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The reference

2.1. On 21 February 2001 the Secretary of State for Trade and Industry referred to the CC for investigation and report under the merger provisions of the Fair Trading Act 1973 (the Act) the proposed acquisition of Harcourt by RE.

2.2. Our terms of reference are at Appendix 1.1. We are required to report by 28 May 2001.

The companies involved

RE

2.3. RE is an international company formed, in 1993, by Reed International PLC (Reed) and Elsevier NV (Elsevier). Each owns 50 per cent of its share capital. It is registered in the UK, and is active worldwide through a range of subsidiaries—though its main areas of operation are in Europe and North America. Its principal activities include: publishing a variety of academic, legal, business, consumer, accountancy and tax titles; organizing exhibitions and seminars; producing materials for the study of English; and providing services for the travel industry.

2.4. RE divides its activities into four business segments.

(a) The first, Science & Medical, produces—in print and in electronic formats—a portfolio of peer-reviewed research journals and other academic publications, including monographs and reference works, and information services, such as abstracting and indexing products, and databases. A number of these titles moved to Elsevier in 1991 when it acquired the Pergamon Press (Pergamon). It also provides associated software for library management. This segment achieved an adjusted operating profit of £252 million in 2000, on a turnover of £693 million.

(b) The second segment, Business, achieved an adjusted operating profit of £264 million in 2000, on a turnover of £1,672 million. It publishes a range of magazines, and provides a number of online information services, as well as organizing trade shows and other exhibitions.

(c) RE's legal segment achieved an adjusted operating profit of £237 million in 2000, on a turnover of £1,201 million. This includes a number of operations, such as Lexis-Nexis, which provide legal, tax and regulatory information in a range of printed and electronic formats. It also sells legal, tax and reference titles.

(d) The remainder of RE's adjusted operating profits (£[∗] million) and turnover (£202 million) for 2000 came from its Education segment which publishes books and other materials for schools and higher education in the UK, the USA, Australia, New Zealand and South Africa.

Reed

2.5. Reed is based in London, and its shares are listed on the London, Amsterdam and New York stock exchanges. As well as owning 50 per cent of RE, it owns 39 per cent of the share capital of Elsevier Reed Finance BV—the business that carries out the finance functions for RE—and 5.8 per cent of the shares in Elsevier.

Elsevier

2.6. Elsevier is based in Amsterdam. Its shares are also listed on the London, Amsterdam and New York stock exchanges, and it owns the other 61 per cent of the share capital of Elsevier Reed Finance BV.

Harcourt

2.7. Harcourt is a US company, based in Massachusetts, and listed on the New York Stock Exchange. At various times in its history it has been involved with the cinema industry, insurance, department stores and bottling soft drinks. But all of these activities have now been sold or spun off to stockholders, so that, nowadays, Harcourt is the holding company for a group of publishers who provide a range of titles and other products and services in the fields of education, training and assessment. Its turnover in the year to 31 October 2000 was US$2.41 billion. Although Harcourt operates worldwide, more than [✂] per cent of its revenues are generated in North America, and much of its output is aimed at the US market. Less than [✂] per cent of its turnover comes from the UK.

∗The CC has advised us that this figure is inaccurate. It has therefore been excised in accordance with section 83(3) of the Fair Trading Act 1973. It should correctly have read '40'.

2.8. Harcourt's business is divided into four groups of publishers:

(a) The first, K-12 education, accounted for 31 per cent of its turnover in 2000. It produces books and other materials—both print and electronic—for US schools from kindergarten to 12th grade, for adult education and for the teaching of English as a foreign language. This group also includes a general publisher of fiction and non-fiction titles.

(b) The second group, higher education, accounted for 15 per cent of Harcourt's turnover in 2000. It produces books and other materials—both print and electronic—for university and college students, distance learning and professional examinations.

(c) The third group, corporate and professional services, accounted for 23 per cent of turnover in 2000. It produces printed and electronic materials in the areas of information technology, corporate training, testing and assessment, and recruitment and outplacement.

(d) The fourth, the STM group, accounted for the remaining 31 per cent of Harcourt's turnover in 2000. It produces books, journals and periodicals—in both printed and electronic formats—in the fields of medicine, life sciences and healthcare (through Harcourt Health Sciences) and in a wide range of scientific and technical subjects (through Academic Press Limited (AP)). It also provides a range of web-based medical information services and other scientific software, databases and computational tools.

The proposed merger

2.9. In May 2000, the directors of Harcourt decided to explore the possibility of putting the company up for sale. They told us that they did this because, although Harcourt had outperformed the publishing sector in the USA in recent years, they felt that the market had not rewarded this achievement in its stock price. They were also conscious of the sums that their competitors were investing in the electronic delivery of their publications and the additional costs that this would involve for Harcourt were it to remain in this business. So they decided to examine other ways—including disposal—of maximizing shareholder value. They solicited potential buyers, and an auction process was held between June and October.

2.10. On 27 October, one of RE's wholly-owned US subsidiaries entered into an agreement with Harcourt (the main agreement) to make an offer to its stockholders to buy all outstanding common shares in the company. Further details of the offer are set out in paragraphs 3.80 to 3.87. On the same day, another of RE's US subsidiaries entered into an agreement (the Thomson agreement) which was subject, inter alia, to the proposed merger going ahead, to sell on parts of Harcourt's business to Thomson for US$2.1 billion. Under the agreements, RE would retain the K-12 education business, STM publishing and two education and clinical testing businesses from the corporate and professional services group. Thomson would acquire the rest of that group, and the higher education group.

2.11. RE launched the offer promised in the main agreement (at a price of US$59 a common share—valuing Harcourt at US$4.4 billion) on 8 November. It is conditional, inter alia, on approvals being obtained from relevant competition and antitrust authorities in a number of countries. The transaction was notified to these authorities in the USA, the UK, Ireland, Germany, Austria and Brazil. The Irish concluded that the transaction was not notifiable under their Mergers and Takeovers (Control) Acts 1978 to 1996. Austria, Germany and the USA have all issued clearances. The investigation by the competition authorities in Brazil is continuing.

2.12. The offer period was initially 20 business days. There is provision for it to be extended, but not beyond 24 July 2001. The offer period has already been extended several times. When announcing, on May 4, the latest extension (to 4 June), RE explained that the offer was being extended to accommodate the continuing regulatory review in the UK and the USA (the US decision to clear the merger was made public shortly afterwards) and that it might be extended further in due course.

Jurisdiction

2.13. Under our terms of reference (see Appendix 1.1) we are required to investigate and report on whether arrangements are in progress or contemplation which, if carried into effect, will result in the creation of a merger situation qualifying for investigation, as defined in the Act, in that:

(a) enterprises under the control of RE will cease to be distinct (within the meaning of the Act) from enterprises under the control of Harcourt; and

(b) the value of the assets, calculated in accordance with section 67, which will be taken over exceeds £70 million (the assets test); or the share of supply test, set out in section 64(2) and (3) of the Act is satisfied.

2.14. Section 63(2) of the Act defines 'enterprise' as the, or part of the, activities of a business. Section 65 specifies the circumstances when two enterprises are to be regarded as ceasing to be distinct. One is where they are brought under common ownership or control.

2.15. If we find that such arrangements are in progress or contemplation, then we are required to consider whether the creation of the merger situation may be expected to operate against the public interest.

