

COMPLETED ACQUISITION BY THE DAVIS SERVICE GROUP PLC OF CO-OPERATIVE CLEANERS LIMITED

A report under Section 125(4) of the Fair Trading Act 1973 on the advice of the Office of Fair Trading, given on 6 June 2003, to the Secretary of State for Trade and Industry under section 76 of the Act.

JURISDICTION

The merger satisfies the share of supply test of the FTA for the supply of textile maintenance services (i.e. laundry services) to the healthcare sector in Great Britain. The ECMR does not apply.

THE PARTIES

The Davis Service Group plc (Davis) is active in textile maintenance and site services. Its UK textile maintenance business is carried out by its wholly owned subsidiary, **the Sunlight Service Group (Sunlight)**. In the year ended 31 December 2001, Davis reported pre-tax profits of £70.6m on turnover of £514.4m and gross assets of £502m. **Co-operative Cleaners Limited**, known as **Society Linen (Society)**, provides textile maintenance services in most parts of England with [over 50 per cent] (see note 1) of turnover accounted for by the healthcare sector. In the year ended 26 January 2002, it reported an operating deficit of £337,000 on turnover of £11.5m and gross assets of £10m. The owners of Society took the decision to dispose of the business and sought bids through an open bid process. Davis made the highest bid of [] (see note 2).

ASSESSMENT

Relevant markets

The parties overlap in the supply of textile maintenance services (i.e. laundry services), especially to the healthcare sector.

Textile maintenance services can be segmented in a number of ways. First, the healthcare sector might be considered separately from services provided to, say, hotels and restaurants. The NHS and some third parties suggest that this is the case as they consider that laundries not active in healthcare would be unable to meet NHS hygiene requirements. In addition some laundries servicing hotels have said they would be unwilling to expand into healthcare because of customer concerns about cross-contamination. However, Sunlight has contended that non-healthcare laundries could offer healthcare services as there is no difference between, for example, hotel and hospital bed-linen. It has cited examples of laundries where both types of linen are processed on the same site. Further, Sunlight has cited examples of where it has switched its own laundries

from servicing the hotel sector into servicing the healthcare sector within 6-8 months and without the need for substantial investment. For example, [] (see note 3) Hospital gave Sunlight sufficient time to build healthcare capacity at its [] facility (see note 3). Sunlight made an investment of [] (see note 2) and was up and running within 6 months. Similarly, Sunlight's [] (see note 3) plant was converted from a workwear plant to a healthcare plant within an 8 month period (including 2 months for design purposes) at a total cost of c £2 – 2.5 million. These examples indicate that switching capacity between sectors in order to respond to demand is possible.

Second, the healthcare sector could be sub-divided between ward linen (bedding, towels, etc.) and theatre textiles (surgeons' gowns etc.). Theatre textiles can be either re-usable, and hence require laundering, or disposable. Re-usable theatre textiles must be sterilised and this can be done by the hospital itself (after washing in a laundry in the same way as ward linen) or by a sterilised laundry service for which purpose-built facilities are required. (Both Sunlight and Society have such facilities.) However, theatre textiles form only a small part of the total healthcare sector and are not crucial to the competition assessment in this case.

Third, there might also be a distinction between different types of laundry service: rental (where textiles are provided by the textile maintenance company); contract (where the textiles are owned by the customer); and total linen management (TLM) – (where all laundry services including the collection and delivery of linen within the hospital are effectively outsourced). For these services there appears to be some degree of substitutability with customers tendering for bids across a combination of some or all of these options. While Society predominantly provided contract laundry services, generally supply-side substitutability appeared to be high.

For the above reasons, the appropriate frame of reference may be no wider than the supply of laundry services to the healthcare sector. However, there may be some supply-side constraint provided by the non-healthcare sector. More specifically, this investigation has tended to focus on ward linen as this is the main area of overlap and theatre textiles form less than 5 per cent of total healthcare laundry requirements.

In 1983, the MMC concluded that for the supply of linen rental (at that time mainly for hotels and restaurants) the geographic market was predominantly regional¹. Sunlight has suggested that for the healthcare sector firms now compete on a supra-regional basis since distribution logistics enable the parties to trunk healthcare linen over relatively large distances [](see note 3). Third parties have suggested 80 to 100 miles as the maximum trunking distance. Firms therefore seem unlikely to compete on a national basis; indeed only Sunlight, Society and one other company operate throughout most of England and only Sunlight also operates in Wales [] (see note 3). Sunlight has provided share of supply figures based on NHS regions but it is unlikely that these 'administrative' areas represent the geographic areas over which competition for healthcare laundry services operates. Moreover, it appears unlikely that a chain of substitution exists linking these regions to create a

¹ Sunlight Service Group/Johnson Group Cleaners/and Initial/Johnson Group Cleaners

national market. Although the geographic scope of competition may be supra-regional it is difficult to delineate exactly what these areas may be. Both regional and supra-regional issues have therefore been considered.

