

2 Conclusions

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Introduction

2.1. On 29 January 2002 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 (the Act)) the proposed merger between POPC and RCCL. We were asked to report by 20 May 2002. Our terms of reference are at Appendix 1.1.

The companies involved

POPC

2.2. POPC was incorporated in July 2000 as part of a demerger that split P&O into two separately-quoted public companies. Its cruising businesses were transferred to POPC in October 2000 and its other activities remained with P&O. Neither POPC nor P&O retained any shareholding in the other.

2.3. Although P&O offered its first cruise programme in 1904, the cruising business developed most strongly in the second half of the twentieth century as ocean liners were displaced by jet aircraft as the means of long-haul passenger travel. In 1974 P&O expanded into the USA when it acquired Princess Cruises, based in Los Angeles, and in 1988 merged another US line, Sitmar Cruises, into it. In 1982 a second UK cruise line, Swan Hellenic, was acquired from Trusthouse Forte plc. Finally, at the turn of the century, P&O extended its operations into Germany. In November 1999 it acquired a majority stake in the German line, AIDA, purchasing the remainder of the company in September 2000. In April of that year, it also bought another German operator, Seetours International (Seetours), which offers both river and ocean cruises.

2.4. POPC is now the holding company for all of these cruise lines. It also owns a travel agency in the UK (P&O Travel Limited) and has land-travel and hotel subsidiaries in the USA. Its shares are listed on the London Stock Exchange, with a further listing of American Depository Shares in New York.

2.5. In 2001 POPC's turnover, worldwide, was £1.7 billion, of which £337.7 million was achieved in the UK (see paragraph 4.41). It currently operates 19 ocean-going ships and has a further six under construction or on order. It also operates two river cruise ships, with another on order. It offers cruises to over 200 destinations around the world including Alaska, Australia, the Baltic, the Caribbean, the Mediterranean, the Far East, and South and Central America. In 2001 it had an average of 3,623 employees ashore (859 of them in the UK) and 15,833 aboard its ships.

2.6. For operational purposes, POPC is organized geographically into five main business divisions:

- *P&O Cruises* covers the UK cruise business and is located principally in Southampton. It operates four ships as P&O Cruises (one of which will be replaced by a newer and larger vessel later in the year) and one as Swan Hellenic. In all, it carried around 142,000 British passengers in 2000.
- *Princess Cruises* covers the North American cruise business and is located principally in Los Angeles. It currently operates 11 ships—three of which will be moved to other POPC lines or withdrawn from service in the course of this year. New vessels will also be joining its fleet over the next few years. It carried 695,000 passengers in 2000—most were North American, but around [] (about [] per cent) came from the UK.

- *Seetours* covers the German cruise business (including the AIDA and A'ROSA brands) and is located in Rostock and Neu-Isenburg, Germany. AIDA currently operates two ocean cruise ships and has another on order. One of the Princess ships is currently being transferred to A'ROSA, and there are three river cruisers on order. Almost all of the passengers carried by the Seetours division are German speaking.
- *P&O Cruises (Australia)* covers the Australian cruise business. It has one ship, which provides mainly round-trip itineraries based on Sydney, where the division is located.
- *P&O Travel* is a UK business-to-business travel agency, which is located in London. It has associated companies in Hong Kong, India, Singapore and Thailand.

RCCL

2.7. RCCL was formed in 1968, by three private Norwegian family businesses, to design, build and operate ships for year-round cruising in the Caribbean. Its first ship entered service in 1970.

2.8. The ownership structure changed in 1988. Two of the original investing families sold their interest and RCCL was reconstituted as a 50:50 joint venture between the remaining Norwegian owner, A Wilhelmsen AS (a company whose indirect beneficiaries were members of the Wilhelmsen family) and Cruise Associates (a Bahamian general partnership beneficially owned by trusts relating to members of two US families, the Pritzkers and the Ofers).

2.9. The appeal of Caribbean cruising broadened during the 1980s and RCCL significantly expanded its capacity between 1988 and 1992 by constructing four new ships and converting an existing vessel. To raise funds for further expansion, it undertook an initial public offering in 1993, which was followed by the ordering of six new ships for delivery between 1995 and 1998. At the same time, some older ships were disposed of. In 1997 RCCL acquired Celebrity Cruises Inc, which operated a fleet of five ships. This acquisition was funded, in part, by an issue of RCCL shares that, along with other issues since 1993, took the combined holdings of A Wilhelmsen AS and Cruise Associates below 50 per cent of issued share capital.

2.10. RCCL is now engaged in a further round of fleet expansion with new ships being delivered or on order, including five Vision-class cruise liners which, with a displacement of 140,000 tons and over 3,100 berths, are currently the largest in the world.

2.11. RCCL is the world's second biggest cruise operator and markets itself under two brands: Royal Caribbean International (RCI) and Celebrity Cruises (Celebrity).

2.12. RCI has a fleet of 14 cruise ships, offering over 31,000 berths in all. Five further ships are on order. Some 85 per cent of RCI's passengers are North American, with around 3 per cent coming from the UK. Although Caribbean cruises still account for over 60 per cent of passengers carried, RCI also offers a range of other destinations including Alaska, Europe, and Central America.

2.13. Celebrity has eight ships—with a ninth about to be delivered—and 14,320 berths overall. Its proportion of North American to UK passengers is the same as RCI's. It too sails to a wide range of destinations, though its main focus is also the Caribbean.

2.14. RCCL's revenues for the year to 31 December 2001 were \$3.1 billion and its operating profits were \$456 million (see Table 4.12). At the end of that year, RCCL had 3,200 employees ashore (500 of them working part-time) and approximately 23,000 aboard its ships.

2.15. In May 2000, RCCL made a \$300 million investment in the UK tour operator and travel agency, First Choice Holidays plc (First Choice). The consideration was paid partly in cash and partly through the transfer of a ship, at market value, to Island Cruises, a 50:50 joint venture formed by RCCL and First Choice to offer cruises to British and European holiday-makers. RCCL told us that its relationship with First Choice gave it the ability to learn more about the UK holiday business and an opportunity to dispose of a ship (to the joint venture) that was no longer suitable for US premium cruises. The day-to-day management of Island Cruises is provided by First Choice and the cruises sold through its brochures. First Choice is currently the smallest of the three UK tour operators in the cruise business. Its share of cruises sold to UK customers in 2000 was around 4 per cent, compared with 16 per cent for Airtours, 10 per cent for Thomson (and 6 per cent for RCCL's two US lines). We have been told that there should be very little overlap between the customers buying berths in RCCL's and Island Cruises' ships. We do not regard RCCL's investment in First Choice as a significant element in our inquiry into the proposed merger and in the rest of this report, we discuss Island Cruises along with the cruise holidays provided by the other UK tour operators. We do not categorize it as a part of RCCL's operations, which we have confined to RCI and Celebrity.

