

Anticipated acquisition by Home Delivery Network Limited of DHL Express (UK) Limited's UK domestic 'business to business' and 'business to consumer' packet and parcel delivery service

ME/4389/10

The OFT's decision on reference under section 33(1) given on 15 February 2010. Full text of decision published 25 February 2010.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. **Parcelpoint Limited** is a wholly-owned subsidiary of **Home Delivery Network Limited** (HDN). HDN's business is a home delivery and collection service, formed in 2005 following the merger of Littlewoods and the home shopping business of GUS plc. HDN's parent company is March UK Limited. HDN operates exclusively business-to-consumer (B2C) delivery services. It is not active in business-to-business (B2B) delivery services.
2. HDN's holding company also owns the Shop Direct group of home shopping businesses¹ for which HDN conducts B2C delivery operations. HDN is operated independently of Shop Direct given its third party parcel business which now exceeds 50 per cent of its B2C parcel volumes.
3. In the year to April 2009, HDN's UK turnover was £333 million.
4. **DHL Express (UK) Limited (DHL Express)** is a wholly-owned subsidiary of Deutsche Post AG. The transaction concerns the UK domestic B2B and UK domestic B2C packet and parcel delivery business of DHL Express (together **DHL UK**), with the exception of DHL Express's 'same-day' B2B, pallets and international parcel delivery businesses, which are conducted through separate networks and are not part of the transaction.

5. DHL UK is active in both B2C and B2B delivery services. Historically, DHL UK was a pure B2B operation. More recently, DHL UK has entered the market for B2C delivery services.
6. The UK turnover associated with DHL UK in 2008 was £ [250-300] million.

TRANSACTION

7. The business and assets being acquired (DHL UK) will be transferred to HDN's wholly-owned subsidiary, Parcelpoint Limited. []
8. The parties submitted a Merger Notice on 5 January 2010. The extended (30-working day) statutory deadline for an OFT decision is 15 February 2010. Completion of the transaction is conditional on OFT clearance.

JURISDICTION

9. As a result of this transaction, HDN and DHL UK will cease to be distinct. The UK turnover of DHL UK exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied.
10. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

BACKGROUND

11. The OFT notes that the Postal Services Commission (Postcomm)² is currently conducting a market review across the whole postal sector, which includes work on identifying the relevant economic markets for parcel-delivery services.³ However, Postcomm's review has reached no definitive conclusion on market definition at this stage.

¹ Which includes brand names such as Littlewoods, Very, Additions, and Woolworths.

² Postcomm has a role in the sector given universal service obligations placed on Royal mail in its licence conditions. Royal Mail has an obligation to provide priority and non-priority mail services for letters and packets up to 2kg and to provide a non-priority service for parcel weighting up to 20kg. Each service must be provided at an affordable and geographically uniform tariff.

³ See Postcomm discussion paper issued in July 2009 – '*the competitive environment for packets*'.

12. Parcel delivery services involve the carriage of parcels from a pick-up address to an end address. Between these points, parcels may be grouped together before being transported through a delivery network to sorting centres and then on to local depots and delivery vans. The vast majority of parcels originate from businesses and are delivered to two broad types of recipient – businesses (B2B) and consumers (B2C).
13. According to the parties' submission, the nature of B2C delivery services has changed significantly since it was last subject to scrutiny by the Competition Commission (CC) in the March/GUS case.⁴ In particular, the parties' view is that the distinction between B2B and B2C delivery services is increasingly outdated: they submit that the volume of B2B activity has been significantly eroded and that B2B carriers have responded to the resulting overcapacity by aggressively seeking volume in the B2C market.
14. In this context, the merging parties submit that when legacy B2B carriers have become active in B2C, they have tended to provide premium services, consistent with the value-added types of services they have historically provided to B2B customers. In conjunction with this, B2C customers (particularly those in e-commerce) are increasingly demanding a higher level of service. As a result, according to the parties, B2B legacy carriers have been able to capture significant B2C volumes. Third party comments provided in response to the OFT's investigation corroborate this.