Horizontal issues

Sunlight has estimated that the parties' combined share of supply for the provision of textile maintenance services to the healthcare sector in Great Britain is [20-30 per cent (increment 3-4 per cent)] (see note 1). For ward linen the estimated combined share of supply is [25-35 per cent (increment 4-5 per cent)](see note 1) with the next largest player being STS Synergy (Synergy) with [less than 6 per cent] (see note 1) of supply. Sunlight has also provided regional shares of supply for ward linen for 2001. These data show high combined shares in some regions, for example, [text deleted] (see note 3). However, these figures may not be truly representative of the parties' competitive positions because they are based on NHS regions which, as indicated above, are unlikely to equate to regional geographic markets.

Hospitals award contracts for textile maintenance services through competitive tender. Contracts typically last 3 to 5 years and are advertised through the EU's Official Journal. This process can be characterised as a bidding market. In such a market, annual shares of supply are not necessarily a good indication of market power. Sunlight has been unable to provide shares of supply over time which might be more representative. The bidding history of Sunlight and Society for healthcare contracts over the last five years has therefore been examined to assess the impact of this merger on competition within the healthcare sector. Sunlight made bids for [] (see note 2) contracts between late 1998 and 2002. It has provided details of which of those tenders it won and which Society bid for and won. It has also indicated, for how many of these [] (see note 2) tenders other competitors bid.

Table 1. Sunlight and Society Bidding History 1998 - 2002 (see note 4)

Year	Sunlight				Society			
	Bid for	Won	For those won:		Bid for	Won	For those won:	
			Av. no. of other bidders	No. where Society bid			Av. no. of other bidders	No. where Sunlight bid
1998*	[]	[]	[]	[]	[]	[]	[]	[]
1999	[]	[]	[]	[]	[]	[]	[]	[]
2000	[]	[]	[]	[]	[]	[]	[]	[]
2001	[]	[]	[]	[]	[]	[]	[]	[]
2002	[]	[]	[]	[]	[]	[]	[]	[]
Total	[]	[]	[]	[]	[]	[]	[]	[]

Source: Davis, * Figures provided for 1998 are incomplete

Table 2. Number of bids by competitors 1998 – 2002 (out of Sunlight’s [] (see note 2) bids)

	Synergy	NHS Eastbourne	NHS CBT	NHS Redbridge
No. of bids	[]	[]	[]	[]
Where active	[]	[]	[]	[]

Source: Davis

(For number of bids – see note 3)

(For Where active – see note 4)

This bidding history shows that Sunlight and Society are competing directly against each other but that other competitors, notably Synergy but also some NHS Trusts, are actively competing, even in NHS regions where combined shares of supply are high. However, Society only bid in [] (see note 2) of the [] (see note 2) tenders that Sunlight was involved in [(less than 25 per cent)] (see note 1) and in only [] (see note 2) of the [] (see note 2) tenders that Sunlight actually won. Thus whilst Society offered a competitive constraint on Sunlight, this constraint appears to have been fairly modest. The bidding history also indicates that Society’s bidding activity has been reducing over time, although the bidding numbers by year are too small to infer a statistically robust trend.

The average number of bidders shown in table 1 is based on a relatively small number of contracts, i.e. those won by either of the parties. Sunlight has estimated the average number of bidders for different types of tender as follows: contract laundry, 3.8 bidders; contract/rental, 4.0 bidders; contract/linen/TLM, 3.8 bidders; TLM, 3.4 bidders; and rental 3.5 bidders. In addition, it has said that in every bid (bar one) in which both parties were present, there was at least one other bidder involved in the tender process. On the basis of Sunlight’s estimates, the loss of Society as a bidder would result in a reduction from between 3-4 bids to between 2-3 bids in the case of a limited number of contracts.

In order to assess whether the loss of Society as a bidder would result in a substantial lessening of competition it is necessary to compare the expected position post-merger with that which might be expected to exist if the merger had not taken place (the counterfactual). It is often difficult to predict what the likely future competitive situation might be and in the absence of evidence of immediate and certain changes in the structure of competition in a market the counterfactual is often taken to be the prevailing (i.e. pre-merger) conditions of competition. In this case, this assessment is further complicated since the owners of Society had taken the decision to sell the business. We have considered and investigated, for example, whether new management might have revitalised Society or another buyer (other than Sunlight) might have turned Society around such that its bidding activity would be maintained or increased. On the evidence available to us, however, we do not feel confident that, absent the merger, there would have been sufficiently certain and imminent changes to the structure of competition that would justify departing from prevailing conditions of competition as the best guide to the counterfactual.

