

## Completed acquisition by Bucher Industries AG of Johnston Sweepers Limited

The OFT's decision on reference under section 22(1) given on 6 April 2005. Full text of decision published 22 April 2005.

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**Please note square brackets indicate information replaced by a range at the request of the parties for reasons of commercial confidentiality**

### **PARTIES**

1. **Bucher Industries AG** (Bucher), a company incorporated in Switzerland, is principally active in the manufacture of agricultural and industrial machines, including sweepers used in the provision of road cleaning and maintenance services. **Johnston Sweepers Limited** (Johnston) is a UK company active in the production of a comprehensive range of outdoor surface cleansing equipment, including sweepers, street-washers and litter collection vehicles.

### **TRANSACTION**

2. Bucher has acquired the entire issued share capital of Johnston<sup>1</sup>. The proposed transaction was notified to the OFT in the form of a Merger Notice dated 18 February 2005. The extended statutory deadline was 5 April 2005. However, on 31 March 2005 Bucher notified the OFT that it had completed the acquisition of Johnston on that date.

### **JURISDICTION**

3. As a result of this transaction, Bucher and Johnston have ceased to be distinct. Johnston's UK turnover does not satisfy the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act). However, the parties' overlap in the supply in the UK of truck-mounted sweepers and the merger would lead to a combined share of supply of [50-65] per cent – an increment of 1.4 per cent. The share of

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<sup>1</sup> This excludes Johnston's North American subsidiaries in Canada (Johnston Madvac Inc) and in the US (Johnston Sweeper Company). Both these subsidiaries have been subsumed into the Johnston Group through a contract entered into prior to Bucher's agreement to purchase Johnston Sweepers.

supply test in section 23 of the Act is consequently met. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

## **RELEVANT MARKET**

### **Product market**

4. Bucher proposes that there are three categories of sweepers relevant to the competition assessment in the merger: 'sub-compact and compact' (less than 2m<sup>3</sup> capacity); 'midsize' (between 2m<sup>3</sup> and 5m<sup>3</sup> capacity); and 'truck-mounted and specialist truck-mounted' (sweepers of generally more than 5m<sup>3</sup> capacity that are installed on chassis supplied by other vehicle manufacturers).
5. Having due regard to the average prices for different categories of sweeper and also to customers' views, the available information suggests that sub-compact and compact sweepers are distinct from each other.
6. Where truck-mounted sweepers are concerned, there appears little scope on the demand-side for substituting between truck-mounted and specialist<sup>2</sup> truck-mounted vehicles. However, the available information suggests that the possibilities for supply-side substitution appear high enough for these two types of truck-mounted sweeper to be considered as part of the same segmentation.
7. On this basis, the product frame of reference considered in this paper consists of the manufacture and supply of the following four segments of sweeper:
  - sub-compact
  - compact
  - midsize
  - truck-mounted and specialist truck-mounted.

### **Geographic market**

8. Bucher submits that the relevant geographic scope for the supply of sweepers is UK wide. However a number of factors suggest a wider – possibly EU – geographic frame of reference.

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<sup>2</sup> 'Specialist' truck-mounted sweepers have been adapted for use in areas such as road construction, harbours, street markets, military & industrial sites, municipal 'spring clean-ups' and other environments that call for more specialised cleansing operations.

## Arguments in favour of an EU-wide frame of reference

9. Customers indicated that they considered imports to be a viable option when making purchasing decisions provided they had access to effective supporting services within the UK. This is supported by significant levels of imports and exports in the sector achieved through UK distributors – although the levels vary between different categories of sweeper. According to Bucher, imports of compact and sub-compact sweepers accounted for more than a quarter of UK sales in 2003 and over a third in 2004. In 2003, Johnston's exports of compact sweepers exceeded the value of all imports of this type of product into the UK.
10. The pattern of imports and exports in the mid-size and the truck-mounted sweeper segments is distinct. Whilst there are very few imports of these two categories of sweeper into the UK, Johnston nonetheless exports significant amounts. According to Bucher's best estimates for 2003, the total value of imports for truck-mounted and specialist sweepers into the UK was approximately £400k: nine units out of a total of 450 units sold in the UK. Over the same year, Johnston exported [250-350] truck-mounted sweepers to a value of £[5-15]m.
11. Customers place considerable importance on the existence of a local/national distribution resource to support their purchases of sweepers. Bucher 'lost' its substantial presence in the UK market when its distribution agreement with Jack Allen ended. A distribution network allows for the products to be tested before purchase, and provides for more reliable maintenance and servicing support operations. Bucher submits that such a network is easy to establish at fairly low cost. The pattern of sales by foreign companies in the UK indicates that establishing a network is not a significant barrier<sup>3</sup>. Similarly, exit costs do not appear particularly high. US producers of sweepers have recently begun selling in the UK. Bucher has already 'entered' and 'exited' the UK twice in the past 15 years. Its business plans state that [extract redacted at the request of the notifying party].

