COMPETITION COMMISSION

Thomas Cook/Co-operative Group/ Midlands Co-operative merger inquiry

A report on the anticipated travel business joint venture between Thomas Cook Group plc, the Co-operative Group Limited and the Midlands Co-operative Society Limited

16 August 2011

Website: www.competition-commission.org.uk

Members of the Competition Commission who conducted this inquiry

Laura Carstensen *(Chairman of the Group)*

John Cubbin

Roger Finbow

Robin Mason

Jonathan Whittaker

Chief Executive and Secretary of the Competition Commission

David Saunders

The Competition Commission has excluded from this published version of the final report information which the Inquiry Group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✂]. Non-sensitive wording is indicated in square brackets. Some numbers have been replaced by a range. These are shown in square brackets.

Contents

Page

Summary

1. On 2 March 2011, the Office of Fair Trading (OFT) referred the anticipated travel business joint venture between Thomas Cook Group PLC (Thomas Cook), the Co-operative Group Limited (CGL) and the Midlands Co-operative Society Limited (Midlands) to the Competition Commission (CC) for investigation and report.

2. Thomas Cook is one of the two major vertically integrated leisure tour operators active in the UK, offering a range of package holidays and associated products and services both through its own and third party travel agencies and direct to consumers. The travel businesses of CGL and Midlands are largely travel agency businesses.

3. On 8 October 2010, Thomas Cook, CGL and Midlands (the main parties) agreed to form a joint venture to include all of CGL's, all of Midlands', and some of Thomas Cook's travel businesses. Thomas Cook will contribute its retail travel agency business to the joint venture but not its tour operating business or its Internet travel agency businesses.

4. The joint venture will thus combine the main parties' travel agency stores and this represents the principal overlap between the main parties' activities. Thomas Cook operates around 780 stores, CGL has around 360 stores and Midlands over 100 stores.

5. We satisfied ourselves that we had jurisdiction in relation to the merger situation.

6. Travel agency business is mainly conducted in high street stores and on the Internet. Although high street sales are currently larger than Internet sales, Internet sales are increasing as a proportion of total sales.

7. Where travel agents sell holidays offered by tour operators, the price is based on a price set by the tour operators. Travel agents may offer discounts on this price by taking less commission for an individual transaction.

8. TUI Travel plc (TUI) is the largest competitor of the merging parties. It is active as both a tour operator and a retail distributor. There are a number of smaller chains of retail travel agent stores but these are significantly smaller than Thomas Cook, CGL and TUI, with the largest operating around 100 stores. In addition, there are a large number of independent travel agents. Most independent travel agents and many of the smaller chains belong to buying groups.

9. We considered that there were characteristics of package holidays as a product and high street agents as a distribution channel which differentiated them and suggested they could form a distinct market. Package holidays are distinct from independent holiday components in a number of ways, principally the convenience offered to customers of a bundled product and the regulatory assurance and protection afforded to consumers.

10. We considered two types of 'theory of harm'. The first type, known as horizontal effects, related to a possible loss of rivalry in travel agency sales of package holidays on a local, regional or national basis. The second type, known as vertical effects, related to the possibility of the joint venture's relationship with Thomas Cook (as a tour operator) being exploited in such a way as to harm competition.

Horizontal effects

11. We considered the impact of the joint venture on competition in the sale of package holidays at a local level, recognizing that customers booking package holidays in stores shop in local retail outlets.

12. We examined the extent to which Thomas Cook, CGL and Midlands have stores in the same local areas. We found that 472 Thomas Cook stores, 287 CGL and 80 Midlands would be in such overlap areas. Viewed nationally, this is a high degree of geographic overlap between the joint venture parties.

13. Competitive effects could arise locally, regionally or nationally. For there to be local or regional competitive effects, we would need to find that local competition would cause local or regional variation in prices or other aspects of the products or services offered to customers.

Local horizontal effects

14. The main parties told us that the retail offers of their stores, including both prices and non-price aspects, were set centrally and predominantly determined by national constraints. The main parties said that although some discounts were decided on a local basis, the discounts given by branches of travel agents were driven largely by pricing information from the Internet.

15. We found no evidence of local variation of non-price aspects in response to local competition. We did not expect that this would change as a result of the joint venture.

16. We found that discounts varied on a local basis. We found that some of this variation was related to local competitive conditions, although we recognized that other factors, such as Internet prices, that apply nationally, were also important. We conducted an econometric analysis of the relationship between discounts and local competitive conditions. This suggested that any link between the two was weak, and any effects of local competitive conditions on discounts were small.

17. We examined whether this situation was likely to change. Whilst we think the joint venture would probably seek to manage local discounts more tightly, given the national constraints like the Internet and the range of other factors which inform local discounting, we did not expect that the joint venture could do so successfully in a way that exploited local competitive conditions.

18. Since margins are low, any upward pressure on prices following the merger would be limited. We found that the scale of any local competitive effects would be limited by the joint venture's ability to reduce discounts.

19. Further, only certain categories of current discounts were potentially relevant. For the majority of Thomas Cook stores, the values of those potentially relevant discounts are in a narrow range and small as a percentage of revenues. For some stores these discounts are more substantial. However, we found that these discounts are responsive to various factors, of which local competition is only one.

20. Moreover, we think that the possibility of entry into selected local areas, by the growth of rivals and by package holiday operators looking to maintain or expand their route to market, is likely to further dampen the joint venture's incentives to reduce discounts. We also recognized that the increasing role of the Internet in this industry and customer response to loss of local rivalry may further reduce the scope for price effects over time.

21. We concluded that, although we cannot rule out the possibility of some price rises (via reductions in discounts given) in certain local areas for certain customer groups, the joint venture would not be likely to result in a substantial lessening of competition (SLC). Moreover we think that any isolated price effects that were to occur would most likely be small, sporadic and eroded over time. We have not formed an expectation of an SLC based on local effects on non-price aspects of the joint venture's offering.

National horizontal effects

22. We then considered the possibility of national effects. We considered whether the formation of the joint venture was likely to create incentives for it to increase prices, or worsen other aspects of their retail offer, at a national level, taking into account evidence of all constraints operating at local and national levels.

23. Many of the factors relevant to national effects are the same as those considered in assessing local effects. However, in contrast with the local effects assessment, at a national level we had to consider the average effect on rivalry across all local areas, including some areas where there are no overlaps between joint venture partners. For this reason, the incentives to raise prices or otherwise worsen the retail offer are likely to be weaker at the national level than at the local level.

24. We concluded that the joint venture would not be likely to result in an SLC at a national level.

Regional horizontal effects

25. We considered the possibility of regional effects. Regional effects would require regional variation in prices or non-price aspects of the retail offer related to variation in competition between regions or an expectation that as a result of the joint venture the main parties might change their strategy in order to vary their offer regionally. We found no evidence of particular regional (rather than local) price variation, regional pricing policies or that other elements of the retail offer varied regionally and we did not consider that this was likely to change. We concluded that the joint venture would not be likely to result in an SLC at a regional level.

Vertical effects

26. We assessed two vertical theories of harm:

- whether the joint ventures' stores would favour Thomas Cook's package holidays above those of other tour operators in a way that would reduce competition among tour operators (customer foreclosure); and

- whether Thomas Cook would disadvantage third party retailers in the sale of Thomas Cook's own packages in a way that would significantly reduce competition at the retail level (input foreclosure).

Customer foreclosure

27. We assessed whether the joint venture had an incentive to favour Thomas Cook's package holidays. We concluded that all of the joint venture stores were likely to favour sales of Thomas Cook's holidays, to the same or lesser extent that Thomas Cook's own stores currently do.

28. We investigated the likely effect on Thomas Cook's upstream rivals. There are a large number of tour operators active in the UK, and we found very few for whom CGL and Midlands were important resellers (in terms of the proportion of their sales which were made through CGL and Midlands). We have been told that most tour operators have the ability to adjust the level of their output from year to year, so they would have the ability to absorb some loss of sales. We concluded that if a foreclosure strategy were to affect significantly any particular tour operators, the number of firms involved would be small and, given the structure of that upstream market, any effects on competition were likely to be negligible.

Input foreclosure

29. We assessed whether Thomas Cook's tour operator business would have an incentive to disadvantage third party resellers under the anticipated joint venture.

30. We did not find clear evidence that Thomas Cook would have an incentive to foreclose. We also considered it highly unlikely that the joint venture could create an incentive that would not otherwise exist. We looked at the increase in Thomas Cook's retail footprint that would arise from the joint venture. We found that 93 per cent of the UK population is within the catchment area of a Thomas Cook store, and 94 per cent would be within the catchment areas of one of the main parties' stores under the joint venture. On this basis we concluded that the joint venture would not create or enhance the incentive for input foreclosure by Thomas Cook.

Responses to our provisional findings

31. We received a response from the main parties and two responses from third parties in response to our provisional findings. We have considered these responses and where we considered appropriate we have addressed points made within the main report.

Conclusion

32. We found that the anticipated joint venture may not be expected to result in an SLC in any market or markets in the UK for goods or services.

Findings

1. The reference

1.1 On 2 March 2011, the OFT referred the anticipated travel business joint venture between Thomas Cook, CGL and Midlands to the CC for investigation and report.

1.2 The reference required us to determine, in accordance with section 36(1) of the Enterprise Act 2002:

(a) whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and

(b) if so, whether the creation of that situation may be expected to result in an SLC within any market or markets in the UK for goods or services.

1.3 We were required to publish our final report by 16 August 2011. On 27 July 2011 we published a notice of the decision to extend the reference period for eight weeks to 11 October 2011 in order to allow sufficient time to take full account of any comments received in response to provisional findings. We stated in that notice that we nevertheless intended to publish our final report as quickly as possible. In the event, the responses to our provisional findings were all received significantly before the deadline for responses, which has assisted us. Our terms of reference are in Appendix A, together with an explanation of how we have conducted our inquiry.

1.4 Non-commercially-sensitive versions of the main party and third party written submissions are on our website, along with other documents relevant to this inquiry. We cross-refer to them where appropriate.

2. The companies

Thomas Cook

2.1 Thomas Cook was formed by the merger of Thomas Cook AG and MyTravel PLC in June 2007. Thomas Cook is one of the two major vertically integrated leisure tour operators active in the UK (the other being TUI Travel plc (TUI)), offering a range of package holidays, flights, holiday accommodation options and associated services both through its own and third party travel agencies and direct to consumers.

2.2 In the year to 30 September 2010, Thomas Cook's total sales globally were £8.9 billion and Thomas Cook's net profit was £3 million.[1] Thomas Cook has around 31,000 employees.[2] In the UK,[3] Thomas Cook generated revenues of £3.1 billion in the year to 30 September 2010.[4]

2.3 Thomas Cook's leisure travel activities in the UK are carried out under a number of brands including Thomas Cook, Going Places, Airtours, Direct Holidays, Flexibletrips, Hotels4U, Gold Medal International and www.flythomascook.com. Thomas Cook also operates Thomas Cook Airlines, which is a charter airline used primarily, but not exclusively, for its package holidays.

[1] Thomas Cook Annual report 2010.
[2] Thomas Cook Annual report 2010.
[3] The UK segment includes Thomas Cook's operating businesses in the UK, Ireland, India and the Middle East.
[4] Thomas Cook Annual report 2010.

2.4 Thomas Cook's tour operating brands offer traditional package holidays (ie a pre-made holiday that includes flights, accommodation and other ground services such as transfer and tour operator reps), dynamic package holidays (ie a holiday that is put together at the time the customer books it, but which in most other respects is very similar to a traditional package holiday[5]), as well as stand-alone accommodation and flights and some financial services. Additionally, Thomas Cook has a number of brands that offer specialist holiday products such as travel to sporting events.

2.5 Thomas Cook has focused in recent years on the supply and distribution of package holidays primarily to short-haul destinations.

2.6 Thomas Cook's retail distribution channels include:

(a) branch-based distribution through around 780 retail outlets in the UK, which distribute Thomas Cook and third party holiday products (including both package holidays and flights and accommodation sold on a stand-alone basis); these retail outlets include Thomas Cook branded travel agents and Going Places branded travel agents;

(b) call centres spread over several locations in the UK, handling customer sales and support calls for Thomas Cook's customers as well as several online booking sites; and

(c) websites, selling both Thomas Cook and third-party-related travel products such as flights, accommodation, packages, insurance, car hire and other ancillary products.

CGL

2.7 CGL was formed in July 2007 by the merger of the then two largest co-operative societies, Co-operative Group and United Co-operative.

2.8 CGL is the holding body corporate of the group which contains the travel business that will be contributed to the joint venture. CGL is the UK's largest co-operative society. Comprising approximately 5.8 million individual members and over 80 corporate members, it is a business with diverse trading interests in a number sectors including banking, insurance, travel, funeral service provision, farming, food retail, legal services and pharmacy operations. Its business is distributed over a wide range of geographic locations within the UK.

2.9 CGL's total gross sales were £13.7 billion in 2010 and its profit before tax, discontinued operations and distribution to members was £414 million.[6] CGL has around 120,000 employees. The CGL travel business generated revenues of around £1 billion in 2010.

2.10 CGL's travel business is a multi-channel operation including a network of high street travel agencies, a business travel operation, call centres and a website. CGL offers consumers package holidays, dynamic packaging or the option to purchase only certain parts of the holiday requirements such as flight only or accommodation only.

---

[5] Dynamic package holidays can be either offered by tour operators or by travel agents. A dynamic package holiday is a holiday where the components of the holiday are assembled at the time of booking and are bought at current market prices (ie they are not prepackaged like a traditional package holiday). From a consumer perspective, dynamic packages generally look the same as traditional packages and are offered at an inclusive price.

[6] CGL annual report 2010.

CGL also offers consumers travel-related services such as foreign currency exchange, car hire, airport parking and other ancillary products.

2.11 CGL's leisure travel business consists primarily of various retail operations, trading mainly under the name of 'the Co-operative Travel', but also including a number of other brands including Freedom Travel buying group, Co-operative Personal Travel Advisors (previously Future Travel), Co-operative Travel Sports and Events, Cumbria Cruises and Cumbria Holidays Direct.

2.12 CGL operates 399 retail outlets across the UK (of which 359 are core branches, 3 are franchises and 37 are managed services). See paragraph 2.14.

2.13 Freedom Travel buying group (see paragraph 5.35 for a description of buying groups), in which CGL has a majority shareholding, is a consortium of over 150 independent travel agents. The main parties told us that the Freedom Travel Group did not have any right of management or control over the operation of the businesses of its members, who remained independently owned. They said that members retained the independence to select their own suppliers (provided they were registered on Freedom's booking system) and set their prices. The main parties said that it was intended that the Freedom Travel Group should remain operational following completion of the joint venture.

2.14 CGL stated that it had 37 managed services branches that were owned by other Co-operative Societies but managed and operated by CGL on their behalf. In addition, it also had franchise agreements with two individuals operating three branches between them. CGL explained that it provided intellectual property, purchasing and back-office services to managed services stores, but did not control the operations of the stores (eg sales priorities or discounts). The stores also had the right to benefit from commercial terms negotiated by CGL with suppliers via CTTG. The main parties told us that the agreements with the franchisees were very similar to the managed services agreements. They also told us that these stores retained the independence to select their own suppliers and set their prices, and that it was intended that CGL would continue with these arrangements under the joint venture.

2.15 We considered how we should treat stores that are members of the Freedom Travel buying group or subject to CGL's managed services contracts in our assessment. We concluded that sales through stores of the Freedom Travel buying group are largely independent from the main parties as it was confirmed to us that the main parties would not have control over their pricing or the products that they promoted in store. We therefore excluded these stores and their sales from our assessment of the horizontal effects of the joint venture. The information provided suggested that the relationship to managed services stores is closer than the relationship to stores that are members of Freedom Travel buying group (we note in particular provisions in these arrangements relating to promotion and advertising) though the main parties told us that they would not have control over their pricing or the products that they promoted in store. We did not explore this relationship as, given the nature of our findings on the effects of the joint venture at a local level and the fact that there are only 40 such stores, the treatment of these stores as independent or as part of CGL would not affect our conclusions. For our purposes we did not include these stores in our analysis as CGL stores. In relation to vertical effects, the relevance of these stores is considered in the footnotes to paragraphs 10.40 and 10.54. We considered also whether there may be a concern arising from the fact that going forward Freedom Travel buying group stores and managed services stores will be participating in these arrangements under the joint venture as opposed to CGL. We note that [✄] and that CGL has indicated that [✄], but even if these arrangements are no longer available or will become less attractive to the relevant stores after the creation of the joint venture we consider that no concern arises given the wide availability of alternative buying groups (see paragraph 5.35), some of which offer very extensive support.

Midlands

2.16 Midlands was created in 1995 through the merger of the Leicestershire and Central Midlands Societies. These two societies represented the consolidation of over 70 smaller societies over the preceding century and covered an extensive area of the Midlands. Since 1995, a further five societies have joined Midlands, including those at Ilkeston and Chesterfield.

2.17 Midlands is an Industrial and Provident Society owned entirely by its members. It has trading interests in a number of sectors including food retail, department stores, travel, funeral service provision, transport, farms and investment properties.

2.18 In the year ended January 2011, Midlands' gross sales were £940 million and profit before tax and distribution to members for Midlands was £31 million.[7] Midlands has around 8,000 employees. Its travel business had gross sales of £310 million in the year ended January 2011.[8]

2.19 Midlands' travel business is a multi-channel operation including a network of over 100 high street travel agencies, a business travel operation, web operations and network of home-working agents.

2.20 Midlands' retail outlets operate under the Midlands Co-op Travel, Co-op Travel, Ilkeston Co-op Travel and The Co-operative Travel[9] brands. Midlands offers consumers package holidays, dynamic packaging or the option to purchase only certain parts of the holiday requirements such as flight only or accommodation only. It also offers consumers travel-related services such as foreign currency exchange.

2.21 Midlands is an Independent Society Member of CGL. It has a holding of £[✂] million of share capital in CGL and its Chief Executive is one of five directors of the Group elected from the independent member constituency.

3. The anticipated joint venture

3.1 On 8 October 2010, Thomas Cook, CGL and Midlands (the main parties) announced a joint venture to include all of CGL's, all of Midlands', and some of Thomas Cook's travel businesses.

3.2 The joint venture will combine the main parties' travel agency stores and this represents the principal overlap between the main parties' activities. Thomas Cook operates around 780 stores, CGL has around 360 core[10] stores and Midlands over 100 stores.

---

[7] Midlands annual report for the year ending 22 January 2011.
[8] Midlands annual report for the year ending 22 January 2011.
[9] The Co-Operative Travel brand name is licensed from Co-operative Brands Limited to Midlands Co-operative Society.
[10] CGL stated that it also had 37 managed services branches that were owned by other Co-operative Societies but managed and operated by CGL on their behalf. In addition, it also had franchise agreements with two individuals operating three branches between them.

3.3 Other businesses contributed to the joint venture include the main parties' foreign exchange services, certain call centres and CGL and Midlands' (but not Thomas Cook's) tour operations[11] and online travel operations.

Outline of the transaction

3.4 The transaction was announced on 8 October 2010.

3.5 The transaction involves a merger of the travel agency and associated businesses of Thomas Cook and the travel businesses of CGL and Midlands into a joint venture to be owned 66.5 per cent by Thomas Cook, 30 per cent by CGL and 3.5 per cent by Midlands.

3.6 Thomas Cook will contribute its retail travel business to the joint venture, mainly Thomas Cook retail stores and foreign exchange operations. Excluded from the business transfer are the parts of Thomas Cook's business which do not comprise a retail travel agency business (including central services, tour operations and the provision of insurance services). Also excluded are all operations conducted exclusively under the Thomas Cook Sports, Flexibletrips or thomascook.com brands and all licensing in relation to the 2012 Olympic Games.

3.7 CGL and Midlands will contribute all their travel businesses to the joint venture. This mainly includes Midlands' and CGL's retail stores, foreign exchange services, call centres, online operations, tour operations and their business travel agent services. CGL will also contribute its interest in the Freedom Travel buying group to the joint venture.

3.8 Under the shareholders' agreement, Thomas Cook will be able to acquire from CGL and/or Midlands their shares in the joint venture after 30 September 2016. Thomas Cook has also granted CGL and Midlands the right to sell all their shares in the joint venture to Thomas Cook after 30 September 2016.

Rationale for the transaction

3.9 The main parties said that as a result of the transaction, they would expand their distribution network in the UK. They said that the impact of the Internet had resulted in a decline in the share of bookings through bricks-and-mortar travel agents and it was therefore necessary for travel agents to manage their costs carefully in order to remain profitable.

3.10 The main parties said that they believed the transaction would generate savings through (downstream) synergies of at least £[✂] million a year, predominantly from cost reductions including the combination of headquarters and back-office functions, the consolidation of IT systems, some store closures and the streamlining of supplier contracts. They also expected the transaction to result in improved commission rates from third party suppliers of holiday components and foreign currency.

3.11 The main parties told us that they also expected the transaction to bring benefits to Thomas Cook's mainstream and independent tour operations as a result of increased distribution of Thomas Cook's products in retail stores (upstream synergies)—although a substantial part of the turnover of CGL and Midlands was already

[11] CGL's and Midlands' tour operations are largely based on dynamic packaging.

accounted for by Thomas Cook products ([✄] per cent and [✄] per cent, respectively, in the 2009 financial year).

3.12 Thomas Cook said that these additional upstream synergies would amount to £10 million a year and were derived from its tour operations and its airline by selling additional capacity and by increasing supply from its businesses that supply independent holidays, particularly Gold Medal, Hotels4U and Flexibletrips.

4. Jurisdiction

4.1 Under section 36 of the Act, and pursuant to our terms of reference (see Appendix A), we are required to decide whether a relevant merger situation will be created.

4.2 Section 23 of the Act provides that a relevant merger situation is created if two or more enterprises have ceased to be distinct within the statutory period for reference and either the share of supply test or the turnover test specified in the Act is satisfied.

4.3 We are satisfied that each of the businesses being contributed to the joint venture by Thomas Cook, CGL and Midlands is an enterprise for the purposes of the Act.

4.4 Enterprises will 'cease to be distinct' if they are brought under common ownership or control. Section 26 of the Act allows for a number of types of control[12] including the ability materially to influence the policy ('material influence'). In the case of this joint venture, while only one shareholder will have a controlling interest it may be subject to the control, within the wider meaning of section 26, of more than one shareholder. Therefore, we considered the position of each of the shareholders.

4.5 Thomas Cook with its shareholding of 66.5 per cent of the joint venture has more than 50 per cent of the voting rights in the joint venture and therefore enjoys a controlling interest.

4.6 The turnover test pursuant to section 23(1)(b) of the Act is met if the value of the annual turnover in the UK of the enterprise being taken over exceeds £70 million. The aggregate of the turnover in the UK of the businesses being contributed to the joint venture by CGL and Midlands exceeds £70 million. On that basis,[13] we are satisfied that the turnover test is satisfied. The share of supply test would also be satisfied.[14] We therefore concluded that a relevant merger situation under section 23(1) of the Act has been created in respect of Thomas Cook's interest in the joint venture.