2.16. It is clear from the main agreement, the Thomson agreement, the offer and from what the parties have told us that arrangements are in progress which, if carried into effect, will result in those enterprises currently under the control of Harcourt (which it is not intended will be sold on to Thomson) and enterprises under the control of RE coming under common control. It is also clear, from paragraph 3.91, that the value of the assets taken over, calculated in accordance with section 67, exceeds £70 million (whether or not those to be sold on to Thomson are included).

Conclusion on merger situation

2.17. So, for the above reasons, we find that arrangements are in progress which, if carried into effect, will result in the creation of a merger situation qualifying for investigation. And thus we are required to consider whether its creation operates or may be expected to operate against the public interest.

2.18. We do not need to consider whether the enterprises that are the subject of the Thomson agreement should be included in the merger situation as they would not, in any event, give rise to public interest concerns (see paragraphs 2.19 and 2.20). So, we shall proceed on the basis that the enterprises that will cease to be distinct are those now under the control of RE and Harcourt which are not covered by the Thomson agreement.

The publications and services concerned

2.19. Of the four businesses into which Harcourt's activities are divided one, corporate and professional services—most of which is to be sold to Thomson—has few sales in the UK, and no significant overlaps with RE's operations in these areas.

2.20. This is also largely true in educational publishing where, although both companies produce schoolbooks, textbooks for university courses and other teaching materials, Harcourt's schoolbook output is focused exclusively on the syllabus taught in US schools, with minimal sales in the UK. RE is much less significant in the publication of university textbooks than it is in STM journals, and Harcourt accounts for only 1 per cent of the university textbooks sold here. It is, in any event, the intention that this part of Harcourt's business will be sold to Thomson, as soon as the proposed acquisition is completed.

2.21. The area where there are overlaps is in STM publishing. This sector can most easily be discussed as two separate segments: books and journals.

2.22. STM books tend to be published once an area of research has reached a reasonably mature state. Their purpose is to document the work that has been done and provide a reference point for those not intimately engaged in research. They are also used as an aid to teaching students and others coming into a field of study. They are particularly important in medicine and other life sciences where there is a large population of practitioners who need to keep abreast of the latest developments, but are not, themselves, active participants in the research community. Harcourt is particularly strong in this area and around two-thirds, by value, of its STM publications sold here are books—it has a 7.6 per cent share, by value, of the UK market. RE, however, is not a significant publisher of STM books (it has a 3.4 per cent UK market share) and we have received no expressions of concern that the proposed merger is likely to raise problems in this area.

2.23. STM journal publishing, however—which focuses much more on current research and plays a central role in how the worldwide scientific community operates—is an area where both companies have a significant presence in the UK market. If their publications were aggregated, they would account for a sizeable proportion of sales. Exactly how big a share is, however, very difficult to say. There is no comprehensive collection of data, and of the several hundred UK libraries that subscribe to these titles only eight have responded to our questionnaire asking for details. The figures that we do have are set out in Tables 4.8 and 4.9, and the limitations on the data explained in paragraphs 4.87 and 4.88. They show RE with about one-quarter of the UK market—both print and electronic—by value, and Harcourt with around 7 per cent, though both companies have pointed out that, not only do these figures include titles that they publish on behalf of others as well as their own journals, but also that their estimate of their share of the UK market is, in any event, lower. Both companies publish STM journals across a large number of fields and their output is sold worldwide. However, to put this in context, it is worth pointing out that only [✂] per cent of Harcourt's STM journal sales are made in the UK, and that they represented only [✂] per cent of the company's total worldwide turnover in the year to 31 October 2000 (a little under US$[✂] million out of US$2.41 billion).

2.24. The companies also overlap in the provision of publication services to learned societies and other bodies which issue journals under their own name. But the position of both is weaker in this sector than in the publication of the titles that they own, for a number of reasons. First, there are many players in contract publishing. Second, while RE and Harcourt are leaders in self-published titles, other publishers, such as Blackwell Science Ltd and Oxford University Press, are more strongly focused on publishing journals for societies. And, third, the sector is much less stable. Societies normally contract out the publication of their titles for a fixed period—usually between one and five years—at the end of which they will seek new tenders or revert to publishing the journal themselves. Society-owned journals account for about 10 to 12 per cent of the total number of titles that RE publishes, and around 25 per cent of Harcourt's.

2.25. So for the rest of this chapter we focus largely on the STM journals that RE and Harcourt publish themselves.

The market for STM journals

Market definitions

2.26. Product markets are generally defined by examining whether there are close substitutes on either the demand or the supply side for the relevant goods or services (supply-side substitutability also takes into account the ease with which a new supplier can enter a market) and by applying the 'hypothetical monopolist test'. This asks whether someone who supplied 100 per cent of a particular product could raise prices by, say, 5 to 10 per cent, and sustain them for a reasonable time, without losing profits as a consequence of customers buying other products, or suppliers of similar products shifting their production to supply the products of the monopolist. If the hypothetical monopolist could not profitably sustain such a price rise, then those other products should be included in the same market as the product under consideration. Applying this approach to STM journals leads to the result that a single leading title can often be regarded as constituting a unique market.

2.27. But if there is little noticeable price competition between journals, there is major competition over quality. This takes its keenest form over the input to the journal: competition to secure and maintain the best people as editors and on editorial boards, for authors, and for high-quality articles that are going to have an influence on shaping the way in which research develops and are going to be quoted and cited by others.

2.28. Another form that competition takes is innovation. Although the well-established journals have strong followings in their traditional subject areas, because the wellspring of research is the quest for new ideas and discoveries, fresh subject areas are constantly emerging, as are novel ways of looking at more traditional disciplines, or at re-evaluating the boundaries between them. This regularly creates opportunities for publishers to identify trends and to launch journals that will take advantage of them.

2.29. Over the last decade there has also been competition in the development of Internet-based delivery platforms to facilitate electronic access to journals. All of the major STM publishers have been active in this area. Harcourt was one of the first to enter the field, and RE is the current industry leader.

2.30. One measure of success in all these forms of competition is winning—or retaining—subscriptions. Those within institutions who take decisions about which subscriptions to keep and which to give up, do so almost entirely on the basis of an assessment of a journal's relative quality and academic pressure. If financial constraints mean that an institution cannot subscribe to all of the journals that it would like to—or even that it used to—take, then it is more likely to sacrifice those that are comparatively weakest in their field, rather than those that are most expensive.

2.31. STM journals operate in a market where a multiplicity of suppliers—some driven to maximize their returns, others not—each with a range, some very large, others very small, of differentiated products, all compete to increase, or at least retain, their share of libraries' and other subscribers' budgets, through quality and innovation.

2.32. As for the relevant geographic market, everyone that we have spoken to has told us that, for STM primary-research journals, it is global—though some of the medical journals that focus on clinical practice can have a more local readership. The distribution of subscribers may vary from subject to subject. A rough rule of thumb is that international STM journals published in Europe will sell about one-third of their subscriptions in their home market, another third in North America, and the remaining third elsewhere. Journals published in the USA often have a higher proportion of subscribers in North America. As English is the lingua franca of STM research, all the truly international journals publish in English wherever they are produced, and researchers who write articles will normally seek to have them appear in the best journal in their field, not the most local one.

What is an STM journal?

2.33. STM journals have a central role within the worldwide community of academic and commercial researchers. They constitute the major forums for disseminating information about current work and provide the means by which new ideas are introduced and—through a process of discussion and review—either rejected, or accepted by the community as a valid addition to knowledge. Over the last 50 years, the resources devoted to STM research worldwide, and the numbers engaged in it, have grown considerably, as has the range of countries and institutions in which work is undertaken. At the same time, there has been a parallel growth in the number of STM journals and articles.