The proposed merger

2.16. We have been told that POPC and RCCL had spoken during the last decade about the possibility of combining their cruise operations in some way. However, as this had not led to a successful outcome, both companies had continued to pursue independent strategies. The proposed merger, which we have been asked to investigate, [

Details omitted. See note on page iv.

] signing of a confidentiality and exclusivity agreement on 11 October.

2.17. As the discussions continued, the two companies began to focus on the form that any combination between them might take. The solution that emerged was a dual-listed company (DLC) with shares being quoted on both the London and New York Stock Exchanges. We were told that the principal benefits of this approach were:

- (a) a lack of disruption for shareholders: other structures might have required investors in the US to sell UK shares, or vice versa;
- (b) both companies being able to retain their current favourable tax status; and
- (c) no 'changes of status' arising under various loan agreements.

2.18. At the same time, the DLC would have many of the characteristics of a fully-merged business—the companies would share a single management; and shareholders' rights to dividends, or on a takeover or winding up, would be the same as if they held shares in a single entity.

2.19. On 18 November 2001, the boards of both companies resolved, at separate meetings, to recommend a DLC combination to their respective shareholders. The following day, POPC and RCCL entered into an implementation agreement for the proposed merger. At the same time, they also signed a joint venture agreement relating to a southern European initiative, by which the combined company would offer cruises tailored to customers from Italy, France and Spain.

2.20. On 20 November both companies announced publicly their plans for the proposed merger, which they made clear was subject, inter alia, to approval by both groups of shareholders and to regulatory consent. Separately, on 3 December, RCCL's two largest share-

holders, A Wilhelmsen AS and Cruise Associates, entered into an agreement to vote in favour of the proposed merger.

2.21. The intention is that, following completion, the DLC will be owned jointly by the existing shareholders. The voting and economic interest of POPC's shareholders in the combined group will be 50.7 per cent, and RCCL's, 49.3 per cent. The two companies will be managed as if they were a single entity. As they are to remain separate corporate entities POPC and RCCL will each have its own board, but the directors—and the senior managers—of both companies will be the same people. And the directors of each company will be able to have regard to the interests of the other, and of the shareholders of POPC and RCCL, in the management of the combined group.

2.22. The two companies have told us of six major benefits that they expect to flow from the proposed merger:

- The combined business will be the world's largest cruise operator, offering 75,000 berths in a fleet with an average age of only six years.
- The combined business will offer scope for synergies of at least \$100 million a year.
- The combined business's greater size and financial strength will offer further opportunities for investment and growth.
- The two companies' geographical strengths are complementary: POPC is particularly strong in cruises originating in the UK and in those destined for Alaska; RCCL's strength is in the Caribbean.
- The proposed joint venture in southern Europe will accelerate both companies' entry into a region where neither currently has a significant presence.
- The companies' brands provide a complementary offering to European customers, with RCI and Celebrity appealing to those who want a US cruise experience, P&O Cruises and Swan Hellenic appealing to UK tastes, and AIDA and A'ROSA to German.

Jurisdiction

2.23. 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 POPC will cease to be distinct (within the meaning of the Act) from enterprises under the control of RCCL; and
- (b) the value of the assets that will be taken over exceeds £70 million (the assets test); or the merger will create or enhance a share of at least one-quarter in the supply of goods or services of any description in the UK, or a substantial part of the UK (the share of supply test).

2.24. 'Enterprise' is defined in section 63 of the Act as the, or part of the, activities of a business. If we find that either the assets test or the share of supply test is satisfied, we are required to exclude the other from our consideration. One of the circumstances in which enterprises are to be regarded as ceasing to be distinct (set out in section 65) is where they come under common ownership or control.

2.25. 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.

2.26. It is clear from the implementation agreement (see paragraph 2.19), and from what the parties have told us, that arrangements are in progress that, if carried into effect, will result in enterprises currently controlled by POPC and by RCCL coming under common control. It is also clear, from Tables 4.9 and 4.16, that the value of the assets employed in the enterprises which cease to be distinct, calculated in accordance with section 67 of the Act, exceeds £70 million.

Conclusion on merger situation

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

The services concerned

2.28. Both POPC and RCCL are in the business of providing holiday cruises. These are shipboard vacations generally offered at a largely inclusive initial price. The format for most cruises is a combination of sailing—often in the evening and overnight while passengers are dining or asleep—and days in port, where passengers can go ashore. Some cruises also involve a flight to and from the port of embarkation/disembarkation, the cost of which can also be included in the initial price.

2.29. Once aboard, passengers will normally find that all their food is provided and that there is free access to a range of entertainments—such as formal dinners, dances, receptions, concerts, variety shows and films. There are often other free amenities, such as swimming pools, games decks, children’s play areas, fitness centres and sun lounges; and, on some of the larger and newer ships, more elaborate facilities, such as ice rinks and climbing walls. Passengers will, however, normally be expected to pay for alcoholic drinks, for purchases from on-board shops, gambling, places in the crèche, and most trips ashore.

2.30. Cruises, especially in ships with a high rating, have a reputation for providing good levels of service and many achieve an unusually high degree of customer satisfaction (see paragraph 7.8). All POPC’s and RCCL’s capacity is categorized as at least 3-star+ on the Berlitz rating and 89 per cent of POPC’s and 78 per cent of RCCL’s is 4-star or above. On the Veness rating, all RCCL’s capacity is classified as ‘Premier’, as is 95 per cent of POPC’s—the rest being rated ‘Superior’ (see paragraphs 3.73 to 3.75 and 5.25, and Appendix 3.4, for a fuller explanation of the rating systems).

2.31. Cruises vary considerably in length. Four-day ‘starter cruises’—designed to enable newcomers to experience cruising for the first time—are the shortest available from the UK, while, at the other extreme, POPC offers a world cruise that lasts several months. But most cruises typically last one or two weeks. Many are free standing, but others may be combined with a period ashore, in a single hotel, or touring around. Destinations also vary to a large extent. The Caribbean is the most popular region, globally, for cruising as it has a good year-round climate and a large number of islands, which allow operators to offer a variety of itineraries. The Mediterranean is also very popular in the spring and summer months. Other locations for cruises originating in the UK include the Baltic and the Atlantic islands. Those starting in the USA include Alaska, the Hawaiian islands and South America.

2.32. Cruises also vary in their nature, some offer relaxation in a warm climate, others, such as Swan Hellenic, will be more focused: providing visits to, say, ancient sites in the eastern Mediterranean and Egypt, backed up by on-board lectures and libraries.

The market for these services

2.33. The demand for cruises has been growing steadily during the last decade. Figures compiled by the Passenger Shipping Association (PSA) show that between 1995 and 2001 the number of cruise holidays taken by UK passengers more than doubled from 339,931 to 776,173 (see Table 3.5 and Appendix 3.3). Growth has been strongest in fly-cruises to overseas locations—principally the Mediterranean and the Caribbean—where numbers have grown by around 192 per cent overall, but the number of cruises originating in UK ports has also grown significantly, by 102 per cent.