## Arguments in favour of a UK frame of reference

12. A significant proportion of customers in the UK display some degree of inertia to switching and appear to have established long-running commercial relationships with their incumbent supplier – and in many cases this is Johnston. This is evidenced by Johnston's strong presence in the UK relative to its somewhat weaker position in other parts of Europe, and also by its pricing behaviour in the UK compared to other countries.

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<sup>3</sup> One competitor, however, disagreed with this proposal and submitted that setting up a network did, in its view, constitute a significant barrier.

13. Bucher, moreover, contends that there are differences in customer preferences across different countries in the EU. In the UK, for example, the majority of customers are private contractors (providing services to public authorities) with a focus on the whole-life cost of the product. In other EU countries, most sales are directly to public authorities, who tend to be more concerned with the purchase price of a machine.
14. Finally, Bucher points to the existence of significant regulatory barriers, particularly as they apply within the UK – where a different side drive is required – and other EU countries. However, such barriers appear to be lower for truck-mounted sweepers which are typically mounted on a chassis provided by a third-party manufacturer and are thus subject to significantly less regulatory burden.

#### Position on the relevant geographic frame of reference

15. On balance, there is evidence to support Bucher's proposition that the relevant geographic frame of reference is the UK. However, given that the possibilities for a wider frame of reference cannot be excluded, consideration will also be given to the effectiveness of any competitive constraint from outside the UK.

#### **HORIZONTAL ISSUES**

16. The parties to this proposed merger overlap in the manufacture and supply of sweepers. Potential effects of the merger on competition within the UK and Europe are analysed in turn.

#### **The UK**

17. Bucher's estimates of shares of the supply of sweepers in the UK are given in Table 1.

Table 1 : UK shares of main parties and competitors in 2004 and (2001-2003) for all categories of sweepers (Data put into ranges at the request of the notifying party)								
Companies	Category of sweeper							
	sub-compact		compact		mid-size		truck-mounted	
	2001-2003	2004	2001-2003	2004	2001-2003	2004	2001-2003	2004
Bucher	-	-	1-5	-	5-10	-	1-5	1-5
Johnston	-	-	40-50	40-50	70-85	70-85	60-75	50-65
<b>Combined</b>	<b>-</b>	<b>-</b>	<b>40-50</b>	<b>40-50</b>	<b>70-85</b>	<b>70-85</b>	<b>60-75</b>	<b>50-65</b>
Schmidt	-	-	20-30	20-30	-	5-10	1-5	-
Faun	-	-	-	-	-	-	-	-
Scarab	-	-	20-30	20-30	-	-	20-30	30-40
Ravo	-	-	-	-	10-20	5-10	-	-
Hako	40-50	20-30	1-5	1-5	-	-	-	-
Kärcher	5-10	5-10	1-5	1-5	-	-	-	-
Applied	30-40	60-70	-	-	-	-	-	-
Egholm	1-5	5-10	-	-	-	-	-	-
Others	5-10	1-5	5-10	10-20	-	-	1-5	1-5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Bucher

18. The figures show that Johnston already has particularly high shares (almost 70-85 per cent and 50-65 per cent respectively) of the supply of midsize and truck-mounted sweepers. Such high shares point to the possibility of Johnston being able to exert a degree of market power over its customers. Johnston's internal documents appear to confirm this. One such document produced by Johnston in the context of its proposed acquisition by Bucher states that 'The UK presents the biggest sweeper market in Europe. [Johnston] enjoys a dominant position in this market and as a result benefits from premium prices<sup>4</sup>'.
19. The parties contended that this statement was made by way of a 'pitch' to make Johnston a more attractive acquisition target for potential buyers.
20. However Johnston's business plans also indicate that the conditions for the supply of sweepers in the UK are less competitive relative to other EU countries. [Remainder of paragraph deleted at notifying party's request].
21. Over the year 2004, there was no overlap between Bucher and Johnston in the supply of sub-compact, compact and mid-size sweepers.