2.34. STM journals offer a variety of services to the international research community, but three are probably more important than the rest. The first is providing a channel through which information can be disseminated. For this to be effective, research articles must be published quickly and the journal must have a global reach. So, over the years, a number of journals have established themselves as the leading publications in specific areas of research, offering high-quality print—and more recently electronic—issues that provide regular and frequent information about the major developments in their field.

2.35. The second service that they provide is a mechanism for authenticating and filtering research findings. In most cases, decisions about what appears in a journal will be taken by an editorial board, made up of acknowledged experts in the subject areas that it covers. Individual articles will be peer reviewed by referees—leading academics or other researchers working in the same field as the author—who report to the editorial boards with an assessment of the originality of the research, whether it is soundly based and whether the conditions under which it was conducted were sufficiently rigorous. They may also suggest ways in which an article can be improved. Editorial boards reject a number of articles at this stage, which fail to meet the required standards. So readers know that the articles that do eventually appear can be regarded as serious and worthwhile contributions to the discipline.

2.36. The third of the major services that these journals provide is to establish priority in new areas of research. With so much work going on in so many centres, the international research community needs impartial arbiters to determine which team was the first to come up with a particular advance. The journals, which carefully record when an article was received, when it was reviewed and when it was published, play an important role in this process.

2.37. Journals have other functions too. Over the years their body of articles comes to constitute a well-documented archive of developments in particular subject areas. And the creation of new journals can help focus attention on emerging fields of study or the development of inter disciplinary research. In medicine particularly, journals also act as a means of keeping practitioners up to date with the latest developments in research. This means that some medical titles have a much larger circulation than most other STM journals, and a few even carry a significant amount of advertising, which those in other disciplines rarely do. Both of these factors can also be reflected in lower prices.

2.38. There are no definitive figures about the number of STM journals produced worldwide, but the International Association of STM Publishers estimates that there are around 12,000 international titles that have more than 500 subscribers. Within this total, the Institute for Scientific Information (ISI) collects data on just over 7,700 of the larger and better established ones and rates journals on the extent to which the articles they publish are cited. It breaks the STM field down into 205 distinct subject areas, the largest of which (psychology) accounted for 392 journals and nearly 16,500 articles in 1999; and the smallest (andrology, a branch of clinical medicine) 4 journals and around 250 articles. An analysis of the most-cited journal in each subject area in 1998 showed that, of the 172 titles concerned (some topped more than one category): 81 were produced by (53) self-publishing learned societies, 80 were produced by (16) commercial publishers—although this figure includes a number of society-owned journals which the commercial publishers produced under contract—and the remaining 11 were produced by (10) university presses. Of the 80 titles produced by commercial publishers, 25 came from RE (7 of them under contract to societies) and 6 from Harcourt.

Who publishes STM journals?

2.39. There are three broad categories of STM publishers.

2.40. Most journals are produced by commercial publishers, a group that includes RE and Harcourt. The number of members of this group has declined in recent years, as a result of consolidation, and those that remain vary significantly in size. But they do include the producers with the largest portfolios of titles. RE, with over 1,200 research journals, is the largest single publisher, both by the number of its titles and their value. Harcourt, with over 500 STM journals, is regarded as the second or third largest. Commercial publishers are long-established players in STM journals, but have become increasingly prominent in recent years, through increasing the size and frequency of their established titles, and through launching new ones.

2.41. The most numerous STM publishers are the learned societies. These are typically membership organizations which academics, other researchers and—in some areas—practitioners join. Most produce journals to publish articles by, or of interest to, their members. In some cases their journals do not develop, and circulate almost entirely within the membership. In others, society journals have become accepted as the leading publications in their field, attracting articles from around the world and circulating to all the major research and university libraries. Although some of the most highly-regarded societies publish a large number of titles—the Institute of Electrical and Electronics Engineers: 93, the American Institute of Physics: 41, and the American Chemical Society: 31—most are much more modest publishers with many producing only one or two. Some societies publish their journals themselves; others contract out publication, but retain control over areas such as content and pricing; while others still produce their journal as a joint operation with a commercial publisher or a university press.

2.42. These university presses constitute the final group of STM journal publishers. They are fewer in number than the learned societies, but each publishes a larger number of titles than most of them. Like the societies, some of their publications do not achieve widespread currency, but others are highly-regarded international journals, sometimes becoming the leading title in the field.

Barriers to entering this market

2.43. There are differing views about how difficult it is to enter this market. New titles appear frequently and, in some ways, barriers to entry are very low. But it is much more difficult—and takes considerably longer—for a journal to become established and secure a strong reputation. The basic raw material for STM journals is articles reporting the outcome of academic research. And the number of them has been increasing at a steady rate over the years. Researchers are keen to publish an article as soon as their work is complete, both to disseminate the findings among their colleagues and the wider academic community, and to establish their own position in the area of study to which it relates.

2.44. Most researchers work in places with ready access to word processing and desktop publishing facilities, and many are highly computer literate. So they would face little difficulty in producing a paper and posting it on a web site—their own or their employer's. Nonetheless, most greatly prefer to publish in established journals if they possibly can. Indeed, while there may often be more than one title in which an author may be willing to publish a particular article, the great majority will aim to place their work in the most prestigious journal that will accept it. They do this for a number of reasons. First, the established journals are peer reviewed, which means that the article will be read and commented on by some of the most respected and knowledgeable authorities in the area, and seen by an editor who is often one of the leading figures in the discipline. The quality of the article can sometimes be improved as a result. Next, being published in a leading journal confers status on an author, as it indicates to the wider academic community that the required standard has been met. The most prestigious journals are generally the most widely read and cited. So an author who is published in one of them can be confident that his work will reach a wide and relevant audience, and will have the maximum chance of influencing further research. In some countries, including the UK, where academic research is formally assessed and the outcome reflected in the allocation of funding, having work published in a leading journal is seen by research academics as a way of enhancing their own career, improving the position of their university or institute, and gaining increased access to future grants.

2.45. This creates an environment in which the leading journals in a field enjoy a prestige and esteem that is difficult for others to challenge. Because the best journals enjoy such a high regard, the best researchers vie to be published in them. This enhances their status further. So it is rare for a new journal to be launched successfully in a subject where established journals already exist. New journals do appear, but they mostly deal with new fields of study, areas where traditional disciplines meet or overlap, or where research grows to the point when the flow of new articles becomes large enough to justify a specific journal.

2.46. Attempts have been made to challenge the dominance of the leading journals in established subject areas. But, although there have been a few isolated successes, overall the position of the leading journals remains very strong in almost all fields of STM research.

2.47. Two examples that we have been told about involved an editorial board leaving one journal en bloc, because they felt that the publisher's subscription charges were too high, and setting up a new journal in the same subject area with a publisher who was willing to charge less. On a larger scale, we have been told about a group of US universities whose libraries have joined together—to form the Scholarly Publishing and Academic Resource Coalition to encourage groups of academics to launch new, cheaper journals to compete with established but more expensive ones in specific fields. And we have also heard about a few simple, desktop publishing operations where researchers have come together to publish articles using their own time and the computing and Internet facilities already available at their institutions.

2.48. Another model is the tried and tested one of learned societies or other academic bodies publishing new journals, either on their own or in cooperation with a specialist publisher.