4.7 We considered whether CGL or Midlands has 'material influence' over the joint venture.[15] Our merger guidelines explain that in assessing material influence we will focus on the overall relationship between the acquirer and the target and on the acquirer's ability materially to influence policy relevant to the behaviour of the target

[12] Section 26 distinguishes between different levels of control: a controlling interest ('de jure' control), ability to control policy ('de facto' control) and the ability materially to influence the policy ('material influence').
[13] For the purposes of identifying the value of the turnover of the enterprise being taken over pursuant to section 23, in relation to this arrangement we consider that the correct approach is, pursuant to section 28(1)(a), to deduct the turnover of those businesses that continue to be carried on under the 'same ownership and control' for those purposes, namely Thomas Cook as parent entity and the business it contributes to the joint venture. See paragraph 4.12 in relation to the treatment of CGL's interest in the joint venture.
[14] For example, the main parties estimate that they had a combined share of distribution of overseas package holidays in UK travel outlets of [40–45] per cent in 2009/10, based on IPS data.
[15] The concept of material influence derives from section 26(3) of the Act.

entity in the marketplace. The policy of the target includes its strategic direction and its ability to define and achieve its commercial objectives.[16]

4.8 We were satisfied that Midlands did not have material influence over the joint venture. Midlands has a shareholding of 3.5 per cent and the right to appoint only one director to a board of seven. We were satisfied that the protections and veto rights afforded to Midlands under the shareholders' agreement between the main parties did not give it the ability materially to influence the policy of the joint venture.

4.9 Both Thomas Cook and CGL recognized that CGL may be considered to have material influence over the joint venture given its representation at shareholder and board level. Thomas Cook emphasized that it did not expect that CGL's rights would significantly restrict the joint venture's ongoing commercial strategy.

4.10 At shareholder level, CGL has a 30 per cent shareholding in the joint venture. Therefore, CGL will have the ability to block special resolutions of the joint venture.[17] At board level, CGL has the right to appoint only two of the seven directors of the joint venture but there are certain 'veto matters' which require CGL approval. CGL can veto investments/liquidation of investments or disposals valued at more than £[✂] million. CGL also has an ability to block a material change in or departure from the strategic vision and integration plan[18] for the joint venture. CGL will have a number of ongoing agreements with the joint venture. We noted in particular CGL's contribution of the 'Co-op'/'Co-operative'[19] brand and the related brand agreement which gives CGL certain protections in relation to use of its brand. We also noted the, currently transitional, arrangements for CGL to provide services to the joint venture.

4.11 Taking into account the overall relationship between CGL and the joint venture including the level of CGL's shareholding and the key veto rights CGL enjoys at board level discussed above, we found that CGL has material influence over the joint venture.

4.12 As noted above, the turnover test pursuant to section 23(1)(b) of the Act is met if the value of the annual turnover in the UK of the enterprise being taken over exceeds £70 million. The aggregate of the turnover in the UK of the businesses being contributed to the joint venture by Thomas Cook and Midlands and over which CGL will acquire material influence exceeds £70 million. On that basis,[20] we are satisfied that the turnover test is satisfied. The share of supply test would also be satisfied.[21]

4.13 We therefore concluded that a relevant merger situation under section 23(1) of the Act has been created in respect of CGL's interest in the joint venture.

[16] CC and OFT *Merger Assessment Guidelines*, *CC2 (Revised)* (CC2), paragraph 3.2.8.
[17] Under section 238 of the Companies Act 2006, special resolutions are defined to require a majority of not less than 75 per cent. In previous decisions of the CC the ability to block special resolutions has been regarded as a very strong indicator of material influence. The OFT in its Jurisdictional and Procedural Guidance notes that a shareholding conferring more than 25 per cent of the voting rights in a company (given that it enables the holder to block special resolutions) is likely to be seen as presumptively conferring material influence.
[18] Both parties pointed to the fact that the integration plan applies for up to 24 months, though we note that there is no time limit on the strategic vision.
[19] The 'co-op' brand is being phased out to be replaced by the 'co-operative brand'.
[20] For the purposes of identifying the value of the turnover of the enterprise being taken over pursuant to section 23, in relation to this arrangement we consider that the correct approach is, pursuant to section 28(1)(a), to deduct the turnover of those businesses that continue to be carried on under the 'same ownership and control' for those purposes, namely CGL as parent entity and the business it contributes to the joint venture. See paragraph 4.6 in relation to the treatment of Thomas Cook's interest in the joint venture.
[21] For example, the main parties estimate that they had a combined share of distribution of overseas package holidays in UK travel outlets of [40–45] per cent in 2009/10, based on IPS data.

4.14 Our conclusion that each of Thomas Cook and CGL acquire control over the joint venture and that in each case a relevant merger situation arises means that in assessing the competitive effects of the transaction we need to consider not only issues arising from the overlap of all three parties activities' within the joint venture but also any interests of each of Thomas Cook and CGL via retained businesses in the same or related activities to the joint venture. In the case of Thomas Cook, this is particularly significant given that it retains its tour operation business outside the joint venture. This is considered in Section 10 on vertical theories of harm. CGL would continue to engage in certain related activities (travel insurance and currency) outside the joint venture via its wider group interests and this is considered in our assessment in Section 11.

5. Industry background

5.1 This section provides an overview of the UK leisure travel industry.

5.2 All parties are active in the leisure travel business, both as tour operators and as retailers.[22] CGL and Midlands also have business travel operations.[23]

Overall demand for travel

5.3 The main parties provided a research report by Keynote, which stated that the outbound sector of the UK travel and tourism market—which covers UK residents travelling abroad—was the main sector served by travel agents and tour operators.[24] The report also stated that domestic holiday travel was less likely than overseas travel to involve travel agents and tour operators, as, in many cases, the holiday destination was reached by car or independently booked rail travel.[25]

5.4 The main parties explained that a holiday was a relatively high-value, relatively infrequent purchase for most people, with a typical price for a holiday being around £600 per person. For most customers a holiday was probably by far the most important expenditure during the year, and as such, they spent time in researching a holiday.

5.5 The main parties explained that in the 1990s, customers obtained holiday information mainly through a travel agent store and brochures. This had changed drastically since then with the emergence of online travel agents, flight consolidators and bed banks and new ways of gathering information, but also with suppliers increasingly selling directly to customers, in particular the emergence of low-cost carriers. The main parties stated that Internet bookings for all holidays had risen from [✂] per cent in 2000 to [✂] per cent.

5.6 The main parties explained that holidays could be put together as traditional packages, dynamic packages and by combining individual components:

(a) Traditional packages combined transportation and accommodation—and often also a transfer and perhaps some additional services in one bundle—and were sold as one bundle at one price.

---

[22] The main parties' domestic travel operations are relatively small and we therefore do not provide an overview of domestic travel in this section.
[23] CGL's and Midlands' business travel operations are relatively small and we therefore do not provide an overview of the business travel in this section.
[24] Keynote Market Report 2010, *Travel Agents & Overseas Tour Operators*, November 2010, p2.
[25] ibid, p3.

(b) Combining components involved the separate selling of transport (eg flights) and accommodation (or at least at separate prices), for example a budget flight with the hotel being booked separately.

(c) Dynamic packages were in between those two, where at the point of purchase, components were bundled—either by an agent (either online, in stores or call centres) or by a tour operator—into one product. So from a customer's point of view, there was unlikely to be much distinction between a dynamic package and a traditional package, because dynamic packages were sold as one service at one price. From an operator's perspective, there was a significant difference with dynamic packages being much closer to the sale of components.

5.7 The main parties provided a report by Mintel on holiday booking processes which included Table 1 below. It shows the number of holidays taken abroad.[26] The report showed that whilst over the period 2005 to 2008 the number and value of overseas holidays taken by consumers had been growing, over the period 2008 to 2010 the number and value of overseas holidays taken has been declining.

TABLE 1 **Overseas holiday volume and value, 2005 to 2010**

	Overseas holidays passengers m	*Index*[A]	*Overseas holidays expenditure* £m*	*Index*[B]
2005	44.2	100	22,272	100
2006	45.3	102	23,300	105
2007	45.4	103	23,949	108
2008	45.5	103	25,526	115
2009	38.5	87	21,787	98
2010	36.1	82	21,349	96

Source: Thomas Cook, International Passenger Survey, Office for National Statistics.

*Overseas expenditure excludes air fares, sea fares, tunnel and train fares and is based on the International Passenger Survey, Office for National Statistics.
Note: [A] Base 2005, overseas holidays volume. [B] Base 2005, overseas holiday expenditure.

5.8 The Keynote report stated that it was becoming easier for individuals to plan and book their own travel (for example, through the Internet) without the services of an intermediary such as a retail travel agent or an overseas tour operator.[27]

5.9 The main parties provided another report by Mintel, entitled *Holiday Review*, which included the data in Table 2 below. This shows the percentage of holidays abroad that are taken as independent holidays.[28] It shows that since 2008 more than 60 per cent of holidays abroad have been booked as independent holidays and that the number of package holidays abroad (labelled inclusive tours in the table) has been declining over the last five years, reflecting both a decline in the total number of holidays taken abroad and the increase in the share of independent holidays.[29]

[26] Mintel, *Holiday Booking Process*, Leisure Intelligence, March 2010, p33.
[27] Keynote Market Report 2010, Travel Agents & Overseas Tour Operators, November 2010, p2.
[28] Mintel, *Holiday Review*, Leisure Intelligence, January 2011, p47.
[29] Independent holidays are holidays where customers book accommodation and transport separately, rather than in a package. Independent holidays are often booked through the Internet rather than in travel agents.

TABLE 2 **Inclusive tours vs independent holidays abroad by volume of passengers, 2005 to 2010***

	Inclusive tours *m*	*Independent holidays* *m*	*Independent as % of total* *%*
2005	19.0	25.2	57.0
2006	19.0	26.3	58.1
2007	18.7	26.7	58.8
2008	17.9	27.6	60.7
2009	14.5	24.0	62.3
2010	14.1	22.0	61.1

Source: Mintel, *Holiday Review*, Leisure Intelligence, January 2011, p47, International Passenger Survey, Office for National Statistics.

The industry structure

5.10 The leisure travel industry can broadly be categorized in three different segments:[30]

(a) suppliers of components of holidays, for example owners of hotel accommodation, cruise ships or airlines;

(b) tour operators (which package components of holidays including accommodation and flights); and

(c) distributors of holidays (ie travel agents), which distribute holiday products (eg package holidays, stand-alone flights and stand-alone accommodation) via the phone, the Internet and retail travel outlets.

5.11 The main parties are active mainly as distributors of holidays and, in the case of Thomas Cook, as a tour operator. The remainder of this section provides a brief overview of these two segments of the UK leisure travel industry.

5.12 The Package Travel, Package Holidays and Package Tours Regulations 1992 (PTRs), which implement the EU Directive of the same name, control the sale and performance of packages sold or offered for sale in the UK. Packages are defined as the prearranged combination of at least two of transport, accommodation and other tourist services[31] that cover a period of 24 hours or more or include overnight accommodation and are sold at an inclusive price. The PTRs specify information that must be given to the consumer, provide terms which must be included in the contract and prescribe the circumstances in which price revisions may be made. They require that the provider (tour operator and/or the retailer, as the case may be) should be strictly liable to the consumer for the proper performance of the contract, irrespective of whether such obligations are to be provided by that other party or by other suppliers of services. They also require that the provider shall provide sufficient evidence of security for the refund of money paid over and for the repatriation of the consumer in the event of insolvency.

5.13 ATOL (Air Travel Organisers' Licensing) is a financial protection scheme managed by the Civil Aviation Authority. If an ATOL tour operator fails, the ATOL scheme ensures that customers do not lose the money paid and are not stranded abroad.

5.14 Under the ATOL scheme, any business selling a package holiday including a flight or a flight alone where the ticket is not issued within 24 hours has to have an ATOL

[30] Thomas Cook, Introduction to Thomas Cook, June 2010 (Thomas Cook website), p14.
[31] Which are not ancillary to transport or accommodation and account for a significant proportion of the package.

licence.[32] The ATOL scheme requires an ATOL Protection Contribution into the pooled Air Travel Trust Fund which meets the costs of refunds and repatriations when a tour operator enters liquidation. Though ATOL existed before the PTRs, holding an ATOL licence is a way in which businesses can comply with the insolvency protection requirements in the regulations.

5.15 ABTA is a travel trade association for tour operators and travel agents. If an ABTA member is acting as an agent, it is a condition of ABTA membership that the agent provides ABTA with security in the form of a bond or other applicable security for this purpose. If the agent's business should fail financially, this bond or security will help to ensure that customers can continue with their travel arrangements or are reimbursed the cost of their travel arrangements.

Holiday distribution

5.16 Traditionally the main distribution channel for holidays has been via high street travel agents. However, the main parties drew attention to the growth in Internet travel agency, to the sales of holiday components by other businesses (for example, sales of accommodation via low-cost airlines' websites) and to the increasing ability of individuals to make holiday bookings with less use of intermediaries (see paragraph 5.8).

Travel agencies

5.17 Travel agencies operate on the high street, via the Internet and via the telephone. There are many such businesses and they vary greatly in both size (from individual stores to large chains) and scope.

5.18 The Keynote report contained the following table for the number of travel agent outlets in the UK.

TABLE 3 **Travel agents by estimated number of branches in the UK**

	Years ended July				
	2006	*2007*	*2008*	*2009*	*2010*
ABTA travel agents					
Top four					
Thomas Cook	615	548	812*	807*	796
Going Places (Thomas Cook)	560	458	-	-	-
Thomson (TUI)	730	650	600	600	650
First Choice (TUI)	302	320	336†	336†	336†
Total top three/four	2,207	1,976	1,748	1,743	1,782
Other ABTA travel agents	3,818	4,024	3,752	3,757	3,918
Total ABTA travel agents	6,025	6,000	5,500	5,500	5,700
Non-ABTA travel agents	1,950	1,800	1,650	1,400	1,200
Total	7,975	7,800	7,150	6,900	6,900

Source: Keynote, Travel Agents & Overseas Tour Operators, November 2010, Table 3.9.

*Going Places travel agencies mostly rebranded as Thomas Cook with effect from February 2008.
†Includes travel shops and holiday superstores, excludes in-store branches in supermarkets.

5.19 Table 4 shows the number of ABTA bonded retail travel agent outlets since the year 2000, estimated by Thomas Cook. Thomas Cook advised us that this table might include some 'non-store' outlets (eg call centres).

[32] On 23 June 2011, the Department for Transport issued a consultation document on reforms to the ATOL scheme designed to extend its scope and make it clear to consumers where sales are structured so as to remain outside the scheme.

TABLE 4 **Number of ABTA bonded retail travel agent outlets**

	2000	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*
ABTA bonded retail travel agent outlets	7,054	6,802	6,653	6,544	6,356	N/A	5,455	5,274	4,777	4,531	4,367	4,355

Source: Thomas Cook.

5.20 Table 5 shows the main parties' estimate of the share of passengers (PAX) from online bookings of package holidays and the share of PAX from bookings of package holidays in retail travel agent outlets as a percentage of all package holiday bookings. It indicates that the share of holidays booked via the Internet is increasing, but also indicates that a larger number of package holidays are still booked in retail travel agent outlets. It also indicates that the overall share of package holidays booked through retail travel agent outlets has been relatively stable over the past five years, but that the number of package holidays taken has been declining over the past five years.

TABLE 5 **Overall PAX for bookings in retail travel agent outlets and online**

	2005/06	*2006/07*	*2007/08*	*2008/09*	*2009/10*
Internet bookings (PAX m)	4.4	4.8	4,9	4.6	4.4
Bookings at outlets (PAX m)	8.2	7.9	7,3	6.7	6.3
Total package holiday (PAX m)	19.1	18.8	18.1	151	14.0
% PAX online (%)	23.1	25.8	27.0	30.3	31.2
% PAX outlets (%)	42.8	42.0	40.4	44.0	45.1

Source: Thomas Cook reply to market questionnaire, document 4.01.

5.21 Thomas Cook's own bookings data shows that over the last four years bookings of package holidays through the Internet have increased in every year, whilst bookings at its retail outlets have generally been declining (see Table 6). Nevertheless Table 6 shows that a clear majority of package holidays booked through Thomas Cook are booked through retail travel agent outlets.

TABLE 6 **Growth of Thomas Cook package holiday sales through retail travel agent outlets and online**

	2005/06	*2006/07*	*2007/08*	*2008/09*	*2009/10*
Internet bookings ('000)	[✂]	[✂]	[✂]	[✂]	[✂]
Annual rate of growth (%)		[✂]	[✂]	[✂]	[✂]
Average annual growth (%)					[✂]
Bookings at outlets ('000)	[✂]	[✂]	[✂]	[✂]	[✂]
Annual rate of growth (%)		[✂]	[✂]	[✂]	[✂]
Average annual growth (%)					[✂]

Source: Thomas Cook reply to financial questionnaire, document 7.11 revised.

5.22 The main parties told us that competition between high street stores and Internet travel agents was intensifying, not just in relation to price but also in terms of quality and service. Whilst service had historically been the cornerstone of store operations, increasingly online providers were introducing enhanced services. For example, some websites now provided 'pop-up' windows that would allow a customer to speak directly to an adviser whilst looking for holidays online. Thus online services were trying to develop a one-to-one customer relationship similar to that usually only found in a store.

5.23 We discuss below some differences between in-store and Internet sales.

In-store

5.24 Traditionally the purchasers of holidays from high street agencies obtained much initial information from brochures provided by the stores. The main parties told us that increasingly these purchasers were instead obtaining such information from the Internet.

5.25 Purchasers of holidays from high street agencies typically obtain advice from the sales staff. Where travel agencies are part of a vertically integrated business that supplies its own holidays, they are likely to recommend their own product if they have an appropriate one. The purchase of a holiday typically takes 45 to 60 minutes. Where a customer purchases a holiday offered by a tour operator through a travel agency, up-to-date tour operator prices, known as ViewData prices, are notified electronically to agents. Agents do not charge more than this but may be prepared to offer discounts to persuade the customer to purchase. Prospective purchasers may seek to obtain discounts by citing price information for holidays from other sources.

Internet travel agency

5.26 The customer dialogue for an Internet sales process is essentially different from that for an in-store sale. There is no equivalent interaction between sales staff and the customer as is the case for in-store sales. The main parties told us that as a result discounts from online retailers were normally given up-front (ie included in the advertised selling price), whereas discounts in stores were normally given in negotiations with the customers.

Tour operations

5.27 The Keynote report contained the following tables (Tables 7 and 8) for the number of tour operators in the UK.

TABLE 7 **Number of ATOL licensed companies in the UK, 2005 to 2009**

	2005	*2006*	*2007*	*2008*	*2009**
ATOL holders	2,440	2,554	2,516	2,438	2,370
% change year-on-year	-	4.7	–1.5	–3.1	–2.8

Source: Keynote, Travel Agents & Overseas Tour Operators, November 2010, Table 3.2.

*Key Note estimate.
Note: ATOL = Air Travel Organisers' Licence.

TABLE 8 **Number of ABTA registered tour operators in the UK, 2005 to 2009**

	2005	*2006*	*2007*	*2008*	*2009*
Number of ABTA registered tour operators	850	850	900	790	900

Source: Keynote, Travel Agents & Overseas Tour Operators, November 2010, Table 3.8.

5.28 Thomas Cook provided an estimate of the number of tour operators in the UK since 2000 based on the number of ATOL licence holders. Thomas Cook noted that using ATOLs as a proxy for tour operators meant that travel agents engaged in dynamic packaging would be included in the figures, overestimating the number of 'traditional' tour operators. Thomas Cook also noted that since 2004 the number of ATOL licence holders included small business ATOL (with fewer than 500 passengers), which meant that the total number of ATOL holders before and after 2004 was not comparable. See Table 9.

TABLE 9 **Number of ATOL licence holders**

	2000	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*
ATOL licence holders	1,851	1,813	1,819	1,894	2,132	2,440	2,554	2,516	2,438	N/A	2,295

Source: Thomas Cook.

5.29 Mintel stated that the ‘big two’ tour operators (TUI and Thomas Cook) accounted for almost 70 per cent of overseas passengers of the top 20 UK travel companies. The Monarch Group (Avro, Cosmos Holidays) and Expedia were the next largest operators with a share of 4.8 and 3.6 per cent share respectively.[33] See Appendix G for more information on the share of supply of UK tour operators.

Competitors

5.30 TUI is the largest competitor of the merging parties. TUI is vertically integrated and is active both as a tour operator and as a retail distributor. In the year ended 30 September 2010, TUI had worldwide revenues of approximately £13.5 billion and reported a net loss of approximately £100 million. TUI’s revenues were approximately £3.5 billion in the UK in the year ending 30 September 2011.[34]

5.31 TUI has over 200 brands (including Thomson and First Choice[35]) which are comprised of mainstream brands and specialist travel businesses.[36] TUI operates approximately 870 retail travel outlets in the UK.

5.32 Table 10 below shows that there are a number of smaller chains of retail travel agent stores. However, these are significantly smaller than Thomas Cook and CGL, with the largest of these operating around 100 stores. In addition, there are a large number of independents.

5.33 Appendix G, Table 1, shows that there are a large number of tour operators in the UK. With the exception of TUI, all these operators are significantly smaller than Thomas Cook.

5.34 Both TUI and Thomas Cook are vertically integrated (ie they are both tour operators and distributors of holidays). The majority of other tour operators and travel agents are not vertically integrated.

[33] Mintel calculated the shares of supply based on the number of seats licensed with ATOL by each operator.
[34] TUI Travel plc annual report 2010.
[35] TUI Travel PLC, *Investor Day*, January 2011, p17.
[36] www.tuitravelplc.com/tui/pages/aboutus/corporateprofile.

TABLE 10 **Travel agency high street outlets (as at March 2011)**

Company name	*Number of outlets*	*% share of outlets*
Thomas Cook*	777	19.0
CGL*	360	8.8
Midlands*	102	2.5
Combined*	1,239	30.3
TUI†	866	21.2
Flight Centre†	90	2.2
Bath Travel†	65	1.6
STA Travel†	51	1.2
Hays Travel†‡	44	1.1
Midcounties Co-operative†	35	0.9
CGL managed services and franchises†	40	1.0
Other ABTA outlets*	1,385	33.9
Non-ABTA outlets*	267	6.5
Total	4,082	100.0

Source: *Thomas Cook, †the companies, ‡at August 2011.

Buying groups

5.35 Buying groups are consortia of travel agents which allow their members to benefit from increased buying strength while retaining independent operational control over their own businesses. The main parties explained that there were consortia that offered varying levels of support including access to ABTA membership and ATOLs, commercial deals, IT systems, back-office support and marketing. Through buying groups, independent agents could obtain access to the required licensing without large capital outlays and without the need to take out their own ABTA and ATOL memberships.