2.34. The UK is the western European country with the largest number of people taking cruises, both in absolute terms and as a proportion of the overall population. In 2001, 1.3 per cent of those resident in the British Isles (the figures include the Republic of Ireland as well as the UK) went on a cruise—more than double the average for western Europe as a whole (0.5 per cent). However, North America is by far the largest source of cruise passengers, accounting for around two-thirds of the world total. Figures from the PSA (see Table 3.5) indicate that in 2001 6.91 million cruise passengers came from there (2.2 per cent of the total population) against 1.99 million from Europe.

2.35. PSA figures (see Appendix 3.3) also show that cruising by UK holidaymakers has been growing at a faster rate than the increase in other types of overseas holidays—an annual average of 15 per cent for cruises since 1991 against 7 per cent for all foreign package holidays.

Pricing

2.36. The pricing of cruises to customers is complex. The one thing that is comparatively clear is that relatively few passengers pay the full brochure price, but the extent to which they are able to secure discounts and the ways in which the cruise lines decide to offer them are far from straightforward. Most cruise operators seem to agree that the economics of their business requires that all their ships should be full when they leave port. This is because almost all the charges in their operations are fixed, so that the marginal cost of carrying the final few passengers is not much more than the cost of their food. As the benefit from on-board revenue to be gained from most passengers exceeds this, there is a strong incentive to fill every berth.

2.37. The way in which cruise lines seek to achieve this varies but most adopt a system of yield or revenue management. The process begins when a cruise is first offered for sale, which is usually a year or more in advance of the date of embarkation. The brochure price will almost immediately be discounted for ‘early bookers’ who respond within a set period of time. From then on, the rate at which passengers sign up for a cruise will be regularly assessed against projections—based on past experience—of how quickly cabins need to be sold for a ship to leave full. If the actual rate runs ahead of the projection, then discounts will be reduced or withdrawn but, if it lags behind, then discounts will be increased or other types of incentive introduced. These can include upgrades to more expensive cabins for those who have already booked, so that their original (cheaper) cabins, which are easier to sell, can be marketed again; promotions targeted at specific groups, such as former passengers, first timers, or those over a certain age or living in a particular region; or other inducements such as free or discounted flights to the port of embarkation (see paragraphs 3.41 to 3.45).

2.38. As most cruises are booked through travel agents—some of which specialize in the cruise business—additional discounts may be available from them too. This is because the

commissions paid on cruises are usually higher than those on other types of holidays, and it may be cost effective for a travel agent to share some of this with a customer to achieve a sale.

2.39. Prices can also vary widely on a single cruise. For example, we have been told that—even though the services and facilities of most ships are equally available to all passengers irrespective of what they pay for their berth—the cheapest cabin typically costs around one-quarter of the most expensive, though most prices are clustered together within a narrower range (see paragraphs 5.43 to 5.51).

2.40. All of that said, from the evidence we have received, it does appear to us that most cruises fall into one of three broad price bands (see paragraph 2.62 for a description of the categories). The standard-level cruises, such as those offered by the UK tour operators, typically sell for below—and sometimes well below—£1,000 for a week. The 4-star-and-above cruises predominantly offered by POPC and RCCL will typically range from somewhere over £1,000 to up to £4,000 for a week with a small number of luxury cruise lines offering weeks at even higher prices. Nonetheless, a degree of overlapping occurs, for example between the most expensive cabin on a cheaper ship and the cheapest cabin on a more expensive one, or when some cabins on a more expensive cruise are heavily discounted, or at less busy times of the year when price differentials are not as marked as in the peak season.

Demand for these services

2.41. As will be clear from the earlier sections, demand for most types of cruising has been growing—in some cases very strongly—over the last decade. And although there was a sharp reaction, particularly among North American passengers, to the events of 11 September 2001, POPC announced in April that prices being charged for its cruises had returned to levels close to the previous year's, and that the pace of bookings was running higher than 12 months before. All the other evidence that we have seen shows that this growth is expected to continue. For example, figures published in the final 2001 edition of the *International Cruise Market Monitor* (see Appendix 3.8) predict that the number of cruising passengers worldwide will increase from 9.35 million in 2001 to 10.54 million in 2003, reaching 13.05 million by 2007. The number of passengers from western Europe is predicted to grow from just over 2 million to 3.16 million from 2001 to 2007.

The suppliers of these services

2.42. In this section we look first at POPC and RCCL and consider the ways in which their businesses differ and the areas where their provision of cruises overlaps. We then look at other major cruise providers.

2.43. The business focus of POPC and RCCL differs in a number of ways. Carrying UK passengers is a core part of POPC's activities. P&O Cruises and Swan Hellenic sell almost all their cruises to UK customers. POPC is the leading UK cruise operator and the only one with a market share above 20 per cent. By contrast, only about 3 per cent of RCCL's passengers come from the UK and its share of the UK market ranks sixth overall. Two other points flow from this distinction:

- RCCL offers hardly any cruises that originate in the UK, whereas ex-UK cruises are a major part of P&O Cruises and Swan Hellenic's business for most of the year. POPC had a 55 per cent share of these cruises in 2000.
- RCCL has few cruises in the Baltic, the Mediterranean and the Atlantic islands, where over two-thirds of UK passengers go. The bulk of its operations are focused on the Caribbean and US waters.

Finally, durations also vary. The average RCCL cruise lasts seven days, while the average for P&O Cruises and Swan Hellenic is 13 days.

2.44. That said, there are parts of the world where POPC and RCCL do both have a significant presence. In all, there are four geographical areas where each company provides around 20 per cent or more of the available cruises (see Appendix 5.4). One is Alaska—which accounted for about 2 per cent of UK cruise passengers in 2000. Both the Carnival Corporation (Carnival) and Norwegian Cruise Line (Star/NCL) (which is part of the Star Group) also provide cruises there. Two other areas are the Panama Canal and the west coast of the USA, which each accounted for less than 1 per cent of UK passengers in that year. The main area of overlap is the Caribbean, which accounted for around 19 per cent of UK passengers—though this is the most heavily-cruised stretch of water in the world and is served by, among others, a number of the Carnival lines, Star/NCL, Fred Olsen Cruise Lines Ltd (Fred Olsen), Airtours, Thomson, Disney Corporation (Disney) and Festival Cruises, all of which sell to UK customers.

2.45. There is a range of cruise lines—other than P&O Cruises and Swan Hellenic—that offer services to mainly UK passengers. Perhaps the best known of these is Cunard, which is owned by Carnival, the world's largest cruise operator. Cunard currently operates two 4-star-or-higher cruise liners—one of which is the *Queen Elizabeth 2*—and its fleet will shortly be supplemented with a new, very large, liner, the *Queen Mary 2*. The other major player is Fred Olsen, with one 3-star and two 4-star ships. There are also a number of recent entrants such as Saga Shipping Company Limited (Saga) and three mainstream tour operators, Airtours, Thomson and First Choice (see paragraphs 3.10 to 3.21).

