<i>Amount paid (US \$m equiv)</i>	<i>% of voting rights</i>	<i>% of total equity</i>
Equity			
<i>Ordinary shares</i>			
<i>Scandinavian investors:</i>			
Copenhagen Handelsbank	4.8	38.6	8.3
Spira	4.0	32.2	6.9
Procuritas	1.9	15.6	3.4
SPP Insurance	0.6	4.9	1.1
Skandia Insurance	0.6	4.9	1.1
MCC	0.1	0.4	0.1
Management	<u>0.4</u>	<u>3.4</u>	<u>0.7</u>
	<u>12.4</u>	<u>100.0</u>	<u>21.6</u>
<i>Convertible loan stock</i>			
MCC	13.7		23.8
Gillette UK	13.7		22.0
SPP Insurance	10.6		18.3
Skandia Insurance	4.8		8.4
ICG	0.3		5.2
Copenhagen Handelsbank	<u>0.0</u>		<u>0.7</u>
	<u>43.1</u>		<u>78.4</u>
Total equity	<u>55.5</u>		<u>100.0</u>
Debt			
			<i>% of total debt</i>
<i>Senior debt</i>	409.0		68.7
<i>Mezzanine debt</i>			
Institutional	69.0		11.6
Lustrasilk (subordinated to Institutional debt)	69.0		11.6
<i>Junior debt</i>			
Stora loan note	<u>47.8</u>		<u>8.1</u>
Total debt	<u>594.8</u>		<u>100.0</u>
Total equity + debt	<u>650.3</u>		

Source: MMC from Swedish Match NV data.

7.30. The manner in which these funds were applied is shown in Table 7.2.

TABLE 7.2 Swedish Match NV: application of funds received for equity and debt finance

	<i>Amount (US \$m equivalent)</i>
<i>Funds received</i>	
Equity	55.5
Debt financing	<u>594.8</u>
	650.3
Sale of non-EC business	<u>72.3</u>
	<u>722.6</u>
<i>Funds applied</i>	
Purchase of the CP Division	627.0
Reacquisition of US shaving business	6.4
Purchase price adjustments, working capital, settlement of inter-company indebtedness, fees etc	<u>89.2</u>
	<u>722.6</u>

Source: MMC from Stora, Swedish Match NV and Gillette data.

7.31. The agreements between the various parties governing their rights as equityholders, including the various pre-emption and conversion rights and options, and the voting and management structure of Swedish Match NV have been described more fully in Chapter 3. Also summarised in that chapter are the rights attaching to the various classes of convertible loan stock (quasi-equity) and the agreements for the provision of senior debt and mezzanine finance.

7.32. Gillette played a central role in initiating the buy-out proposal and in settling the details of the various agreements between officers and directors of the parties. Gillette Industries played a major part in this, with Board approval from The Gillette Company. Gillette UK acquired some 22 per cent of the 'equity' of Swedish Match NV, but its holding carries no voting rights. Neither Gillette UK nor any other member of the Gillette group has any right to attend Board meetings or equityholders' meetings or to use its position as an equityholder to obtain information about Swedish Match NV's financial condition and operations. It has also expressly covenanted in the Voting and Management Agreement that it will not exert or attempt to exert any influence over the Board or any member of the Board of Swedish Match NV.

7.33. Gillette UK has, however, pre-emption rights in the event of a proposed sale of equity, whether ordinary shares or equity loan stock, to a third party. An equityholder may not sell any equity to a third party purchaser unless it is first offered to the other equityholders on the same terms and conditions, and, in the case of Gillette, neither Gillette UK nor any person selected by it (subject to the approval of certain other investors) wishes to take up the shares.

7.34. The Equityholders' Agreement also provides that in the event of a proposed sale by a selling group comprising 75 per cent of the equity (excluding Gillette), or 64 per cent of the equity (excluding Gillette but including a majority of the managers), this equity would first have to be offered to Gillette UK or to a non-associated nominee of Gillette UK. Gillette UK could therefore increase its equity position and acquire voting rights as a result of a sale by another equityholder. Should it elect not to do so, and such sale of equity to a third party takes place, Gillette UK may then convert its non-voting equity loan stock into ordinary voting shares.