2.49. All of these approaches have achieved a degree of success, but none has had a significant impact of the position of the leading journals. There seem to be a number of reasons for this. One is that the funds available to university libraries, at least in the UK, have not been keeping pace with the annual increase in the prices of STM journals. This has made it difficult, if not impossible, for these institutions to buy new titles without giving up existing ones. And there has been strong resistance to this both from researchers, who want to continue to have access to the leading journals in their field, and from librarians, who are reluctant to stop buying a journal in which they have established an unbroken series stretching back many years. Indeed, as financial pressures have grown, libraries are having to give up less well-regarded titles simply to maintain their subscriptions to the leading journals.

2.50. Another factor, which favours the existing journals, is that, at the purely academic level, there remains a strong preference for what they have to offer. As well as the benefits to authors of having their work appear in their pages, readers prefer them because they can be confident that the articles they contain are scholarly, of high quality and have been reviewed by leading figures in the field. And in the major international fields of study the amount of research going on around the world is substantial, and the established journals perform an essential function in filtering the considerable flow of articles that are being produced and presenting the most important and well attested findings in a limited number of widely available titles. This gives academics the confidence of knowing that if they continue to read the key journals, they will be able to keep abreast of all the major new developments, without having to waste time on poorly researched or insufficiently attested work.

Pricing

2.51. The prices charged for annual subscriptions to STM journals vary considerably.

2.52. First, the journals themselves can be very different. At one extreme, some publishers produce only one or two issues a year with a limited number of articles. At the other, issues may be published weekly, or even more frequently. Some journals are also much larger than others. We have been told that, as the amount of research continues to grow, so does the number of articles. Some of the extra ones find their way into new journals, but others serve to increase the size and/or frequency of existing titles.

2.53. Next, the way in which journals are paid for can vary. For those produced by commercial publishers and the university presses, the usual method of payment is by annual subscription—normally in the autumn, for the year beginning the following January—which covers the full price. Many learned societies, however, provide their journals as part of the wider service that they offer to their members. This can mean either that the cost of the journal is largely or wholly included in the annual membership subscription and so is subsidized by the membership or, alternatively, the proceeds from the journal are used to finance other activities of the society, such as an annual conference.

2.54. Third, the availability of advertising varies widely. For many STM journals, there is next to none, but some medical titles, especially those with a substantial circulation to individuals, carry a large number of advertisements, often from drug companies.

2.55. Fourth, circulation levels can vary widely. As journals published by societies often go to all their members, they can have print runs amounting to several thousand copies. This is also true of some titles—especially medical—where there is a large practitioner community, keen to keep up with developments in research. Journals which are produced just for sale to institutional libraries, on the other hand—whether by commercial publishers or university presses—sometimes have runs of only 500 copies or even fewer. The differing potential that this offers for recovering production costs can be reflected in the price of the journal.

2.56. Fifth, attrition is also a factor. We have been told that because of the constraints on library budgets, publishers face a continual erosion in the number of annual subscriptions that are renewed (paragraphs 4.101 to 4.104, 5.31 and 5.114). To varying degrees they take this into account when they come to establish the prices for their journals in the coming year.

2.57. Sixth, production costs can be influenced by the amount of colour printing, photographs and other graphics required in some sorts of STM publishing. One university press—which publishes both types—told us that this was one of the reasons why the prices of STM journals were higher, as a genus, than those covering the humanities, though the relationship between costs and prices in individual journals is neither clear nor consistent (paragraphs 4.22 and 4.23).

2.58. Seventh, the objectives of publishers can be very different. Some learned societies may see the purpose of their journals as the provision of a service to their members or the wider academic community, and so will be content if they can cover their costs. The commercial publishers, on the other hand, are in business to make money and will aim to take full advantage of any opportunities to increase their profits. Most university presses appear to occupy a middle ground between these two positions, and aim to make a lower level of profit for their parent institution.

2.59. For all these reasons, subscription rates vary widely between journals. Some commercial publishers, including RE and Harcourt, have sought consistently to maximize returns from their journal portfolio. The view of the UK university libraries that gave evidence to us is that they have gone about their task systematically, making a careful assessment of the value to researchers of their more prestigious titles, and pricing them accordingly. As most libraries have felt unable to cancel these key journals, even though their prices have risen well ahead of other publications and inflation generally, it is subscriptions to the less well-regarded journals that have suffered as a result.

2.60. There is some evidence, however, that this approach has been moderated over the last year or so because the point may have been reached where the detriment to the income of some commercial publishers from cancelled subscriptions has neutralized—or at least seriously undermined—the benefit from increased prices. RE's decision to give a pledge that the year-on-year price increase in its own journals would not exceed 10 per cent is seen as an example of this. Clearly the smaller a journal's circulation, the more significant will be the loss of a given number of subscribers. There are reputational issues too. As a journal's circulation falls, fewer researchers have access to it. If they do not see its articles, then they will not cite them in their own work, and if the number of citations falls, a journal's reputation will decline. So there is a complex nexus of issues that publishers have to take into account when they come to set the prices for their subscriptions. There are differing views too on how price rises should be assessed. Although they are conventionally described as year-on-year increases in annual subscriptions, a journal may issue more volumes in a given year than it did in the one before, or carry more articles per volume. So a growth in subscription rates can sometimes translate into a smaller increase—or even a fall—in price per volume or per article. Nonetheless, RE is still seen as a price leader by many of those that we have spoken to, and its journals still figure at the top end of subscription rates in a number of subjects. And, despite its recent pledge about limitations on annual price rises, the more significant rates of increase that it achieved in earlier years are still locked into its prices.

2.61. That said, price competition is not a dominant feature of this market. Because so many journals have a particular reputation or specific focus in the subject matter that they cover, the willingness of researchers to substitute a cheaper journal for an expensive one is often limited, if it exists at all. This means that the constraint on pricing for any one journal is much more what the market will bear—ie what libraries are able or willing to pay—than what other publishers are charging. We have been told that this can sometimes lead to perverse results. For example, if a very well-regarded but expensive journal increases its price further, it is the cheaper, but less-well regarded journals in the same field that are cancelled, so that the subscription to the leading journal can be maintained. This means that a publisher sometimes has the potential to increase his market share by raising his prices.

Demand for STM journals, and those who buy them

2.62. Demand for the most highly-regarded titles appears to be very inelastic. Academics working in the specialized fields that most individual journals cover regard easy access to key publications as a central element in keeping up with what is happening in their research community.

2.63. The market for STM journals is largely circular. Academics and other researchers write the articles; their colleagues peer review them, and these same members of the research community—or rather the libraries of the institutions that employ them—then subscribe for the journals that result. But while the academic community is passionate about the quality of these journals, we were surprised by the fact that one respected editor whom we met did not know the price at which his journal was being sold, or that it had risen substantially in recent years.

2.64. STM journals are sold largely to academic libraries in universities and other centres of scientific research. Those published by learned societies are also bought by individual members. And some medical journals have a wider distribution. Many Harcourt journals are particularly well placed in this sector.

2.65. Funding is a major concern for university research libraries, at least in the UK, and we have been told by many of those whom we have seen that while expenditure on scientific research has risen significantly over recent decades—and with it the number of STM journals and articles—funding for libraries has failed to keep pace. We were told that only about one-third of the money that libraries receive is spent on books and journals, with the other two-thirds going to meet staff and building costs. Several UK libraries told us that at the moment they are at a difficult juncture. They have to maintain their subscriptions to print titles, because not all journals are yet available electronically—and even for those that are, there are concerns over archiving and access to past issues. A printed journal, once bought, remains on the shelf. For an electronic journal, access rights have to be negotiated and there are doubts about how permanent electronic archiving will prove to be. This means that libraries have to pay for both their traditional subscriptions to printed journals, and the supplementary charges for electronic access. They need to equip themselves to provide terminals and other tools to facilitate electronic access, while keeping in service the reading rooms and storage stacks—together with the staff—needed to continue to provide the traditional print-based service.