RATIONALE

15. The parties submit that the merger will create a viable and sustainable delivery business capable of withstanding intensifying competition from a wide range of traditional B2C and legacy B2B carriers, and capable of competing more effectively with Royal Mail in lower-weight packets.
16. In addition, they submit that combining the HDN and DHL UK businesses will enable the merged entity to present a 'best in class' service proposition to its customers across all parcel weights and levels of service, from standard to higher value-added services.

⁴ CC report in *March UK Limited and the home shopping delivery business of GUS plc*, January 2004.

COUNTERFACTUAL

17. Although the parties do not rely on a failing firm argument, they submit that DHL UK is a loss-making business and is unlikely to be as effective a competitor going forward. Furthermore, they submit that DHL's poor trading performance would have future implications for its effectiveness as a B2C competitor going forward, in the counterfactual scenario.
18. The OFT has not needed to form a final view on the above argument, given the absence of concern arising as a result of the transaction.

MARKET DEFINITION

19. The parties overlap in the provision of domestic packet and parcel delivery services to consumers (B2C) in the UK.

Product scope

20. As pointed out by the parties, there are a number of bases on which delivery services could be segmented.

B2B vs. B2C

21. A possible segmentation relies on the identity of the recipient – B2B or B2C customers.
22. Past UK and European cases have drawn a distinction between B2B and B2C delivery services.⁵ In the March/GUS report, differences in terms of service offerings and customers' requirements contributed to a conclusion that B2B and B2C delivery services should be regarded as two distinct product markets. In a recent decision, the European Commission took the view that standard packet and parcel delivery services to consumers and businesses constitute distinct product markets.⁶
23. As pointed out above, the parties submit, and some third party responses corroborate, that the distinction between B2B and B2C delivery services is increasingly outdated. On the demand side, consumers now demand the same level of value-added service as that which was historically only

⁵ CC report in *March UK Limited and the home shopping delivery business of GUS plc*, January 2004, para.5.53 and COMP/M.5152 *Posten AB / Post Danmark A/S*, para.58-63.

⁶ COMP/M.5152 *Posten AB / Post Danmark A/S*, para.58-63.

provided to businesses. On the supply side, the tendency has been for B2B legacy carriers to diversify their activity towards the B2C market. In parallel, significant growth in B2C activity has been generated by online/internet purchasing.⁷

24. The OFT considers that B2B and B2C delivery services may be converging towards a single product market for delivery services. However, even on the basis of a cautious approach confined only to B2C delivery services, the OFT is satisfied that no substantial lessening of competition will arise as a result of the transaction. On that basis, the OFT does not need to conclude whether B2B and B2C packet and parcel delivery services constitute separate markets.

Domestic vs. international

25. Previous decisions⁸ have considered a distinction on the basis of the sender's or recipient's location, mainly on the basis that domestic packet and parcel delivery services are provided by companies operating national distribution networks, whereas international packet and parcel delivery consist of collecting parcels to be transported and delivered abroad. These previous decisions have noted limited demand- and supply-side substitution between domestic and international packet and parcel delivery services.
26. On the basis of a conservative candidate market confined to the provision of domestic packet and parcel delivery services, the OFT is satisfied that no substantial lessening of competition will arise as a result of the merger. On that basis, the OFT does not need to conclude whether domestic and international packet and parcel delivery services constitute separate markets.

Weight bands

27. The parties note that the CC's report in March/GUS⁹ identified the relevant market as being the provision of UK-wide B2C delivery services of parcels weighing between 350g and 32kg. The parties note, however, that some B2C operators now provide services across the full weight range, including

⁷ The parties estimate the B2C delivery sector to be worth around £ [1-2] billion annually and the volume of deliveries to have increased by around 19 per cent between 2004 and 2008.

⁸ BET UK Limited/Target Express Holding UK Limited (ME/2826/07), FedEx Corporation/ANC Holdings Limited (ME/2938/07).