7.35. The Equityholders' Agreement also gives Gillette UK certain rights when a listing is proposed. If 26 per cent or more of the equityholders (excluding Gillette UK) wish to seek a stock exchange listing, Gillette UK or its nominee has the option for seven days to buy the equity of these equityholders at the price at which it is proposed to obtain the listing, provided that an identical offer is made to the other equityholders. In the event of a listing taking place, Gillette UK may convert its non-voting equity loan stock into ordinary voting shares.

7.36. In addition, the Loan Stock Instrument provides for the stock to be convertible into ordinary voting shares in the event of winding up. In summary, therefore, Gillette UK's non-voting equity loan stock is convertible into ordinary voting shares in the event of: (a) a sale of Swedish Match NV equity, in the circumstances described in paragraph 7.34; (b) a listing of Swedish Match NV shares on a stock exchange; or (c) a winding up of Swedish Match NV. However, Gillette UK's ability to exercise voting rights on any ordinary shares that it obtained would be subject to the terms of undertakings given to the US Department of Justice following anti-trust proceedings, unless prior written consent has been given by the US authorities.

7.37. Gillette UK also has certain pre-emption rights over the sale of Swedish Match NV's assets. Swedish Match NV cannot sell 'the whole or any substantial part' of its wet-shaving business or assets unless it has first offered them to Gillette UK (or its nominee) at the same price and on the same terms.

7.38. As already noted, Lustrasilk, a subsidiary of Gillette Industries, is a major creditor of Swedish Match NV. It contributed \$69 million of mezzanine debt (11.6 per cent of the debt of the company). Interest on this loan (at a rate of LIBOR plus 6 per cent) is capitalised and is payable when the principal is repaid. This loan is repayable in 12 equal six-monthly instalments, beginning six months after the institutional mezzanine debt has been paid in full (which cannot happen until the senior debt has also been paid in full) or after 14 years (December 2003) if earlier. Lustrasilk is bound by decisions of the other creditors on such matters as enforcement or waiver of covenants and enforcement in the event of default.

7.39. In order to ensure that the deal went through, Gillette UK ceded 2 per cent of its equity to ICG. The Gillette Company also agreed to make payments to Stora of up to \$11 million to reflect the fact that its loan note carried no right to interest (although \$4 million of this will not be payable if the loan note is repaid by the end of 1995).

7.40. As already noted, as part of the arrangements it was agreed that Swedish Match NV would sell the non-EC razors and razor blades businesses to Gillette for a sum of \$72.3 million, enabling The Gillette Company to manufacture and to sell products under the Wilkinson Sword name and trade mark in such non-EC countries. Wilkinson Sword remained free to supply own-label products to non-EC countries and new brands under certain constraints, but was unable to export products under the Wilkinson Sword name outside the EC. This part of the transaction was covered by the Non-EC Sale Agreement and the Intellectual Property Manufacturing and Distribution Agreement (the IP Agreement). As a result of the anti-trust proceedings in the US, however, Swedish Match NV subsequently reacquired the US business for a consideration of \$6.4 million, in the form of a loan note, subordinated to the Stora loan note. A supply agreement was subsequently agreed between Wilkinson Sword and The Gillette Company for supply of Wilkinson Sword products to Gillette for non-EC/US markets. These arrangements extend to the end of 1991.

7.41. Gillette therefore played a central role in setting up the transactions. The outcome is that it has a non-voting equity interest through Swedish Match NV in the Wilkinson Sword wet-shaving business, with various pre-emption and conversion rights and options; it is a significant creditor of Swedish Match NV; it owns the trade marks and other intellectual property rights of Wilkinson Sword outside the EC/US; and it has a Supply Agreement with Wilkinson Sword until the end of 1991.