5.36 CGL's and Midlands' travel operations participate in the Co-operative Travel Trading Group (CTTG). The CTTG can be best described as a buying group whose members also cooperate in relation to their marketing and advertising activities. Its members are CGL, Midlands and other UK retail co-operative societies, with CGL and Midlands being the largest members. [✂]

6. The counterfactual

6.1 We assessed the competitive effects of the formation of the joint venture relative to the competitive situation without the merger (the 'counterfactual'). Our merger assessment guidelines explain that we may examine several possible counterfactual scenarios and must select the most likely scenario absent the acquisition.[37] The guidelines note that 'the CC will typically incorporate into the counterfactual only those aspects of scenarios that appear likely on the basis of the facts available to it and the extent of its ability to foresee future developments'.[38]

6.2 The main parties provided individual confidential submissions as to what would have happened to their businesses absent the joint venture. The main parties also provided some relevant context in their joint submission. We consider this context first.

[37] *CC2*, paragraph 4.3.6.
[38] *CC2*, paragraph 4.3.6.

Context

6.3 The main parties drew attention to the pressures on travel agencies due to industry trends such as customers booking the components of their own holidays (ie the separate booking of flights and hotels)—often using the Internet (see paragraph 5.16).

6.4 The main parties also drew our attention to a Mintel report on travel agents, which stated that the number of high street travel agents had contracted since 2005, falling by an estimated one-third in the ten years to 2009.[39] Mintel was of the view that the use of high street travel agents would continue to decline.[40] See paragraphs 5.18 and 5.19.

6.5 Thomas Cook, CGL and Midlands are currently operating around 780, 360[41] and 100 retail travel outlets respectively.

6.6 The main parties' business plans indicated that they were planning for a continued annual decline in the number of retail travel agent outlets of around [✂] per cent a year.

6.7 In the announcement of the transaction, Thomas Cook stated that profitability for CGL's travel operations was low (with CGL estimating that it would operate around the breakeven level in 2010) and that the businesses that Thomas Cook contributed to the merger had margins on net revenue (ie supplier commissions and other incomes on the sale of travel products and foreign exchange less discounts) of around 4.6 per cent.[42]

6.8 Appendix F shows the profitability of retail travel agent outlets.

The counterfactual for each of the main parties

6.9 In this section, we examine the counterfactual for each of the parties to the transaction.

Thomas Cook

6.10 In its submissions to us, Thomas Cook told us that, absent the merger, it would expect the number of stores it operated to decline by around 2 per cent a year for the next three years (based on April 2010 expectations); it said that the market was moving online, but there was currently still an important part of the distribution which was through stores.

6.11 We considered internal documents from Thomas Cook to help us understand what it would have done absent the merger. They included the following information:

(a) In its May 2010 UK Retail Strategic Plan, the earnings before interest and tax (EBIT) of its retail operations was forecast to [✂].

[39] Mintel, *Travel Agents*, Leisure Intelligence, December 2010, p34.
[40] Mintel, *Travel Agents*, Leisure Intelligence, December 2010, p35.
[41] CGL also has 40 stores operating under managed services or franchise agreements.
[42] The level of profitability for Thomas Cook's retail travel operations that are contributed to the joint venture is not reported profitability, but based on pro-forma data supplied by Thomas Cook as part of the merger.

(b) In its 16 June 2010 Budget for the 2010/11 financial year, Thomas Cook noted that its key assumption was a 2 per cent channel shift away from retail to online travel agents.

(c) In its 29 April 2010 Three Year Plan, Thomas Cook envisaged a 2 per cent a year decline in the number of retail outlets it operated.

(d) Thomas Cook appeared to be looking for opportunities to acquire retail outlets.[43]

CGL

6.12 In its submissions to us, CGL told us that, absent the merger, [✂].

6.13 CGL suggested that if the joint venture was not to be approved, [✂].

6.14 [✂]

6.15 [✂]

6.16 [✂]

6.17 [✂]

6.18 We considered internal documents from CGL to help us understand what it would have done absent the merger. They contained the following information:

(a) CGL's Travel Strategic Plan in May 2010 stated that [✂].

(b) CGL's Three Year Plan for 2011 to 2013 showed that it forecast [✂].

(c) CGL's Travel Business Plan 2010–2012 stated that [✂].

(d) CGL's Travel Strategic Plan in May 2010 stated that [✂].

6.19 [✂]

Midlands

6.20 In its submissions to us, Midlands told us that, absent the joint venture, it might [✂].

6.21 Midlands also made some observations as to its future plans if the anticipated joint venture proceeded but without Midlands.

6.22 Midlands told us that without the merger [✂].

6.23 Midlands did not provide any projections or internal documents to indicate [✂].

6.24 We considered internal documents from Midlands to help us understand what it would have done absent the merger. Documents submitted to us by Midlands contained the following information:

(a) Midlands stated that it had been [✂] over the last few years. However, it had also been [✂] in the last few years.

---

[43] [✂]

(b) Midlands was [✂].

(c) Midlands' strategy plan for 2008/09 assumed an annual [✂].

6.25 Midlands considered that our assessment of its profitability should also take into account the effect of allocation of directly attributable group-level costs and the potential removal of the Co-operative group dividend on the travel business's profit levels.

Assessment

6.26 We consider it likely that the number of retail travel agent outlets will continue to decline in the foreseeable future, mainly driven by the growth of the proportion of customers who either book their holidays by themselves or use the Internet for package holiday bookings. We note that the rate of decline in recent years has been moderate.

6.27 In the absence of the merger, based on its submissions, Thomas Cook would continue to operate in its current form for the foreseeable future, with some adjustments to its number of retail travel agent outlets to respond to changes in demand.

6.28 The situation is less clear for CGL. [✂] At a national level, [✂], it is likely that it would remain a relatively large travel agency business with a significant number of outlets. [✂]

6.29 Midlands provided us with evidence that it [✂] in its retail travel agent stores in the last three years after the inclusion of the Co-operative group dividend. We consider that the Co-operative group dividend would continue to be paid for the foreseeable future in the counterfactual scenario as the counterfactual is based on the assumption that the joint venture is not going ahead (either in its proposed form or between TCG and CGL only).

6.30 With regard to Midlands, it appears likely that it would continue to operate for the foreseeable future, with some adjustments to its number of retail travel agent outlets to respond to changes in demand. [✂]

6.31 Based on the evidence submitted, we formed the view that the relevant counterfactual was that in the absence of the joint venture the main parties would continue to operate as at present, but with some store closures. In the case of all three parties, we have not seen evidence that would enable us to form a view on the specific localities in which such store closures would be likely to take place.

Analysing the joint venture in the context of the counterfactual

6.32 Our counterfactual recognizes the likelihood of some store closures. In the case of all parties, we considered that some store closures would be likely. However, in light of the limited evidence available, we are not able to form a view as to the timing or precise scale of closures or on the closure of any particular store. We therefore decided to analyse the competitive effects of the joint venture based initially on the pre-merger situation and then to take account of the differences between this and the counterfactual based upon our specific findings.

6.33 For example, in relation to local competitive effects we took the approach that, if we were to find a potential substantial loss of competition in a specific local area, we would then examine the situation more closely to form a view on the likelihood of a local store closure absent the merger.

6.34 Given the nature of our findings in relation to the local and national effects of the joint venture, we did not need to revisit the use of a counterfactual based on the pre-merger situation.

7. The relevant markets

7.1 As set out in our guidelines, the purpose of market definition is to provide a framework for the analysis of the competitive effects of a merger.[44] We will identify the relevant markets in which the merger may give rise to an SLC. In practice, the analysis of the identification of the market or markets and assessment of competitive effects will overlap, with many of the factors affecting market definition being relevant to the assessment of competitive effects and vice versa.[45] Market definition and the assessment of competitive effects should not be viewed as two distinct analyses. We have adopted this approach in this inquiry. Our approach to the investigation was to consider the assessment of market definition and the assessment competitive effects of the joint venture as overlapping analysis recognizing the dynamic nature of both exercises as our analysis and evidence base evolved.

7.2 The main parties' view was that the relevant market was a national one for all holidays, however sold. Thus they considered the product market to include package holidays, dynamically packaged holidays and independent holiday components (eg flights and hotel accommodation). Sales might be made by various means, including bricks-and-mortar travel agents, travel agency websites, telephone bookings and direct sales by tour operators, airlines and accommodation providers. They considered that the market was national because of the role of the Internet and because the retail offer in high street travel agencies was driven by national product and sales channel constraints.

7.3 We did not think that the markets were necessarily as wide as the main parties suggested. We also considered it possible that within a broad market for differentiated products there could be submarkets in which an SLC could occur. Our investigation allowed for a number of possible relevant markets by ensuring in our competitive assessment we considered all relevant constraints and the weight that should be attributed to each of them. Our approach is set out below.

Product markets for holidays

7.4 We identified that, based on the nature of the main parties' overlapping activities, the effects of the joint venture were likely to be most immediate and significant in relation to the sale of overseas package holidays (including dynamic packages) via high street travel agents and decided that was the appropriate candidate market to adopt as the focus of our assessment of competitive effects.

7.5 We believed it was sensible to focus on this candidate market as our starting point for a number of reasons. First, all three joint venture parties' businesses are heavily weighted towards sale of overseas package holidays and sale via high street agents. Secondly, there were specific features of package holidays as a product and high street agents as a distribution channel which differentiated them and suggested they could form a distinct market. Package holidays (including dynamic packages) are

[44] *CC2*, paragraph 5.2.1.
[45] *CC2*, paragraph 5.1.1.

distinct from independent holiday components in a number of ways, principally the convenience offered to customers of a bundled product and the assurance and protection afforded to consumers by the PTRs (see further information in paragraph 5.12). We also identified certain distinct features in relation to high street distribution, particularly in the context of sale of package holidays. High street agents have traditionally offered an element of service and advice as a feature that distinguishes the channel from other forms of distribution.

7.6 We also noted that while the sale of package holidays via the Internet is increasing, the majority are still sold via the high street channel (see paragraph 5.11 and Table 5). The distribution mix for package holidays is different from that of independent holiday components, where online distribution plays a greater role. See Appendix D, Tables 10 and 14, and Table 5 above.

7.7 While the above suggested that it was a sensible approach to adopt sale of overseas package holidays via high street agents as our candidate market, to ensure that we took into account all relevant constraints in our competitive assessment we needed to consider constraints from outside that candidate market and the possibility of segmentation within it.

7.8 We noted the main parties' submissions that the Internet formed part of the market. The main parties provided evidence to suggest that certain Internet distributors were seeking to introduce features that offered service aspects to customers. We identified distribution from the Internet as a possible constraint we needed to explore carefully in our assessment. We also needed to consider other distribution channels, such as telesales.

7.9 We recognized that, as the main parties argued, sales of other holiday products could form a constraint on the sale of overseas package holidays. But equally we recognized that our analysis could show that there were separate segments, or even markets, for types of holiday—such as ski holidays, cruise holidays, short-haul beach holidays and long-haul beach holidays. We were open to both possibilities in our approach to the competitive assessment.

7.10 We also recognized that our competitive assessment could identify other constraints which were not possible to identify when identifying our candidate market. Our competitive assessment identified as relevant other factors that influence a customer's willingness to pay. It was difficult to attribute weight to these factors but we recognize that these could include various factors such as price perception gained from other non-joint-venture high street agents, the Internet, television or other advertising as well as possible constraints from other holiday types (eg domestic holidays) and customers' previous experience.

7.11 Therefore, our framework for assessment started with a candidate market for overseas package holidays via high street agents but took into account possible constraints from outside that market and segmentation within it. This ensured that in our competitive assessment we considered the range of constraints discussed above.

7.12 Following our competitive assessment, we did not reach a firm view on which specific subset of the constraints identified, together with the main parties, would form a market that would satisfy the hypothetical monopolist test in this case.[46] In light of the nature of the industry model (in particular, the practice of individual price negotiation via a discounting model, the emphasis placed on advice at the point of sale and the

[46] *CC2* notes in paragraph 5.2.1 that we will ensure that the relevant market we identify satisfies the hypothetical monopolist test.

time-sensitive nature of any package price given), we did not think a conceptual substitution exercise would be worthwhile. We were satisfied that having taken into account and identified all relevant constraints in our competitive assessment no choice of market definition that was defensible based on the findings of that analysis would have led to a different result on the substantive effect of the joint venture.

7.13 In our competitive assessment we also considered other areas in which the main parties' activities overlap. Namely:

(a) flight-only sales through retail travel agent outlets;

(b) accommodation-only sales through retail travel agent outlets;

(c) foreign exchange (retail and corporate);

(d) domestic travel;

(e) tour operations;

(f) holidays sold over the phone;

(g) holidays sold via online travel agents;

(h) business travel; and

(i) ancillary services (eg travel insurance).

We considered whether we needed to identify the relevant markets in relation to each of these areas. We conducted an initial assessment as to whether these products might be in a market where there is a prospect of the joint venture giving rise to an SLC and considered this to be unlikely. We consulted on this view in our issues statement and did not receive any comment from third parties that suggested otherwise. Therefore, we did not consider these to be in relevant markets for the purpose of our assessment of the effects of the joint venture. We recognized that some of the activities above, for example flight-only distribution, may act as a constraint on the candidate market we were investigating of sale of overseas package holidays via high street agents, and as outlined above the possibility of such constraints were taken into account in our competitive assessment.

7.14 In assessing our vertical theories of harm,[47] it was necessary to consider the relevant upstream and downstream markets. The relevant candidate downstream market, the sale of overseas package holidays by high street agents, is that discussed above in relation to our horizontal theories of harm. We identified as our candidate upstream market the provision of overseas package holidays by tour operators as that is the related market in which Thomas Cook is active. We note that, like at the retail level, the upstream provision of package holidays has specific regulatory requirements under the PTRs and the ATOL scheme. As they are similarly defined in regulation, there is a direct connection between the product at operator and retailer level. We therefore used this candidate upstream market in relation to our assessment of the vertical effects of the joint venture but, where relevant, we considered the possibility of segmentation within this market, eg package holidays to particular destinations. Given the nature of our findings on vertical foreclosure, including our consideration of third party submissions in relation to adverse effects in relation to specific destinations (discussed in Section 10 and paragraphs 12.24 to 12.29), it was not necessary

[47] See Section 10.

to conclude on the relevant market as no reasonable market definition would have led to a different result as to the substantive effects of the joint venture.

Geographic markets for holidays

7.15 We considered that there may be local, regional and national aspects to competition and therefore there may be local, regional and/or national markets.

7.16 The main parties argued that the market was purely national and there were no local markets. We took the approach that it was appropriate to consider as a framework for our competitive assessment the possibility of local markets. This recognizes that transactions take place on the high street in bricks and mortar stores. In relation to local markets, our starting point was to identify overlaps between competing stores of the main parties in local areas. It was appropriate to develop a working basis to identify a candidate geographic framework for considering competition in specific localities—the catchment analysis we applied is discussed in Appendix B, paragraphs 20 to 22. In structuring our assessment by focusing on the impact of the joint venture in local areas, we still took into account in our assessment of possible local effects constraints that were not specific to the local candidate market, for example the Internet. We were also open in our assessment to the possibility of constraints that operate regionally and the possibility of regional markets.

7.17 It was not necessary to reach a view on the boundaries of any local or regional market that would satisfy the hypothetical monopolist test as, given that we had taken into account all constraints local, regional and national in our assessment, we were confident that we would not have reached a different conclusion on the substantive effect of the joint venture based on any choice of market definition that would be defensible on the findings of that analysis.

7.18 Our assessment also identified a national market in relation to distribution of overseas package holidays. The national market would satisfy the hypothetical monopolist test.

7.19 For our vertical theories of harm,[48] our candidate upstream market is the sale of overseas package holidays via tour operators in the UK. We considered whether there were regional markets, relating to particular airports, for the upstream provision of package holidays. We saw no evidence that there were capacity issues at airports that might assist a hypothetical monopolist in exploiting their existing position. We also noted that brochures and travel agent systems show all available options in relation to departure airport. The main parties told us that customers were willing to travel between airports if they thought there was an advantage to doing so. We therefore used a national candidate market for provision of package holidays and in our assessment of the vertical effects of the joint venture and considered whether anything came out of our assessment that might suggest that Thomas Cook might have the incentive and ability to vary its offering on a local or regional basis as a result of the joint venture.

[48] See Section 10.

8. Theories of harm

8.1 We identified and published theories of harm in our issues statement.[49] Our view was that there were four possible ways in which the transaction may be expected to result in an SLC (referred to as 'theories of harm'):

(a) loss of rivalry in various local areas between travel agents' stores for the sale of overseas package holidays;

(b) loss of rivalry nationally or regionally between travel agents for the sale of overseas package holidays;

(c) the joint venture's travel agents favouring Thomas Cook's overseas package holidays; and

(d) Thomas Cook limiting the access of other travel agents to its holidays.

8.2 We describe *(a)* and *(b)* as horizontal theories of harm and consider them in Section 9. We describe *(c)* and *(d)* as vertical theories of harm and consider them in Section 10.

8.3 In our issues statement, we also considered potential concerns in related areas that we did not consider would give rise to an SLC. These potential concerns are discussed in Section 11.

9. Horizontal theories of harm

Introduction

9.1 As explained in paragraph 7.4, the focus of our assessment of competitive effects is on the effects of the joint venture in the sale of overseas package holidays via high street travel agents.

9.2 The main parties told us that the retail offers of their stores, including both prices and non-price aspects, were set centrally and predominantly determined by national constraints. The main parties said that discounts given by branches of travel agents were driven largely by the Internet.

9.3 Our normal starting point for assessing retail mergers[50] is to consider the impact on competition at a local level, recognizing that customers shop in local retail outlets. The effects on consumers of any loss of local competition may arise at the national level or a local level. For there to be local competitive effects, there would need to be local variation in prices or other aspects of the products or services offered to customers that are due to local competition. A loss in local competition could result in national effects (national prices and changes in, say, service quality) if sufficiently large to affect a firm's incentives when setting national aspects of its competitive offer.

9.4 We formulated two horizontal theories of harm, both of which were based upon the impact on rivalry of the joint venture in local areas. These were:

---

[49] Issues Statement.
[50] See *Commentary on retail mergers*, paragraph 3.7, OFT and CC, March 2011.

(a) loss of rivalry in various local areas between travel agents' stores for the sale of overseas package holidays such that the joint venture was able to increase prices for overseas package holidays, offer lower discounts, offer customers a reduced quality of service or in some way alter its offering to the detriment of customers; and

(b) loss of rivalry nationally or regionally between travel agents for the sale of overseas package holidays based on a change in the level of competition in a sufficient number of local areas to affect the incentives of the joint venture at a national or regional level; this theory has several elements in common with *(a)* above.

9.5 This section focuses on the evaluation of these theories of harm. A third party put it to us that the joint venture might lead to a loss of competition due to the enhanced buyer power of the joint venture. That possibility is discussed at the end of this section.

Nature of overlap between the joint venture parties

9.6 As explained in paragraph 3.2 above, the main parties overlap in the sale of package holidays through bricks-and-mortar stores. The online business of the CGL and Midlands business will be contributed to the joint venture while the Thomas Cook online business will remain outside the joint venture. The online business of the CGL and Midlands is, however, currently small at less than £[✂] million across all products including flight and accommodation only. We do not consider the Thomas Cook online business to be an independent constraint on the joint venture given Thomas Cook's common interests.

9.7 The main parties said that they offered a similar range of package holiday products and services. On prices, summary information suggests that on average Thomas Cook in-store prices may be lower. Over the last three financial years, the average discount on the tour operator price for all in-store sales of package holidays has been between [✂] and [✂] per cent for Thomas Cook, [✂] and [✂] per cent for CGL and [✂] and [✂] per cent for Midlands.

9.8 We identified local areas where there were stores owned by the different joint venture partners and where therefore the joint venture would lead to an increase in concentration. To identify such local overlap areas, we used a catchment area analysis based on the geographic area within which stores derive a large percentage of their business. Using booking data for the main parties, we estimated that on average 80 per cent of CGL and Midlands customers lived within 5 miles of the store at which they had booked their package holiday and Thomas Cook customers within about 7.5 miles. Some of our analysis was based on average catchment area sizes, some was based on catchment areas calculated for individual stores or store types. Our catchment area analysis was also used as an input in our other analysis (for example, our econometric work). The precise catchment areas we used in our analysis, the information used to calculate those and how this work was used is discussed further in Appendix B, paragraphs 10 to 28).

9.9 Using individual store catchment areas, we estimated that 472 Thomas Cook stores, 287 CGL and 80 Midlands would be in overlap areas, out of total of about 780, 360 and 100 stores respectively in each party's retail network. Viewed nationally, there is therefore a high degree of geographic overlap between the joint venture parties, particularly for CGL and Midlands stores.

9.10 For each overlap area, we identified the number of competing travel agency fascias in the area and whether the stores were owned by TUI, other chains or independents and whether the owners were members of a buying group.

9.11 We identified 11 overlap areas where there would be no competition to the joint venture stores from within the catchment area. There were a further 43 areas where there would be two competing fascias. Whilst in the majority of these areas there was at least one TUI store, there were 12 areas where there was no TUI store and five areas where the only competitor to the joint venture would be from an independent travel agent.

9.12 Each overlap area represents a potential area of concern. Our analysis drew on individual features of each area, such as the competitor set, local demographics and known sales information. For our initial analyses, we did not take account of very specific local features, such as topography (eg the effects of rivers and roads on the accessibility of certain stores), whilst considering all the overlap areas. We recognized that such features might be important should we identify potential local competition issues in particular local areas.

Analyses

9.13 As a starting point, we sought to understand customer behaviour, based on various sources of evidence including that submitted by the main parties, third party submissions and a customer survey that we commissioned. We were particularly interested in customers' buying and research behaviour in order to inform our assessment of how they would be likely to react if the joint venture was to, say, seek to reduce discounts.

9.14 There were a number of components to our analysis:

(a) We conducted a customer survey.

(b) Documentary evidence and submissions provided by the main and third parties. We examined:

(i) the main parties' policies on local flexing of price and non-price aspects of the retail offer;

(ii) the constraint from the Internet; and

(iii) local constraints from other travel agents.

(c) The effects of local competitive factors on travel agencies' offers: we analysed:

(i) variations in discounts between stores; and

(ii) variations in non-price factors between stores.

We tested whether, and if so to what extent, these were related to the presence of local competitors.

(d) The incentive and ability of the joint venture to change its offer (eg reduce discounts): we analysed:

(i) the possible consumer response to reductions in discounts in local areas;

(ii) the incentives for the joint venture to take such action; and

(iii) whether possible entry or expansion by competitors would deter this.

9.15 The joint venture parties submitted analysis done on their behalf by Oxera relevant to the assessment on the horizontal theories of harm. Broadly these were:

(a) an analysis of the relationship between joint venture stores opening and closings event and the financial performance of local joint venture parties' stores;

(b) an analysis of the relationship between Thomas Cook customer perceptions of retail offer of stores and local competition;

(c) pilot customer surveys, estimates of diversion ratios based on pilot survey of six local areas, and the application of these results to Indicative Price Rise analysis, a critical loss analysis and market definition; and

(d) an analysis of the relationship between discounts and margins and local competition.

9.16 The aim of this analysis was said to be to assess local competition between travel agents' store offerings of package holidays and to provide evidence in response to one of the theories of harm set out in the CC's Issues Statement; namely that an SLC might occur due to a loss of rivalry in various local areas between travel agents' stores for the sale of overseas package holidays as a result of the joint venture.