2.46. In providing cruises to North Americans—and to a relatively small number of customers who travel to US and Caribbean ports from Europe and elsewhere—Princess Cruises and RCCL face competition from a wide range of lines, including some relatively small operators, such as Radisson, who offer exclusive, luxury cruises at high prices. Their major direct competitors, however, are two other lines owned by Carnival: the Holland America Line (Holland America), with ten ships, and Carnival Cruise Lines, with 16 ships (both lines have five new ships on order) and Star/NCL, with seven ships (see Appendices 3.1 and 3.6).

How these services are supplied

2.47. Most of the cruises taken by customers from the UK are provided by established companies that are dedicated to the business, such as POPC, Fred Olsen, RCCL, Carnival and Star/NCL. Those that have entered more recently, such as the package tour operators and Saga, in the UK, and Disney in the USA, have a background in other aspects of the travel and/or leisure sectors. This could be a continuing trend for the future.

2.48. Whoever provides the cruises, however, passengers tend to buy their tickets through a travel agent. For example, [§] per cent of the cruises that POPC sold to UK customers in 2001 were booked in this way, as are over [§] per cent of RCCL's sales in this country (see paragraph 3.8). We have been told that this is because cruise bookings are complex, involving decisions about a range of items such as destination, duration and type and location of cabin, and that customers prefer to deal with an agent, face to face or over the telephone, rather than fill in a booking form or book over the Internet.

2.49. Sales are divided between the multiple travel agencies, with a large number of retail outlets across the country, and the much more numerous independent agents, sometimes with only one or two. For RCCL and POPC—and for many other cruise lines—it is the independent agents that account for the majority of their sales. A number of these agents specialize in selling cruises while a much larger group—currently over 1,200—have shown sufficient expertise in

cruising to be accredited by the PSA, following appropriate training for their staff. There is also a much smaller set of independent travel agents that provide their own cruises. The most notable of these are Saga Travel, which is linked to Saga, which has its own cruise ship, and Page & Moy Ltd, the largest cruise agent in the UK, which also offers its own cruises by chartering vessels from other operators. As will be clear from earlier paragraphs, three of the multiple travel agents also have ships providing cruises to their customers. The cruise line of one of these, First Choice, is a joint venture with RCCL. RCCL expects that its relationship with First Choice will increase the number of its own cruises sold through its retail outlets, though it told us that it believed that the majority of its sales would continue to be handled by independent travel agents.

The customers for these services

2.50. Anyone who takes a holiday above a certain price can be seen as a potential customer for a cruise, though those who choose this form of vacation do differ in some respects from the population as a whole.

2.51. First, they are older. And the growth in the number of older people as a proportion of the total population may be one explanation why the number of cruises sold has increased so rapidly over the last decade. Although the average age of those who take cruises fell from 56.5 in 1994 to 54.2 in 2001 (see Table 3.6) it is still the case that 57 per cent of all UK cruise passengers were over 55 in that year, compared with some 30 per cent in the population as a whole.

2.52. Second, they are better off. For example, POPC told us (see paragraph 6.4) that 42 per cent of the passengers taking P&O Cruises in the Caribbean are drawn from social classes A and B—again much higher than the proportion in the population overall. Once more, the growth in disposable income among this group in recent years may help to explain the extent of the rise in the number of cruise holidays being taken.

2.53. Finally, those who take cruises are more likely to holiday in couples rather than in family groups.

2.54. But cruise operators are increasingly marketing their services to younger people in the UK, and the success of the US lines in bringing down the average age of their passengers indicates that cruising's customer profile may change in the UK too as its popularity continues to grow.

The nature of competition

2.55. Cruise operators compete in a wide variety of ways. First, and most obviously, they compete on price. As we have already seen, the industry is committed to having its ships sail full and has well-developed procedures for managing the discounting that is needed to ensure that this happens. The UK tour operators that we spoke to also stressed the importance of pricing their cruises in relation to the land-based holidays in their brochures. The premium cruise operators, such as RCCL and POPC—who do not sell their own land-based holidays in any numbers—are still constrained by the prices of holidays sold by others, as well as being limited, upwardly, by the prices that are charged by the smaller, luxury lines and, downwardly, by the standard cruise operators.

2.56. Next, they compete on quality. This can take a number of forms. One of the most important is brand. This is especially so in the UK where the two leading premium cruise providers, P&O Cruises and Cunard, are both very well-established names with a long maritime history. And the newcomers to cruising have also been successful in transferring across their

brands and reputation from other parts of the holiday and travel industry. Another aspect of quality is level of service, which can manifest itself in such things as the ratio of cabin staff to passengers; the range and variety of dining options available; or the number and type of amenities that are on offer. For example, the tour operators told us that one of the ways in which they made cruising more attractive to their customers—and thus widened its appeal overall—was by providing less formal, buffet meals, as opposed to the traditional ‘black tie’ dining that can be a feature of other cruise lines. A further example of quality is the design and location of accommodation. One recent innovation has been the introduction of many more cabins with outside balconies, which, we were told, were particularly highly valued by passengers (see paragraphs 3.64 to 3.68).

2.57. Another form of competition is the nature of the cruise itself. This covers issues such as destination and whether it has a purpose—for example, visiting and learning about ancient sites in the eastern Mediterranean, or wildlife in Alaska—or whether it simply provides relaxation and high levels of comfort in a warm climate.

2.58. Nationality, culture and language are other areas where cruise lines compete. Although many ships carry a number of passengers from outside their core geographical market, most are dominated by one national culture and language, which is reflected in things such as the type of food served, the style of dining and the nature of the entertainment provided. This is most clearly shown in operations such as POPC and Carnival, both of which have separate cruise lines, which market themselves to separate groups of nationalities. P&O Cruises and Swan Hellenic’s passengers come mainly from the UK, Princess Cruise Lines’ from North America, and AIDA’s and A’ROSA’s from Germany. Carnival Cruises’ and Holland America’s customers come predominantly from North America, Costa Cruises’ (Costa) from southern Europe and Cunard’s from the UK (see paragraph 3.68).

2.59. Finally, there is the ship itself. The new larger cruise liners that are now coming into service offer substantial amounts of public space that can house a wide range of facilities and amenities. They can also provide the latest technical conveniences, such as extensive Internet links for passengers. On the other hand, some of the luxury providers continue to prefer smaller and sometimes older vessels that can offer a sense of exclusivity and tradition, to which their target customers attach a high value.

Market definitions

2.60. Markets are generally defined by examining whether there are close substitutes on either the demand or supply side for the products or services that are being examined. The relevant geographic market is defined in a similar way. These issues are all explored in depth in Chapter 5.