⁹ CC report in *March UK Limited and the home shopping delivery business of GUS plc*, January 2004, para.5.66 to 5.68.

for parcels weighing less than 350g. They further note that delivery services below 2kg are subject to Royal Mail's universal service obligations.

28. In the absence of any substantial lessening of competition arising on any particular weight band as a result of the merger, the OFT does not need to form a final view on whether a particular weight band constitutes a relevant market.

Service levels – Premium vs. non-premium

29. A distinction could also be made on the basis of service levels, between premium and non-premium services. As indicated in Postcomm's discussion paper,¹⁰ a premium service corresponds to express and time-guaranteed deliveries and is typically used for goods of high value or importance. Non-premium or 'economy' service is not express or time-guaranteed and is typically used for lower value items. The OFT has also previously considered the distinction between standard and express delivery services¹¹ on the basis of speed, reliability, traceability of the status of the parcel, proof of delivery and insurance. Finally, this distinction is also consistent with previous European Commission decisions¹² in the sector.
30. The parties' view is that the distinction between premium and non-premium services is no longer appropriate.
31. On the demand side, the parties submit that there are differing requirements for each customer depending on their needs and (crucially) the expectations of their customers. They point to the March/GUS CC's report¹³ whereby the CC considered that there is a chain of substitution linking the various B2C offerings. According to the parties, this suggests a single B2C market encompassing both premium and non-premium services.
32. On the supply side, the OFT understands that each type of service may require different infrastructure and involve different value-added operations of the kind mentioned in paragraph 29. However, the parties submit that carriers are relatively easily able to introduce new delivery standards (in

¹⁰ Postcomm Discussion Paper, paragraph 2.24.

¹¹ BET UK Limited/Target Express Holding UK Limited (ME/2826/07), FedEx Corporation/ANC Holdings Limited (ME/2938/07).

¹² For example COMP/M.5152 – Posten AB / Post Danmark A/S – para.53, COMP/M.3155 – Deutsche Post/Securicor, COMP/M.2908 – Deutsche Post/DHL, COMP/M.1405 – TNT Post Group/Jet Services, COMP/M.1347 – Deutsche Post/Securicor.

¹³ CC report in *March UK Limited and the home shopping delivery business of GUS plc*, January 2004, para. 5.65.

terms of timeframes and reliability) and new functions. They refer to HDN having achieved a significant broadening of its services and having recently introduced and enhanced its 'track and trace' capability, its timed delivery, its customer query handling, its SMS advisory/text alert service and its store-based delivery/collection.

33. The OFT notes that DHL UK, as a legacy B2B carrier, principally operates premium B2C services only. In any event, however, the OFT is satisfied that on the basis of a narrow candidate market confined to premium B2C services, the merger will not result in any substantial lessening of competition. Therefore, the OFT does not need to conclude whether standard and premium parcel delivery services constitute separate markets.

Conclusion on product scope

34. The OFT does not find it necessary to reach a definitive view on whether any of the candidate markets considered above may constitute relevant markets, as it is satisfied that no substantial lessening of competition will arise as a result of the transaction on the basis of any of them, or on any wider candidate market.

Geographic scope

35. The parties submit that the appropriate geographic market is the UK. The OFT has seen no evidence to contradict this. In particular, the OFT has seen no evidence pointing towards a sub-national geographic market. Further, a national geographic market is consistent with previous European Commission, CC and OFT decisions¹⁴ and is supported by all third party responses received.

Conclusion on the relevant market

36. Given the absence of concern arising on any candidate market as a result of the present transaction, the OFT does not consider it necessary to conclude on the precise boundaries of the relevant market in this case. The OFT's competitive assessment is therefore conducted with regard to the two candidate markets in which the parties overlap: namely the provision of **all** domestic parcel delivery services to B2C customers in the UK and the

¹⁴ COMP/M.5152 – Posten AB / Post Danmark A/S – para.74; CC report in *March UK Limited and the home shopping delivery business of GUS plc*, January 2004, para.5.70; BET UK Limited/Target Express Holding UK Limited (ME/2826/07), FedEx Corporation/ANC Holdings Limited (ME/2938/07).

provision of **premium** domestic packet and parcel delivery services to B2C customers in the UK.