9.17 Oxera concluded that overall there was consistent evidence that there were no local competition effects in bricks-and-mortar retailing of package holidays that would give rise to an SLC and that this result held across all pieces of analysis and was robust to a range of theories of harm. They said that these findings were consistent with the hypothesis that bricks-and-mortar travel agents were closely constrained by competition from online and telephone booking channels.

9.18 In our assessment of the horizontal theories of harm, we have had regard to this evidence prepared by Oxera and submitted by the joint venture parties. The scoping of our econometric analysis was informed by Oxera's analyses and comments. However, we had questions concerning the interpretation of some results. Given the results of our own analyses, we did not find it necessary to take a view on these. If the results of our own analyses had been materially inconsistent with Oxera's conclusions, then we would have investigated the reasons for the differences between Oxera's conclusions and our own.

9.19 Using anonymized extracts of the CC survey data, Oxera investigated results on the use of the Internet by respondents when booking package holidays in-store. Oxera concluded that this further analysis revealed that while in the majority of cases customers of the main parties do not use other bricks-and-mortar stores to research or compare prices before booking, many do use the Internet or other non-bricks-and-mortar sources in researching their holidays.

9.20 In the remainder of this section, we first report the evidence and results of our analyses. We then set out our assessment of the evidence in relation in local, national and finally regional effects. Much of the evidence and analysis that is relevant to local effects is also relevant to national and regional effects. Rather than reproduce this evidence and analysis in these latter discussions, we draw on the relevant aspects where appropriate.

Customer survey

9.21 We surveyed customers who had booked a package holiday in a Thomas Cook, CGL or Midlands store in the last 12 months. We were particularly interested in understanding their reasons for booking in a store, what they considered to be their alternative options and their readiness to use the Internet (for holiday research and/or purchases).

9.22 We interviewed people who had booked a package holiday in Thomas Cook, CGL or Midlands stores located in areas where there is a Thomas Cook store within 5 miles of a CGL and/or Midlands store and, in particular, in areas where if the merger went ahead the result would be four competing travel agents[51] or fewer. The survey therefore focused on areas where any impact of the joint venture on local competition appeared likely to be greatest. The survey was also designed to cover a range of areas defined by the characteristics of local competition taking into account the number of competitors in the area and whether the competitors were TUI, another chain and/or an independent. For the independents, we distinguished between those that were members of buying groups and those that were not. We did not attempt to survey each possible problem area but sought to design a survey that would provide the information required to assess local competitive effects given the characteristics of areas in terms of the number and type of competing agents (or fascias).

9.23 The key results that relate to customer responses to 'forced divert'[52] questions are discussed in Appendix B, paragraphs 132 to 135 and 136 and our analysis of these results is set out in Appendix B, paragraphs 136 to 145 and 147 to 155. With regard to the buying and research behaviour of the surveyed customers, the key results were:

(a) The majority of customers booking package holidays in Thomas Cook, CGL and Midlands stores had a preference for booking a holiday in-store rather than by using the Internet; 77 per cent of respondents said that they preferred to book package holidays at a travel agency store, and in response to questions as to how they would have responded to the closure of the chain of stores at which they had booked their package holiday, 68 per cent of respondents said that they would still have booked their holiday in a travel agent store.

(b) If they booked flights only, the majority of respondents said that they preferred to use the Internet for this activity. In particular, of the respondents who had booked 'flight-only' holidays via some channel, 62 per cent (excluding respondents who had 'no preference') said that they would prefer to do so via the Internet.

(c) Customer choice of travel agent store appears to be essentially local with 77 per cent of respondents booking in stores that are close to their home or work, or are otherwise easy to get to.

(d) Around 70 per cent of customers had done some research on their holiday plans before booking their holiday in-store. In particular:

(i) 27 per cent of respondents had visited one or more other stores before booking;

(ii) 49 per cent of respondents said that they had used the Internet; and

[51] Measured by the number of fascias, not the number of stores.
[52] This terminology is explained in paragraph 9.72.

(iii) 20 per cent of respondents who booked in stores said they had used the Internet to compare prices before booking. (This result, which could under-state the use of the Internet as a source of price information, is discussed further in Appendix B, paragraphs 125 and 127 and in paragraph 9.24 below.)

(e) 38 per cent of respondents said that they had asked for a discount when they booked their package holiday in-store. Of these respondents, 25 per cent said they asked because the price was cheaper online and 4 per cent said they asked as they had been offered a cheaper price at another travel agent.

9.24 In relation to the result referred to in paragraph 9.23*(d)*(iii) above, the parties argued that the phrasing of our question on the use the respondents had made of the Internet before booking their package holiday in-store would result in an under-estimate of the Internet as a source of information on prices. We asked respondents who had used the Internet as a source of information for further details of the purpose for which they had used the Internet. We asked the question 'What exactly did you look for on the Internet?' The main parties said that such a question would not capture use of the Internet that would have given respondents information on prices even though they may not have actively or intentionally searched for prices. We accepted that there was some risk of this.

9.25 The main parties also argued that the framing of the forced diversion questions[53] was likely to bias responses towards another bricks-and-mortar store. We asked customers 'Thinking back to when you booked your latest [package] holiday, if when you were considering booking your holiday you knew that the shop you used was permanently closed, what would you most likely have done instead?' The main parties said that this would have focused customers on the point of booking (ie when they were sitting in the store) and therefore after the customer had chosen their holiday. The main parties said that asking about this point in time was likely to bias customers towards recreating the exact purchasing decision they made which was likely to affect the likelihood of the product being purchased in-store. We consider that the main parties' argument relies on an artificial interpretation of this question. We had no reason to expect that respondents would have understood the question in this way.

9.26 The main reasons given by respondents for booking package holidays in-store were concerned with the benefits of dealing face to face with the travel agent. Of those who said that generally they preferred to book in-store, 66 per cent gave 'personal contact and advice' as reasons and 26 per cent 'reassurance and protection'. Price-related factors were mentioned by around 17 per cent of respondents.

9.27 We also asked respondents about the factors that would influence their choice of particular store. The most frequently mentioned factors were again 'personal contact and advice', with 24 per cent of respondents giving these as reasons for booking at the particular store, but other factors were also important: 20 per cent mentioned prices, discounts and offers and 17 per cent mentioned convenience. 23 per cent said that they had always used or previously used the agent.

9.28 We explored further with respondents the role of location in the choice between stores in the survey. 56 per cent said that they had booked with the travel agent closest to their home and 17 per cent with the travel agent closest to work or work and home.

[53] These questions are referred to in paragraphs 9.23 and 9.23*(a)* above and in Appendix B, paragraphs 132–135 and 136, and our analysis of these results is set out in Appendix B, paragraphs 136–145 and 147–155.

9.29 Further results from the survey are shown in Appendix B, paragraphs 112 to 134.

Local effects

9.30 We considered the likelihood of local competitive effects resulting from the merger.

Documentary evidence and parties' submissions

9.31 We examined documents provided by the main parties for evidence on local flexing of their retail offer in response to local competitive constraints. The main parties also provided submissions on this matter.

The main parties' policies on local flexing of the non-price aspects of the retail offer

9.32 The main parties told us that the retail offer in high street travel agencies was driven by national constraints and that range (ie what was available to book in a travel agency), quality (including store refurbishments) and service (opening times, staff levels and experience) were determined by reference to nationally set criteria; not the degree of local competition and not by local market dynamics.

9.33 We examined documentary evidence provided by the main parties including that relating to staff training, decisions to open and close stores and store refurbishments. We do not find evidence of variation in non-price aspects of the retail offer related to local competitive conditions: the internal documents provided suggest that staff training does not vary between stores for any of the main parties and the presence of particular competitors in an area does not appear to have been a factor in decisions to close/open stores or a reason for prioritizing the refurbishment of particular stores.

The main parties' policies on local discounting

9.34 Price competition between high street travel agencies arises from the offering of discounts by the travel agents on the ViewData prices of tour operators (see paragraph 5.25). The main parties' discounts which are relevant to our analysis may be considered in three categories:

(a) National campaigns, in which a decision is made centrally to promote certain holidays by offering a discount and this discount is on offer at all the agent's stores. The level of discount is set centrally.

(b) Price matching, where the agent will match competitive prices of rivals; there are strict national policies as to when and how these discounts are granted and there must be a 'like-for-like' comparison between the two holidays. When the conditions are met, the level of discount is set by reference to the price being matched rather than other discretionary factors.

(c) Discounts made at local discretion, typically with the aim of achieving a sale that might otherwise be forgone. An upper limit on the level of discount that can be offered by the local sales staff is set centrally but the actual discount offered within that limit in relation to a particular transaction is determined locally.

9.35 The main parties told us that the retail offers of their stores, including discount policies, were set centrally and predominantly determined by national constraints. We sought to clarify our understanding of this position so that we would be able to form a view as to the likelihood of changes following the joint venture—either as a result of the transaction or for other reasons.

9.36 Thomas Cook told us that it operated a single national discounting policy that allowed each sales consultant some discretion to give discounts based on his or her own judgement. Thomas Cook thought that this discretion had led to some discounts being given unnecessarily and considered that there was an opportunity to reduce this cost.

9.37 We asked the main parties to provide documentary evidence relevant to their retail strategies on prices or other aspects of their in-store retail offer. The documents Thomas Cook provided included a copy of a retail strategy document dated May 2010 which set out proposals for improving efficiency in discounting by managing discounts by categories of stores. These categories would be identified by, among other things, local competitive circumstances. Thomas Cook told us that this document had been developed at working level.

9.38 Thomas Cook said that its UK board and senior distribution team concluded that it would not be sustainable to differentiate pricing by area given the nationwide constraints imposed by the Internet and telesales. The proposal for the local categorization of stores was not taken forward.

9.39 Thomas Cook said that following the May meeting, its retail team continued to consider what would be the best strategy to reduce discount costs through additional central control. A proposal was prepared for its UK board in September 2010. This proposal identified the systems development required to improve central control of discounting by means of nationwide discount caps. No functionality was proposed to differentiate discount policy based on local factors or to set specific caps for individual stores or regions. The proposal was approved and the development work was completed at the end of 2010.

9.40 The September 2010 board paper referred to a proposal to develop a longer-term solution on discounting and suggested that this might [✂]. Thomas Cook told us that these ideas were at a very preliminary stage but that it was envisaged that [✂]. Thomas Cook said that longer-term solutions would be determined only after an evaluation of the effectiveness of the nationwide capping system.

9.41 The documentary evidence we had for CGL or Midland did not suggest that either party had considered a change of strategy to allow for local flexing of their discounting policies or other aspects of their retail offer related to local competitive conditions.

Customer survey results and aspects of the main parties' submissions relevant to the rivalry between stores and the Internet

9.42 Our survey provided evidence that, for the majority of customers booking package holidays in-store, the main reason for doing so was the benefit of face-to-face contact with the travel agent, including the personal advice and the reassurance gained from the travel agent making the booking. Internet-based travel agents do not provide customers with this face-to-face contact or the level of personal service.

9.43 The survey also provided some information on the aspects of the online retail offer that were important to customers. We found that the majority of respondents who preferred to book a package holiday in-store preferred to book flights-only holidays using the Internet for reasons related to price and convenience. In particular, 64 per cent of these respondents gave reasons related to price and 51 per cent reasons related to convenience and ease for this preference.

9.44 This suggests that currently the retail offer of the two channels is different and that the choice between them will depend on how important the benefits of having face-to-face contact with the travel agent are to a customer. The survey suggests that this is important for the majority of the people booking in stores. These people have a preference for booking in-store. However, these people may still use the Internet for research, including research on price, even if they then book in-store. Key results on the use of the Internet by respondents to the CC customer survey are summarized in paragraph 9.23*(d)* and *(e)*.

9.45 The main parties commented that the CC's survey did not seek to measure the strength of the preference for personal services relative to price and that this limitation was particularly important given that the survey was conducted at a time when bricks-and-mortar and online prices were similar. We agree that the responses to the CC survey reflect preferences given the current retail offers in-store and online.

9.46 The main parties also told us that competition between stores and online was intensifying, not just in relation to price but also in terms of quality and service. We were told that increasingly online providers were introducing more service features, for example the provision of a pop-up window so that a customer could speak directly to an adviser whilst looking for holidays online. The main parties noted that stores still had an advantage in this respect, but that this trend meant that stores needed to do even more to differentiate their advantages.

Third party evidence on rivalry between travel agencies

9.47 We considered how the retail offer in the sales of package holidays compared on price (or discounts), product range and quality of service between different categories of travel agents. We were consistently told by third parties that compared with the large national chains, other travel agents, with the possible exception of the independents that are not part of buying groups, provide the same or better range and quality of service.

9.48 On price, we were told that smaller chains and independents that were members of buying groups were able to negotiate competitive commission rates with tour operators. We were also told, however, that some independent agents and not others would compete on prices with the large chains, and that independents would generally be reactive in giving discounts. Thomas Cook tour operator commission rates for each of the last two winter and summer seasons were consistent with chains and members of buying groups being able to negotiate competitive terms. The commissions for independents that are not members of buying groups were substantially lower.

Effects of local competitive factors on the main parties' retail offer

9.49 We investigated whether the local competition faced by joint venture stores from other travel agents had had an effect on the average discounts given on the sale of package holidays. We looked at price and non-price effects. In doing so, we looked separately at different types of holidays (eg beach, ski, cruise). We analysed:

(a) Thomas Cook data on the reasons why discounts are given in-store;

(b) the effects of local competition from rival stores of various types on the main parties' stores discount;

(c) the effects of the opening or closure of a Thomas Cook store on the discounts offered by CGL or Midlands stores in the local area and vice versa; and

(d) the effect of local competition on the quality of the service provided in Thomas Cook stores.

Analysis of Thomas Cook discounts

9.50 We examined Thomas Cook data for the period from June 2010 to March 2011.[54] About three-quarters of overseas package holiday bookings were discounted (both by volume and value). On average, these discounts were [less than 10] per cent of the total value of sales over this period.

9.51 We noted the main parties' comments that their discount policies were set centrally. We note that a centrally determined policy might still be applied locally having regard to local factors resulting in local variation.

9.52 At time of booking, discounts were allocated to one or more of eight 'reason codes', the main ones being 'cruise', 'other bookings', and 'price match'. For each of these reasons, there are a number of sub-reason codes. Of particular interest to us were discounts allocated to the 'close the sale' and 'manager's discretion', and price-match sub-reason codes as discounts that may reflect a price response to local market conditions including competition.

9.53 Price-match discounts are given where customers can demonstrate that they could get the same or equivalent holiday more cheaply online or at another travel agent. Nationally set guidance is provided to sales staff on the criteria to apply in deciding whether an alternative holiday can be regarded as 'the same or equivalent'. 31 per cent of discounts (by value) are described as price matching. The main parties drew particular attention to the proportion of price-match discounts that related to Internet prices and suggested that this was evidence that the Internet was a strong constraint on high street stores. Table 11 shows the results of our analysis of price match discounts. Discounts to match Internet prices accounted for [✂] per cent of all discounts allocated to the price match codes and [✂] per cent of the total discount value. Discounts to match 'bricks-and-mortar' prices accounted for [✂] per cent of discounts allocated to match price codes and [5–10] per cent of the total discount value.

TABLE 11 **Analysis of price match discounts**

Source of price that was matched	*Proportion of price match discounts %*
Thomas Cook Internet price	57.0
High street agent	23.3
Third party Internet	10.9
Independent agent	[✂]
Direct holidays	[✂]
Cruise agent	[✂]

Source: Thomas Cook data, CC analysis.

[54] The full set of data was only available for this ten-month period.

9.54 The majority of price-match discounts were to match Internet prices. We also noted that the vast majority (84 per cent) of discounts to match Internet prices were given to match prices available from Thomas Cook online. This raises some issues as to how we should interpret this customer behaviour. Although these figures are not inconsistent with the main parties' argument, taken on their own they do not enable us to determine the nature of the constraint offered by the Internet.

9.55 28 per cent of discounts, by value, were given to 'close the sale' and 3 per cent of discounts were given at 'manager's discretion'. These are fairly general categories of discount allowing the salesperson or manager discretion albeit within centrally determined parameters. Thomas Cook told us that these discounts would reflect the customer's negotiation and that that was likely to have been informed by Internet prices.

9.56 In particular, the discounts given to match prices available at other high street chains or independents are likely to be related to the local competitive conditions, although we recognized that they could be responsive to wider factors. While this data provides information on the source of pricing information cited by customers, the competitive constraints are not necessarily all attributable to local competition; for example, the lower price quoted by another local store may have been a response to competition from the Internet and, absent the local source, some customers might have referred to Internet prices in their negotiation. Equally, local price match figures are unlikely to capture all such discounting related to the local competitive conditions as price-matching discounts are only available for holidays that were the same or equivalent, so we might expect some of such discounting to have been allocated to the local discretion categories discussed below.

9.57 Decisions on whether to give 'close the sale' and 'manager's discretion' discounts and the amount of discount to give are taken locally by individual sales staff at the time of booking, albeit within centrally determined parameters. We have for our purposes labelled these 'local discounts'. We took the view that whilst some of these discounts might be influenced by local competition, these categories would also be influenced by a range of other factors including national constraints. These categories are likely to reflect other factors such as pricing awareness of customers (from a range of sources local and national), negotiating ability, previous experience of package holiday purchases and any other factors that relate to a customer's willingness to pay.

9.58 We also looked at the variation in discounting across Thomas Cook stores. For the period June 2010 to March 2011, we found that for Thomas Cook stores the average discount ranged from 2.0 to 7.9 per cent of the total overseas package holiday sales of a store. The discounts allocated to the 'close the sale' and 'managers' discretion' sub-reason codes taken together accounted for discounts in the range of 0.1 to 6.1 per cent of the total overseas package holiday sales of a store. For price matching other travel agents, the range was 0.5 to 5.5 per cent. Finally, the discounts allocated to all these sub-reason codes accounted for discounts in the range of 0.2 to 6.6 per cent.

9.59 Overall, for the period June 2010 to March 2011, discounts given in Thomas Cook stores on sales of overseas package holidays amounted to [less than 10] per cent of the total value of these sales. Around 30 per cent of these discounts were discretionary discounts given to 'close the sale' or at 'managers' discretion'. A further 30 per cent of the discounts are given to match prices available from elsewhere including from other high street stores. The overall extent of discounting, and the reasons for giving discounts, has varied between stores. For some stores, discounts accounted for as little as 2.0 per cent of the value of the overseas package holiday sales and as much as 7.9 per cent. If we look at discount sub-reason codes that would include discounts given in response to local competition, the discounts given ranged between stores from 0.2 to 6.6 per cent.

Econometric analysis of discounts

9.60 We undertook an econometric analysis to assess the effect of the presence in a local area of the various parties on discounts, for example whether Thomas Cook discounts appeared to be related to the presence of CGL or Midlands stores in the local area. This analysis is described in detail in Appendix B, paragraphs 58 to 111.

9.61 Most of our analysis did not identify statistically significant relationships between discounts given by the joint venture parties and local competition. In particular: analysis of the relationship between Thomas Cook discounts by product and local competition using baseline and alternative measures of competition; Thomas Cook discounts by product allocated to certain sub-reason codes and competition allowing for distance effects in the competition measures, for linear and log specifications of the model; and CGL and Midlands discounts by product and competition using the baseline measure of competition.

9.62 We found that there were some statistically significant relationships related to the distance between stores. Our analysis suggested that the presence of a CGL and/or Midlands store in a particular local area would have an effect on total discounts[55] in that area—the nearer the CGL or Midlands store, the higher the discounts.

9.63 The distance of CGL and Midlands stores from a Thomas Cook store gave rise to statistically significant (at the 5 per cent level) effects on discounts for short-haul beach, long-haul beach, city break and ski holidays. The effects are small; we estimated that, all other things being equal, discounts on short-haul beach holidays given by an average Thomas Cook store where there is a CGL or Midlands store very close by would be less than one-third of a per cent higher than those Thomas Cook stores where the nearest CGL or Midlands store is the average distance from the Thomas Cook store (6.13 miles).[56] We note that a similar analysis, at the level of 'discount type', as opposed to across all discounts, did not produce statistically significant results; we therefore place limited weight on this result. However, taking account of the uncertainties, this analysis provides some support for a view that discounts are to some extent affected by local factors.

Analysis of opening and closure events

9.64 The purpose of this analysis was to examine the effect on discounts given by Thomas Cook, CGL or Midlands stores of the opening or closure of rival joint venture stores in their local areas. We adopted a difference-in-difference analysis[57] of events over the period October 2008 to September 2009.

9.65 During this period CGL closed 15 stores and did not open any new stores. Midlands closed one store and did not open any new stores. Twenty Thomas Cook stores were exposed to the closure of a CGL store within their catchment areas. Whilst we had reservations about analysing this data due to the small sample sizes, we carried out some initial work. The results of this work suggested that generally the closure of these CGL stores had not resulted in statistically significant reductions in the dis-

[55] By total discounts, we mean the total discount granted by the travel agent, accumulating the discounts given for different reasons.
[56] Average discount on beach (short-haul) is [✂] percentage points.
[57] This is explained in Appendix B, paragraphs 97 to102.

counts given by nearby Thomas Cook stores. The only exception to this was in relation to cruise packages. Given the early indications of a generally weak effect on Thomas Cook discounts of the closure of CGL stores and the small sample sizes, we did not pursue this analysis further. For further details, see Appendix B, paragraphs 97 to 102.

Econometric analysis of non-price local competition effects

9.66 We also investigated the effect of local competition on the quality of the service provided in Thomas Cook stores. We constructed two measures of the in-store service quality using the results of Thomas Cook's pPQRS (customer perceptions of price, quality, range and service) customer survey referred to below and the floor size of Thomas Cook stores.

9.67 Since January 2011, Thomas Cook has conducted monthly online surveys asking customers who have made enquiries and booking holidays in its stores to grade stores on various aspects of the quality of stores and the service provided. We took the average overall score achieved by each Thomas Cook store for bookings and enquiries. These scores ranged from 0 to 10.

9.68 Store size was used as a single measure that would reflect the range and quality of service provided in-store including the availability of brochures, the number of sales desks and the availability of foreign exchange facilities.

9.69 We found no statistically significant evidence that those Thomas Cook stores facing more local competition provided their customers with a higher quality of service.

Use of margins and diversion ratios

9.70 Our normal approach to assessing retail mergers is to consider whether some of the profits lost by one of the merging parties (resulting from an hypothetical change in the retail offer) would be recaptured by the other merging party. If so, the merger may create an incentive to change the retail offer. The strength of this incentive will depend, among other things, on the profits from sales that the merging parties would recapture from the change to the retail offer.

9.71 The profits from recaptured sales are determined by two factors: diversion ratios and margins. Diversion ratios and margins may also be informative in their own right in considering the closeness of competition between the merging parties and their incentives to worsen the retail offer post-merger. For example, diversion ratios are evidence of the closeness of competition between the joint venture parties pre-merger, between the joint venture parties and other high street agents, and between distribution channels.

Diversion ratios

9.72 We asked respondents how they would have responded had the store at which they booked their package holiday closed permanently, or all Thomas Cook, CGL or Midlands stores, as appropriate, had closed. These are referred to respectively as the store and brand forced diversion questions.