Sale by Swedish Match NV of its matches and lighters businesses

7.42. It was envisaged that the matches and lighters businesses would be sold by Swedish Match NV over a two-year period. The businesses in Chile, Thailand and the Dominican Republic were sold for \$30.5 million, and contracts were signed for the sale of those in Colombia and India for a further \$10.8 million. Agreement was reached in October 1990 on the sale of most of the remainder of the matches and lighters businesses to a consortium for \$277.5 million (part of which would be payable by way of a loan note, repayable in instalments up to March 1992). This sale was subject to the approval of the Swedish Government and to there being no reference to the MMC. The only remaining match business, in the Philippines, is to be sold separately. Swedish Match NV expects to receive about \$33 million for this business.

7.43. Swedish Match NV expects that these sales will enable it to repay the \$300 million tranche of the senior debt by the end of 1991 and the rest of the senior debt and part of the institutional mezzanine debt by the end of 1994. Some \$40 million of institutional mezzanine debt, the Gillette mezzanine debt (with accruing interest) and the junior (Stora) debt would, however, remain (see Table 3.10) as well as the debt of \$6.4 million for the repurchase of the US shaving business. As mentioned in paragraph 3.51, in the absence of a substantial injection of equity as part of a refinancing exercise, Swedish Match NV is likely to continue to have a large deficit of tangible assets for the foreseeable future. By 1994, according to Swedish Match NV's latest projections, the Gillette mezzanine debt would amount to \$153 million, including capitalised interest, which, as shown in Table 3.10, would be almost 60 per cent of Swedish Match NV's total outstanding debt of approximately \$257 million.

The public interest

7.44. Against this background, we now turn to the question of whether any action or omission on the part of Gillette UK, Gillette Industries or The Gillette Company in respect of the matter specified in the reference operates or may be expected to operate against the public interest. The issues which arise are also relevant to our separate report on merger situations under a reference made to us by the Secretary of State.

7.45. Gillette was the prime mover behind the transaction. It worked closely with the other investors and senior management of the CP Division of Stora to set it up. Together with its advisers, Lazard Brothers and Co Ltd (Lazards), it devised the scheme and brought together the various participants. Lazards was also instrumental in arranging the financing and brought in the US banking group J P Morgan & Co Incorporated (Morgan), which had a long-standing banking relationship with Gillette. In our view, Gillette's position as prime mover enabled it effectively to determine the structure of the transactions. Moreover, the transactions would not, in our view, have been concluded at all had Gillette not taken part in the way described above. We note in this connection that Gillette UK agreed to cede 2 per cent of the

equity to ICG, and that The Gillette Company undertook to Stora to make payments (in certain circumstances) of up to \$11 million to reflect the fact that Stora's loan carried no right to interest, in order to ensure that the deal went through.

7.46. Gillette itself contributed over SEK 86 million (almost US \$14 million) in equity loan stock and almost \$69 million in mezzanine debt. It paid \$72.3 million to Swedish Match NV for the Wilkinson Sword wet-shaving businesses outside the EC.

7.47. Gillette told us that it had not previously made any significant investments in, or provided significant loans to, any non-associated company and that there was certainly no group policy with regard to arrangements of this type, which would be considered on a case-by-case basis.

7.48. Gillette's objective in this transaction is clear and indeed is acknowledged by Gillette: it was to acquire as much of the Wilkinson Sword wet-shaving businesses throughout the world as was permitted by competition authorities. Gillette told us that preventing a competitor from acquiring Wilkinson Sword was obviously a factor, but was not the sole or the principal purpose of its involvement. It has told us that it sought throughout to structure its ultimate involvement so that it would not be, or be seen as being, able to exert any active or passive influence over Swedish Match NV or the businesses which Swedish Match NV would operate, or to have access to any of Swedish Match NV's internal information once it commenced operating.

7.49. Gillette did, however, obtain important rights in relation to Swedish Match NV. In particular, Gillette UK has pre-emption rights over the sale of equity, whether ordinary shares or equity loan stock, to a third party, as described in paragraphs 7.33 and 7.34. This latter provision was included specifically for Gillette's benefit; other equityholders waived this right under side letters, except for the Scandinavian investor group in the limited case where the proposed disposal was by one of the Scandinavian investors.