2.61. The key points that emerge from this analysis is that there are two elements that need to be considered in deciding which services should be included within the market: one is the cruises themselves; the other is the wider holiday business.

2.62. On cruises we have considered a range of views. At one extreme is the contention that they constitute a single and separate market, ie that all cruises and cruise lines compete with each other for customers. At the other, it is argued that cruises constitute a series of separate markets—or market segments—differentiated by quality; by language and/or national styles or preferences; or by both. On quality the most usual division is into three categories. The middle one, commonly called ‘premium’, is characterized by 4-star ships and a high level of service. This is the one in which both POPC and RCCL operate. Of the other two segments, one is commonly called ‘luxury’—where 5-star ships offering a very high level of service are the norm—and the other is characterized by most ships being 3-star and below. This has been variously described as ‘mass-market’, ‘contemporary’, or ‘economy’. In this report we refer to

it as the ‘standard’ segment. It is also sometimes claimed that there are divisions between, say, lines such as AIDA or Fred Olsen that are focused almost entirely on customers of one nationality or language; lines such as Costa or Louis Cruise Lines (Louis), with a more international, multi-lingual customer base; and many of the US lines which, although aimed predominantly at North American customers, usually draw around 15 per cent of their passengers from elsewhere.

2.63. On the relation between cruises and the wider holiday market, the range of options that we have considered is equally wide. At one extreme is the proposition that the market for cruises is separate from that for other types of holidays, and that there is little or no competition between them. The other end of the spectrum is the view that cruises are simply one part of the overall holiday market and that there is regular and active competition between cruise lines and other holiday providers for the same potential customers. We have also looked at intermediate positions, for example that competition for customers and the substitutability of cruises and other types of holiday are more prevalent at, say, the standard level than the luxury level.

2.64. We have not been able to come to a single view on these issues. Some of us considered that cruises are part of the wider holiday market, while others prefer the view that cruises constitute a separate market, or series of markets. What we did all agree on, however, was that the existence of other types of cruises outside the categories in which POPC and RCCL operate, and the presence of the wider holiday market, both constrained these companies’ actions and limited their commercial freedom, to varying degrees, whether or not they were regarded as being in the same markets. Likewise, we all agreed that there were clear distinctions between different quality levels and national styles, whether or not they constitute different markets. So in the rest of this report we draw attention to some or all of these wider considerations to the extent that seems to us appropriate in particular cases.

2.65. We found defining the geographic market for our inquiry less problematic. Our conclusion is that it is the UK, ie that our report should be concerned with cruises taken by passengers drawn from this country, irrespective of whether they sail on ships focused almost entirely on UK customers or on other, mainly US and European, lines; or whether they embark in the UK or fly to an overseas port before going on board.

Barriers to entering the cruise business

2.66. As will be clear from earlier sections of this chapter, cruising has been growing rapidly over the last decade and a good deal of that growth has come from established players, such as POPC and RCCL, increasing their capacity by buying more and larger ships. But there have also been a number of significant new entrants (see paragraphs 3.27 and 3.28).

2.67. The most important new entry, in terms of the amount of additional cruising capacity made available to UK holidaymakers, has been the arrival of three of the major tour operators: Airtours, Thomson and First Choice. Together they have added around 7,000 berths and account for about 30 per cent of all cruises sold to UK customers. They have also been able to widen the appeal of cruising by focusing their offering less on the traditional cruise passenger and more on those to whom they have previously been selling land-based package holidays. They have achieved this by reducing the average price paid for a cabin and by providing a more informal experience than is usual on board the ships of many of the more established cruise lines. They have also chosen to buy—or charter—older cruise ships rated as 3-star+, 3-star or 2-star+, as opposed to the 4-star-and-higher vessels that predominate in POPC’s and RCCL’s fleets. And, by making use of the charter airlines that they operate and their existing relationships with hotel groups in the Mediterranean and elsewhere, they have been able to offer a range of fly-cruise holidays that have attracted large numbers of first-time passengers.

2.68. Another recent new entrant into the UK cruise business is Saga—part of the wider Saga Group, which provides a range of services to the over 50s. Another part of the Saga Group, Saga Holidays, had been selling cruises on other lines for a number of years to its extensive customer base. But, in the mid-1990s, the Group decided to enter the business directly. It too bought an older ship, but one that is still rated as 4-star. Saga has been very impressed with the return that it has achieved over the last four years and has recently acquired a second ship.

2.69. The common factors that characterize these four new UK entrants are that they had no background in shipping before coming into the cruise business, but all had experience of selling—and to varying degrees also providing—holidays. As a result, they all had an extensive database of potential or actual cruising customers to whom they could market their offerings. Another common factor is the relative ease with which they were all able to buy or charter existing ships. All those new entrants to whom we have spoken have expressed themselves very satisfied with the results of their diversification into cruising and all intend to maintain or expand their presence in the business.

2.70. The experience of these entrants also shows that large amounts of capital are not needed to enter the UK market as it is possible to do so by buying or chartering an older, smaller ship at a price well below that of a large, new vessel. Some of these operators have then gone on to add newer and larger ships to their fleet as they have become established in the business. Their experience also illustrates that economies of scale are not essential to becoming a new entrant in the UK market, as all of them began to offer cruises with only one or two ships (see paragraphs 3.28 and 5.83 to 5.86).

2.71. Another recent entrant that we have been told about—this time offering cruises off the USA—is the Disney (see paragraph 3.28). This too conforms to the pattern of an established tourist operator—this time with hotels and theme parks—being able to use its expertise and established customer base to enter the cruise business successfully—though we have been told that, unlike the entrants into the UK market, Disney did begin operations with two new ships. We have also heard that Canyon Ranch, the US health resort and specialist vacation group, is also about to launch a luxury cruise line.

2.72. One feature that unites all these new entrants, both actual and potential, UK and US, is that they each have a strong brand and reputation in their traditional area of operations, which can be transferred successfully into cruising. However, we have heard of other entrants without these attributes that have also established themselves in the business.

2.73. We next considered a number of potential practical and operational constraints that had been drawn to our attention that could still limit the activities of some new entrants, even after they had acquired a ship and succeeded in transferring their brand identity to the cruise business. The first of these is the difficulty of gaining access to some destinations or ports. We have examined this issue, but we do not believe that its implications are serious, or that it will be made worse by the proposed merger. It is true that there are some parts of the world where there are restrictions on the number of ships that can visit. The two that we have heard most about are Bermuda, where there is a government-imposed limit on the number of ships that can offer cruises to the island, and Glacier Bay in Alaska where a finite number of licences to visit are issued each year. In both cases we have been told that incumbency is a major factor in deciding which has access: so, to the extent that POPC and RCCL currently have a favourable position in these areas, that will continue whether or not the proposed merger goes ahead. However, the two companies do not compete directly in Glacier Bay, where RCCL does not have a licence, so the proposed merger will not have a direct impact in there.