9.73 The purpose of asking these questions was to inform our assessment of the closeness of competition between the joint venture parties and also between the joint venture parties and other competitors. Responses to these questions can be used in considering how customers might respond to price increases at the store or chain of stores at which they booked their package holidays. We used the responses to estimate diversion ratios, the percentage of respondents who told us that they would have booked with another travel agent who would, for example, have booked a holiday at another joint venture store.

9.74 Table 12 shows the diversion ratios between the joint venture parties across all responses (excluding don't knows). For example, for all respondents who had booked a package holiday in a Thomas Cook store, 46 per cent said that they would continue to book with Thomas Cook (in-store, by phone or online), 10 per cent said that they would book with CGL or Midlands and 11 per cent said that they would book with TUI.

TABLE 12 **Diversion ratios between joint venture parties in response to store closure**

	Store at which the booking was made		
	Thomas Cook	*CGL*	*Midlands*
Store to which the customer would divert:			
Thomas Cook	46	18	17
CGL/Midlands	10	33	38
TUI	11	10	9

Source: CC analysis of CC customer survey data.

Base: All respondents (2206) excluding 'don't knows'; ie all respondents who said they would book with the agent they actually booked with or with a different travel agent either in-store, by phone or online or change their holiday plans.

9.75 We expect that these figures understate the diversion between the main parties because of 'don't knows' and because nearly half of the respondents who said that they would book at a different travel agent did not identify a particular travel agent. It appears reasonable to assume that at least some of these respondents would have booked a holiday with another joint venture party.

9.76 On brand forced diversion, our analysis[58] suggested that overall, faced with the closure of all stores operated by the Thomas Cook, CGL or Midlands, as appropriate, 61 per cent[59] of all respondents would have switched to booking in-store with a different travel agent.

9.77 We used the results of the survey to estimate diversion ratios between the joint venture parties for stores in areas where we might expect the joint venture to have the greatest impact on local competition (see paragraph 9.79 below). We estimated a model of diversion ratios controlling for the number of store (by types of store) in the catchment of the joint venture store and local market demographics. For further information, see Appendix B, paragraphs 136 to 155.

9.78 We estimated the model on two bases: for all respondents, and respondents who said they would divert to a different travel agency or change their holiday plans, ie excluding those who said they would stay with the same travel agency. We considered that these provided a range for diversion ratios between the joint venture parties.

9.79 We used the results of these models to predict diversion ratios between the joint venture parties for local areas where intuitively we might expect the merger to have the greatest impact on local competition based on the number, type and location of the competitors. In particular, we estimated diversion ratios for areas where the store of another joint venture party is within 0.5 miles of the relevant store and, in addition:

[58] See Appendix B, paragraph 134.
[59] See Appendix B, paragraph 145.

(a) no TUI stores and no 'other large chains' (or chains that are not members of buying groups) within 1 mile of the relevant store;

(b) stores of 'other large chains' but no TUI stores within 1 mile of the relevant store;

(c) TUI stores but no stores of 'other large chains' within 1 mile of the relevant store;

(d) no TUI stores and no 'other large chains' within the catchment area of the relevant store;

(e) stores on 'other large chains' but no TUI stores within the catchment area of the relevant store; or

(f) TUI stores but no stores of 'other large chains' within the catchment area of the relevant store.

9.80 The full results are provided in Appendix B, Tables 38 and 39. As we might have expected, the estimated diversion ratios are highest where the joint venture stores do not face competition from either TUI or any of the other larger chains (proxied for these purposes by those that do not belong to a buying group). These results suggest diversion ratios from Thomas Cook to CGL/Midlands in the range of 14 to 31 per cent and from CGL/Midlands to Thomas Cook in the range of 22 to 35 per cent.

9.81 We consider that these figures will understate the diversion between the joint venture parties because nearly half of the respondents who said that they would book at a different travel agent did not identify a particular travel agent. In particular, of those who said that they would switch to a different travel agent, 28 per cent said they had no preference, 14.8 per cent said they did not know which travel agent they would have used and 5.1 per cent said they would use the nearest travel agent. It appears reasonable to assume that at least some of these respondents would have booked a holiday at another joint venture store in the area. Estimated diversion ratios would be around 50 per cent in some areas under certain assumptions.

Sales margins

9.82 Margins may be an indicator of the strength of competition faced by the joint venture parties pre-merger; high margins may be associated with weak price competition. The same information can also be used in considering the potential impact of the merger on consumers. Margins would be one input to an assessment of post-merger incentives to increase prices.

9.83 We considered that the relevant margin is the store level margins earned on additional sales of overseas package holidays. This will be the store commission income less discounts funded by the travel agent and any additional in-store costs incurred in making the additional sales which, in this case, may then be expressed as a percentage of the total value of these additional sales or the additional commission income before discounts earned on these sales. We were of the view that the former is the relevant measure in assessing the impact the joint venture may have on the prices paid by customers for holidays. This has been referred to as the revenue margin.

9.84 Each party provided information on annual average net revenue margins for all sales of package holidays and by type of package holiday, for each of the last three financial years. These average net revenue margins were in the range of around [✂] to [✂] per cent depending on the party, product and year.

9.85 We also looked at the relationship between costs and volume of sales. The results of this work are set out in Appendix B, paragraphs 156 to 163. Based on these results, we estimated that the effect of allowing for variable staff costs would be to reduce these margins by between 0.25 and 0.5 percentage points.

9.86 We recognized that if we were to consider the impact of the merger on the profitability of the travel agency business we would be looking at much higher figures. We could do this directly using available information on margins on the sale of overseas package holidays expressed as a percentage of commission income before discounts, or indirectly by first looking at the possible impact of the joint venture on retail prices and then thinking about what this would mean for commission income. We calculated that roughly, a [✂] per cent increase in price of a holiday would give a travel agent an increase in commission income of around [✂] per cent.

9.87 We considered that the implications of possible price increases for the profitability of travel agents was relevant in considering the prospects for entry and, in particular, whether entry would be a constraint on the joint venture raising prices or otherwise worsening the retail offer.

Assessment

9.88 We examine the potential effects of the joint venture on competition at a local level, We consider first the possibility of local competitive effects following the joint venture, second we assess the scale of any such effects, third we consider the sustainability of such effects over time and finally we set out our conclusions on the basis of this assessment.

Possibility of local competitive effects

9.89 Using individual catchment areas for each store, we found that 472 Thomas Cook stores, 287 CGL and 80 Midlands would be in overlap areas (although the exact numbers are sensitive to the assumptions used, the broad scale is not), out of total of about 780, 360 and 100 stores respectively in each party's retail network. Viewed nationally, there is therefore a high degree of geographic overlap between the joint venture parties, particularly for CGL and Midlands stores.

9.90 For a loss of rivalry in local areas as a result of the joint venture to give rise to local competitive effects, there would need to be local variations between the offers of the joint venture stores, and these would need to be related to the local competitive conditions. We assess the extent to which such variation is present and appears to be related to the local competitive conditions currently. We then assess whether the joint venture might change its approach, in response to the change in local competitive conditions as a result of the joint venture.

9.91 As set out in paragraph 9.2, the main parties told us that the retail offers of their stores, including both prices and non-price aspects, were set centrally and predominantly determined by national constraints. The main parties said that discounts given by branches of travel agents were driven largely by the Internet.

9.92 We examined whether currently there were any variations in price or non-price aspects of the main parties' offers that appeared to be related to the local competitive conditions. We also considered whether this was likely to change following the joint venture.

- *The current situation*

9.93 We found no evidence of any local variations in non-price aspects of the main parties' offers that were related to the local competitive conditions.[60]

9.94 As regards price, we found that while the basic price is set by the main parties nationally, discounting takes place at a local level, albeit within centrally set parameters.

9.95 It was relevant to identify whether any element of local discounting currently appeared to be responsive to local competitive conditions. We considered that an element of the local price variation—price matching of offers made by other local stores—was likely, by its nature, to be related to the local competitive conditions, although we recognized that local pricing could be responsive to wider factors. This is because although price matching of local competitors identifies the source of pricing information responded to as 'local', the pricing response was not necessarily all attributable to local competition. In the absence of such a local source, some prospective customers might have cited Internet prices to obtain a discount. Price matching of local stores amounts to a small proportion ([5–10] per cent) of the total value of discounts given by Thomas Cook.

9.96 We also considered that some other discounts which are applied locally on a discretionary basis, namely manager's discretion and close the sale, might be influenced to an extent by local factors such as the presence of competing travel agencies (see paragraph 9.52) but recognized that they would also be influenced by a range of other factors. 'Close the sale' discounts are likely to reflect a number of factors, including customers' negotiating ability, pricing awareness from a variety of possible sources, experience of previous package holiday purchases, general expectation of being granted a discount and willingness to 'close the sale' only if offered a discount. Close the sale and manager's discretion amounts to 28 and 3 per cent respectively of total discounts given by Thomas Cook.

9.97 We conducted an extensive econometric analysis of the relationship between discounts and local competitive conditions, using techniques likely to detect any causality that might be present, given the sample sizes in the available data (see paragraphs 9.60 to 9.63). However, the results of most of the econometric analyses did not provide statistically significant results supporting this relationship. In particular the following analyses did not provide statistically significant results: analysis of the relationship between Thomas Cook discounts by product and local competition using baseline and alternative measures of competition; Thomas Cook discounts by product allocated to certain sub-reason codes and competition allowing for distance effects in the competition measures, for linear and log specifications of the model; and CGL and Midlands discounts by product and competition using the baseline measure of competition. Only one of our analyses suggested that discounts are to an extent determined by local competition. The effect identified in that instance was small and not straightforward to interpret.

9.98 Although we would not necessarily expect our econometric analysis to pick up small effects in the presence of significant 'noise', we consider that the fact that we could not find other statistically significant relationships suggested to us that the link between discounts and competition is weak.

[60] See paragraphs 9.32 & 9.33.

- *Likelihood of changes to allow for local flexing of retail offer in response to local competitive conditions*

9.99 The above aspects of the analysis assess the discounts and other aspects of the retail offer given under current policies and current competitive conditions. The policies with regard to local discounting and other aspects of the retail offer might change for a variety of reasons, including the impact of the joint venture and the way that high street and Internet pricing interactions develop over time.

9.100 As discussed in paragraphs 9.34 to 9.41 we asked the main parties about their discounting policies and explored in detail some work that Thomas Cook had done on possible changes. Neither the main parties' current policies, nor our examination of discounts given, provide evidence that the main parties currently seek to vary their discounts structures or policies locally in such a way as to reflect local competitive conditions. The main parties told us that this was not a worthwhile strategy due to the constraint from Internet and telesales prices.

9.101 In the event of the anticipated joint venture proceeding, the joint venture may have greater incentives to manage more precisely the granting of discretionary local discounts (in the case of Thomas Cook, discounts currently allocated to the close the sale and manager's discretion categories), for example by judicious targeting, because the benefits in the post-merger environment could be greater.

9.102 Our examination of Thomas Cook's internal papers suggests that Thomas Cook had considered whether adjusting discount limits to take account of various local conditions, including local competitive conditions, might be a worthwhile strategy. Moreover, although Thomas Cook does not currently pursue this strategy, the possibility was not totally dismissed. However, this evidence suggests that it was not clear to Thomas Cook whether such a strategy could work and whether the benefits would outweigh the costs. In fact, such a strategy was not attempted.

9.103 The formation of the joint venture could increase the potential gains from such a strategy, were it deliverable. Whilst we think the joint venture will probably seek to manage local discounts more tightly, given the Internet constraint and the range of other factors that appear to operate currently to inform local discounting such as customers' willingness to pay (which itself is influenced by a range of factors of which local competition is likely to be only one), we have not formed an expectation that the joint venture would do so successfully in a way that exploited local competitive conditions efficiently enough for the strategy to be sustainable.

9.104 We considered whether the joint venture would be likely to start adjusting the non-price aspects of its offer so as to exploit local competitive conditions. Our review of documentary evidence provided nothing that would suggest that the main parties had considered doing this. Whilst we think the joint venture may examine this possibility, given the constraints operating on the main parties and the bluntness of changing the non-price aspects compared with changing discounts,[61] we have not formed an expectation that the joint venture would do so successfully in a way that exploited local competitive conditions efficiently.

[61] When thinking about changing discounts in response to local conditions, the joint venture could offer different discounts to different customers, the level being determined to some extent by the local salespeople or manager. It is harder to achieve this 'targeting' with non-price aspects of the retail offer as these tend to apply to the store and not to particular customers who use the store, eg opening hours. In this sense, changing non-price aspects of the retail offer is more of a blunt instrument than changing discounts.

9.105 We also formed the view that industry developments, including improvements to Internet offerings and customer propensity to use them (see paragraphs 5.21 and 5.22) are likely over time to diminish both the scope and the ability of the joint venture to fine tune local offerings.

- *Indications from basic upward pricing pressure analysis*

9.106 We found that diversion ratios between the main parties' stores may be high in some areas.[62] High diversion ratios between merging parties can indicate that price increases would be profitable, where the profitability of price increases can also represent the profitability of changes to other (non-price) aspects of the retail offer. Absent the joint venture, if Thomas Cook were, for example, to raise prices (reduce discounts) beyond current levels, it would expect to lose some customers and, under standard assumptions about profit maximization, we expect that this would be unprofitable for Thomas Cook. Under the anticipated joint venture, some of the customers it loses would be expected to go to CGL or Midlands stores (if they have branches in the local area), and so the joint venture would retain the margin earned on those customers. Hence the loss to the joint venture from, for example, raising prices would be reduced and there may be some upward pressure on prices.

9.107 However, this evidence should be interpreted cautiously, especially in light of the low margins we observe for travel agents.[63] Since margins are low, the value of margins from customers who switch to a CGL/Midlands store is also low, which suggests that any upward pressure on prices, for example, would be limited.

Size of possible local competitive effects

9.108 The scale of local competitive effects would be limited by the joint venture's ability to reduce discounts. Further, we consider that the effects would be limited to discounts that currently relate to local competitive conditions. As set out above, local price-match discounts amount to [5–10] per cent of total discounts allocated by Thomas Cook and those categories that involve local discretion relate to 31 per cent.

9.109 For the majority of Thomas Cook stores, the value of discounts allocated to 'close the sale', 'manager's discretion' sub-reason codes and to price-matching local competitors is somewhere in the range of [✂] to [✂] per cent of the store's sales revenue for overseas package holidays, but for some stores the figure is around [✂] per cent. See Appendix B, Figures 3a to 3e, for further details.

9.110 However, as set out in paragraphs 9.95 and 9.96, we think that these are responsive to various factors, of which local competition is only one.

Sustainability of any price or non-price effects

- *Entry as a possible constraint*

9.111 We examined the likelihood of entry both from the perspective of entry barriers and from the point of view of attractiveness. (See Appendix E.)

9.112 Whilst we do not expect substantial entry to be likely within the foreseeable future, this is due to a lack of market attractiveness rather than structural features. We think

[62] See Appendix B, Tables 38 & 39.
[63] See Appendix B, paragraphs 156–163.

there is a significant possibility of entry into selected local areas by expanding rivals, and by package holiday operators looking to ensure their route to market, if the joint venture were, for example, to raise prices. This prospect is likely to further dampen the joint venture's incentive to modify its offer based on local rivalry.

- *Internet*

9.113 We also recognized that the scope for the increasing role of the Internet in this industry may further reduce the scope for price effects over time.

Conclusion on local effects

9.114 We conclude that, although we cannot rule out the possibility of some price rises (via reductions in discounts given) in certain local areas for certain customer groups, the evidence is not sufficient to give rise to an expectation of an SLC. In doing so we took account of all of the above considerations, including: the limited scale of current local variation of prices in response to local competitive conditions and the range of other factors that appear to inform local discounting; the lack of a discernible pattern of price variation (via discounts given) on the basis of local competitive conditions; the practical challenges of implementing a strategy reducing discounts that is driven by local competitive conditions against this background; and the lack of an expectation that these features are likely to change as a result of the joint venture. Moreover, in the context of the considerations discussed in our assessment, we consider that any isolated price effects that were to occur would most likely be small, sporadic and eroded over time.

9.115 We have not formed an expectation of an SLC based on local effects on non-price aspects of the joint venture's offering. We have observed no current variation in the non-price aspects of the main parties' offerings in response to local competitive conditions, nor have we seen any evidence that the main parties have considered flexing their non-pricing offering in this way. We have not formed an expectation that the joint venture will reduce the quality of its non-price offer in specific localities going forward to exploit any reduction in local rivalry resulting from the joint venture.

National or regional effects

9.116 National or regional effects might arise were the joint venture to result in a loss of rivalry between stores at a local level that would not be exploited at a local level (for example, because there is limited ability to vary pricing between different local areas) but rather would be exploited at a national or regional level. National or regional effects may take the form of an increase in prices or a reduction in the quality of the products or services provided to customers in-store. We have considered regional effects in view of the fact that the overlaps between the joint venture parties are concentrated in certain parts of the UK and Northern Ireland.

9.117 The incentives to raise prices or otherwise worsen the retail offer at a national level are likely to be smaller than incentives at a local level. This is because the incentives will depend on the average effect of the merger on rivalry across local areas including, for example, some areas where there are no overlaps between the joint venture parties. It may, however, be easier for the joint venture to change its retail offer at a regional or national level.

National effects

9.118 In our assessment of national effects, in principle, we need to consider the incentives the joint venture may create for the main parties to raise prices online as well as in-store. Thomas Cook's Internet business is not included in the joint venture, but given Thomas Cook's controlling interest in the joint venture, we would not expect the online business of the joint venture to act as a constraint on Thomas Cook's online business going forward or vice versa so this would create a reduction in rivalry. In practice, however, the Internet businesses of CGL and Midlands are small, with annual sales of less than £[✂] million in total including sales of package holidays and flight- and accommodation-only products. This compares with £[✂] million for Thomas Cook's Internet business.

9.119 We considered whether the joint venture with CGL and Midlands and, in particular, their in-store businesses would create an incentive for Thomas Cook to raise its Internet prices. Key to this is evidence on the closeness of competition between Thomas Cook's Internet service and CGL and Midlands stores. Just 7 per cent of CGL and 5 per of Midlands customers we surveyed said that they would switch to the Internet site of a different travel agent in response to a store closure. This is evidence that pre-merger Thomas Cook's Internet business was not a close substitute for the CGL and Midlands stores.

9.120 In the remainder of this section we focus on the national effects in the sale of package holidays in-store.

9.121 The main parties argued that the effects of the merger should be considered at a national level. They said that it was not appropriate to look at local level effects as the retail offer of their stores (including prices) was set centrally and was predominately determined by national constraints. The range of holidays available to book in a travel agency, store refurbishments and service levels including opening times, staff levels and experience were said to be determined by reference to nationally set criteria and not the degree of local competition.

9.122 The main parties also argued that nationally the Internet was a strong constraint on high street travel agents. The Internet was said to drive competition at the national level, acting as a clear constraint on bricks-and-mortar agents. It therefore appears that the main parties see the Internet as the main constraint on the prices offered in-store and not competition from other high street travel agents. However, in response to questions as to how prices compare online, the main parties also suggested that Internet prices were set, in part, by reference to the prices on offer in-store.

9.123 Thomas Cook said that in order to be price competitive with discounts that were obtainable in-store and with other online distributors, its Internet prices for package holidays were arrived at by taking the brochure and ViewData prices set by the tour operators and applying a discount to these that was usually broadly equivalent to the average discount expected to be given on in-store sales. Thomas Cook said that the selling prices for online and in-store sales were ultimately very similar.

9.124 Thomas Cook said that the average percentage discount for online package holiday bookings, as a percentage of the value of sales, in 2009/10 was [✂] per cent compared with [✂] per cent for in-store sales, and [✂] and [✂] per cent respectively for discounted sales. CGL said that its online price for package holidays would be the tour operator price less a CGL-funded discount, in line with its discounting policies. For overseas package holidays provided by third party operators, the average discount applied to online sales is [✂] per cent and on average, an in-store point-of-sale discount of [✂] per cent is applied in order to close a sale or to price match.

Midlands was not able to provide similar information but provided a similar explanation of the overall approach.

9.125 We are not satisfied that competition from the Internet is by itself a sufficient competitive constraint on the joint venture store network. The results of our survey suggest that the majority of people who booked holidays in Thomas Cook, CGL or Midlands stores had a preference for booking package holidays in-store. We also know that a substantial proportion of people booking package holidays in-store in last 12 months did not do any research before they went into the store to book their holiday, 30 per cent, and that at least 50 per cent[64] had not specifically researched the prices online before doing so. These results are consistent with the answers which indicated how respondents would react to the closure of stores or chains at which they booked their package holiday. Given the nature of the sales process, customers who are not well informed about prices available online may be in a weaker negotiating position. For example, one reason a discount may be given is that the customer can demonstrate that they could get a better price online for the same or equivalent holiday.

9.126 We considered whether the joint venture may be expected to create incentives for the main parties to increase prices, or worsen other aspects of their retail offer, at a national level, taking into account evidence of all constraints operating at both a local and national level.

9.127 In this case, national price effects might take the form of lower discounts where these are determined centrally, for example campaign discounts, or tighter controls on the ability for sales staff to offer discounts negotiated in-store; national non-price effects might take the form of reduced opening hours and a lower level of service, for example by reducing staff numbers.

9.128 In practice, it is unlikely that the joint venture would change its policy on offering price-match discounts as these are highly targeted, and a reduced willingness to give such discounts could be costly. Around [✂] per cent of the value of discounts given by Thomas Cook, over the period June 2010 to March 2011, was to match prices available online and a further [5–10] per cent to match prices available on the high street. It is more likely that any reduction in discounting would take the form of tighter caps on local discretionary discounts (over 30 per cent of discounts by value given by Thomas Cook over the same period were discretionary, largely allocated to 'close the sale') and lower national campaign discounts (around [✂] per cent of discounts by value given by Thomas over the same period were national campaigns and other offers, and [✂] per cent by value were discounts available to loyal customers).

9.129 With regard to the non-price effects of the merger, we note that a national worsening of the service aspects of the retail offer would be a 'blunt instrument' in that it would be likely to affect all customers. We have placed greater emphasis on explicit consideration of the potential for price rises as we considered these to be a more likely source of harm in the case of this transaction. However, the quality of the product and service offered and the price that can be achieved for it are closely linked by the competitive constraints faced by the joint venture. As a result, the conclusions of our analysis of the potential for price increases also apply to the potential for worsening of the non-price aspects of the retail offer.

9.130 The degree to which the joint venture parties might have an incentive, as a result of the merger, to worsen their retail offer nationally will be influenced by the degree to which they overlap pre-merger, the extent of the loss of rivalry in these areas as a

[64] 49 per cent of respondents said that they had used the Internet—see paragraph 9.23*(d)*(ii).

result of the joint venture, and the remaining competitive constraints, both local and national.

9.131 As explained above,[65] we concluded that 472 Thomas Cook stores, 287 CGL and 80 Midlands would be in overlap areas, out of total of about 780, 360 and 100 stores respectively in each party's retail network. Viewed nationally, there is a high degree of overlap, particularly for CGL and Midlands stores.