7.50. Gillette UK also has rights, as described in paragraph 7.36, to convert its equity loan stock into ordinary voting shares in the event of a sale of Swedish Match NV's equity (in the circumstances described in paragraph 7.34), a listing of Swedish Match NV on a stock exchange or a winding up of the company. The evidence of some of the main investors in Swedish Match NV was that either a listing or the sale of the company was likely to take place within five years. Indeed, the investors did not see themselves remaining as shareholders in the long term but would be pressing for an 'exit' within three to five years, and a listing or sale were seen as the main options. Swedish Match NV also confirmed that an early flotation or sale would be in the interests of its shareholders (see paragraph 5.95).

7.51. Gillette UK's rights under the Equityholders' Agreement where a listing is proposed are described in paragraph 7.35. In effect Gillette UK could prevent a listing by buying, or nominating a purchaser for, the equity of the other shareholders if one was proposed. It also has pre-emption rights under the Equityholders Agreement over the sale of Swedish Match NV's assets. Swedish Match NV cannot sell 'the whole or any substantial part' of its wet-shaving business or assets, unless it has first offered them to Gillette UK (or its nominee) at the same price and on the same terms. Gillette is therefore also in a position to block the sale of Wilkinson Sword, or a substantial part of its wet-shaving assets, to a company which it did not want to own the business or assets. The mere existence of these rights would, in our view, affect the likelihood of bids being made for the business or assets, given the significant costs associated with assessing and making a bid.

7.52. With these rights, Gillette could, in effect, determine the ultimate destination of the effective control of Wilkinson Sword or of the assets or business of Wilkinson Sword, keeping out another competitor or a potential competitor, and preventing the management from entering into a merger or joint venture with someone of whom Gillette did not approve.

7.53. Under an agreed settlement of proceedings by the US anti-trust authorities, Gillette and Swedish Match NV gave undertakings to the US Department of Justice, which led to a consent order being entered by the US Court in July 1989, as set out in Appendix 2.3. Gillette undertook not to acquire any additional interest in securities of Swedish Match NV other than as interest on existing debt or as conversions of existing shares to voting shares, and not to buy assets from Swedish Match NV except in limited circumstances. The undertakings do not, however, prevent Gillette selecting a person to take up its rights where it is entitled to do so. If Gillette were to acquire voting rights by conversion of its existing loan stock

(as would be permitted) it would have to use a proxy to cast all voting rights in the exact proportion as the votes cast by other equityholders. Gillette also undertook not to participate in management, or to suggest or nominate any Board members, managers, officers or advisers for Swedish Match NV. Gillette undertook not to use its creditor position to prevent or restrict the raising of new credit or capital or to do anything to cause Swedish Match NV to become insolvent or, if it was insolvent or at risk of becoming insolvent, to vote against any reorganisation plan proposed or supported by Swedish Match NV. The undertakings may be waived with the agreement of the Department of Justice or the US courts.

7.54. In our view, the actions on the part of Gillette UK, Gillette Industries or The Gillette Company relevant to the public interest to be considered are:

- Gillette UK, Gillette Industries and The Gillette Company's involvement as the prime movers in setting up the transactions relating to the acquisition of the CP Division of Stora by Eemland.
- Gillette UK's participation in the equity of Swedish Match NV, through its subscription for convertible loan stock.
- The participation of Gillette Industries, through its subsidiary Lustrasilk, as a creditor of Swedish Match NV, through its provision of mezzanine debt of \$69 million.
- Gillette UK's participation in the Voting and Management Agreement.
- Gillette UK's acquisition of pre-emption and conversion rights and options, set out in the Equityholders Agreement (as amended by the side letters to that Agreement) and in the Loan Stock Instrument.
- The Gillette Company's acquisition of the non-EC/US businesses of Wilkinson Sword, and its participation in the IP Agreement.
- The supply arrangements between Swedish Match NV and The Gillette Company.