How STM journals are produced and supplied

2.66. Over the last decade there has been a significant change in the way in which journals are produced, and supplied to readers.

2.67. The traditional approach was to focus on the printed product. Authors would post manuscripts of their articles to publishers who—after the necessary peer review and editing—would turn them into printed text. Articles would then be grouped together into a journal issue, which would be distributed, normally via a subscription agent, to the libraries that had paid for it.

2.68. The arrival first of information technology and then of the Internet has transformed that process. The more advanced publishers—which include RE and Harcourt—now provide authors with an electronic template for their articles. Once an article is produced, the author e-mails it to the publisher who then e-mails it to the editor and the referees, thus cutting down the time needed to turn a draft article into the finished product. Once the review process is complete, articles are put together in two formats. One is the traditional printed issue; the other is an electronic journal, which is lodged in the publisher's database that subscribers can access via the Internet.

2.69. We have been told that RE's Internet service, known as ScienceDirect, is the most developed of these services and that Harcourt's International Digital Electronic Access Library (IDEAL) is also one of the best available. ScienceDirect—which about half of RE's subscribers now make use of—offers access to around 1,150 of the group's current STM journals, and also allows readers to call up articles from earlier issues going back to 1995. RE told us that it plans to add earlier years to the site as time goes on. It also provides a platform for (some 80) titles produced by other publishers and incorporates a range of search aids, connections to associated databases, and hypertext links. IDEAL offers access to 320 of Harcourt's journals. Other STM journal publishers also provide electronic offerings, such as Blackwell Science Online Journals, Wiley InterScience, Kluwer Online, Taylor & Francis Journals Online, and Bertelsmann's Link. Others are listed in Table 4.4.

2.70. The development of these sites is acting as a catalyst to other changes in the ways in which journals are distributed and accessed. This is because they are not simply supplementing printed formats with electronic. They are also providing researchers with a search facility, hypertext linking, remote access and the capacity for several readers to look at an article simultaneously. Along with this comes the ability for readers to check references at the end of articles and move on to view abstracts of them or their full texts. For the library they offer easier storage, lower cost per view and a simple way of monitoring usage. This means that the new systems are not only supplanting print publishing but they are also encroaching into areas that were formerly the preserve of subscription agents and librarians. They offer the prospect of even more thoroughgoing changes in the sector in the not too distant future.

2.71. Although discussions are still continuing between the publishers, new patterns of access are now beginning to emerge. First libraries—or consortia such as the National Electronic Site Licence Initiative (NESLI) in the UK—are negotiating access rights direct with publishers instead of using subscription agents, as was previously the pattern with printed journals. Next, most publishers are offering—and many, but not all, libraries seem to be happy to accept—package deals providing electronic access to all, or a large selection of, their journals, not subscriptions to individual ones, as was the norm in the era of print-only.

2.72. The emergence of electronic publishing is raising other issues too. In the print-only era, the journal—not the publisher—was the point of focus. We have been told that many academics could be unaware of who was publishing a journal in their field even though they might have been reading it for many years and even have contributed articles to it. The delivery of journals electronically, as part of a much wider portfolio of titles, is changing that perception, as readers become more conscious of electronic platforms and the publishers that operate them.

2.73. This has implications for all publishers. When journals were available only in print, then one could be as highly-regarded and as easily accessed as another, even when one was produced by a major publisher and the other was the sole offering of a small society. While that is still the case for journal quality, accessibility is changing. The small journal which has not taken steps to publish electronically—on its own site, on the platform of a larger publisher, or by making use of one of the independent sites that are now becoming available—may be accessible only from the library shelf, during normal opening hours, whereas the product of the larger publishers (all of whom have their own sites) can be read from a researcher's computer screen, whenever it is needed.

2.74. At the publisher level it is also leading to some smaller publishers accepting offers from larger ones to have their journals included in the latter's site. This has obvious benefits for researchers as it gives them access to a wider range of journals from a single portal, and for the smaller publishers, as it allows their material to appear on a site that is much more sophisticated and that commands a much wider readership than anything that they could hope to create for themselves. But it does add to the power of the larger publishers and increases further—at least for the moment—their market position.

2.75. That said, we have heard from a number of medium-sized publishers—with portfolios of 75 titles or more—that it has not been too difficult or expensive for them to build electronic sites, as much of the software involved is widely available, and will probably get cheaper, rather than more expensive, over time. And for those with only a handful of titles—for whom creating a stand-alone portal could be both challenging and expensive—there are other options. The most developed one that we have been told about is HighWire Press, which has been set up by Stanford University in California to provide a platform for smaller and not-for-profit STM publishers. A UK-based example is Ingenta.

2.76. But the key element in all this—and the one which publishers and librarians are continuing to discuss—is how access is to be priced. Here too, the sector is in transition. The option, which RE is currently using—along with most other commercial publishers—is to offer libraries its electronic service as an extra in return for a premium payment over the price they already pay for print journals. This has a couple of advantages. It minimizes the charge ostensibly being made for the electronic offering, which has tax benefits for UK libraries as printed journals are zero rated for VAT but electronic ones are not. And it also provides a proxy for size and likely usage, as the larger institutions tended to buy more print journals than the smaller ones. But as the electronic service becomes the norm—rather than the add-on—it is growing increasingly difficult to sustain a linkage with the prices of print-only journals and to insist, as RE and Harcourt initially did, that libraries continue to subscribe for the same number of print journals as they did in the past. Finding a new and sustainable basis for charging is another of the elements of change that is characterizing this sector. RE has told us that, as its current contracts with libraries come to an end, librarians will be free to cancel any of the print journals for which they currently subscribe and negotiate a new contract based on the print titles that they want to continue to receive, and the extent of their electronic access to ScienceDirect. RE has put together a range of packages that it would expect to form the basis of future contract negotiations. Three of them have been endorsed by NESLI and so are likely to be the ones that are used in discussions with UK libraries.

The nature of competition

2.77. Competition in this area displays a number of unusual features.

2.78. First, it is a truly global market place. English-language STM journals are sold world-wide without translation or any other adaptation or modification to local markets or conditions. This means that STM journals from all parts of the world are in the same market.

2.79. Second, STM journals are offered at a global price—give or take transitional arrangements on the part of some publishers (including RE) which aim to spread, over time, currency fluctuations between one annual price setting and the next. Again there is little or no variation for local conditions.

2.80. The third unusual aspect is that in many cases customers do not appear to see journals as being alternatives to each other, and therefore competing. What seems to have happened is that the market has developed in such a way that many journals have created what amounts to a unique segment for themselves. The most obvious type of segmentation is by subject area. Clearly no one seeking information about research in plant science would regard a physics journal as an acceptable substitute for one in botany. But, even within subject areas, we have been told that many journals acquire a name for specializing in one part of an academic discipline, or an aspect of interdisciplinary study, or are known to focus on particular types or levels of research. This has led, over time, to the creation of a network, or pecking order, of journals within the larger subject areas, which—though informal—would be widely acknowledged by researchers, and would determine where they would seek to publish particular articles and where they would go to look for specific types of information. The power of reputation is also indicated by the way in which journals are sold, with subscriptions being bought, months before the first issue of the year appears.