9.132 As with the assessment of local effects, the focus of our analysis of national effects is therefore the impact of the joint venture in local areas where the main parties overlap, taking into account both local and national constraints that operate in those areas. For both assessments, we considered evidence on how closely the joint venture parties competed with each other in the overlap areas and evidence on remaining pre-merger competitive constraints on the joint venture parties. Remaining constraints may be local, for example the presence of rival stores in the area or the behaviour of customers in an area, or national constraints, such as the Internet.

9.133 The difference between the two assessments is that at a national level we are considering the average effect of the reduction in rivalry across all local areas, including, for example, some areas where there are no overlaps. For this reason, the incentives to raise prices, or otherwise worsen the retail offer, are likely to be weaker at the national level.

9.134 In the assessment of local effects, we considered whether the joint venture would have the incentive and the ability to raise prices (or otherwise worsen the retail offer) in local areas, in particular in areas where we would expect the effect of the joint venture on local competition to be greatest.

9.135 We consider the following elements of the local effects assessment to be relevant to our assessment of national effects:

(a) The survey evidence suggests that other travel agents in a local area would be close competitors to a joint venture store. Asked why they had chosen to book at the store that they did rather than another store in the local area, the main reasons were personal advice and service followed by price and then convenience factors. We do not have a basis for distinguishing between travel agents on any of these factors.[66]

(b) The survey also suggests that there was not loyalty to travel agents, while there was loyalty to tour operators. Asked what they would have done if the tour operator they had booked with were no longer available in the store they booked in, 67 per cent said that they would have booked the same holiday in a different way. For customers who booked Thomas Cook packages in CGL/Midlands stores, 68 per cent said that they would have booked the same holiday elsewhere.

(c) The Thomas Cook data on the allocation of discounts to reasons codes provides direct evidence of discounting in-store to compete with prices available online with about [✂] per cent of the value of all discounts allocated to matching prices available online over the period June 2010 to March 2011.[67]

(d) The Thomas Cook discount data also provides direct evidence of discounting to compete with high street travel agents with [5–10] per cent of the value of dis-

---

[65] Paragraph 9.89.
[66] Paragraphs 9.42 & 9.43.
[67] Paragraph 9.127.

counts allocated to price matching other high street travel agents. Only some of this would be attributable to Midlands and CGL stores. It will also include discounts given to price match TUI stores and travel agents operated by the smaller chains.[68]

(e) The value of discounts allocated to the price-matching codes is likely to understate the constraint from these sources as these discounts are available only for the same or identical holidays. It is likely that some of the discount allocated to 'close of sale' or 'manager's discretion' will be given in response to competition from the Internet or local competition.

(f) Information on the national and store level margins earned on the sale of package holidays which is informative on the degree of pre-merger competition from all sources, national and local. We observed that these margins are low in the context of considering the impact of the joint venture on the incentives to worsen the retail offer.[69]

9.136 Taking into account all these considerations, we concluded that the incentives created by the joint venture to raise prices, or otherwise worsen the retail offer, at a local level as a result of the joint venture would be limited. We therefore consider it unlikely that the joint venture would create incentives to raise prices, or otherwise worsen the retail offer, at a national level where the incentive will be further diluted by averaging across all areas where the joint venture stores have a presence including non-overlap areas.

Regional effects

9.137 Regional effects would require regional variation in prices or non-price aspects of the retail offer related to variation in competition between regions or an expectation that as a result of the joint venture the main parties might change their strategy in order to vary their offer regionally.

9.138 The available evidence suggests that the range and quality of the products or services offered in-store by the main parties does not vary with competition or other local or regional characteristics. In addition to the econometric analysis which investigated local variation in the non-price aspects of the offer retail offer,[70] we looked at documentary evidence on the main parties' policies and approach to staff training, incentives and performance management, refurbishment programmes and decisions to close or open stores. We also asked for information on opening hours. This information was consistent with these being determined nationally. Where we did see some variation, for example in store opening hours, we do not have evidence to suggest that regional competition was a factor.

9.139 Similarly, we do not have reason to think that there is regional price variation. We had good reasons for expecting some local price variation in pricing with all parties operating in-store discount policies that allow sales staff and store managers some discretion on whether to give certain types of discount and by how much to discount. This judgement appears to be exercised at a local level. There is no evidence of pricing or discount policies, or pricing decisions being taken at a regional level or of coordination at a regional level.

---

[68] Paragraph 9.127.
[69] Paragraph 9.107.
[70] Paragraph 9.66.

9.140 We also considered whether as a result of merger the joint venture might have an incentive to adopt a strategy that would allow for regional variation in the retail offer. In our assessment of local effects, we did not form an expectation that the joint venture would introduce local variation that would successfully exploit local competitive conditions. In terms of a strategy that exploited regional competitive conditions, the issues are much the same as those discussed in the assessment of the local effects, although it would be easier to adjust a retail offer at a regional level than it would be to do so at a local level. We have no indication that the main parties have considered this. We concluded, therefore, that the joint venture would be unlikely to create an incentive for such a change in strategy. In particular, given our assessment that the joint venture would create limited incentives to raise prices, or otherwise worsen the retail offer, at a local level in areas where the effect of the merger on competition would be greatest, we considered it unlikely that the joint venture would create incentives to raise prices or otherwise worsen the retail offer at regional level across local overlap and non-overlap areas.

9.141 For these reasons, we do not expect that the joint venture would result in an SLC at a regional level.

Competitive effects due to the main parties' increased buyer power

9.142 Virgin Holidays told us that the joint venture's increased size would result in 'enhanced buying power' which would give the main parties the incentive and ability to 'price other cruise resellers out of the market, thus giving customers less choice of suppliers, and in the long term allow the joint venture effectively to eliminate competition and raise prices without fear of losing market share'. Virgin raised this as a particular concern with respect to cruise holidays, where there is no vertical integration between suppliers and Thomas Cook, CGL/Midlands or TUI and there is a small number of large suppliers, as well as some smaller operators.

9.143 We considered whether the main parties may have increased buyer power generally (across all types of package holidays) under the terms of the joint venture. We note that Thomas Cook and CTTG[71] are already two of the three largest travel agents, so it is not obvious that the joint venture would necessarily improve the terms they are able to negotiate. We also note that almost 70 per cent of Thomas Cook stores' sales of package holidays are of Thomas Cook's own holidays,[72] and its 'buyer power' for Thomas Cook's holidays would not be affected.

9.144 If the joint venture did lead to higher commissions for the main parties—which means, effectively, lower wholesale prices—this would normally be regarded as an efficiency and pro-competitive since, other things being equal, we would expect that it would lead the main parties to charge lower prices (give higher discounts) to consumers. This might affect particular competitors or industry structure, but that would only concern us if it had negative effects on competition.

9.145 Nevertheless, we have considered whether it was likely that a hypothetical increase in buyer power would give the joint venture the ability and incentive to exclude other travel agents by undercutting them, and to subsequently raise prices.

9.146 First, package holidays (and especially cruise holidays) are relatively complex products and travel agents do not compete solely on price. Therefore, even if the joint venture was able to offer better prices than rival retailers, there is no presumption

[71] The buying group through which CGL and Midlands negotiate terms with operators.
[72] See paragraph 10.4.

that those rivals would be eliminated. For example, Internet prices are typically lower than high street prices but high street retailers continue to operate.[73]

9.147 If the concern is that the joint venture would undercut rivals specifically on cruise holidays, most rivals' stores offer a range of holidays and it would be difficult to eliminate them if only cruise holidays were affected. We would expect generalist travel agents to continue to stock cruise holidays. It is more plausible that cruise specialists could be affected, but we have not seen evidence suggesting that the constraint on cruise pricing comes from cruise specialists.

9.148 Secondly, we do not have strong evidence that the joint venture would be able to raise prices even if it was successful in forcing certain rivals out of the market. In order to reach this conclusion, we would have to believe that the main parties' prices are constrained by rivals who would be forced to exit. We have found limited evidence of local variation of prices in response to the presence of particular travel agents, and so we would expect that the joint venture would derive little if any benefit unless it could cause large-scale exit.

9.149 Therefore we consider that even if the main parties derive greater buyer power as a result of the joint venture, it is unlikely that they would have the incentive and ability to exclude rival travel agents. It is more plausible that they would reduce retail prices and/or enjoy higher margins.

10. Vertical theories of harm

10.1 This section considers possible vertical theories of harm in this inquiry. Thomas Cook is a vertically integrated business with a significant upstream business as a tour operator, whereas CGL/Midlands are essentially only active downstream as travel agents.[74] To distinguish clearly between the different levels of Thomas Cook's business, in this section we refer to Thomas Cook's upstream operations as Thomas Cook Holidays (TCH), its downstream bricks-and-mortar operations as Thomas Cook Stores (TCS),[75] and the wider corporate entity as Thomas Cook Group (TCG).

10.2 We assessed several possible vertical theories of harm, which can be classified into two types:

- whether the joint venture's stores will favour Thomas Cook's holidays above other tour operators in a way that will substantially lessen competition among tour operators (customer foreclosure); and

- whether Thomas Cook will disadvantage third party retailers in the sale of Thomas Cook's own packages in a way that will substantially lessen competition at the retail level (input foreclosure).

10.3 For each theory, we explain what conditions must hold in order for there to be an SLC. The conditions can be classed as incentive, ability and effect. We describe what kind of analysis we have carried out to assess whether there is likely to be an SLC.

[73] We also note that Thomas Cook's vertical integration already means that it could undercut rival travel agents on a range of holidays, but we have not seen evidence of rivals being excluded.
[74] CGL/Midlands have small tour operator businesses [✂].
[75] These terms are not used by the main parties. Thomas Cook operates stores under two brands and offers package holidays under several brand names, so it is convenient to be able to group together all the stores under one term and all the tour operations under another.

Customer foreclosure

Introduction

10.4 TCS, CGL and Midlands all currently retail package holidays supplied by third party tour operators (by which we mean all operators other than TCH). Sales of third party products made up [approximately a third] of TCS's sales of overseas package holidays in 2009/10, [approximately three-quarters] of CGL's and [more than two-thirds] of Midlands'.[76] TCS distributes holiday products of around 100 independent tour operators, whereas CGL distributes holiday products of around 200.[77]

10.5 The main parties told us that part of their strategy for the merger was to increase the share of sales of TCH in CGL/Midlands stores; their target is [✂] per cent of sales in those stores. We noted also that the shareholder agreement[78] did not contain any express protections for CGL and Midlands in relation to a strategy that favours sale of TCG packages in the joint venture stores even at the expense of joint venture profits.

10.6 The joint venture's stores might favour TCH in one or more ways:

- stop stocking third party tour operators' holidays altogether (we refer to this as total foreclosure);
- reduce the range of third party tour operators' holidays that it stocks;
- increase retail prices (reduce discounts) when selling third party tour operators' products in the joint venture's stores; or
- divert marketing and sales efforts away from rival tour operators' products towards TCH (we class these latter three strategies as partial foreclosure[79]).

10.7 Any of these actions is likely to have (at least) two effects:

(a) some customers who would have bought a third party package in one of the joint venture's stores will switch to a TCH package; and

(b) some customers who would have bought a third party package in one of the joint venture's stores will buy their holiday from a third party's store instead (or not buy a holiday at all).

---

[76] Based on value of sales of overseas package holidays in stores. Data supplied by the main parties in response to Additional Market Questionnaire, CC analysis.
[77] OFT decision, paragraph 57 and footnote 57.
[78] The shareholder agreement is designed to protect CGL and Midlands to some extent from Thomas Cook pursuing a strategy that maximizes TCG profit at the expense of the joint venture. The shareholder agreement acknowledges that commission rated paid by Thomas Cook's tour operations to the joint venture shall in principle be fixed until [✂], and provides that thereafter there are parameters around how the commission rates can be changed. In particular, it recognizes that any change shall be justified by evidence (including a change in market rates or the non-competitiveness of existing commission rates), require [✂] and be capped at a [✂] per cent increase or decrease a year. Further, it is agreed that the commission rates paid to the joint venture shall not be lower than those rates paid to [✂] (as well as that the prices for holidays offered by Thomas Cook's tour operations to [✂] shall not be lower than those offered to the joint venture). The shareholder agreement also provides that, at any time, in the event that Thomas Cook tour operations acting in good faith believe that (i) the prevailing commission rates paid by Thomas Cook tour operations to the joint venture are harmful to the business of the joint venture or Thomas Cook tour operation businesses, by virtue of the commission rates affecting the price of the relevant holidays meaning the holidays are not competitive in the general market, or (ii) there is a structural change in commissions in the market, the parties agree to discuss, and if appropriate, negotiate revised commission rates. There is no express provision in the shareholder agreement, however, that restricts TCH's ability to adopt a strategy that maximizes sale of TCH packages in the joint venture stores even if that has an adverse effect on the joint venture's profits.
[79] In economics, the term 'partial foreclosure' is normally used to refer specifically to raising rivals' costs. Here we use it to describe any strategy by which TCG might try to increase sales of TCH in TCS, short of entirely ceasing to stock third party holidays.

10.8 So we would expect that, other things being equal, the joint venture's stores would sell more TCH packages, but fewer packages in total. The scale of these effects will depend on the importance of the brand of package holidays to consumers.

10.9 TCG's incentives are based on the combined profits it derives from the wholesale and the retail level. TCG would gain the wholesale margin from extra sales of its TCH packages, and lose the retail margin from customers who no longer buy their holiday from the joint venture's stores.[80] Since TCG has control of the joint venture but takes only a 66.5 per cent share of the joint venture's profit, TCG's incentive to foreclose would be higher under the joint venture than absent the joint venture, because under the joint venture it keeps all of the wholesale gain but only forfeits a partial share of the retail loss.

10.10 We expect that joining the joint venture may change the incentives and behaviour of CGL and Midlands stores, as we explain below. We have also considered whether the incentives and behaviour of Thomas Cook Stores might change once they are held within the joint venture.

10.11 In line with our merger guidelines for non-horizontal mergers, we have assessed the likely effects of the joint venture in terms of incentive, ability and effect. Specifically, in order to find an SLC arising from customer foreclosure we would need to establish three conditions:

- TCG has the incentive to engage in customer foreclosure because the profit gained by TCH from selling more of its packages exceeds TCG's lost profit from customers who switch to a retailer outside the joint venture (incentive);

- the behaviour affects an important route to market for tour operators, and the joint venture has a significant position in the distribution market (ability); and

- the impact of such customer foreclosure on the upstream market would be significant in terms of rivalry (effect).

10.12 We note that TCG may have two different types of incentive for foreclosure:

(a) *Business incentive.* TCG's gains from increased sales of TCH and losses from reduced sales of third party products can be modelled, as we discuss below, in a standard 'vertical arithmetic' analysis.

(b) *Strategic incentive.* If this behaviour weakens upstream competitors, or causes them to exit the market, then TCH may ultimately benefit from lessened competition. This is difficult to quantify, but closely related to considerations of ability and effect.

The main parties' view

10.13 The main parties told us that 'A broad range [of third party products] is crucial to attracting customers into the store in the first place and then establishing customer loyalty'. They told us that they had no plans to reduce the range of products sold in CGL and Midlands stores.

---

[80] There may also be another gain or loss if the retail margin on TCH is different from the retail margin on third party packages. This gain or loss will apply to all extra sales of TCH packages.

10.14 The main parties told us that they had no incentive to foreclose. They provided a report prepared by Oxera, *Customer foreclosure incentives modelling*, which concluded that 'the levels of required retention [for a total foreclosure strategy to be possible] are clearly very high'. The main parties concluded that '[the analysis] performed by Oxera also shows that the merged entity will not have the incentive to [totally] foreclose'.

10.15 The relevance of Oxera's report to our inquiry is limited for a number of reasons: it includes flight-only and accommodation-only products; its approach to upstream margins did not address any strategic incentive to foreclose (see below); and it only assessed total foreclosure. For these reasons, we have not relied upon the Oxera analysis in drawing our conclusions, although it has informed our own analysis.

Incentive for total customer foreclosure

10.16 We addressed TCG's business incentive for foreclosure using vertical arithmetic, as described in Appendix C. The group of consumers we considered is those who would, absent a foreclosure strategy, buy non-TCH packages in the joint venture's stores. Under a total foreclosure strategy, those third party packages would no longer be available in the joint venture's stores. These customers will either *(a)* stay at the joint venture's store and buy a TCH package, or *(b)* leave the joint venture's store (go to a different retailer or not buy a holiday). We calculated what proportion of these customers the joint venture would need to retain—group *(a)*—in order for this strategy to be profitable for TCG, under a range of assumptions, and compared this figure with the proportion we would expect them to be able to retain.

10.17 The two inputs that are most difficult to estimate are the size of wholesale margins and the likely level of customer retention. The incentive to withhold is greater when wholesale margins are high relative to retail margins, and when a high proportion of customers can be retained (ie customers are more loyal to the store than to the tour operator).

10.18 Based on our arithmetic, we did not rule out the possibility that Thomas Cook could have an incentive to cease selling third party products in the joint venture's stores. For reasons discussed below, we did not find it necessary to reach a definitive conclusion on this question.

Incentive for partial customer foreclosure

10.19 Thomas Cook stores already engage in practices similar to partial foreclosure: they stock fewer third party products than CGL/Midlands stores, and have a directional selling policy. Partly because of these factors, TCH accounts for a higher proportion of sales in Thomas Cook stores than in CGL or Midlands stores.

10.20 From the main parties' submissions, we expect a change in behaviour at CGL and Midlands stores: they will also introduce directional selling, and can be expected to sell more TCH packages. However, the merger may not affect incentives for existing Thomas Cook stores.[81] The joint venture can be expected to have this incentive regardless of any effect on third parties (ie even without any strategic incentive).

[81] As discussed above, since TCG will take only 66.5 per cent of retail profits from the joint venture, its incentives with respect to TCS will change: it will bear less of the loss from any customers who stop purchasing holidays from TCS, so its incentive to sell TCH packages will increase. That may or may not translate into any change in behaviour. For example, TCG may find it profitable for the joint venture's stores to discount TCH packages more aggressively than TCS did prior to the joint venture. On the other hand, if the main method of promoting TCH packages is directional selling, there may be limits to what can be done (ie there may not be a smooth relationship between the 'strength' of directional selling and the sales of TCH packages).

10.21 We expect the CGL and Midlands stores to be able to increase TCH's proportion of their sales (although not necessarily to the same level as in TCS). We understand that staff will be directed to sell directionally and in addition, from documents we have seen from Thomas Cook and Midlands, [✂].

10.22 We have not explicitly considered whether any favouring of TCH packages could be carried out on a local or regional basis (ie whether it would be possible to heavily promote TCH packages, or reduce the range of third party holidays offered, only in areas where the joint venture's stores faced little effective competition). We note that at present Thomas Cook stores, at least, have a national stocking and promotion policy, which implies that if favouring TCH packages is profitable, it is largely carried out in ways that are difficult to quantify (eg through directional selling effort by staff). We also found that TCS offer slightly higher and slightly more frequent discounts on TCH packages than on third party packages.[82]

10.23 In order to assess the incentive for this type of strategy, we revised the vertical arithmetic that we used to consider total foreclosure. The key group of consumers to consider is still those who would, absent a foreclosure strategy, buy non-TCH packages in the joint venture's stores. Under partial foreclosure, these customers have three choices (rather than two): buy a TCH package, leave the joint venture's store, or continue to buy a third party package.

10.24 A partial foreclosure strategy would be profitable if the proportion of affected customers who switch to a TCH package is sufficiently high relative to the proportion who leave the store. We estimated how high it would need to be (again taking account of the difficulty in estimating wholesale margins). We found that, depending on the assumptions used, the joint venture's stores would have to be moderately successful in switching customers to buy TCH packages (for example, under one assumption they would have to successfully switch one customer for every two that left the store).

10.25 We do not have any direct evidence on the likely success rate of switching customers under any particular strategy. However, we consider that it is likely that stores could be fairly successful in persuading customers to switch without driving them away from the store. This view is supported by the directional selling policy used by TCS.

10.26 The main parties told us that the joint venture's stores would engage in directional selling and so we conclude that they will engage in, at least, some kind of partial foreclosure strategy. This is consistent with our consideration of their incentives.

Comparison of incentives for total and partial foreclosure

10.27 We also considered whether partial foreclosure is likely to be more or less profitable than total foreclosure. This is discussed in more detail in Appendix C. As we would expect, looking at customers buying non-TCH packages, this depends on how many fewer customers the joint venture's stores lose under partial compared with total foreclosure, and how many fewer customers they 'convert' to TCH under partial compared with total.

10.28 We find that partial foreclosure is more profitable than total:

[82] See the last section of Appendix C.

(a) if partial foreclosure is a good way of getting people to switch to TCH holidays without driving many people away from the joint venture's stores;[83] and

(b) if the wholesale margin is large relative to TCG's share of the retail margin.

Again, we do not have any relevant evidence on customer behaviour to judge this against, but we think it is likely that partial foreclosure would in general be more profitable than total foreclosure, partly because the main parties have a range of 'soft' strategies that are likely to be effective in selling TCH packages without losing too many sales, and partly because TCS currently engages in partial but not total foreclosure strategies.

Strategic incentive

10.29 We have also considered whether there is a strategic incentive for this type of behaviour: foreclosure could lead to exit by TCH's rival tour operators and/or make entry harder, and this might benefit TCH. This would increase TCG's incentive to engage in this strategy. There is a merger-specific issue only if three conditions are met:

- Thomas Cook has a strategic incentive to foreclose other tour operators, ie exit upstream will benefit Thomas Cook;
- pre-merger, Thomas Cook's ability effectively to foreclose upstream rivals is limited and so a foreclosure strategy is not profitable; and
- post-merger, Thomas Cook's increased retail scale gives it a greater ability to foreclose upstream rivals, sufficient to make a foreclosure strategy profitable.

10.30 Given our conclusions below on the joint venture's lack of ability to foreclose TCH's upstream rivals, we did not assess this incentive further.

Ability to foreclose

Upstream operators

- *Likely total effect of foreclosure strategies on upstream sales*

10.31 We considered the likely effects upstream of the joint venture operating a foreclosure strategy. The effects will depend on the volume and value of sales that move from third party packages to TCH packages. As discussed in more detail in Appendix C, we considered three possible benchmarks for sales of TCH packages in CGL and Midlands stores:

(a) [✂] per cent, which is the upper bound used in Thomas Cook's Synergy Model;

(b) 75 per cent, which is slightly higher than TCH's share of sales in TCS;[84] and

(c) 100 per cent, for a total foreclosure strategy.

[83] In other words, if the proportion of customers that would leave the joint venture's stores under total foreclosure but not under partial foreclosure is large relative to the proportion of customers who would switch to a TCH package under total foreclosure but would not do so under partial foreclosure.
[84] TCH packages make up [✂] per cent of sales of package holidays in TCS. We used this slightly higher figure to allow for any change in TCG's incentives due to giving up 33.5 per cent of retail profits, as discussed above.