HORIZONTAL ISSUES

37. The parties provided estimates of 2008 B2C market shares derived from an analysis by Datamonitor (a market research company) supplemented with their own internal data. According to these estimates, the parties' combined share in the provision of domestic packet and parcel delivery services to B2C customers in the UK amounts to 17.1 per cent with an increment of 2.8 per cent. A significant proportion (around 40 per cent) of HDN's B2C delivery is 'in house', namely deliveries on behalf of Shop Direct and other significant group retail businesses. The parties submit that it would not be profitable for them to switch capacity to deliveries in the merchant market even if prices were to rise. The OFT acknowledges that the combined share of supply quoted above may overstate to some extent HDN's position with respect to third-party or 'merchant' demand from independent customers. However, it does not need to conclude on this issue given an absence of concern even in including HDN's in-house deliveries in the combined share.
38. Royal Mail Group (including Parcelforce) is the market leader in the provision of domestic parcel delivery services to B2C customers in the UK with a share of 30.9 per cent. The parties submit that the merged entity will continue to face intensifying competition from the Royal Mail Group. A set of smaller but non-negligible competitors will remain in the market post-merger: notably Hermes, City Link and DPD (with 13.5, 6.2 and 4.6 per cent of domestic delivery services to B2C customers in the UK, respectively).
39. According to the parties' submission, HDN and DHL UK compete in the premium end of the market. The OFT notes that in this segment, the combined share of the merged entity also amounts to some 17 per cent with an increment of 6.5 per cent. HDN submits that in relation to premium services in particular, the parties compete closely with Parcelforce (part of the Royal Mail group), DPD, CityLink, each having at least a 10 per cent share of supply of such services. Other carriers such as FedEx, TNT, Nightfreight are also active to some extent.

40. Evidence before the OFT suggests that competitors in the market will be able to place a significant competitive constraint on the merged firm. Some, like Hermes, DPD, UPS and FedEx, belong to well-resourced multinational groups operating in B2C and B2B. In addition, the parties submit that given the current growth in B2C deliveries (essentially in e-commerce), competing players have an incentive to compete aggressively as most of them have substantial excess capacity. This is confirmed by third parties' responses to the OFT's investigation.
41. However, there is significant differentiation across packet and parcel delivery services – not least as delivery timing requirements vary significantly and the core delivery service can be bundled with added-value elements like traceability of the status of the parcel, proof of delivery, insurance and time guarantees. Given this differentiation, the OFT has considered the extent to which the competition between the parties that is removed by the merger may actually be greater than is implied by their combined market share.
42. In this respect, the parties submit that, given DHL's historical focus on B2B activity, their respective activities overlap only to a certain extent and each party's customers often have different profiles and come from different industry sectors.¹⁵ The majority of customer responses confirm this. In particular, in response to the OFT's investigation, many customers comment that they do not currently regard HDN and DHL UK as close competitors. Several third parties even express the view that the parties' current ranges of services are largely complementary, and not substitutable. For example, one customer views the merger as allowing for 'a range of additional services to be offered under one network thereby increasing the choice open to us for use'.
43. Finally, the OFT has also considered how competition affects price-setting in the market. In this regard, the parties submit, and third parties confirm, that competition occurs primarily through informal tendering processes. Contracts are typically for limited duration (usually no longer than 12 months) and allow customers to terminate at short notice. The parties also submit (and third party responses corroborate) that customers often use multi-carrier strategies. This is done either by using different carriers for

¹⁵ B2C delivery accounts for only about 15 per cent of DHL UK's turnover, the remainder stemming from B2B services in which the parties do not directly overlap.

different types of parcel, or by simply choosing whichever contracted carrier offers the best proposition when needed.