Identifying public interest issues

2.81. In order to form a view on whether or not the situation created by the proposed merger operates, or may be expected to operate, against the public interest, we have looked at its implications for the UK market. We have also considered the nature of current competitive conditions in the UK for the publications that both companies supply—predominantly STM journals. In the course of this inquiry we have examined carefully the material provided to the Director General of Fair Trading (DGFT) in the period leading up to the making of this reference, and we have also gathered further information from those who might have an interest in the questions raised in our terms of reference. We have visited one of RE's publication centres in the UK and held a series of hearings. We have also advertised to encourage those with information or views on these issues to share them with us. There has been a strong, adverse response from university libraries. The degree of interest shown by the academic and research community and by other publishers has been smaller, and their views have been more evenly split.

2.82. We began our identification of public interest issues by examining the main characteristics of this market, some of which are unusual, and by assessing how they would be affected by the proposed merger.

2.83. The first characteristic of the market that we looked at was the large number of publishers involved and its very fragmented nature. Although there has been a degree of consolidation—particularly among commercial publishers—there are still several thousand players in the field, with new ones entering all the time, producing tens of thousands of titles. Even the more established journals, that enjoy an ISI rating, number over 7,700. Clearly any merger within the group that publishes these titles will reduce their number by one, but in this case, Harcourt is not fighting to retain its independence, but has taken a conscious decision to put itself up for sale. So, if this proposed merger were not to go ahead, then the most likely outcome would be that Harcourt's titles would be sold to another STM publisher, and probably a large one. Though, as RE is already the largest publisher in this area by some margin, if anyone else were to acquire Harcourt that merger would not produce a unit with such a large market share, nor would it strengthen further the position of the industry leader.

2.84. The next market characteristic that we examined was the diversity of the publishers in this area: the learned societies, the university presses and the commercial publishers. Each has differing reasons for being in this business and different attitudes towards its journals and customers. RE and Harcourt are both firmly placed in the commercial sector, with their primary focus on their own titles and a smaller, but not insignificant interest in the contract publishing of STM journals for others. So the proposed merger will not bring about any change in the balance within the sector between the different types of publisher, as Harcourt's 500 or so titles will be transferring from one commercial company to another.

2.85. Another feature of this sector is the unique market position of many leading titles. This too is unlikely to be changed by the proposed merger as past transfers of ownership have shown that the niche that established titles have developed persists, even when a journal is taken over by a new publisher.

2.86. One area where we do expect to see a change, as a result of the proposed acquisition, is in another area that is characteristic of this market: the increasing significance of electronic publishing and Internet delivery. These are activities which both publishers have devoted considerable resources to developing.

2.87. The coming together of RE's ScienceDirect and Harcourt's IDEAL creates both potential benefits and concerns. The benefits include the possibility of readers being able to consult around 1,550 journals from a single portal and pursue references and citations both between journals and back in time through past issues. This offers the prospect of providing considerable assistance to researchers, enabling them to review a substantial network of STM resources much more quickly and easily than if Harcourt's titles were sold to anyone else.

2.88. RE has also drawn our attention to its position in electronic archiving, its commitment to maintaining an active electronic archive, and its provision of access to that archive for all subscribers—all of which would be available to Harcourt's subscribers, post-merger. It has told us that following the merger, it intends to add to ScienceDirect the 320 Harcourt titles that are currently available electronically, via IDEAL. It has also told us that, in the future other Harcourt titles would be added to ScienceDirect and that its programme to create an electronic archive of RE journals, back to their first issue, would be extended to the Harcourt portfolio, too. This would be a clear benefit to Harcourt's subscribers over the current position.

2.89. The potential concern—which would not arise immediately after the proposed merger, but could occur before too long—is that the ScienceDirect/IDEAL combined package would become so extensive that it would make it increasingly difficult for others to compete. Other publishers can offer sites that could compete with the ScienceDirect/IDEAL technologically, but cannot hope to match its range of articles and breadth of subject area coverage. Another aspect of this concern is that ScienceDirect/IDEAL might seek to deny other platforms linkages to its store of electronic journals.

2.90. RE and Harcourt have both told us that they consider this concern exaggerated, if not misplaced. What they see happening is an increasing linkage between STM journal sites based on technologies such as those which lie behind the CrossRef initiative, which they were both instrumental in starting and continue to support. Their view is that the portal through which access to STM journals is gained is not important. Once researchers, or their parent institutions, have subscribed for access to particular titles, or portfolios of titles, they will be able read or download them through a variety of routes, and will be able to move from one publisher's platform to another with very little effort. Indeed, as the typical STM journal reader will be interested in a relatively narrow range of titles defined by the academic discipline they cover, rather than the company which publishes them, following a particular thread of research from platform to platform will be the norm: not staying within one publisher's site to access a series of unrelated titles.

2.91. Even with around 1,550 titles, ScienceDirect/IDEAL would be providing less than one-tenth of all the STM journals currently being published and less then one-fifth of those that have an ISI rating. And there are also many other types of material, such as scientific databases, information stores and electronic versions of STM books and magazines that researchers will continue to want to access. We have been told that the UK higher education sector is already spending considerable sums of money in creating a different kind of portal that will give researchers electronic access not only to the journal databases provided by publishers and aggregators, but also to the other electronic materials that they need: such as videos, image collections and other databases, packaged along subject lines.

2.92. So the development of a major site based on a merging of ScienceDirect and IDEAL could have alternative outcomes for the development of competition in the sector. One would be to create such a strong position for its owner that other publishers would seek to cooperate with it rather than compete, so that, over time, it would become the accepted portal for STM researchers, with long-term consequences for the continuing competitiveness of the market.

2.93. The other would be that the ScienceDirect/IDEAL offering would simply form part of a network of sites, of differing sizes and natures, providing STM information. These would be linked in a variety of ways so that researchers could move between RE or Harcourt articles, those from other publishers, and different types of research materials, with little effort and without knowing who owned the site that they were visiting—just as many academics do not know who publishes print journals. This second, more desirable, outcome would emerge only if RE and Harcourt, who own so many important titles, participate in the development of alternative mechanisms for linking databases and facilitating access to STM material by the institutions who have subscribed for it.

2.94. Whichever course is taken, there can be little doubt that acceptance of electronic means of delivery is growing fast in STM research. And many of those to whom we have spoken have told us that we are within a year or so of the e-journal supplanting print as the norm—if we are not there already in some areas.

2.95. The wide disparity in the prices that publishers charge for print journals is another feature of this market. There are two views on whether the proposed merger will have implications in this area. The librarians to whom we have spoken fear that it will. They point to past experience when Elsevier took over Pergamon in 1991 when there was a significant rise in the prices of the former Pergamon titles. They have also drawn our attention to research, based largely on US experience, that indicates that price rises often result from mergers between commercial publishers, whichever companies are involved (paragraphs 4.119 to 4.123).

2.96. The contrary view is that the prices of the more prestigious commercially-produced titles have already reached the point where further significant increases would simply lead to more subscription cancellations, leaving publishers as a whole no better off. While the impact of this attrition varies from publisher to publisher, RE has told us that it was a factor in moderating the rate of growth in the price of its STM journals over the last year or so. But this may not yet be the case with Harcourt's titles which our own analysis of prices (paragraphs 4.109 to 4.114) indicates are still at levels below those charged by RE for comparable journals and are experiencing a much faster rate of increase year on year—even after allowing for numbers of subscribers, numbers of articles and area of research. This would indicate that there might be scope for Harcourt's current prices to be raised further.