10.32 We adjusted these figures by netting off sales of the Co-op's own tour operations [✂]. We estimated that an upper limit under a partial foreclosure strategy (if TCH were to account for 75 per cent of sales in CGL/Midlands stores) would be that [✂] per cent of the total market could be affected. The upper limit for a total foreclosure strategy (if TCH were to account for 100 per cent of sales in TCS, CGL and Midlands stores) would be [✂] per cent of the total market.[85]

10.33 On this basis, it seems likely that a partial foreclosure strategy would have a relatively small overall effect on the upstream market. In the following sections, we consider the possibility that a large number of operators could be significantly affected, meaning that the total affected output could be larger than the numbers above.[86]

- *Affected operators*

10.34 We looked at the data available on tour operators used by CGL and Midlands to try to determine if any operators would be significantly affected should they lose sales through CGL/Midlands. Full details can be found in Appendix C.

10.35 One obvious group of potentially affected operators would be those who are currently sold in CGL/Midlands stores but not in Thomas Cook stores. We found that operators sold by CGL/Midlands but not TCS accounted for less than 3 per cent of all package holidays sold.[87] We found that sales through CGL/Midlands accounted for less than 15 per cent of the sales of each of these operators—considerably less in most cases.

10.36 We also tried to find any other operators who make a sizeable proportion of their sales through CGL/Midlands, or alternatively through all of the three parties. We found only 15 operators[88] out of the largest 250 operators who sold more than 10 per cent of their seats through the three parties combined. Of these, four were cruise operators and, as we discuss later in this report, it is not clear that TCG would have an incentive to change the way it supplies cruise operators. Of the remainder, only one sold more than 20 per cent of its passengers through the main parties' stores, and a further two sold more than 15 per cent.

10.37 We examined whether there was evidence of smaller operators who might also be affected. Our data on them was more limited, but we found only 13 who may have had 10 per cent or more of their sales through CGL/Midlands stores, and we estimated that their combined operations carried fewer than 61,000 passengers per year.

- *Effect on operators*

10.38 Harm to affected operators would be mitigated if they could increase sales through other channels (other stores, and online/phone/direct sales). The main parties told us that:

> … almost 70% of all holidays [not just package holidays] were booked over the Internet or by telephone in 2009. Internet sales have increased rapidly … Online travel agents have shown resilient growth even through the recession. Therefore, third-party operators will continue to

[85] We lay out the calculations underlying these figures in Appendix C.
[86] In other words, the total effect could be the entire output of all affected operators (for example, if all affected operators exited the market).
[87] We used data on AITO licences, which has some limitations. These are discussed in Appendix C.
[88] Excluding TCH and Co-operative Travel.

have direct access to customers through the Internet and over the phone, a route to market which is relatively inexpensive. Indeed, the parties estimate that direct routes have been used exclusively by 80% of AITO members.

10.39 There is a large number of small tour operators, which suggests that the minimum efficient scale for tour operators is small and barriers to entry are likely to be relatively low (although a change in stocking policies in the joint venture's stores could erect a barrier). For many of them, independent travel agents are significant trading partners. Therefore we consider that even if a few tour operators were affected by the joint venture's behaviour, it will probably not have much impact on upstream competition.

Conclusion on ability to foreclose

10.40 We concluded that, because few tour operators would be affected relative to the large number operating in the UK, a total foreclosure strategy would be unlikely to have a significant effect at the tour operator level, and a partial foreclosure strategy would be even less likely to do so.[89]

Effect of customer foreclosure

Effects on prices

- *Effect on prices set by tour operators (list prices)*

10.41 As we concluded above, the number of operators who are likely to be significantly affected appears to be relatively small, especially relative to the large number of tour operators active in the UK. Therefore we do not consider that upstream price rises are likely to arise from the joint venture.

- *Effect on downstream prices (discounting)*

10.42 We considered whether downstream prices were likely to be affected by vertical issues (for example, if CGL/Midlands had very different discount policies for TCH products compared with third party packages). We found slight differences, which are described in Appendix C, but these differences were small. The main difference we found was that TCS gave slightly higher and more frequent discounts on TCH packages than on third party packages. If this were replicated in CGL and Midlands stores under the joint venture, we would be concerned if the stores reduced the frequency and size of discounts on third party packages, but not if they increased the frequency and size of discounts on TCH packages. It is difficult to conclude on which is more likely, but we note that TCS in general gave larger and more frequent discounts than CGL or Midlands. Since our hypothesis is that CGL and Midlands stores are likely to

[89] We did not include Freedom Travel buying group stores or managed services stores in our assessment. We understand that TCG would have limited ability to influence the behaviour of Freedom Travel stores, apart from the ability to reduce the range of tour operators available to them to purchase within the existing arrangements. This could contribute to any effect the joint venture might have on particular operators but, based on our analysis of sales in CGL and Midlands stores as a proxy, we do not consider that the addition of these stores would alter our view that the joint venture would be unlikely to have a significant effect on competition at the tour operator level. We also note that Freedom Travel stores would have the ability to move to a different buying group if they felt that TCG was restricting the availability of holidays to them against their own commercial interests. We have not explored, and therefore cannot rule out, the possibility that TCG could have more influence over managed services stores (eg the ability, even indirectly, to encourage some degree of directional selling), but due to the relatively small number of managed services stores we do not think that their inclusion would affect our conclusions. We also note that the inclusion of Freedom Travel and managed services stores would not alter TCG's incentives for customer foreclosure (since incentives are determined by the proportion of customers who can be sold a TCH package, rather than the number of stores).

replicate the behaviour of TCS, and since the differences were in any case relatively small, we did not conclude that there was any evidence that this line of enquiry led to any reason to expect prices (after discounts are applied) to increase as a result of the joint venture.

- *Possible efficiencies*

10.43 In vertical mergers, we often see a pro-competitive effect due to efficiencies arising from removal of double marginalization (ie compared with upstream and downstream firms each trying to earn a profit margin, an integrated firm may set a lower final price). However, in this case, the structure of the joint venture may prevent this efficiency. A true vertically integrated firm can remove double marginalization because it does not care which level of the firm earns profits (ie it could set the 'wholesale price' anywhere between marginal cost and retail price). In this case, it is important for CGL and Midlands that the downstream joint venture earns profits and so both TCH and the downstream joint venture will be looking to earn a margin.[90] So any efficiency of this sort may only be effectively realized if TCG took full ownership of the joint venture.

Cruise holidays

10.44 TCH does not offer its own cruise products so it does not have the same incentives to foreclose as for other types of holidays. Virgin Holidays argued that the joint venture's increased scale at retail level will mean that the joint venture is in a better negotiating position with cruise operators than the individual parties since the major cruise operators 'will have no option but to transact with the joint venture to distribute their cruise holidays'. Virgin argued that the joint venture would strike better deals with the major cruise operators and not stock, or not directionally sell, smaller ones.

10.45 This argument implicitly assumes that the major cruise operators would strike deals with the joint venture that would incentivize it to favour those operators at the expense of others. We see no reason why those operators could not strike similar deals with the main parties in the absence of the joint venture. TCS and CTTG (through which CGL and Midlands negotiate with operators) are almost certainly already two of the three largest sellers for major cruise operators, so cruise operators would already be reluctant not to trade with either one. Therefore if there is a concern, it does not appear to arise from the joint venture.

Example from MyTravel merger

10.46 Thomas Cook suggested that the best analogy to the current situation was Thomas Cook's merger with MyTravel in 2007.

10.47 This is not an ideal analogy to the current inquiry, because MyTravel was a vertically integrated firm with a large tour operator division, whereas CGL and Midlands' upstream (dynamic packaging) operations, Escape and Co-op Holidays respectively, are relatively small tour operators. In 2006/07, 60.7 per cent of MyTravel's in-store sales of overseas package holidays were MyTravel holidays (by value[91]); whereas in

[90] We understand from the main parties' documents that the terms of the joint venture protect CGL and Midlands by fixing the commission rates paid by TCH to joint venture stores.

[91] In this section all sales are expressed in value terms, rather than volume. The inclusion of dynamic packages makes calculating sales in volume terms difficult, since a single dynamic package may have two or more suppliers (flight, hotel, transfers etc), whereas a traditional package holiday would only have one. Hence there is a degree of double counting when adding up sales by volume. We have performed the same analysis on a volume basis and the results are similar.

2009/10, in-house products (including Escape and Co-op Holidays respectively) made up [approximately 15] per cent of CGL's and [approximately 12] per cent of Midlands' in-store sales of overseas package holidays. Nevertheless we have examined the data to see if it can provide any insight.

10.48 We found that among in-store sales of third party package holidays, the share of sales attributable to third party suppliers (ie excluding Thomas Cook and MyTravel packages) fell by a very small amount between 2006/07 and 2009/10. In MyTravel stores we found that there had been a substantial switch from packages sold under MyTravel's brands to packages sold under TCH's brands, but the growth in TCH sales did not come at the expense of third party suppliers.

10.49 We found 15 suppliers of package holidays who were sold through the merged parties in 2006/07 but not 2009/10. Of these, nine are no longer trading, and the remainder sold small quantities of holidays through the merged parties (amounting to around £1.2 million of holiday sales through all Thomas Cook and MyTravel channels in 2006/07). We did not find any evidence that the nine no longer trading had closed as a result of being delisted by Thomas Cook stores; in most cases, Thomas Cook stores seem to have continued selling packages offered by these operators until they ceased trading.

10.50 Although we place limited weight on this evidence with respect to TCG's incentives, it provides no reason to believe that TCG would have either incentive or ability to foreclose other tour operators in the current case.

Conclusion on customer foreclosure

10.51 We conclude that the joint venture will favour TCH products to some extent, but we consider it unlikely that it will cease to sell other operators' products. This behaviour may cause some harm to certain competitors, but we do not expect it to cause the exit of efficient competitors or a material change in the conditions of upstream competition. Hence we do not consider that an SLC may be expected to result from the joint venture on these grounds.

Input foreclosure

10.52 TCH currently supplies its packages to other retailers (including CGL and Midlands). Sales outside Thomas Cook's retail channels made up [35–40] per cent of TCH's sales of overseas package holidays in 2009/10, of which [✄] per cent was in CGL stores and [✄] per cent was in Midlands stores, so around [25–30] per cent of TCH's sales were through parties outside the joint venture.[92]

10.53 TCH could favour the joint venture's stores in one of two ways:

- ceasing to supply TCH packages to third party stores (total input foreclosure); or
- reducing commission rates (ie increasing wholesale price) to third party stores (partial input foreclosure).

10.54 The intuition behind both of these is the same: TCG hopes to encourage customers to use the joint venture's stores. It would lose some sales of TCH packages through

[92] Package holidays by volume. The figures for CGL and Midlands reflect in-store sales only.

third party stores but would hope to gain from extra retail profits in the joint venture's stores.[93]

10.55 In order to identify an SLC based on input foreclosure, we need to consider the following three questions (analogous to those we looked at for customer foreclosure):

(a) Incentive: would it find it profitable to harm rivals, for example through raising prices or refusing to supply them?

(b) Ability: would TCG have the ability to do so?

(c) Effect: would the effect of any action by TCG be sufficient to reduce competition in the affected market to the extent that, in the context of the market in question, it gives rise to an SLC?

10.56 In order to find an SLC, we would have to answer in the affirmative to all three of these questions. We also need to consider whether the joint venture changes TCG's incentives, ie does having a larger retail presence make this a more effective strategy. If not, then this is not a 'merger-specific' issue.[94] The nature of retail competition means that there could in theory be a merger-specific issue. We consider evidence relevant to this argument below.

Total input foreclosure

10.57 Under this theory, TCH would withhold sales of its packages to third party retailers in order to encourage customers to use the joint venture's retail stores. TCG's gain would be its share of the retail commission from the extra sales in the joint venture's stores (ie it would not pay retail commission to third party retailers for the sale of the same packages). TCG's loss is the wholesale margin on packages that it no longer sells.

Partial input foreclosure

10.58 Under this theory, Thomas Cook would continue to supply its packages to third party retailers, but would increase the list price or reduce the commission it pays. In either case, it effectively increases the minimum price at which third parties can sell TCH packages, ie it is effectively increasing the wholesale price. This in turn would make it harder for third parties to compete on price with the joint venture's stores in the sale of TCH packages, and would reduce their incentives to sell TCH packages in favour of third party packages. If TCH packages are particularly important, this could soften retail price competition generally and lead to higher prices.

The main parties' view

10.59 Thomas Cook told us that it was unlikely to have an incentive to foreclose other travel agents. It said that it had an incentive to sell through a wide range of stores; and even with more stores under its control, it would be more profitable for it to maximize distribution and sales, rather than to restrict supply to competing travel agents. It also told us that the transaction would be unlikely to change its existing incentives.

---

[93] The relationship of the joint venture to both Freedom Travel buying group stores and managed services stores was not relevant to our assessment of input foreclosure as TCG would not benefit from retail profits in these stores.
[94] We have used the term 'merger-specific' in accordance with standard terminology, even though we are investigating a joint venture.

10.60 We asked Thomas Cook what would be involved in increasing capacity, and we understand that it would be fairly straightforward to expand capacity for the following season at similar unit costs to existing capacity. Therefore we have not considered capacity constraints when assessing Thomas Cook's incentives.

Incentive for total input foreclosure

10.61 If it were to stop selling TCH packages to third party retailers, TCG would gain its share of the retail commission from the extra sales in the joint venture's stores, and lose the wholesale margin on packages that are no longer purchased. The group of consumers that we need to consider is those who would otherwise buy TCH packages in third party stores.

10.62 We modelled this incentive in Appendix C. This modelling indicated that input foreclosure is more likely to be profitable if the joint venture's stores can recapture a large proportion of these customers, and if retail margins are high relative to wholesale margins. We find that even on the most generous assumption about wholesale margin, TCG would need to recapture at least 40 per cent of consumers who would, absent the strategy, have bought a TCH package in a non-joint-venture store; and if we use conservative assumptions, that target number could be as high as 86 per cent.

10.63 Although we have not explicitly included it in this calculation, it is possible that some additional recapture could come in the form of sales through Thomas Cook's direct channels outside the joint venture (such as Thomas Cook's website). In that case, TCG would benefit from 100 per cent of the retail margin (rather than 66.5 per cent for sales through the joint venture's stores) and so it would not need to recapture such a large proportion of customers.

Likely level of recapture

10.64 Our survey suggests that there is considerable loyalty to tour operators for holidays. We asked customers what they would have done if the tour operator they had booked with were no longer available in the store they booked in.[95] 67 per cent said that they would have booked the same holiday in a different way. For customers booking TCH packages in CGL/Midlands stores, 68 per cent said that they would have booked the same holiday. Since our survey was limited to customers buying in the main parties' stores, we do not know if this level of loyalty would apply to customers booking TCH packages in non-joint-venture stores. It is difficult to conclude from this whether TCG would have an incentive for input foreclosure.

10.65 Thomas Cook told us that it faced highly elastic demand for its products (in the region of [✂] by holiday subproduct), which would suggest that input foreclosure would probably not be profitable. Thomas Cook told us that it calculated elasticities for sets of package holidays, which it referred to as PSUs.[96] It does not calculate cross price elasticities. Typically we would expect that PSUs would have higher elasticities than larger sets (such as all cruise holidays, or all package holidays) because when the price of a PSU rises, customers will switch to other products; but when the price of all products rises, they will have less ability to switch. Therefore high elasticities for individual PSUs imply that if Thomas Cook increased the price of a PSU, it would lose a

[95] This question was not asked to customers buying a Thomas Cook holiday in a Thomas Cook store, partly because we thought it would be confusing, and partly because for these purposes we are not interested in that group of customers.
[96] A PSU is a 'price sensitive unit' and includes 'a set of packages that have a comparable range of sold prices as well as a departure time period'.

lot of sales; but they do not tell us what would happen if Thomas Cook increased the price of all products, and we have not placed significant weight upon these estimates.

Incentive for partial input foreclosure

10.66 We have considered whether TCG might have an incentive for partial input foreclosure—probably by reducing the commission it pays on TCH packages—in order to make it harder for third party travel agents to compete with the joint venture's stores.

10.67 We have not carried out a vertical arithmetic calculation. We note that vertical arithmetic is sometimes used for partial foreclosure when the upstream firm supplies one input into a manufacturer's product, because it is important to understand what effect an increase in the price of an input will have on the price of the output.[97] In this case, the upstream product is one of many downstream products sold by competing retailers.

10.68 We considered whether reducing commission was likely to be an effective strategy for TCG. In order to be effective, it would have to cause consumers to switch to one of the joint venture's stores, and/or reduce price competition so that the joint venture's stores can charge higher prices (give less discounts) on TCH packages.

10.69 We believed that this strategy would be much less effective than total input foreclosure in driving customers to the joint venture's stores.

10.70 Since package holidays are sold based on a list price and a retailer's discretionary discount, it is not obvious to us that a small cut in commission rates would significantly affect the discounts or price that travel agents would be willing to give on TCH packages. A large cut in commission rates probably would make it difficult for travel agents to discount and so would be effective in increasing the post-discount prices paid for TCH packages. It is likely to be profitable only if either it did not result in many lost sales of TCH packages, or it led to higher prices in travel agents generally.

10.71 On the second point, there are many possible sources of competition for the sale of TCH packages in travel agents, including sale of the same packages via the Internet, similar holidays formed by dynamic packaging, and packages from a wide range of other tour operators. Thomas Cook estimated that TCH's share of package holidays across all channels was [less than a quarter].

10.72 We also considered the likely response by travel agents. Based on Thomas Cook's sales and the projections for sales of TCH products in the joint venture's stores, we believe that directional selling can be effective for some customers. If TCH reduced the commission rates it pays, we would expect travel agents to have the incentive and ability to shift sales from TCH products to other operators' products.

Experience of TUI commission reduction

10.73 A few years ago, TUI cut its commissions to third party travel agents quite substantially, although the terms it negotiated with TCS did not change substantially. We have been told by several sources that TUI sales fell substantially and the policy was reversed.

[97] For example, this analysis was relevant in the TomTom/TeleAtlas merger.

10.74 Due to a dispute over commission, TUI (Thomson) reduced the rate of commission it paid to CTTG members for sales of Thomson holidays from [✂] to [✂] per cent from 5 January 2006. TUI increased its commission rates in October 2007, back to levels similar to those paid in 2005. During the period January 2006 to October 2007, CTTG members ceased to actively promote or discount Thomson holidays. We asked TUI its rationale for the changes and the effect of them, and we asked CGL and Midlands what effect this had on their sales of Thomson holidays.

- *Evidence from TUI*

10.75 TUI told us that Thomson reduced the rate of commission it paid with the aim of attracting new customers more successfully, using the money saved to reduce package prices and fund increased marketing efforts.

10.76 TUI told us that 'between September 2005 and the end of October 2006, sales of summer 2006 season Thomson holidays by third party travel agents decreased by approximately [✂] per cent compared to equivalent sales the previous year. A similar trend is evident from the data for the winter 2005/2006 season'. This should be taken in the context of the general decline in bookings through bricks-and-mortar stores.

10.77 TUI told us that other major tour operators (Airtours and Thomas Cook) had not reduced their rates of commission, and therefore their sales through independent travel agents had increased at Thomson's expense: 'Sales by Thomson and First Choice[98] of their holidays through their own respective retail sales channels were not sufficient to make up for this loss of sales through third party travel agents.'

10.78 TUI told us that following the increase in commission levels, 'by October 2008 third party sales [of summer 2008 holidays] had increased by approximately [✂] per cent compared to the previous year'.

- *Evidence from CGL and Midlands*

10.79 At CGL, Thomson's share of sales fell from [more than 10] per cent for 2005 to [less than 5] per cent for 2006. The change happened very quickly—from [more than 10] per cent in November 2005 to [less than 5] per cent in January 2006 (down [approximately 10] per cent year on year). After the change back, sales quickly recovered to [more than 10] per cent of sales over the subsequent 12 months (up [more than 5] per cent year on year the month after the change back).

10.80 At Midlands, Thomson's share of sales fell from [more than 15] per cent in the month before the commission cut to [less than 5] per cent in the month after (down [more than 10] per cent year on year). In the period after the change back, Thomson's share rose to [more than 15] per cent (up [more than 10] per cent year on year).

10.81 On the face of it, these significant changes in sales indicates that travel agents have a significant ability to affect customers' choice of tour operator via their promotional efforts and discounting strategy, and that a change in commission rate can incentivize them to do so. The evidence suggests that a partial foreclosure strategy was not profitable for TUI, and therefore provides no support for a theory that it would be profitable for Thomas Cook.

[98] First Choice also cut its commission rates to third party travel agents. First Choice joined the TUI group in 2008 and hence TUI was also able to answer on behalf of First Choice.

Merger-specific incentives for input foreclosure

10.82 Thomas Cook does not currently restrict the sales of its holidays in other travel agents; nor (to the best of our knowledge) does it engage in partial foreclosure. For example, [✂].

10.83 Therefore, in order for us to find that TCG would have an incentive to engage in some kind of input foreclosure under the joint venture, we would have to explain why the joint venture creates that incentive, ie why having a larger retail presence makes it a more effective strategy.