7.55. Gillette has important continuing rights and interests in Swedish Match NV, as well as having played a crucial role in setting up the transaction. The main question is whether these various rights and interests, whether considered alone or in conjunction with Gillette's actions in setting up the transactions, have implications for competition in the wet-shaving market.

Effectiveness of Wilkinson Sword as a competitor

Gillette's involvement in the transactions

7.56. Gillette saw no reason why the fact that it had provided Swedish Match NV with finance should deter Swedish Match NV from competing with Gillette in the United Kingdom or elsewhere. Any suggestion that Swedish Match NV ought to show deference to Gillette because of its equityholder and creditor status was unfounded, notably because the terms of the transaction ensured that Gillette held none of the rights to influence generally associated with such status. Swedish Match NV also said that it intended to compete as vigorously as before.

7.57. We consider, however, that a prudent management would be bound, in formulating its policy, constantly to take into account the fact that Gillette was a major shareholder in its parent company, was its parent company's largest creditor and had important rights in relation to significant decisions relating to the future of the company, notwithstanding the limits to Gillette's rights as described earlier. The fact that Gillette was the prime mover behind the transaction and was a major party in the detailed discussions, with the CP Division management and others, which led to the transaction is also likely to lead Wilkinson Sword where possible to avoid damaging the interests of Gillette. For each of these reasons, we expect that Wilkinson Sword would compete less aggressively with Gillette than would otherwise be the case.

7.58. We have already noted that the wet-shaving market has few suppliers world-wide and there are a number of practical barriers to entry. Distribution channels do not encourage new entry and strong consumer loyalty also makes it more difficult. Dry-shaving and depilatory products are not considered by most wet shavers to be close substitutes for wet-shaving products. Gillette is the largest United Kingdom supplier, and Wilkinson Sword is the next largest competitor in value terms and Gillette's only significant United Kingdom competitor across the whole range of wet-shaving products. In view of these facts, we consider that any reduction in how aggressively Wilkinson Sword competes with Gillette will have an adverse effect on competition which would not be offset by increased competition from other sources (such as smaller suppliers, new entrants or imports).

7.59. We conclude therefore that the actions of Gillette UK in participating in the equity of Swedish Match NV, through its subscription for equity loan stock, Gillette UK's participation in the Voting and Management Agreement, Gillette UK's acquisition of rights under the Equityholders Agreement (as amended by the side letters to that Agreement) and the participation of Gillette Industries, through its subsidiary Lustrasilk, as a creditor of Swedish Match NV, through the provision of mezzanine debt, may be expected to operate against the public interest in that they may be expected to lead to a reduction of competition in the wet-shaving market.

The structure of the transactions

7.60. We have already seen that the structure of the transactions was effectively determined by Gillette (see paragraph 7.45). The financial structure of Swedish Match NV was highly leveraged and remains so, even after the sale of the matches and lighters businesses. The evidence does not suggest that the viability of Swedish Match NV is in doubt. As noted in Table 3.8, however, the value of the goodwill arising on the transaction is likely ultimately to amount to nearly \$250 million. This represents almost 40 per cent of the purchase price for the CP Division of \$627 million. If, moreover, the amounts received or expected to be received for the non-EC/US shaving business (\$66 million) and the matches and lighters businesses (\$352 million) are deducted from the purchase price for the CP Division, it will be seen that the residual net cost to Swedish Match NV of the EC and US shaving businesses was some \$209 million. This represented the \$250 million attributed to goodwill, less a deficit of \$41 million on net assets, and was largely financed by debt rather than equity. The exceptionally high gearing, a consequence of the structure devised by Wilkinson Sword's main competitor, is a factor which is likely to impose some inhibitions on Wilkinson Sword's ability and propensity to engage in aggressive and innovative competition.