2.97. We looked separately at the pricing for access to Harcourt's and RE's electronic platforms: IDEAL and ScienceDirect. This is an area in transition where publishers and libraries are currently negotiating about how to shift the basis of charging from subscriptions for print journals to one that is more relevant to the new technology. This is not an easy process. Our main source of information on this was NESLI, the body charged with carrying out these negotiations on behalf of the UK university libraries. It has told us that, while both RE and Harcourt were tough negotiators, it did, in the end, feel able to recommend RE's model contract to their member libraries in the current round. But it was not able to endorse Harcourt's. So, from that perspective, the absorption of Harcourt's electronic offering within RE's ought to be welcomed rather than otherwise.

2.98. The next aspect of the market that we looked at was editorial freedom. Both RE and Harcourt operate very similar arrangements by which selection (or rejection) of articles for their journals is entirely a matter for their editorial boards. Neither company attempts to interfere with that, as both recognize that the quality and integrity of the journals—and of the articles that are published in them—is the bedrock of their business. So we have no concerns that the proposed merger will have any implications in this area.

2.99. Finally, we looked at the issue of professional competence: the extent to which the two companies deliver the timeliness, accuracy and availability that successful STM journal publishing requires. We had no concerns about RE's performance on this score. Indeed, several academics have told us about the high quality of its operations as a scientific publisher and others have told us about its investment in the development of online delivery, and its capacity in more basic business areas such order fulfilment and invoicing.

2.100. So our review of the implications of this merger for the UK market in STM journals has identified potential public interest concerns arising from the proposed merger in two areas: electronic delivery, and pricing. The following section sets out our conclusions on these points.

Conclusions on the public interest

2.101. It was at this point that differences of view began to emerge within the Group charged with carrying out this inquiry. The conclusions that follow represent the position of two members of the Group, Mr Clothier, who chaired the inquiry, and Dame Helena Shovelton. The third member, Mr Stark, explains where his position differs from that of his colleagues in a supplementary note at the end of this chapter.

2.102. On electronic delivery, it was clear to us that RE had spent a considerable amount of money on developing ScienceDirect and that, as a system, it had the potential to entrench further RE's already powerful position in the STM journal market. Not only does it offer ready access to RE's existing portfolio of titles in electronic form, but it also provides search and archiving facilities and access to other STM information databases which, in the era of print, would have been part of the librarian's role not the publisher's. The direct method of delivery that ScienceDirect makes possible, and the fact that RE has substantially increased its own sales force in the UK to help sell the system to libraries, also begin to disintermediate the traditional role of the subscription agent. The agglomeration of so much STM information and resource into one site has created a package that it would be very difficult for science research libraries to ignore. Adding a further range of 320 titles from Harcourt to this portfolio will make ScienceDirect an even more powerful offering.

2.103. Our concern is whether the enhancement to ScienceDirect that the merger would bring about creates a situation where this considerable and important corpus of STM material would be controlled by one company which, if it were so minded, would be in a position to exploit its market strength—to an extent that would not have been possible in the absence of the merger—without fear of an adverse response from competing publishers. The two instances put to us were:

(a) that RE could refuse to link any of the ScienceDirect content to the other formats for electronic access to STM material currently in existence or being developed; and

(b) that it could insist that libraries have to take all the ScienceDirect package and could not select individual titles or groups of titles within it.

2.104. On linkages with other electronic platforms, RE told us that it was its policy to allow publishers' databases and any other STM access formats that were in existence or being developed to link with ScienceDirect content, provided that they did so by means of the industry-standard IT mechanisms, agreed for that purpose. This would continue to be its position and it would extend this policy to all of the Harcourt titles that would be added to its portfolio, should the proposed merger go ahead. RE said that while it had refused requests from those seeking to establish linkages with its electronic offerings in the past, it had done so only because the requests had been made before industry standards had been agreed for IT, or those making the request had wanted to use non-standard IT links. RE told us that it saw advantage to itself, and to the STM research community more widely, in libraries being able to access the information for which they had subscribed via a number of routes, and pointed to its prominent role in the development of CrossRef as evidence of its commitment. And, while we had received some expressions of concern from others in the industry that RE might try to undermine its competitors by denying them links with ScienceDirect, we did not receive any evidence that this had actually happened—despite RE already having a very strong position in electronic publishing with far more e-journals available on its platform than on any other publisher's. In the light of this experience, the fact that the addition of Harcourt's journals would represent a change of degree rather than kind and, to a lesser extent, what RE told us about its current policy and future intentions, we did not have an expectation that the increase in the number of titles that it would control following the merger would lead to any adverse change in RE's behaviour, in this area.

2.105. On dealings with its customers, RE told us that—once their current contracts came to an end—its policy was to allow them to subscribe for whatever number of printed journals they wanted and to negotiate whatever level of electronic access to ScienceDirect that they thought appropriate to their needs. At the moment, many of its larger library customers were receiving two services that they had never had before: free, or very low-cost access to a large number of STM journals, via ScienceDirect, that they had not previously bought in print; and detailed monitoring information—again through ScienceDirect—which told them which journals were being read, and how often. RE expected that this would lead many libraries to change the journals to which they subscribed: cancelling those which they used to buy, but which were not much read, and replacing them with titles that they had not previously bought, but which the monitoring exercise had shown were popular with readers. This could lead to some customers buying a similar number of RE journals in future, and to others buying more or fewer than in the past. Some customers would want no electronic access, some would want it only for the print titles that they bought, while others still would want electronic access to all RE's titles, or to a subset that had proved popular with their readers. RE told us that its policy was to accommodate any combination of options that libraries wanted to subscribe for. That said, RE made it clear that neither it—nor, it believed, any other publisher—could be definitive about what form charging for electronic access to journals would take until the current transitional phase had come to an end. This could take a number of years. It did tell us, however, that it would not be its practice to impose 'bundling'—refusing to sell a journal or an access option except as part of a wider package—on its customers and that it would be willing to tailor its offering to whatever form a particular customer's requirements took.

2.106. The rate of change in this area is so rapid and the nature of current arrangements so fluid, that there is, to date, insufficient experience to provide evidence that the proposed merger would be likely to increase the pricing of access to RE's electronic services. Accordingly we did not have an expectation that the merger would operate against the public interest in this area.

2.107. On pricing, we have received many complaints from university libraries about the persistent increases in RE's journal subscriptions, particularly during the 1990s. They told us that for a number of years they rose well beyond general inflation and beyond the rates charged by many other publishers for similar titles. We have also been told about the steep rise in the price of Pergamon titles after Elsevier acquired it in 1991, and we have seen US research which points to a general tendency toward price increases in the journals of a target company once a merger between two publishers has taken place.

2.108. We put all of these points to RE. On the US research, RE provided us with a response (set out in paragraphs 4.124 to 4.126) that argued that the points the thesis puts forward are open to question, and that they could not be shown to apply with any degree of certainty to the proposed merger. In the Pergamon case, RE showed us evidence that the price rises that followed the Elsevier acquisition were planned by Pergamon's former owners and could have been expected to take place whether or not the titles had moved to Elsevier. We did not attempt to come to a definitive conclusion on either of these issues. The US research was general in nature and not particular to the proposed merger, and the purchase of Pergamon had taken place a decade ago. Our task was to come to a conclusion about the proposed merger between RE and Harcourt that was planned to take place later this year. So our focus was necessarily on complaints about more recent pricing experience.