<sup>4</sup> Page 25 of 'Information memorandum – Johnston Engineer Division 2004' – prepared by Altium Capital Limited

## Europe

22. The parties overlap in the supply of sweepers to customers in a number of EU Member States including the UK, Germany, Italy, Spain and the Benelux countries. Bucher's estimates of its own and of its competitors' shares of supply at this EU level are given in Table 2. According to these figures, Bucher and Johnston would have a combined share of over [50-65] per cent of the supply of truck-mounted sweepers. The closest competitor would be Scarab, with under [10-20] per cent. The parties' combined share of the supply of compact sweepers would also be significant, at just under [30-40] per cent. The closest competitor would be Schmidt with just over [20-30] per cent. In mid-size sweepers, the parties' combined shares of supply would amount to almost [20-30] per cent. However, two other principal competitors remain with substantial shares. There is currently no overlap between the parties in the sub-compact market.

<b>Table 2: EU shares of main parties and competitors in 2004 and (2001-2003) for all categories of sweepers</b>								
Companies	Category of sweeper							
	sub-compact		compact		mid-size		truck-mounted	
	2001-2003	2004	2001-2003	2004	2001-2003	2004	2001-2003	2004
Bucher	1-5	5-10	20-30	20-30	20-30	20-30	20-30	20-30
Johnston	0.0	0.0	10-20	10-20	5-10	5-10	30-40	30-40
<b>Combined</b>	<b>1-5</b>	<b>5-10</b>	<b>30-40</b>	<b>30-40</b>	<b>20-30</b>	<b>20-30</b>	<b>50-65</b>	<b>50-65</b>
Schmidt	-	-	20-30	20-30	20-30	20-30	1-5	5-10
Faun	-	-	-	-	-	-	5-10	5-10
Scarab	-	-	5-10	5-10	-	-	10-20	10-20
Ravo	-	-	1-5	1-5	30-40	30-40	-	-
Hako	20-30	20-30	5-10	5-10	-	-	-	-
Kärcher	20-30	20-30	1-5	1-5	-	-	-	-
Applied	5-10	20-30	-	-	-	-	-	-
Egholm	10-20	10-20	-	-	-	-	-	-
Others	20-30	10-20	10-20	10-20	10-20	10-20	10-20	10-20
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Bucher

23. The three sweeper segments in which Bucher and Johnston overlap have a high degree of market concentration. Post-merger, the level of concentration, as expressed in terms of an HHI, ranges from around [2000-2750] in compact and mid-size to over [3500-4700] in truck-mounted. The increments in share of supply are also significant in all three segments. In terms of HHI, these range from just under [250-350] in mid-size to just under [1500-2000] in truck-mounted.
24. With the exception of Bucher, no other firm with a significant EU presence currently supplies the whole range of sweepers. However, UK customer

respondents indicate that the ability to supply a complete range of sweepers does not prevent customers from pursuing the best deal in each category. There are a number of competitors active within each of the relevant sweeper segments – although they have not necessarily supplied customers in all EU countries over the time period under discussion.

25. The supply of truck-mounted and mid-size sweepers is particularly concentrated at the EU level. In the truck-mounted category there are only three main competitors to the merging firms and in recent weeks two of them (Schmidt and Faun) have set up a joint venture for the production of truck-mounted sweepers. A consequence of this joint venture is that the proposed merger will further reduce the number of significant manufacturers from four to three both in the mid-size and truck-mounted categories.