2.74. The other aspect of this issue is capacity at the more popular embarkation ports, such as Miami or Vancouver, which may be full at certain periods, especially in the high season or at weekend peaks. Again, we have been told that incumbency can be a major consideration in

deciding which has access to these resources. We have also heard, however, of other solutions to this problem. One is for the ports to build more capacity, or to designate, say, container slots for cruise ships at peak times. We have been given examples of where both have occurred—though it may take time for a port to be satisfied that the additional demand from cruise ships is likely to be permanent rather than temporary, and there may be planning requirements to be satisfied before extra capacity can be built. Cruise lines themselves also have the option of creating new embarkation ports by using alternative locations further along a coast or on a neighbouring island. And again, we have been given a number of examples of this happening. It has also been put to us that a combined POPC/RCCL would have a greater ability to secure desirable port slots than the companies have now as independent entities. We do not believe this to be a significant concern in relation to the proposed merger. The companies involved are currently the second and third largest cruise operators in the world and so are already attractive customers for most ports; and, perhaps even more important, outside the Caribbean, there is not a significant degree of overlap between their operations, so that the additional presence that the combined company would have in, say, the Baltic or off the coast of South America would not be great. And, within the Caribbean, there is a wider choice of cruise ports, and a larger number of competitors' ships, than anywhere else in the world.

2.75. Another area of concern that has been put to us relates to distribution through the travel agencies. For example, one issue that has been raised is that generalist travel agents—ie those that do not specialize in the cruise business—may in future decide simply to concentrate substantially on the cruises of POPC/RCCL. There have been similar concerns that racking space in shops will be limited in the same way. This does not appear to us to be a significant cause for concern. A counter-argument that has been put to us is that travel agents would be unlikely to ignore the potential of cruises because:

- (a) their take-up is growing at more than twice the rate of other types of holidays (see Appendix 3.3);
- (b) commissions paid to travel agents by cruise lines are normally higher than those paid by other tour operators; and
- (c) travel agents are likely to see the cruise business as having more of a future for them than, say, selling an airline seat or a straightforward package holiday, since booking a cruise is a complex process—with a large number of options to be discussed, such as cabin types, destinations, duration, etc—that requires a travel agent's traditional skills and expertise.

In any case, the increment that is represented by RCCL's business with UK customers (around 6 per cent) is not a substantial enhancement of POPC's existing position with the independent UK travel agents.

2.76. Nonetheless, there is another issue that has been put to us, which is potentially more substantial. As paragraph 3.37 makes clear, the rewards that travel agents receive from most cruise operators are made up of three elements: a standard commission, an override, [

✂]. The standard commission is a fixed percentage of the value of the sale, offered to all agents; the override is paid on an agent's sales in a given year and reflects the previous year's performance together with the agent's general standing and future potential; [

Details omitted. See note on page iv.

].

2.77. Tables 5.7 and 5.8 set out the commissions offered by POPC and RCCL, both to the multiple travel agents and to independent agents [*Details omitted. See note on page iv.*].

2.78. [*Details omitted. See note on page iv.*] are designed to encourage travel agents to sell the larger operators' cruises as this increases their likelihood of qualifying for higher

commissions. To counter this, other operators would have to offer higher commission rates, even though their sales volume is smaller.

2.79. By bringing together RCCL's UK sales with those of POPC, the proposed merger has the potential to accentuate the concerns that flow from the commission structure. But, as has already been said, the increment to POPC's share of the UK market is unlikely to be substantial; and is not, in our view, likely to make POPC/RCCL sufficiently large to be able to impose exclusivity deals on travel agents. It is also worth noting that the level of commissions which RCCL currently pays (as might be expected from a relatively small player in the UK market) is higher than POPC, both at the standard rate ([redacted] per cent as against POPC's [redacted] per cent) and at the standard rate plus the override (between [redacted] and [redacted] per cent as against POPC's [redacted] to [redacted] per cent).

2.80. In any event, when we put these concerns to POPC and RCCL, both gave us an assurance that they did not intend to integrate or combine any elements of the current commission structures offered by the two companies; and both told us that, in so far as they were considering changes in this area, their thinking was moving in the direction of greater, rather than less, differentiation between their various brands' dealings with travel agents.

2.81. We ended this part of our inquiry by looking at whether new entry or continued growth by those who had recently entered the market could be expected to continue. We decided that it could, for a number of reasons. First, the significant number of new entrants since the mid-1990s had demonstrated that it was possible to offer cruises successfully without previous experience in shipping. All the new entrants that we spoke to (Airtours, First Choice and Saga) have been pleased with what they had achieved. None regretted the decision to enter the market and all intended to continue with—or expand—their operations. Next, customer demand has been growing steadily for most of the last decade and the trend is forecast to continue. The group from which those who take cruises has traditionally been drawn—the over 55s—continues to increase both in affluence and as a proportion of the overall population. The average age of cruise passengers is also falling and the US experience indicates that it is possible to reduce it still further and to widen the population range from which cruise passengers can be drawn. Another factor is the availability of ships. There is no shortage of second-hand vessels to buy or charter at the moment and there are examples of some newcomers entering the market with new ships, or considering having one built a few years after entry. Furthermore, as the major cruise lines focus increasingly on newer and larger ships, it can be expected that more of their current, smaller, ships will come on to the second-hand market. We have also been told of a number of 'nearly-new' vessels that are now available, following the collapse of the Renaissance Line in the USA.

2.82. Therefore the conclusion that we draw from this part of our investigation is that barriers to entering the cruise business are not insurmountable—especially for those with existing expertise in travel or tourism. Although some new entrants will inevitably find it more difficult than existing players to establish themselves with both customers and travel agents, the speed with which a number of recent arrivals have won acceptance leads us to believe that the obstacles that new entrants are likely to face are not insuperable.

Conclusions on the public interest

2.83. 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 the implications for the UK market in cruises. We have also considered the likelihood of current competitive conditions continuing into the future. In the course of this inquiry we have gathered information from those who might have an interest in the questions raised in our terms of reference. We have visited four cruise ships and three ports. We have held a series of hearings with other cruise lines, with tour operators and travel agents, and with industry experts and

representatives of the consumers. We have advertised widely to encourage anyone with information or views on these issues to share them with us. The level of response has been reasonably high—both from the cruise lines themselves and from those who sell their services.