7.61. Wilkinson Sword's margins have been much lower than those of Gillette. The need to reduce its debt was implicitly recognised by the increased margins contained in the financial projections made for the new company. Swedish Match NV has told us that it considers that it would be able to achieve these increases in its margins by improvements in productivity rather than by raising prices. It has already secured some margin improvements by closing the Spanish factory and restructuring production in the Cramlington factory. Nonetheless, an important potential competitive strategy, of gaining market share by lowering prices, is likely in our view to have been effectively ruled out by its debt structure and gearing. The pressure to repay its debt is also likely to affect its expenditure on R&D, and on advertising and promotion, both of which, as noted in Chapter 4, are important in this market. The range of products offered by Wilkinson Sword is therefore likely to be adversely affected. It is also likely to limit its risk-taking and innovation.

7.62. We therefore conclude that the actions of Gillette UK, Gillette Industries and The Gillette Company, as the prime movers in setting up the transactions relating to the acquisition of the CP Division of Stora by Swedish Match NV in such a way as to place a heavy burden of debt on that company, may be expected to operate against the public interest by reducing the competitiveness of Wilkinson Sword and inhibiting competition in the wet-shaving market.

Implications of the IP Agreement

7.63. The Gillette Company acquired the branded wet-shaving businesses, most notably the trade marks, know-how and other intellectual property, of Wilkinson Sword outside the EC and the US, as an integral part of the arrangements. This involves a significant loss of export markets for the Wilkinson Sword brands. The volume of sales to these export markets represented about 40 per cent of United Kingdom production in 1989 (although since then a factory in Spain has been closed and certain production transferred between Wilkinson Sword's production facilities in the United Kingdom and Germany).

7.64. It was suggested that Gillette's ability to sell Wilkinson Sword products in Austria and other EFTA countries, which have duty-free access to the EC, might open up the possibility of imports back into the EC of those very products at prices below those of Wilkinson Sword itself. (The price Gillette pays under the Supply Agreement is considerably-mostly 20 to 50 per cent-below Wilkinson Sword's wholesale prices in the United Kingdom). Swedish Match NV considered that Gillette would keep to the terms of its contractual undertakings not to damage the Wilkinson Sword trade mark, but felt that other parties (eg customers of Gillette in those territories) might act differently, which would be of concern. Although Swedish Match NV had legal rights to prevent the resale of those products within the EC, it did not think that it could in practice enforce those rights as to do so might involve taking action against some of its own major customers, which operate in both Austria and Germany. Moreover, if Gillette or its customers did undercut Wilkinson Sword's prices in neighbouring non-EC markets the potential problems arising from the contiguity of markets are less relevant to the United Kingdom. Any effect on Wilkinson Sword's performance in the United Kingdom would therefore be less direct. We do not consider that the evidence establishes that this may be expected to happen, or, if it did, that it would have a significant effect on the United Kingdom market.

Effectiveness of Gillette as a competitor

7.65. A related issue is whether any of the actions set out in paragraph 7.54 will have any implication for Gillette as a competitor. As a result of its involvement in the transactions, Gillette saw detailed financial projections for Wilkinson Sword, including margin and sales estimates. It also gained access to certain technology. Neither Swedish Match NV nor Gillette considered that this technology would be especially valuable to Gillette, but we consider that access to detailed margin and sales information and knowledge of the state of Wilkinson Sword's technology must have strengthened Gillette's competitive position *vis-à-vis* Wilkinson Sword. As a result of Gillette's acquisition of the non-EC/US Wilkinson Sword wet-shaving businesses, Gillette will also benefit from further economies of scale, and, having bought the Wilkinson Sword businesses, will probably be able to save on advertising and promotion costs in a number of markets, which could also assist its ability to compete in the United Kingdom.

7.66. Gillette has no right as an equityholder to internal information about Swedish Match NV, no right to attend meetings of equityholders, and no Board representation. This self-imposed exclusion from involvement in management was, however, not sought by the other shareholders or by Swedish Match NV itself, but was included to meet Gillette's concern to avoid action by competition authorities. We also note that, as Gillette will be Wilkinson Sword's main customer until the end of 1991, there is a need for regular contact and goodwill between the two companies. If Gillette were to retain the various rights and interests which it has in relation to Swedish Match NV, we would expect that in time the Wilkinson Sword management would wish to get closer to Gillette, which would not be prevented by the constraints mentioned above. This would be detrimental to competition. We conclude that the actions of Gillette in participating in the acquisition of the CP Division in the ways described in paragraph 7.54 may be expected to operate against the public interest in that they would lead to a reduction in competition in the wet-shaving market.