#### Competition between Bucher and Johnston in the UK

26. Bucher currently has a servicing agreement in the UK with Greenman Municipal Ltd to cover its existing equipment and any new sales. This company is currently able to supply Bucher products in the UK and has been making occasional sales.
27. Bucher first set up a distribution network in the UK in 1989, which it maintained until 1993. Bucher subsequently 're-entered' the UK in 1996 through another distributor (Jack Allen Ltd). The distribution contract with Jack Allen was terminated in 2003; Bucher products not having been actively marketed during 2002 or 2003. Bucher submits that it has not been a commercial priority for it to appoint a replacement UK-based distributor. However one of Bucher's stated objectives in acquiring Johnston is to gain a presence and to participate in the UK sweepers market. Furthermore, its business plans have anticipated sales in the UK from 2005 – even absent a merger with Johnston. Figure 1 shows Bucher's past and forecast UK shares of supply against Johnston's UK shares.

[Figure 1 deleted at the request of the notifying party]

28. Shares in the supply of different categories of sweeper, particularly in individual countries, are subject to some degree of volatility, given that relatively small changes in unit sales impact significantly on aggregate volume and value terms. Bucher's shares of supply in the UK were significant in 2000 when its share of midsize sweepers reached [35-45] per cent (but the overall volumes were small). Its share in the supply of all sweepers in the UK has been in decline since. [Remainder of paragraph deleted at notifying party's request].
29. Looking to future years, Bucher's plans indicate an objective of achieving significant market shares in the UK in the next three years, particularly in the supply of mid-size sweepers. However, Bucher stated that previous experience in

the UK shows that its planned sales and market share levels are not a reliable guide to, and typically overestimate, its future sales levels.

30. Johnston's internal documents show that competition from Bucher is considered a threat to Johnston's position in the UK both as an actual and a potential competitor. However these documents also show that current competitors in the UK – particularly Scarab and Schmidt – also pose a threat to Johnston's prominent market position. Scarab in particular has recently been successful with an innovative small-scale (4m<sup>3</sup> capacity) truck-mounted sweeper.

### **Barriers to Entry**

31. There are a number of firms supplying sweepers across the EU. Some are active in several EU states while others are smaller and operate at no wider than a national level. The presence of a number of small firms in the sector suggests that entry barriers are not insurmountable.
32. Bucher estimates that entry costs are relatively small. A new entrant with no previous experience in the sector would incur expenditure of around £[2-5] million in R&D and plant. A firm wanting to sell sweepers in a country in which it had not previously been active, would incur costs of up to [£500k-£1m] in order to be in a position to achieve a share of supply of around [3-5] per cent. Bucher estimates that advertising and promotion (including the sales force) would cost between [£500k and £1m].
33. According to Bucher, the UK presents further R&D requirements for compact and mid-size vehicles which need to be designed with a left-hand drive<sup>5</sup>. This, according to the parties, adds costs of around £[200k-500k] and takes approximately 6-12 months. Country-specific and EU regulations also impose costs. In general, however, the bulk of such costs are not relevant to truck-mounted sweepers which are built on a donor chassis in relation to which regulatory approvals will have already been obtained.
34. Several companies have started supplying in the UK during the past five years. Bucher makes reference to:
  - Mathieu, a French company, who entered the UK in 2002 with an innovative compact machine.
  - Elgin, a US company, started supplying truck-mounted sweepers in the UK in 2004. Elgin had previously attempted to supply the UK in the nineties but exited. Bucher submits that US companies currently benefit from advantages due to the current exchange rate.

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<sup>5</sup> In compact and mid-size sweeper vehicles the steering wheel is normally on the opposite side to that of a normal vehicle.



- Other examples of entry in the supply of compact sweepers, including Hako, Kärcher and Applied Sweepers.
35. Although there is evidence of successful entry into the UK of smaller segments of sweeper, there appears to be generally less scope for entry into the truck-mounted segment. Bucher provided a list of firms who could potentially start supplying truck-mounted sweepers in the UK. However the majority of these firms appear to be local producers with no significant presence at a European level. It is doubtful whether these smaller firms could be competitive both in terms of product features and in terms of production costs as they are unlikely to be able to afford R&D expenditure of a size comparable to the main EU competitors. The only exception to this group of firms is Faun, a German company who has recently set up a joint venture with Schmidt (who is already present in the UK) for the production of truck-mounted sweepers.