2.109. On this point, RE acknowledged that, during the 1990s, subscriptions to its journals did rise at prices well beyond inflation. While it has claimed that part of this increase could be explained by the growth in the number of articles that some journals carried during these years, RE accepted that that did not provide a complete explanation. It also told us that a consequence of this continual increase in prices had been a steady growth in the rate of attrition experienced by a number of its titles to the point where a major re-evaluation of its pricing policy had had to be made. This had three objectives: to slow down the rate of attrition; to address RE's unpopularity with many of its customers born of a number of years of continual price increases, and to secure RE's long term future in the STM journal business. The result of the review was encapsulated in RE's public announcement that future increases in annual subscription rates would be held to below 10 per cent. This announcement was made two years ago, well before Harcourt's decision to put itself up for sale. Since then, the actual level of RE's increases—in 2000 and 2001—has been in the area of 6 to 7 per cent, worldwide: a level of price inflation significantly below that recorded by Harcourt's STM journals in the same two years. In response to our questioning, RE told us that it was its intention to continue with its present pricing policy in the future. It could not envisage any present circumstances that would cause it to return to annual prices rises of over 10 per cent, unless there were to be a substantial change in inflation rates in the economy more generally. It has already written to customers about its intention to extend the policy to AP journals, and has told us that its price pledge would be further extended to cover all of the Harcourt titles acquired under the proposed merger, leading to a reduction in their current rate of annual price increases.

2.110. As for the concern that a new owner would seek to raise Harcourt's subscription prices so as to harmonize them with the higher rates charged for its other titles, RE's price pledge—for as long as it is honoured—provides reassurance. But as RE is by no means the only STM publisher that charges high prices, we do not consider that it would be likely to raise Harcourt's more steeply than any other publisher that might take over its journals—or any non-publisher that might be looking for an acquisition as a means of entering this market—were the proposed merger not to go ahead. So we did not have an expectation that the merger would lead to an increase in the price of Harcourt's journals above the levels that might otherwise have occurred.

2.111. So, for all of these reasons, Mr Clothier and Dame Helena Shovelton conclude that, while the proposed merger raises concerns, they do not have an expectation that it would operate against the public interest. As they form a majority of the Group constituted to consider this reference, their conclusion is to be regarded as the CC's conclusion in this inquiry.

2.112. Mr Stark, whose minority position is set out in a supplementary note to this chapter, concluded that the proposed merger could be expected to operate against the public interest.

2.113. All three members of the Group also wished to record two final points. The first is that, during the course of the inquiry a large number of representations has been received about the implications of the current VAT regime for STM journals. The point that has been made is that, while print journals are zero rated for VAT purposes, contracts to receive these same journals electronically are subject to the standard rate of 17.5 per cent. It seems to the Group that this is inequitable and threatens to retard further progress in the electronic delivery and dissemination of knowledge.

2.114. The second point is that this inquiry has brought to light a number of features of the market for STM journals that are unusual and may benefit from further examination. The continual rise in the price of STM journals has been represented to us as a problem by many of those—both publishers and libraries—who have given us evidence. It appears to be endemic in the sector and, while not related to the ownership structure of the industry and so to the proposed merger, there are many who feel that it does need to be examined. Although they lie beyond the CC's terms of reference on the present occasion, if the DGFT believes that there are matters giving rise to wider concerns and are not being resolved, then he may wish to consider whether a wider review is necessary.

Supplementary note
By Mr J D S Stark

1. I agree with my colleagues up to paragraph 2.100.

2. Where I disagree with them is on their conclusion about the electronic access to journals and on pricing (paragraphs 2.102 to 2.110). My belief is that RE's current pricing model is now well established and that the larger the corpus of material supplied at a low or minimal additional cost, the more attractive the offer becomes to the purchaser. In making their decisions about future journal subscriptions, UK librarians will evaluate any linked benefits such as access to previously unsubscribed journals; these benefits will be proportional to the size of the corpus of journals. A larger corpus similarly presents a larger barrier to entry to a competitive journal seeking to supplant a journal in this larger corpus. The potential loss of any linked access to unsubscribed journals must be accounted for.

3. I believe that, as a consequence of the development of this pricing model, RE would be in a position, if it were so minded, to exploit its market strength to an extent it would not have been able to do in the absence of the merger, without fear of an adverse response from competing publishers. The largest competitor to RE/Harcourt would have a corpus of material available in the UK of only around one-quarter by sales value of that held by RE/Harcourt.

4. I believe that in the medium term RE would not feel constrained by its 10 per cent pledge and if it saw it as being in its financial interest to raise prices more steeply, readopting something similar to the pricing model which it pursued for many years prior to 1999, it could do so. On RE's pricing, I believe that, having established an electronic pricing model that conveys greater market power to the holder of the larger corpus of information, it would be less constrained than in the years prior to 1999 when it was in the main supplying paper copies and when a higher price/high attrition model was the pricing model of choice for commercial publishers. I therefore expect RE to raise prices, in the medium term, by a greater amount than if it had not been able to acquire Harcourt. I also believe that these price increases would be greater for Harcourt titles as, on average, they currently have lower prices per article than RE titles. I also believe these increases would be higher than might have been applied by Harcourt alone or any potential purchasers of Harcourt, as Harcourt with its largest competitor excluding RE would have a market share of 16 per cent by value compared with RE/Harcourt's 31.7 per cent (see Table 4.9). As I have described, the larger the corpus the larger the market power in the pricing model adopted for electronic delivery.

5. I also believe that RE could insist on libraries taking all the ScienceDirect/IDEAL electronic package and not selecting individual titles or groups of titles within it. It could refuse to accept cancellations at the end of a contract period without a disproportionate loss of the linked access to unsubscribed titles. It could raise the premium for electronic access. It could refuse to link any of the ScienceDirect/IDEAL full text content to the other formats for electronic access to STM journals currently in existence or being developed—ie aggregators or databases. In this way it could disintermediate secondary publishers. RE has stated that it would not be in its interest to prevent access to its material by any route, but I believe that, with the enlarged corpus and the development of the electronic pricing model, whereby the majority of the product is sold by way of an inclusive contract with linked benefits, RE would find it in its financial interest to pursue some or all of the above courses of action and I would expect it to do so.

6. I recognize that the views of the academic community, who provide the journal content largely without cost, might restrain some of these actions, but I do not believe that any of the established or mooted 'not for profit' alternative initiatives will succeed to any significant degree.

7. Overall I believe that in the medium term the merger will result in:

(a) higher prices for access to STM journals in electronic or print form than would otherwise have been the case; and

(b) more restrictions on the development of other mechanisms being developed to facilitate access to STM journals via other portals than would otherwise have been the case.

8. I regard these results as effects adverse to the public interest.

9. RE outlined a number of benefits to the public interest that it said could be expected from the merger. I accept that benefits could be expected. In particular Harcourt's customers will benefit from RE's considerable technical competence and commitment to developments such as electronic archiving. Nevertheless I do not believe that these benefits outweigh the effects adverse to the public interest previously outlined. In my opinion, therefore, the proposed merger may be expected to operate against the public interest.

10. However, as my colleagues did not share this conclusion, we did not go on to consider what remedies might be appropriate to deal with the detriment to the public interest that I have identified. Nonetheless, I would like to record my belief that my concerns about pricing would have been substantially met by behavioural remedies on future price levels, which RE told us it would have been prepared to offer had the CC come to an adverse finding in this case.

J D S STARK
24 May 2001