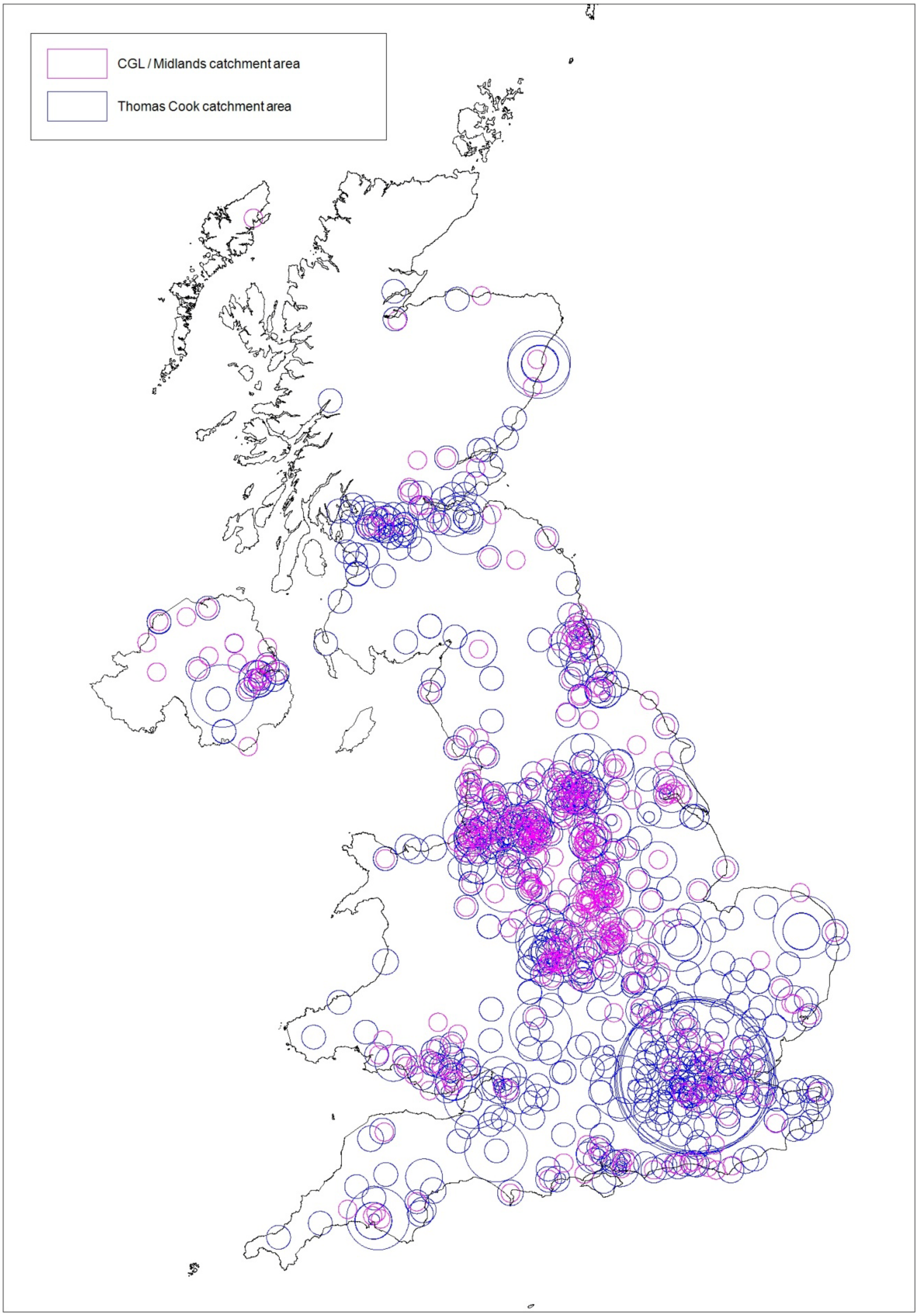
10.84 This is possible in theory. For example, suppose that Thomas Cook considered a strategy where it would cease supplying any other retailers with TCH products, hoping that this would drive more customers to retail stores under TCG's ownership; and suppose we found that TCG would need 75 per cent of these lost wholesale sales to buy from TCG's retail stores for this strategy to be profitable. But before the joint venture, only (say) 60 per cent of these customers may have a Thomas Cook store within convenient range, whereas under the joint venture 90 per cent of these customers can visit one of the joint venture's stores. So the merger could make this strategy feasible.[99]

10.85 In order to investigate this possibility, we calculated what proportion of the population would be within the catchment area of one of the joint venture's stores, compared with the proportion that was within the catchment area of a Thomas Cook store. We found that 93 per cent of the UK population is within the catchment area of a Thomas Cook store pre-merger, and 94 per cent is within the catchment areas of one of the joint venture's stores post-merger, giving an increment of 1 per cent.[100] This is illustrated in Figure 1 below, using the same catchment areas as we defined in our local area horizontal analysis.[101] It is clear that it is very rare for the catchment area of a CGL/Midlands store to lie outside the catchment area of a Thomas Cook store.

[99] The presence of chains and large buying groups makes it difficult for Thomas Cook selectively to withhold its holidays from other retailers, ie Thomas Cook might wish to do so only in areas where there was a Thomas Cook store, but this is unlikely to be feasible.
[100] Population data comes from the 2001 Census. Although this data is quite old, since we are looking at the proportion of population, we believe that it should provide a good guide.
[101] See Appendix B.

FIGURE 1

Catchment areas for Thomas Cook and CGL/Midlands stores



Source: Store location data from the main parties, CC analysis.

10.86 We also note that the joint venture may reduce TCG’s incentive to engage in this type of strategy, because the incentive depends on the retail margin being sufficiently large relative to the wholesale margin. Under the joint venture, TCG’s gain from retail sales is lower than in the counterfactual, because TCG only benefits from 66.5 per cent of the joint venture’s profit.

Conclusion on incentive to foreclose

10.87 We did not find clear evidence that Thomas Cook would have an incentive to foreclose other travel agents. Furthermore, we consider it highly unlikely that the joint venture could create an incentive that would not otherwise exist.

Ability to foreclose

10.88 There are many travel agents in the UK and we do not know what proportion of sales TCH represents for individual agents or chains. We have been told by several parties that both a wide range of travel products, and travel products from large brands such as Thomas Cook, are important to travel agents, and that without access to TCH products it would be more difficult to attract customers to their stores. This suggests that a total input foreclosure strategy could be damaging to travel agents out of proportion to actual sales of TCH packages.

10.89 In light of the evidence available on incentives and the likelihood of the existence of a merger-specific foreclosure strategy, we have not investigated this further.

Conclusion on input foreclosure

10.90 We conclude that the joint venture will not create or enhance an incentive for TCG to restrict the sale, or worsen the terms of sale, of its package holidays through third party travel agents. Hence we do not consider that an SLC may be expected to result from the joint venture on these grounds.

11. Non-package-holiday businesses

11.1 We also assessed the likelihood of an SLC in relation to the business activities of the merging parties that fell outside the distribution of package holidays through travel agent retail outlets.

11.2 We identified the following areas of overlap in the non-package holiday business activities of the main parties:

(a) flight-only sales through retail travel agent outlets;

(b) accommodation-only sales through retail travel agent outlets;

(c) foreign exchange (retail and corporate);

(d) domestic travel;

(e) tour operations;

(f) holidays sold over the phone;

(g) holidays sold via online travel agents;

(h) business travel; and

(i) ancillary services (eg travel insurance).

11.3 We set out our conclusions below. The main parties' submissions and other information we considered in coming to our conclusions is set out in Appendix D.

11.4 We only assessed the prospect of an SLC in these areas at a national level. We did not consider that an SLC was likely on a regional or local level because we considered that, where any of the services in paragraph 11.2 are sold through retail stores, any SLC in those business areas would likely be captured in our analysis of package holiday distribution through retail stores in Section 9. For the distribution of holidays over the phone and over the Internet, we considered that these businesses operated nationally and we considered that a regional or local assessment was therefore not necessary. We did not consider it necessary to assess local and regional effects on tour operating activities due to the low incremental share of supply contributed by CGL and Midlands.

11.5 The main parties' share of supply for the distribution of flight-only bookings through retail travel agent outlets was approximately [✂] per cent[102] in the winter 2009/ summer 2010 season and has been rising over the last few years. However, the share of supply was significantly different in short-haul and long-haul when looking at LTM data[103] and we therefore assessed the likelihood of an SLC separately for each.

11.6 We considered that the incremental share of supply contributed by CGL and MDL for short-haul flight-only sales through retail travel agent outlets as well as the overall share of supply of the main parties for short-haul flight-only sales through retail travel agent outlets was at a level that indicated a low likelihood of an SLC, in particular given the constraints imposed on such sales by the Internet (see paragraph 11.7*(b)* and *(c)* . The main parties' share of supply for the distribution of short-haul flight-only sales through retail travel agent outlets was around [27–32] per cent with an increment of between [1 and 7] per cent.[104]

11.7 In respect of long-haul flight-only sales through retail travel agent outlets, we noted that the merging parties may have a share of supply of up to [✂] per cent. TCG estimated that the main parties' share of supply for long-haul flight-only bookings based on IPS data was [✂] per cent. We have not been able to confirm independently the appropriate share of supply in long-haul flight-only bookings through retail travel agent outlets for the main parties. However, we consider that an SLC is unlikely for flight-only bookings. We set out the reasons below:

(a) We note that the incremental share of supply contributed by Midlands and CGL is relatively small at around [less than 5] per cent for long-haul flight-only bookings and has been declining over the last two years.

(b) In our survey of people who made overseas package holiday bookings (in the last 12 months) in travel agents, a majority (around 60 per cent) said that they preferred to make flight-only bookings online. The survey showed that only a minor-

---

[102] The range is due to the estimates being based on both the LTM data set and the IPS data set for bookings through retail travel agents only.

[103] There was also a difference when looking at IPS data, but the difference was only around [✂] percentage points in winter 2009/summer 2010. We note that due to limitations of its coverage, LTM data is likely to understate significantly the size of each sector and therefore overstates the market shares of certain suppliers, including Thomas Cook. Hence the LTM shares quoted in this report are likely to overestimate the main parties' true shares of supply.

[104] The range is due to the estimates being based on both the LTM data set and the IPS data set for bookings through retail travel agents only.

ity of respondents (around 25 per cent) preferred to book flight-only products through retail travel agents. This shows that the Internet is likely to form a strong constraint on flight-only bookings.

(c) The proportion of flight-only bookings that are made in retail travel agent outlets is in a range of around [6–25] per cent[105] for all flight-only bookings. This proportion is around 40 to 50 per cent lower than for package holiday products.[106]

(d) We also note that we have not received any third party representations in relation to flight-only bookings.

11.8 We considered that the incremental share of supply contributed by CGL and MDL for accommodation-only sales through retail travel agent outlets as well as the overall share of supply of the main parties for accommodation-only sales through retail travel agent outlets was at a level that indicated a low likelihood of an SLC. The main parties estimated that their combined share of supply in accommodation-only bookings in retail travel agent outlets was in a range of [14–25] per cent with an increment (from CGL and Midlands) of between [1 and 5] per cent.

11.9 We considered that the share of supply of the main parties for retail foreign exchange was at a level that indicated a low likelihood of an SLC. The main parties estimated that their combined share of supply of retail foreign exchange was around [less than 20] per cent.

11.10 We considered that the incremental share of supply provided by CGL and Midlands in the supply of foreign exchange to corporate travel customers was at a level that indicated a low likelihood of an SLC. CGL and Midlands' foreign exchange sales to corporate travel customers were less than £[✄] million. We note that both CGL and Midlands stated that their share of supply in corporate foreign exchange was [less than 3] per cent.

11.11 We considered that the share of supply of the main parties for the distribution of domestic holidays was at a level that indicated a low likelihood of an SLC. The main parties estimated that their combined share of supply in the distribution of domestic holidays through all sales channels was [less than 5] per cent.

11.12 We considered that the incremental share of supply provided by CGL and Midlands in tour operations was at a level that indicated a low likelihood of an SLC. Sales from CGL and Midlands' tour operations were less than £[✄] million (and this represented [less than 5] per cent of the sales of TCG's tour operations). We noted that CTTG accounted for less than 1 per cent of the ATOL licences issued to the 250 largest ATOL licence holders.

11.13 We considered that the main parties' distribution of holidays over the phone was unlikely to lead to an SLC because these operations were likely to be constrained by direct sales of holidays over the phone from tour operators and from sales over the phone by other retail travel agents.

11.14 We considered that the incremental share of supply provided by CGL and Midlands in online travel agent services was at a level that indicated a low likelihood of an SLC. Online travel agent sales by CGL and Midlands were less than £[✄] million,

[105] See the various estimates in Appendix D, paragraphs 34–38.
[106] Appendix D, Table 8, further indicates that there is not a significant difference between the proportion of all long-haul and all short-haul flight that are booked via retail travel agent outlets. See also Appendix D, paragraph 34.

which was around [3–8] per cent of TCG's online travel agent sales.[107] We noted in this context that TCG estimated the total online travel agent sales in the UK to be €4.8 billion in 2008, which would imply a share of supply of CGL and MDL of [less than 3] per cent.

11.15 We considered that the share of supply of the main parties for the provision of business travel agent services was at a level that indicated a low likelihood of an SLC. Thomas Cook does not provide business travel agent services and the main parties estimated that the combined share of supply of CGL and Midlands' business travel agent services was [less than 7] per cent.

11.16 In respect of ancillary services, we considered that the share of supply of the main parties for the provision of travel insurance (which is one of the largest elements of ancillary services sales) was at a level that indicated a low likelihood of an SLC. The main parties provided evidence that showed that [less than 20] per cent of travel insurance sales are sold through retail travel agents, which means that the main parties' share of supply is even smaller. We considered that the incremental share of supply provided by CGL and Midlands in other ancillary services was at a level that indicated a low likelihood of an SLC, in particular when taking into account that these sales are for a variety of distinct products and that the overall sales of ancillary services of Midlands and CGL (other than travel insurance) were less than £[✂] million in 2010.

11.17 Therefore, we do not consider that the joint venture may be expected to result in an SLC in any market or markets containing each of the above business activities, even on the narrowest reasonably defensible market definition.

11.18 In relation to foreign exchange and travel insurance, it was necessary to consider in our assessment the activities of businesses retained by CGL in these areas (see paragraph 4.14). The level of these activities was sufficiently small that it did not affect our conclusion that no SLC arises as a result of the joint venture.

12. Submissions received in response to our provisional findings report

12.1 We received a response from the main parties and two responses from third parties in response to our provisional findings. We have considered these responses and where we considered it to be appropriate we addressed points made in the previous sections.

12.2 In this section we summarize the submissions received and comment upon them.

The main parties' response

12.3 The main parties told us that they agreed with our provisional conclusion that the transaction will not give rise to an SLC in any market, but that they considered that several important pieces of evidence supporting that conclusion had been ignored or not been given sufficient weight in our provisional findings. In particular, in relation to horizontal theories of harm:

(a) We should have acknowledged the evidence indicating that the relevant markets were likely to be wider than our candidate market.

[107] Thomas Cook's online business is not contributed to the joint venture.

(b) We should have acknowledged clearly the weight of documentary evidence demonstrating that the main parties did not flex price or non-price variables in response to local concentration pre-merger.

(c) We should have relied on both Oxera's and our own opening/closure analyses; these, the main parties argued, provided strong support both for the proposition that there were no local effects pre-merger and that no local effects could be expected post-merger.

(d) We had wrongly omitted a variety of evidence which demonstrated the importance of the Internet constraint (pre- and post-merger) and instead had downplayed the role of the Internet solely on the basis of a few isolated results from the Accent survey.

(e) We should have drawn explicitly on evidence that any post-merger local effects would likely be defeated by new entry.

12.4 The main parties provided a detailed elucidation of the above points. Our comments on these general points are set out below. The main parties raised a number of additional points of detail, which we did not find persuasive and have not specifically reflected in our summary below or in our discussion of the evidence and analysis in Section 9. A non-confidential version of their submission is provided on our website.

Our comments

12.5 We considered the main parties' response. On a number of issues the main parties' submission was that in their view we should have placed greater weight on certain evidence. This report sets out the reasons for our decision and reflects the weight we have placed on the analyses and other evidence. We therefore do not accept the main parties' submissions on these points and have not made any amendments to our assessment in response to these comments. In a number of instances, the main parties' comments highlighted additional information it was useful to include or points it was helpful to expand upon or clarify in our discussion of the evidence and our assessment of it. Those points are reflected at the relevant points in the preceding sections. The paragraphs below address the general points raised by the main parties referred to above.

12.6 In relation to the main parties' comments on market definition, we have set out the evidence we have gathered in reaching our decision on the various constraints and, as noted in paragraph 7.12, we did not reach a firm view on which specific subset of constraints, together, with the main parties, would form a market satisfying the hypothetical monopolist test.

12.7 We have expanded our discussion on documentary evidence to reflect the evidence we reviewed in relation to flexing of non-price variables. Our provisional findings included a discussion of documentary evidence on flexing on price aspects and reflected its role in our assessment. As such, we have not made any changes in response to the main parties' comments on that point.

12.8 In paragraph 9.19 we discuss how the body of analysis prepared by Oxera informed our assessment in this case. In relation to its open and closure analysis, our initial review of the analysis showed that in order to have relied on the evidence, we would have needed to examine more closely the combined effects of the relatively small sample sizes in some cases, the limited number of events in areas of interest (ie where there were not many rival travel agents to those owned by the joint venture parties) and the lack of third party events in the Oxera analysis. Given that we pursued our own analysis, we did not rely on the Oxera analysis so it was not necessary to explore these important limitations.

12.9 The main parties made a number of comments about our use of evidence related to the Internet. As set out above, we considered in our assessment the constraint imposed by the Internet and our discussion in Section 9 reflects the evidence on the role of the Internet and our findings in regard to the nature of this constraint. The main parties made a number of specific points in relation to interpretation of our survey data. Where we consider the points raised are of value in evaluating the survey results, these are included in our discussion in Section 9. Some of the additional evidence they cited, whilst providing general context, does not describe the preferences or behaviour of customers who purchase holidays in stores which was one of the key elements of our analysis and therefore we have not reflected this in our assessment.

12.10 With regard to the potential for entry, we have considered the specific comments of the main parties in relation to this issue and are not persuaded, based on the points they raised, that entry should be given any additional weight in our reasoning.

Third parties' responses

12.11 In response to our provisional findings, we received two responses from third parties.

Response 1

12.12 We received a submission from [✂], a tour operator that deals exclusively with package holidays to a particular destination ([✂]).[108]

12.13 This operator told us that CGL and Midlands currently dealt with a large number and wide range of suppliers. It also told us that neither Thomas Cook nor TUI dealt with such a large number of suppliers. The joint venture could result in suppliers such as the respondent losing the ability to make sales through CGL and Midlands.

12.14 The respondent told us that it, along with many other tour operators and suppliers, did not have the marketing funds and budgets to be able to replace this business directly and that there were not enough other independent agents in the major towns where CGL and Midlands had branches to allow sales to be redistributed through independent agents. As a result, the high street customer would have a limited choice of product and company to choose from and the respondent would no longer be able to compete on the high street.

12.15 The respondent asked that some form of condition be put in place such that all current CGL and Midlands branches/businesses must be able to continue to deal with and support their existing suppliers. Without such a condition, Thomas Cook would simply stop the joint venture dealing with companies that were in competition with Thomas Cook's own tour operations, which would have the effect of strangling competition by destroying independent tour operators' major source of high street distribution.

---

[108] [✂]

Our comments

12.16 We addressed these points in Section 10 of our report, where we concluded that it was possible that the joint venture's stores would sell a smaller range of tour operators and that some operators could be adversely affected, but that alternative routes to market exist, and overall we would not expect a material change in the conditions of upstream competition.

Response 2

12.17 In response to our provisional findings, we received a submission from [✂], a specialist tour operator that deals exclusively with package holidays to a particular destination ([✂]).

12.18 This tour operator told us that entrance to the market was extremely difficult and the success/viability of an operation was heavily reliant on support from travel agents in the independent sector as it took approximately five to seven years to establish a brand. Therefore new operators relied on independent agents' recommendations and support to survive.

12.19 This tour operator told us that CGL was the largest independent group, and that losing its support would certainly hinder new entrants competing against the big two (Thomas Cook/TUI Travel) and make the viability of launching new operations extremely limited, thus resulting in limited choice.

12.20 This tour operator indicated that it was realistic to anticipate a directional shift in the choice of holidays being offered via the joint venture and that the joint venture would be likely to remove from sale other operators' offerings that it perceived as duplicating its own offering or that competed directly with its in-house sales. This would have a significant negative effect on new entrants to the market and on existing small/medium-sized tour operators and would ultimately limit customer choice.

12.21 This tour operator told us that one of the key strengths of a high street agent compared with online travel agents was to make forward sales, which from a tour operator's perspective were the most important and profitable sales made. During the 'lates' period (8 to 12 weeks prior to departure) the market was a more commoditized price-led arena, rather than product-led, allowing online to become a larger share of sales as late bookings were more price-motivated.

12.22 This tour operator told us that our provisional findings did not take into consideration destination geography. Key geographical areas were strategically important to tour operators and formed an integral part of any strategic plan. One such key area was [✂]. When looking at this area in a little more detail and understanding the potential impact of the joint venture if a foreclosure strategy were adopted, there was the potential for a duopoly of the two largest tour operators, Thomas Cook and Thomson, arising over a relatively short period of time. This would result in a lack of competition in the sale of UK package holidays to [✂], leading to less choice and the potential for higher prices to the consumer.

12.23 This tour operator observed that a large percentage of dynamic packaged holidays to [✂] could be controlled by Thomas Cook and Thomson as flying stock, particularly from Birmingham and airports further north, was, in the main, available only via charter aircraft (ie no low-cost airlines or scheduled services operated).

Our comments

12.24 Other than the two operators that responded to our provisional findings, we have not received submissions indicating that any particular destination would be affected in this way.

12.25 In order to find an SLC, we would have had to find that: *(a)* there are destinations which only a limited number of tour operators serve; *(b)* a number of those tour operators are in the category of particular tour operators adversely affected by the joint venture; *(c)* this would be sufficient to cause a material reduction in rivalry in the provision of packages at tour operator level to that specific destination; and *(d)* the likely response of customers and potential suppliers would not be sufficient to overcome any consequent price increase. We have not carried out a detailed analysis in relation to specific destinations (although we note that we have not received evidence that would found an expectation that *(a)* to *(c)* are likely to hold in relation to any specific destination). We discuss and consider *(d)* below.

12.26 We considered that, for most destinations, consumers would be willing and able to find good substitutes, either within the same country or between different countries. For example, Thomas Cook told us that Turkey had become a very popular destination recently as a result of the Eurozone becoming more expensive and customers choosing to travel to Turkey instead of, for example, Spain.[109] This seems particularly likely in the case of beach holidays and ski holidays, which together make up a high proportion of package holidays.

12.27 We also took account of the fact that, for most destinations, dynamic packages could be offered as good substitutes for traditional packages. Although we note this respondent's concerns about access to charter aircraft, Thomas Cook told us that its charter airline sold flight seats to dynamic packaging tour operators and its bedbank (Hotels4U) generally made the same hotels/resorts available to dynamic packaging tour operators. CGL explained that charter airlines such as Thomson and Monarch sold flight seats to dynamic packaging tour operators and the same hotels/resorts as those used by charter-based tour operators were also generally available to dynamic packaging tour operators. We note that if supply was sufficiently restricted that prices of holidays to a particular destination increased, that may present an opportunity for other airlines to enter relevant routes and offer seats to dynamic packaging operators.

12.28 If there are specific destinations without good substitutes, we would not be concerned by the exit of existing tour operators if we anticipated that any price rises would lead to entry of other effective competitors. We acknowledge the comment that de novo entry may be difficult due to various possible barriers to entry (such as the need for ATOL bonding and potential difficulties in arranging distribution through third party travel agents and websites). However, we note that there are a very large number of tour operators active in the UK (there are well over 2,000 ATOL licensed operators according to the CAA), many of which are small, which provides an indication that economies of scale are unlikely to form a significant barrier to entry. We consider that expansion by existing tour operators to new destinations would not be difficult in a relatively short time frame, since they would already have appropriate licensing, back-office systems and distribution in place. We also note the growth of dynamic packaging operations, as well as travel companies which have expanded to engage in dynamically packaged tour operations (for example, Jet2 Holidays and

[109] This is consistent with evidence from Mintel reports which suggested substitutability of similar destination types on the basis of, among other things, perceived value for money of the destination, with the number of visitors to countries within the Eurozone diminishing whilst the number of visitors to countries such as Turkey and Egypt increased.

easyJet Holidays) and which would have the incentive to offer holidays to these destinations subject to the availability of flights and hotels.

12.29 Taking into account the above, we did not consider it likely that the joint venture would give rise to an SLC in relation to provision of packages at the tour operator level to specific destinations.

13. Conclusions on the SLC test

13.1 We concluded that the travel business joint venture between Thomas Cook, CGL and Midlands, if carried into effect, will result in the creation of a relevant merger situation. (See paragraphs 4.6 and 4.13.)

13.2 We concluded that we do not expect that the travel business joint venture between Thomas Cook, CGL and Midlands will result in an SLC within any market or markets in the UK for goods or services, including the distribution of holidays, including package and independent holidays, via bricks-and-mortar travel agencies in the UK and the distribution of package holidays only via all distribution channels or via bricks-and-mortar travel agencies separately in the UK.