Barriers to *de novo* entry to the healthcare laundry sector are acknowledged to be high. Estimates suggest that to gain a 5 per cent share of supply of the ward

linen sector could cost around [] (see note 2), within a total healthcare sector worth [£200-250m] (see note 1). However, entry might be facilitated through acquisition of, either, an existing NHS laundry, or a private non-healthcare laundry and taking on healthcare work over time. Views on whether non-healthcare laundries could, and would, switch to the healthcare sector are mixed. As already indicated, the NHS and some third parties do not regard this as a viable option and it has been suggested that healthcare specific plant and machinery would be required. However, Sunlight has cited a number of examples where both non-healthcare and healthcare laundry is done on the same site with the same facilities. (These include four other laundry companies as well as all of Society's [] (see note 2) plants and [] (see note 2) of Sunlight's plants.) Evidence was also mixed on whether barriers to expansion would prevent existing healthcare laundries from bidding for more contracts. Third party comments suggest that such laundries are already operating at 90–100 per cent capacity indicating that they would be unable to take on new contracts. However Sunlight argues that expansion is possible if such laundries adopted different working practices, e.g. increasing the number of shifts operated.

Buyer power in a bidding market would normally be expected to be high providing that the number of potential bidders was sufficient to ensure rivalry at the bidding stage. However the level of concern raised by third party customers suggests that the loss of Society as an independent bidder could be a concern.

Third party views

Third parties expressed a high and consistent level of concern about the merger. Competitors were concerned about the growth of the Davis Group with some raising the possibility that the reason behind the merger was to remove a competitor or prevent Society being acquired by an existing competitor. In response to this, Sunlight contended that the rationale behind this merger was to address its own capacity constraints particularly in London and the South. Prior to Society being offered for sale it had explored building a new facility [] (see note 3).

The NHS Purchasing and Supply Agency (PASA) and four out of the five hospital trusts contacted expressed concern that the merger would lead to a reduction in the number of bids they receive for textile maintenance contracts which, they considered, would lead to higher prices. This is an understandable concern although one third party pointed out that following the previous merger in this industry – when Sunlight acquired Midland Laundry Group – contract prices fell by 3 per cent. The extent to which prices might rise as a result of this merger would be influenced by the extent to which Society acted as a competitive constraint upon the pricing of Sunlight as well as barriers to sector entry for non-healthcare laundries. The information we have received appears to suggest that Society was not a major bidder for new contracts. In addition the examples cited by Sunlight suggest that barriers to sector entry for existing laundries do not appear as high as those who have raised concerns have stated. Further it might be possible for NHS Trusts to effectively 'sponsor' such entry by allowing sufficient lead-times in the tender process to allow non-healthcare laundries to make any necessary changes. Sunlight has suggested that such lead-times have been a feature of a number of healthcare tenders.

CONCLUSION

At the national level, the combined share and increment for the supply of laundry services to the healthcare sector arising from the merger are not particularly significant. In some NHS regions, the combined share is high but these regions are unlikely to be representative of the geographic scope of competition for contracts. We have carefully examined the bidding history for healthcare contracts provided by Sunlight. The available evidence suggests that, pre-merger, Society represented a weak constraint on Sunlight in the significant majority of tenders and that there are other bidders for healthcare contracts that competed with Sunlight even in those NHS regions where combined shares are high.

The evidence on supply-side constraints (i.e., supply-side substitution, barriers to entry, and expansion) is mixed. On the one hand some third parties suggest non-healthcare laundries are unable or unwilling to switch to healthcare work. On the other hand, there are actual examples of healthcare and non-healthcare work being done on the same site and examples of where a laundry has switched from supplying non-healthcare to healthcare customers suggesting that such barriers are not insurmountable. Conflicting views on whether expansion by healthcare laundries is prevented by capacity constraints have also been put forward. The strength of buyer power is unclear. Within the NHS it is seen as low but arguably this is something which NHS Trusts as the main customers could seek to address. While we acknowledge the consistency of third party concerns regarding the reduction in the number of bidders, and while it is possible that the merger will lead to some reduction of competition in the short-term in a minority of contracts, on balance we do not consider that this merger, in itself, will result in a substantial lessening of competition.

We therefore **conclude and recommend** that you **do not refer** this merger to the CC.

Notes

1. Figure changed to a range at the request of the parties for reasons of confidentiality.
2. Figure deleted at the request of the parties for reasons of confidentiality.
3. Text deleted at the request of the parties for reasons of confidentiality.
4. Figures in table deleted at the request of the parties for reasons of confidentiality.