44. Third parties' views therefore support the parties' proposition that switching costs are low, that the B2C delivery market is characterised by frequent re-tendering and that, consequently, the frequency of customer switching is high.
45. On the basis of the above, the OFT is satisfied that the merger will not result in a realistic prospect of a substantial lessening of competition in the supply of domestic delivery services to B2C customers in the UK. Neither will it result in a realistic prospect of a substantial lessening of competition at the premium end of domestic delivery services to B2C customers in the UK.

Coordinated effects

46. The OFT has seen no evidence of pre-existing coordination in the supply of domestic packet and parcel delivery services in the UK.
47. Furthermore, the OFT does not believe that the merger will create conditions in the market which will be conducive to coordination: the parties submit and third parties corroborate that there will remain a large number of competitors in the overall B2C sector, and within any relevant segment. The parties further submit that B2C delivery services are not characterised by a high degree of transparency as to which carriers are supplying which customers, or as to what the terms of that supply are. In addition, the OFT notes that frequent retendering and multi-sourcing strategies employed by many customers is likely to allow players in the market to quickly observe and undermine attempted coordination. Finally, no third parties have raised concerns about possible coordinated effects.
48. In light of the above, the OFT believes that the merger does not give rise to any concern over coordinated effects and will therefore not result in a substantial lessening of competition in the supply of domestic packet and parcel delivery services in the UK.

Barriers to entry and expansion

49. In *March/GUS* the CC considered that technical barriers to entry and large-scale expansion (namely equipment, staff systems and IT) would not prove an obstacle to the potential entrants that it had identified. However, the CC

considered that competitive cost disadvantages arising from a lack of scale and a failure to achieve sufficient distribution density could constitute barriers to entry.

50. As noted above, the parties submit that there is generally spare capacity amongst suppliers. Third party comments broadly confirm this view, meaning there is scope for existing competitors to expand their activities if the parties sought to worsen their competitive offer post-merger.
51. The OFT does not need to form a definitive view on barriers to entry in the present case as it is satisfied that the merger will not result in a realistic prospect of a substantial lessening of competition in the supply of domestic delivery services to B2C customers in the UK.

Buyer power

52. As indicated above, the parties submit that the B2C delivery market is generally characterised by frequent re-tendering and high switching frequencies. Third party responses corroborate this proposition and further indicate that some large customers use software packages which enable them to switch deliveries between carriers according to which offers the most competitive proposition when needed.
53. Finally, the OFT has been provided with numerous examples of customers exercising negotiating power through the tendering process and by switching volume to achieve price reductions.
54. The OFT does not need to form a definitive view on buyer power in the present case as it is satisfied that the merger will not result in a realistic prospect of a substantial lessening of competition in the supply of domestic delivery services to B2C customers in the UK.

VERTICAL ISSUES

55. HDN's holding company also owns the Shop Direct group of home shopping businesses, which includes Littlewoods, Very, Additions, and Woolworths. HDN supplies B2C delivery services to Shop Direct. On this basis, the OFT has considered whether the merger may give HDN the ability and incentive to foreclose 'upstream' parcel delivery services to 'downstream' rivals of Shop Direct.

56. However, on the basis of the OFT's conclusion on unilateral effects, the merged firm will not acquire significant market power as a result of the transaction. Therefore, the OFT is satisfied that no concern over input foreclosure will arise.
57. The OFT understands that some customers operate as 'brokers or resellers' acting as intermediaries in the supply chain by aggregating demand from a range of smaller customers to negotiate a better rate with carriers. The parties indicate that these operators have the same range of carrier options available to them as large customers.
58. Some third parties consider that these intermediaries could be regarded as the parties' competitors to some extent, as they offer packet and parcel delivery services to retailers. A view was expressed that the transaction could allow the parties to reduce the margin between wholesale and final prices and as a result, force intermediaries out of the market.
59. However, in the absence of market power acquired by the merged firm as a result of the merger, and given the number of alternatives remaining in the market post-merger, the OFT considers that the merger will not result in foreclosure of intermediaries and, in turn, will therefore not give rise to a substantial lessening of competition in the supply of domestic packet and parcel delivery services in the UK.