Effects on potential competition

7.67. Gillette UK has important pre-emption rights in relation to the sale of shares, and in relation to the sale of the whole or a substantial part of Swedish Match NV's wet-shaving business or assets. It is therefore in a position to block the sale of Wilkinson Sword, or a substantial part of its wet-shaving assets, to a

company which Gillette did not want to own that business or those assets. It is also in a position to block a joint venture, if this involved the sale of shares or assets. These rights also enable Gillette to prevent deals such as a sale of business or assets to a competitor or a potential entrant. Such deals could be beneficial in terms of competition compared with sale to a Gillette nominee. We have already noted that there are significant entry barriers to a new entrant becoming established in the United Kingdom market, even one which is a significant player in other markets. For Gillette to be able to prevent an acquisition of Wilkinson Sword or its assets is, in our view, not in the interests of competition as it could prevent companies such as Warner-Lambert or American Safety Razor from increasing their currently small market share, or a major new player from entering the market. Moreover, as we have already noted in paragraph 7.51, the mere existence of the rights would affect the likelihood of bids being made for the wet-shaving business or assets of Wilkinson Sword given the significant costs involved in assessing and making a bid. Indeed we consider it to be against the public interest for Gillette to have any influence in relation to the sale of shares or assets of its principal competitor in the United Kingdom market. We conclude that Gillette UK's acquisition of pre-emption and conversion rights and options under the Equityholders Agreement (as amended by the side letters to that Agreement) and in the Loan Stock Instrument may be expected to operate against the public interest, as they reduce potential competition in the wet-shaving market.

Reduction in competition

7.68. We have identified a number of reasons for expecting competition between Gillette and Wilkinson Sword to be less active than it would have been if Gillette had had no involvement in the transactions relating to the acquisition of Stora's CP Division by Swedish Match NV. Gillette suggested to us that there was vigorous competition, and potential new entry, from Wilkinson Sword, Bic, Schick and own-label suppliers. We have already noted that the largest own-label supplier is Wilkinson Sword, and that Bic only supplies disposable razors. The Schick brand is not well developed in the United Kingdom, with a share of only 1 per cent. We have also noted (see paragraph 7.18) that recent price competition, particularly in the systems razor segment and in part of the disposable razor segment, has been less than vigorous. There are a number of practical barriers to entry. The view of Warner-Lambert and Bic was that it was very difficult for companies to get established in the market, and that significant advertising support as well as technological development was needed. Distribution channels do not encourage new entry and strong consumer loyalty also makes it more difficult. In our view it cannot be expected that new entry, development of Bic or Warner-Lambert's position or imports will occur to any significant extent and therefore they are unlikely to act as a check on the diminution of competition which we expect to result from the transactions.

7.69. We expect the result of the reduction in competition to be that prices will be higher than they would otherwise be. There is also likely to be a reduction in Wilkinson Sword's ability to introduce new products.

Conclusions in respect of the public interest

7.70. We therefore consider that the effect of Gillette's involvement in the transactions, and specifically the giving of assistance to and the provision of finance for Swedish Match NV in or in connection with the acquisition of Stora's CP Division in the ways described in the above paragraphs, is to weaken the competitiveness of its main competitor in the United Kingdom, to strengthen its own competitive position, and to reduce potential competition. These effects derive either separately or from the combination of each of the actions specified in paragraph 7.54 as explained in detail above. As we have shown, the particular effect adverse to the public interest is that both actual and potential competition in the supply of razors and razor blades is likely to be reduced. For the reasons we have given, this will result in prices being higher than they would otherwise be and in a reduction in consumer choice.