2.84. The concern that lies behind almost all the issues that have been raised with us is that a combined POPC/RCCL would have too large a share of the markets in which they operate. The argument, at the global level, is that, at the moment, there are four companies that between them have over 70 per cent of the world cruising market. The largest is Carnival, which in 2001 controlled 29 per cent of available capacity. Next came RCCL with 23 per cent, POPC with 10 per cent, and Star/NCL with 12 per cent (see Table 3.3). No other operator had over 3 per cent of the market, and all of them together accounted for less than 30 per cent. By 2006, when the new ships currently on order or under construction will have entered service, the prediction is that their combined share will have reached 75 per cent of global capacity, within which the combined RCCL/POPC will account for 34 per cent, as against 33 per cent in 2001 (see Appendix 3.1). This certainly constitutes a high share, but high shares do not automatically confer market power. That depends on whether there are significant competitive constraints. So we concluded our inquiry by examining whether or not such constraints could be said to operate sufficiently both within and without the economic markets in which POPC and RCCL are active.

2.85. As will be clear from the section on market definition, we were unable to reach a conclusion on the definition of the relevant service market for our inquiry. So, in the rest of this section we examine the impact of the proposed merger on a number of possible scenarios that range from a narrow to a broad definition of the market.

2.86. We began by looking at a very narrow definition, a market limited to premium cruises aimed at specific nationalities. For the lines owned by the companies that we have been asked to consider, this approach gives us three potential markets: the UK premium market, the German premium market, and the US premium market.

2.87. In the first two of these, the proposed merger gives rise to no significant issues, as only POPC has any presence in either market. There is the conceivable concern that RCCL might have been regarded as a potential new entrant to either or both of these markets as an independent company, but not as part of a merged POPC/RCCL. But we do not regard that as a serious objection to the proposed merger because:

- (a) POPC's main rival in UK premium cruising, Cunard, is in the process of more than doubling its capacity in this market;
- (b) one new player, Saga, has entered in recent years—and announced an increase of its capacity in May 2002; and
- (c) there is also a significant prospect of providers of standard cruises in the UK expanding into the premium market.

2.88. The position is different in the US premium market, where both companies have a substantial presence, P&O through Princess Cruises, and RCCL through RCI and Celebrity. Here we can expect to see the market position of the merged entity being enhanced. There could then be a concern that POPC/RCCL might seek to use this enhanced position to try to lead an overall raising of prices in the US premium market. There are two ways in which it might attempt this: by seeking to restrain capacity or and by changing its pricing practices so as to be able to bring about a reduction in the level of discounts currently prevalent in the market.

2.89. Constraining capacity in this market will involve considerable challenges over the next few years, because all three of the major players, Carnival, RCCL and POPC, are currently engaged in major shipbuilding programmes. Compared with the levels in 2001 (see Appendix

3.1), we have been told that by 2006 Carnival will have added over 32,000 new berths, RCCL over 18,000 and POPC over 16,000. Star/NCL will also be adding almost 4,000. While it may be possible to reduce the impact of this increase on the US premium market to some degree—by slowing down the rate at which new ships are built or accepted into service, by accelerating the rate at which older ships are sold off, or by diverting more ships to lines which are focused on other markets—all of these options will have costs attached to them, which would need to be offset against any notional gains that might be achievable from any reductions in discounting in the US premium market. For example, in the next year or two, most of the proposed new ships have already been laid down, so scope for delay is very limited. And the most obvious alternative location for diverted vessels is Europe, where Carnival already operates two cruise lines and where POPC/RCCL will have the existing UK and German lines, and the new, planned, entry into southern Europe. All of these could be harmed by a further increase in capacity there.

2.90. As for being able to enhance its pricing practices, the fact that POPC/RCCL will control a larger share of US premium market than either company individually will mean that it might in principle be able to fill its ships with smaller discounts than when each company risks being undercut by the other—especially if it were possible to persuade Carnival that it was in its interests to cooperate. The quality of the merged entity's strategic pricing decisions might also be improved, by its having better internal information about more ships operating in that market, by having fewer rivals to monitor, and by being able to share best practice. That said, turning this improvement into a sustained increase in revenues from the US premium market would be very far from easy. Indeed, if the major players in the US premium market were to seek to raise prices there, the effect could well be to encourage other operators to offer more cruises, given the ease with which existing providers can move ships around the globe.

2.91. To set against these potential concerns, we have also considered some other factors. First, the proposed merger will also give rise to synergies, most of which will occur in the US premium market, and will enhance the financial position of POPC/RCCL compared with what the two independent companies would have enjoyed. This in turn offers the possibility of lower prices to their customers, while still allowing the merged companies to retain, or even improve, their current levels of profitability.

2.92. It is also the case that the US premium market is not the most important one for UK cruise passengers. From the figures that we have seen, it appears that over two-thirds of all UK cruise passengers sail on ships from the lines that are aimed at UK customers. The rest are divided fairly evenly between lines focused on North America and those aimed at a general European customer base.

2.93. Therefore even if the proposed merger were to have undesirable implications for the US premium market—and our conclusion is that it is far from certain that it would—then its impact would be felt by only around 15 per cent or so of UK cruise-takers. Those customers would, of course, all have the option of shifting their business to lines operating in the UK or European premium markets—a number of which cover many of the same destinations as those active in the US premium market. They could also consider moving to one of the standard lines, some of which also offer cruises in the Caribbean, if not to other North American destinations.

2.94. So, although we have found some potential concerns to which the proposed merger might give rise in the US premium market, we have also identified other factors that could offset or mitigate their effects. We therefore do not conclude that the likely impact of these concerns on UK cruise customers is such as to constitute a serious objection to the proposed merger.

2.95. We next looked at a more widely defined market: all cruises available to customers from the UK—ie without any segmentation for quality or for nationality or language. POPC is the largest player in this market (see Figure 3.1), accounting for around 23 per cent of all UK

cruise passengers carried. RCCL is the sixth largest, accounting for 6 per cent of UK passengers. This means that the combined entity would have 29 per cent. This is a sizeable market share, but not one that, in our view, confers enough market power, in this case, to raise prices in the way suggested in paragraph 2.88. Not only is there the possibility of some, admittedly more limited, synergies here too, but entry is easier than in the US premium market, and the wider cruise market embraced by this definition is diverse, dynamic and growing rapidly. This can be illustrated by the four companies that occupy the second, third, fourth and fifth positions in the list of market shares of UK cruise passengers—ie the places that separate POPC and RCCL. Between them they are represented in a number of distinct parts of this wider market: the US premium sector, which sells some of its capacity to UK customers; the dedicated premium segment which is focused largely on the UK market, with many cruises leaving from domestic ports; UK standard cruises, most of which involve a flight to the port of embarkation; and the European cruise lines, both premium and standard, which include UK passengers among their international, multilingual customer base. All these segments are increasing in size and in the competitive restraints that they impose on the companies involved in the proposed merger.