### **Buyer power**

36. Local authorities and commercial sub-contractors are the main customers in the UK. Bucher states that approximately 25 per cent of sales go through a formal (OJEC) tender process, but those that do not are not necessarily less competitive transactions. The parties pointed out that their customers are very sophisticated buyers who are very aware of alternative products and are able to use the often substantial size of their orders as an effective negotiating tool.
37. Given the degree of bargaining that appears to take place in the market, whether through a formal tender process or informal contacts with suppliers, a reduction in the number of firms does not in itself signal a risk of lower intensity of competition. However, customers do not have an ability to backward integrate or to sponsor entry given the need for suppliers to be able to also provide an effective support (maintenance/servicing) service.

### **VERTICAL ISSUES**

38. The merger does not appear to have any significant vertical dimension.

### **EFFICIENCIES**

39. Bucher proposes that the merger will lead to efficiencies. It will increase the choice of sweepers available to UK customers and will introduce products from Bucher's range (such as snow ploughs) not currently sold by Johnston. It will also provide additional resources to Johnston R&D program, and finally it will provide significant savings in sourcing inputs for both companies.

## THIRD PARTY COMMENTS

40. Customers were generally unconcerned as to the effect of the merger on current competition in the sweepers market in the UK; although one customer commented that this was on the basis that the market was currently 'uncompetitive' and the merger would not change that. There was some uncertainty among some customers as to how the merged entity would market or develop its products in the future. Competitors were more concerned, contending that the merger would increase barriers to entry to the UK market.

## ASSESSMENT

41. The parties overlap in the supply of sweepers: principally vehicular<sup>6</sup> machines used in street-cleansing. Sweepers are categorised according to size, capacity etc. into four main segments: sub-compact, compact, mid-size and truck-mounted.
42. Johnston's UK shares of supply indicate that it enjoys market power over its customers, at least in the supply of mid-size and truck-mounted sweepers. [Remainder of paragraph deleted at notifying party's request].
43. Bucher has been present with varying success in the UK for 13 of the past 15 years; between 1998-2001 accounting for some 10-15 per cent of the UK market. The termination of its contract with its UK distributor in 2003 culminated in its departure as an active supplier in the UK. However it has maintained a UK servicing agent through which it has continued to make marginal sales.
44. Internal documents produced by Bucher clearly indicate its intention [extract redacted at notifying party's request]. Johnston's internal documents [extract redacted at notifying party's request].
45. The OFT believes therefore that Bucher is exercising a competitive constraint on Johnston. Bucher's stated intention of re-entering the UK market in the supply of sub-compact, compact, mid-size and truck-mounted sweepers is credible given that it is the leading player in Europe; has a strong brand; and has had past success within the UK. It is reasonable to expect that Bucher would have the incentive and resources to achieve market entry and so become a much more effective competitor to Johnston in the near future. Other firms not already active in the UK, are not comparable challengers to Johnston's market power in the UK. Consequently, there is a realistic prospect that the proposed merger would give rise to a reduction in the potential for increased competition within the UK in the near future, particularly in the supply of truck-mounted sweepers.

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<sup>6</sup> The exception being the smallest ('sub-compact') category of sweeper which is guided by a human operator on foot.

46. The majority of customers are unconcerned by the merger although some did have reservations regarding the general competitiveness of the market and also as to the impact of the proposed merger on Johnston's product range. However, these customers would be unaware of Bucher's intentions of re-entering the UK market and the potential for an increase in competition and choice that would result.
47. In sum, the proposed merger would combine the market leader in the UK with its biggest EU competitor and – as evidenced by Bucher's and Johnston's own internal documentation – a potential competitor in the UK in the near future. It is unclear as to (a) whether current competitors in the UK could either compensate for the loss of potential constraint from Bucher or pose sufficient on-going competitive challenges to Bucher/Johnston post-merger and (b) whether any other potential entrants to the UK could provide effective competitive constraint on the merged entity.
48. It is difficult to quantify the loss of potential competition which would result from the transaction in the supply of compact and mid-size sweepers. However, the OFT believes that the combined loss of actual and potential competition which would result from the transaction in the supply of truck-mounted sweepers in the UK is substantial.
49. Consequently, the OFT believes that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

## **DECISION**

50. This merger will therefore **be referred** to the Competition Commission under section 22(1) of the Act.