Benefits arising from the transaction

7.71. Gillette's submission was that the transactions would have no anti-competitive effects or public interest consequences. Swedish Match NV said that had the transactions not been concluded, the likely alternative would have been a sale to a competitor, which would have led to increased concentration in the market. We do not consider that this factor in any way reduces the adverse effect we have identified. Moreover, it is by no means clear, given the market structure, that purchase by another company would have been more detrimental to competition in this market. Swedish Match NV told us that it considered that the sale of the non-EC/US businesses had resulted in some benefits to it as it led to a more focused business. We consider, however, that any such benefits are more than outweighed by the detriments we have identified. We do not consider that other benefits arise, nor did the various parties suggest any.

US undertakings

7.72. Gillette's undertakings given to the US Department of Justice, as discussed in paragraph 7.53, are set out in Appendix 2.3. As noted in that paragraph, the undertakings may be waived with the agreement of the Department of Justice or the US courts. These undertakings were drawn up to take account of competitive considerations in the USA which are not in all respects-notably the share that Wilkinson Sword has in the market-comparable with those in the United Kingdom. Although the undertakings reduce to some extent the adverse effect arising from the transactions, they do not remove the concerns that we have identified about the effects on competition in the United Kingdom wet-shaving market.

Remedies

7.73. We have concluded that a monopoly situation exists in favour of Gillette UK, Gillette Industries and The Gillette Company. We have also concluded that certain actions on the part of those persons may be expected to operate against the public interest. We have specified the particular effect, adverse to the public interest, which we consider those actions may be expected to have. We now have to consider what action should be taken for the purpose of remedying or preventing that adverse effect.

7.74. As noted in paragraph 7.65, as a result of its involvement in the transactions, Gillette gained access to detailed financial information about Wilkinson Sword. Any benefit Gillette has gained from this cannot be removed. Other aspects can, however, be remedied. A remedy which was suggested to us was to require Swedish Match NV to divest Wilkinson Sword, thus removing the main links that have been created between Gillette and Wilkinson Sword. This, however, would be likely to place a significant financial penalty on other investors in Swedish Match NV, whose involvement does not give rise to public interest concerns. Moreover, other equally effective remedies are available. We therefore do not consider that such divestment should be recommended.

7.75. The views of Gillette and Swedish Match NV on possible further remedies are given in paragraphs 5.75 to 5.85 and 5.134 to 5.144 respectively. Although Gillette maintained that its involvement in the transaction had no effects which would operate against the public interest, it indicated, in response to our invitation in the course of the inquiry to discuss possible remedies on a hypothetical basis, that it would be prepared, if necessary, to offer undertakings on the lines of those set out in paragraph 5.85. Some of these undertakings mirror those given to the US Department of Justice, but others go further. These undertakings would, however, not in our view sufficiently remedy the adverse effect which we have identified.

7.76. We consider that the correct approach is to remove the aspects of the continuing arrangements which contribute to the influence of Gillette over Swedish Match NV and to the likely reduction in competition, namely the various rights and interests which Gillette has acquired in Swedish Match NV.

7.77. We therefore recommend that:

- (a) Gillette UK should dispose of its equity interest in Swedish Match NV, and all pre-emption and conversion rights and options in the Equityholders Agreement and the Loan Stock Instrument. This should not be to an associated company.
- (b) Gillette UK should require its subsidiary Lustrasilk to dispose of its interest as a creditor of Swedish Match NV. This should not be to an associated company. It may be that Swedish Match NV will see it as in its interest to refinance this debt in the near future. In this case, Lustrasilk's interest as a creditor would be removed anyway. We would therefore suggest that the timing of this requirement should be considered by the Director General of Fair Trading and the Secretary of State in the light of Swedish Match NV's intentions.
- (c) Pending these disposals, Gillette UK should waive its pre-emption and conversion rights and options and should give undertakings similar to those given to the US Department of Justice.

M S LIPWORTH (*Chairman*)

J S BRIDGEMAN

R O DAVIES

J D KEIR

G C S MATHER

S N BURBRIDGE (*Secretary*)

12 December 1990