2.96. The second and third places in the market share list (see Table 5.6) are occupied by Airtours (with 16 per cent of the market) and Thomson (with 10 per cent). These companies represent the high street tour operators who, together with First Choice, have been responsible for establishing a substantial standard cruise sector in the UK. Although the first of their ships began offering cruises only in 1995, five years later they were, between them, carrying 30 per cent of all UK cruise passengers. Although their focus is still on the customers who buy their other packaged holidays, we have been told that Airtours, in particular, has improved the quality as well as the size of its offering. POPC told us that its latest ship, *Sunbird*, displayed many of the characteristics of its own vessels. It also believed that when Thomson started operations in 1995, many of its passengers had previously cruised with POPC.

2.97. The fourth place in the rankings is occupied by Carnival, which accounts for 9 per cent of UK passengers on a variety of lines. Carnival is the largest cruise operator in the world (see Table 3.3). It had 29 per cent of global capacity in 2001, and this is expected to increase to 32 per cent in 2006 when its new ships have come into service. Part of this increase will occur in its operations focused on the UK with the planned growth in Cunard's activities. In May of this year, the line—which is already the second largest (after P&O Cruises) provider of UK premium cruises and accounts for 17 per cent of that narrowly-defined market—intends to reposition the *Caronia* for round-trip cruises from Southampton. It is also committed to the construction of a new 1,968-passenger ship for the UK holiday market that it expects to be delivered in 2005. In addition, Cunard has the 2,620-berth *Queen Mary 2* under construction. This ship will more than double its existing capacity and will be used on a number of cruises originating in the UK. But Carnival's strongest focus is on North America where it operates two lines, Holland America and Carnival Cruise Lines. These lines compete with RCCL, Princess Cruises and many others, and carry a small percentage of UK customers on their cruises. The third area where Carnival is active is in Europe where its Costa line, aimed chiefly at mainland European customers, accounts for a further 2 per cent or so of all UK cruise passengers.

2.98. The fifth ranking is occupied by Louis (with 8 per cent), a European operator that, like Costa, markets itself to a range of nationalities and language groups.

2.99. There are also other sizeable players in all of these parts of the market: First Choice (albeit through a joint venture with RCCL) is another UK tour operator (accounting for 4 per cent of UK passengers) that is active in providing standard cruises; Star/NCL (also accounting for 4 per cent) is the other major line aimed at North America, but there are a number of others offering both premium and luxury berths; Fred Olsen (3 per cent) is a third line aimed at the UK premium sector; and Paradise Cruise Lines (also 3 per cent) is only the largest of a number of other European operators offering cruises to UK customers. The remainder of the UK market

(13 per cent) is accounted for by a number of lines with shares of around 1 per cent or less. Notable among these is Saga, which began offering cruises in 1997 having bought a 4-star liner from Cunard (see paragraph 3.21).

2.100. Next, we considered the possible courses of action available to rival cruise lines, and to others in the holiday or travel business, which would enable them to intervene in the wider cruise market for UK customers should they see signs that a combined RCCL/POPC was attempting to assert market power. There seemed to us to be a number of options. First, the established US and mainland European lines that already sell a significant amount of cruises to UK passengers—the most developed cruising market outside North America—could increase the number of berths that they offer over here. This should not be difficult. Many are currently expanding the capacity of their fleets; they already have long-standing links with UK travel agents; and their existing yield management systems are adept at varying the number of places on offer, and the prices charged, to exploit rises or falls in demand. Some also have the option of increasing the number of ships that are targeted on the UK market. We have already seen how POPC moves ships between its US and UK lines, and Carnival, for example, could do the same, should a market opportunity arise over here. Others could simply deploy more of their ships to locations that are popular with UK passengers. Unlike other holiday assets such as hotels and airports, cruise liners can be moved around the globe relatively easily, in line with demand. Next, the existing UK cruise operators could increase their competitive response by varying their prices, or by further increasing their capacity, which we have been told by some that they are already planning to do. Third, more new entrants could come into the market. Although three of the major UK tour operators have established a presence in cruising in the last few years, the fourth has yet to do so. And there are examples from the USA of other types of company making successful entries into the cruise business.

2.101. It is also worth noting that the nature of the cruising is changing. As we have already made clear, the fastest-growing area among UK new entrants is in the standard segment, which appeals substantially to those who have not previously considered cruising as a holiday choice. POPC has recently announced that it intends to compete directly for these customers with its ‘Ocean Village’ initiative, which will offer cruises in this segment. In the USA too, the large increase in the number of people taking cruise holidays has gone hand in hand with a widening of the groups from which passengers are drawn, and a lowering of the average age of those on board. If recent UK experience is any guide, then new entrants may well be as able, if not more able, than the established cruise operators to attract these new customers; and the value of an established shipping name and reputation may not be as important in attracting new types of customers as it seems to be in retaining the loyalty of existing ones.

2.102. Next, we considered whether either of the potential concerns that we had identified in the US premium market—POPC/RCCL attempting to restrain capacity and change pricing practices, so as to be able to bring about a reduction in the level of discounts—were also likely to be issues for the wider cruise market for UK customers. We decided that constraining capacity would be an even more difficult task in this market. It contains a wider variety of different types of cruise providers than the US premium market, and a number of them have already demonstrated an ability to reintroduce into service ships sold off by the larger lines. For example, Saga’s current ship was bought from Cunard and most of those used by the UK tour operators were formerly with one or other of the major US lines. We concluded that changing pricing practices would be even more difficult. The additional increment brought about by the merger would be smaller in the wider cruising market for UK customers than it would in the US premium market—put simply, Princess Cruises is a much larger provider to North American customers than RCCL is to the UK. And there would be a greater number of players whose cooperation would be needed if a concerted price rise were to be attempted.

2.103. So, given the variety and strength of the other participants in the wider cruise market for UK customers, the relative ease with which others can enter, and the range of options available to counter any anti-competitive practices that POPC/RCCL might seek to attempt, we

do not conclude that POPC/RCCL's likely share can be expected to constitute a serious objection to the proposed merger.

2.104. Finally, we looked at cruising as part of the holiday market. We identified no concerns using this very wide market definition. This is because all UK cruise holidays (754,000 in 2000) accounted for only 3.8 per cent of foreign package holidays, or 2.1 per cent of all foreign holidays (see Table 5.6). The share of POPC and RCCL in this market would, in our view, be too small to give rise to any objections to the proposed merger.

Conclusion

2.105. The conclusion that we draw from all this is that the UK cruise market is characterized by growth, variety and new entry, and that this can be expected to continue. The number of passengers carried more than tripled between 1990 and 2000 and around a third of the berths provided in 2000 were being offered by operators that did not enter the business until 1995 or later. Furthermore, between one-third and one-quarter of UK passengers chose ships that were focused mainly on North American or mainland European customers, rather than lines aimed at the domestic market. So, given all this diversity and choice—and the widespread view among commentators on the industry that cruising capacity will continue to grow—we do not conclude that by bringing together RCCL and POPC the proposed merger is likely to have a significant impact on competition.

2.106. Accordingly, we conclude that the proposed merger cannot be expected to operate against the public interest.