CUSTOMER BENEFITS

60. The parties submit that the present transaction will result in efficiency benefits in the form of fixed and marginal cost reductions. They submit that these cost reductions should arise as the merged entity will be able, as a result of the merger, to [].
61. The parties argue that the merged entity will therefore be able to compete more effectively across the B2C market and in particular for sub-2kg parcels, delivery of which is currently dominated by Royal Mail.
62. Given the absence of concern resulting from the transaction, no detailed evidence needed to be provided by the parties in support of these arguments. Notwithstanding the fact that there is no need for it to form a final view on the extent of likely efficiencies arising from the transaction,

the OFT notes that some customers' and competitors' comments do anticipate network and service enhancements arising from the transaction.

THIRD PARTY VIEWS

63. Two third parties suggest that low pricing by the merged entity would be likely to force market exit or further consolidation. The OFT considers that these concerns, if anything, are supportive of an efficiency argument in favour of the transaction. Another third party, broadly unconcerned, points to a residual issue that the merged entity might seek to strengthen some of its core market offerings or new products by denying access to niche markets (e.g. flowers) without securing business in other service areas. The OFT notes, however, that it has seen no evidence supporting that proposition.
64. A few customers express concerns about the loss of competition between the merging parties and potential market power being obtained by the merged entity as a result of the transaction. However, these complainants represent a small minority and include members of the brokers/resellers category identified above. Their views are dealt with in greater detail above, in the vertical effects section.
65. Customers are generally unconcerned. They point to some consolidation and exit having taken place in recent years. However, they identify a healthy range of alternative supply options which they actively consider in their tendering processes. Furthermore, some recognise that the merger could bring service enhancements in the B2C market. In particular one expresses the view that this transaction is an opportunity for the merged entity to offer competitiveness, performance and choice to its customers.

ASSESSMENT

66. The parties overlap in the provision of domestic packet and parcel delivery services to B2C customers in the UK. The OFT notes that there are a number of bases on which delivery services could be segmented. However, given the absence of any substantial lessening of competition resulting from the transaction, the OFT does not consider it necessary to conclude on the precise boundaries of the relevant market. The competitive assessment in the present case is therefore conducted on the conservative

basis of the provision of (all and premium) domestic delivery services to B2C customers in the UK.

67. The parties' combined share amounts to 17 per cent with an increment of 2.8 or 6.5 per cent, depending whether all or only premium services are considered. Evidence put to the OFT suggests that competitors in the market are able to place a significant competitive constraint on the merged firm. The parties anticipate intensifying pressure from the market leader, Royal Mail Group. Given the context of growth in B2C deliveries, the remaining players are regarded as having the incentive to compete aggressively, since evidence suggests that most of them have spare capacity.
68. According to the majority of customers, the merging parties are not close competitors. On the contrary, their view is that the parties' current ranges of services are largely complementary to each other. Customers generally consider the merger as giving the merged firm the scope to offer enhanced service and greater choice.
69. Finally, the OFT has seen evidence that customers benefit from low switching costs and that the B2C delivery market is characterised by frequent re-tendering and high switching frequencies.
70. In light of the above, the OFT does not believe that the merger will result in a realistic prospect of a substantial lessening of competition in the supply of domestic delivery services to B2C customers in the UK. Neither will it result in a realistic prospect of a substantial lessening of competition at the premium end of domestic delivery services to B2C customers in the UK.
71. The OFT has also considered a potential vertical effect: the transaction could potentially give the parties the ability and incentive to reduce the margin between wholesale and final prices and as a result, force brokers/resellers out of the market. In the absence of market power acquired as a result of the transaction, and given the number of alternative suppliers remaining in the market after the merger, the OFT considers that the merger will not give rise to any vertical concern and therefore, will not result in a substantial lessening of competition in the supply of domestic packet and parcel delivery services to B2C customers in the UK.

72. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

73. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.