ACQUISITIONS (PACKAGE HOLIDAYS): THE AIRTOURS / FIRST CHOICE CASE

Subject:	Acquisitions Collective dominance Undertakings by parties
Industry:	Package Holidays (Implications for most industries)
Parties:	Airtours plc First Choice Holidays plc Thomson Thomas Cook
Source:	Commission Statement IP/99/695, dated 22 September 1999

(Note. Outright opposition to a proposed concentration under the Merger Regulation is still rare enough for a case to be news; there have only been twelve cases since the Regulation came into force ten years ago in which a proposal has been blocked. In the present case the new Commissioner explained that he was afraid that the proposed merger would place control of the British package holiday market in the hands of three tour operators; and, in current parlance, this would create a "collective dominant position" or oligopoly. But an oligopoly presupposes a certain degree of concertation between the operators concerned; and, although the Commission Statement refers to two factors which may imply some concertation, - the "incentive to keep the market tight" and the links in distributing one another's products, - the Commission does not assess the amount of competition between the operators. Perhaps the answer to this lies in the text of the full decision, which is not yet available. If so, we will provide a further report in due course. In the meantime, there is some force in the comment attributed to the Chairman of Airtours, to the effect that the Commission had chosen the case as "a marker on the issue of oligopolies".)

The Commission has prohibited the acquisition by Airtours plc of First Choice Holidays plc. The proposed operation affects the supply of foreign package tour holidays to UK residents and in particular, those package holidays (a large majority of the total) made by air to the popular short haul destinations in the mainland and islands of southern Europe and North Africa. The market structure is already highly concentrated with four vertically integrated companies having some 80% of the short-haul tour operating market between them. The rest of the market is fragmented amongst a large number of much smaller operators, none of them fully integrated and most with market shares of 1% or less. The takeover would create a market structure in which the remaining three vertically integrated companies would collectively have a dom in ant position, as First Choice would disappear both as a competitor in its own right and as a supplier of charter airline seats and travel agency distribution to the non-integrated operators. Airtours has proposed undertakings which were not however, sufficient to prevent the creation of a position of collective dominance.

Both parties are UK companies active principally in tour operating, and both are fully vertically integrated with substantial interests in charter airline operations and travel agencies. Airtours is active in tour operating, travel agencies, charter airlines, hotels and cruise ships with operations in 17 countries across Europe and North America. First Choice engages in tour operating, travel agencies, charter airlines, seat broking and car rental broking, mainly in the UK and Ireland, with some activities in Canada.

On 29th April 1999 Airtours announced its intention to acquire First Choice by way of a public bid. After the Commission decided on 3rd June 1999 to launch a detailed investigation under the Merger Regulation, Airtours announced on 10th June 1999 that it had allowed its bid to lapse but it could, in the event of a clearance decision by the Commission, launch a new offer for First Choice.

The Commission has found that in the UK market for short haul foreign package holidays, the operation would create a collective dominant position held jointly by Airtours/First Choice and two other remaining large vertically integrated operators, Thomson and Thomas Cook. Package tours are a high volume low margin product, which has a particular characteristic in that capacity (number of holidays) is basically fixed before sales begin and only relatively minor adaptations are possible afterwards. As a result the overall supply/demand balance has a strong effect on profitability. In particular competition for market share risks leading to oversupply with serious negative financial consequences for market operators, whereas constraining capacity will result in markedly improved profitability for all operators. Therefore, tour operators have an incentive to keep the market tight.

Moreover, the major operators are linked insofar as they supply one another with airline seats and distribute one another's products, they have similar cost structures, and there are high barriers to entry and growth and no countervailing buyer power.

The industry has gone through a consolidation process as a result of which it has become much more concentrated as well as vertically integrated. The consolidation has mainly taken place through acquisitions rather than organic growth. The four large vertically integrated tour operators, Airtours, First Choice, Thomson and Thomas Cook which have emerged as a result of this process today have about 80% of the market. The remainder is accounted for by a large number of small mainly non-integrated suppliers, who are constrained in their competitive effectiveness by their need for access to charter airline seats and travel agency services, which are to a large extent controlled by the four large integrated operators. The small operators have experienced difficulties in getting their holidays distributed through the agencies of the large integrated operators, who give preference to their own products (so-called "directional selling").

The direct impact of the merger would be to eliminate First Choice as a competitor in itself, and also to marginalise further the small non-integrated operators, since First Choice would be lost as a supplier of charter airline seats and travel agency distribution channels to such small operators. Crucially, the merger would lead to a collective dominant position on the part of the remaining three large integrated operators in that it would increase their incentive to restrict capacity and facilitate sustained strategies to do so, by strengthening their interdependency as regards capacity decisions which are crucial to the market outcome.

On the last day of the three-month period provided for doing so (other than in exceptional circumstances) by the relevant Commission regulation, Airtours offered certain undertakings to address the Commission's concerns. These were considered by the Commission in consultation with interested third parties in the industry and with the competition authorities of Member States. It was concluded that the undertakings were not sufficient to prevent the merger from creating a dominant position. In particular, they were not considered likely to recreate a fourth force to replace First Choice in short-haul package tours that would be strong enough to offer sufficient competition to an enlarged Airtours and the other two major players.

A few days ago, Airtours submitted a revised package of undertakings. The Commission does not consider that any exceptional circumstances are present such as would justify accepting these undertakings out of time. Moreover, there was not enough time left for the Commission to evaluate arid consult on the new package different from earlier commitments in several respects - before the legal deadline for a final decision, which cannot be extended. Finally, it was not obvious that the revised undertakings would prevent the creation of a dominant position. The Commission, therefore, decided that it could not consider the revised package of undertakings.

It has been difficult to identify satisfactory remedies. Where, as here, the competition problem concerns the companies' core activities rather than small parts of a much larger and more diverse business, the typical structural remedy - divesting all the overlapping activities of one or other party may threaten the commercial rationale for the operation. But if only partial divestment is to be effective, it is vital that the market structure post-merger contains enough players, and with sufficient strength, to ensure sufficient competition. In concentrated markets with barriers to entry or expansion, that may not always be realistic. □