

---

## Anticipated acquisition by Tesco Holdings plc of Dobbies Garden Centres plc

The OFT's decision on reference under section 33(1) given on 3 August 2007. Full text of decision published 24 August 2007.

---

Please note that square brackets indicate figures or text which have been deleted or replaced with a range by the OFT or at the request of the parties for reasons of commercial confidentiality or public interest.

### **PARTIES**

1. **Tesco Holdings Limited** is a wholly own subsidiary of Tesco plc (Tesco), a public company whose shares are listed on the London Stock Exchange. Tesco is the UK's largest grocery retailer. It also operates outside the UK. In addition to its grocery retailing business, Tesco has various other operations in the UK, which include non-food retailing.
2. **Dobbies Garden Centres plc** (Dobbies) is a public company whose shares are listed on the London Stock Exchange Alternative Investment Market. It operates a chain of 22 garden centres in the UK.<sup>1</sup> Dobbies latest annual report and accounts for their financial year ended October 2006 showed a turnover in the UK of £69 million.

### **TRANSACTION**

3. The boards of directors of Tesco and Dobbies announced on 8 June 2007 that they had reached agreement on the terms of a recommended cash offer, to be made by Tesco Holdings Limited, to acquire the whole of the issued and to be issued share capital of Dobbies not already held by Tesco

---

<sup>1</sup> This includes the Dobbies store at Balborough, near Sheffield, which is due to open in September 2007.

Holdings Limited. The whole of the issued and not yet issued share capital is valued at in excess of £155 million. The acquisition is proceeding under the City Code on Takeovers and Mergers.

4. The parties notified the OFT by way of a Merger Notice of 21 June. The statutory deadline expires on 3 August 2007.<sup>2</sup>

## **JURISDICTION**

5. As a result of this transaction Tesco and Dobbies will cease to be distinct. Tesco has a share of supply in grocery retailing in the UK of in excess of 25 per cent and as Dobbies makes sales of some grocery products in the UK, there would be a small increment to this share following the transaction. As a result, the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. The OFT therefore believes that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

## **FRAME OF REFERENCE**

### **Product market**

6. The parties overlap in the retailing of garden products;<sup>3</sup> grocery products and other non-gardening non-food products.<sup>4</sup>
7. Within each of these three broad product areas, the parties have also identified specific sub-categories of products.<sup>5</sup> On the demand side, the OFT considers that these different sub-categories of products are unlikely to be viewed as substitutable by consumers. On the other hand, from a supply side perspective it is relatively easy for an existing retailer of, for example, garden products to begin retailing an additional gardening product, subject to either sufficient sales floor capacity or the ability to

---

<sup>2</sup> The statutory deadline was initially extended by 10 days under section 97(2) of the Enterprise Act and then by a further one day under section 97 (5) of the Enterprise Act 2002.

<sup>3</sup> The garden products include: plants, seeds and bulbs; fertilizers, compost and chemicals; gardening equipment; outdoor furniture; barbeques and accessories; pots and containers; garden architecture (such as sheds and greenhouses); and water gardening products (hosepipes, ponds and fountains).

<sup>4</sup> The non-gardening non-food products include: indoor furniture, homeware, cookware, books, toys, stationary, pets and aquatics, clothing, footwear, newspapers and magazines.

<sup>5</sup> See footnotes 3 and 4 above.

reduce the space given to other, less profitable products. Therefore, the OFT considers that, within the three broad categories identified by the parties (garden product retailing, grocery retailing and non-gardening non-food retailing), supply side substitution would suggest a wider market than any particular sub-categories or group of products. However, for completeness, the OFT has examined those sub-categories where the share of supply and/or increment is considered to be material.

8. Whether this ability to supply-side substitute exists to such a degree that all three product areas should be included within the same product frame of reference is unclear. Issues such as store or chain branding and availability of sufficiently knowledgeable staff and management will make it much more difficult for a retailer in one of the three product areas to successfully move into one of the other product areas. Moreover, planning consent restrictions may limit the retailing scope of an outlet. Therefore, the OFT's analysis has been carried out on the assumption that the three broad product areas identified by the parties form separate frames of reference.

#### Non-garden non-food retailing

9. In relation to the retailing of non-garden non-food products, the parties' shares of supply are low (with increments of a fraction of one per cent), with a share of supply greater than 10 per cent (albeit with an increment of less than one per cent) resulting in only one sub-category of products, Pets and Aquatics. The parties have submitted that although they both operate within this broad area, they concentrate on different products, Tesco offering branded and unbranded pet foods, whilst Dobbies concentrates more on pet equipment and aquatics, and are therefore not particularly close competitors. Given the above points, and the fact that such products are sold in a wide variety of competing outlets, the OFT does not consider that competition concerns arise in relation to the supply of non-garden non-food products and this will therefore not be considered further.

## Convenience retailing

10. 14 Dobbies gardening centres also contain a food hall,<sup>6</sup> of which only four give rise to an overlap between the parties in relation to the retailing of grocery products.
11. Three categories of grocery shopping have previously been identified by the OFT and Competition Commission (CC):<sup>7</sup> convenience shopping, where a few emergency or impulse items are purchased; secondary, or top-up shopping, where a top up of regular purchases is made; one-stop shopping which can include a major replenishment of supplies.
12. It is clear that the size of a store is influential on what category it falls into, as well as the type of shopping which is undertaken. Generally, small stores (i.e., those generally below 280 square metres) can only carry a limited range of products. Because of this, they tend to meet customers' needs for convenience shopping only. However, convenience shopping is undertaken by customers in a wide range of retail outlets, including in mid-range and large stores. Evidence from the *Safeway Report* and previous OFT investigations<sup>8</sup> indicates that mid-range and large stores represent a competitive constraint on small stores.
13. In this case the Dobbies stores in which groceries are sold generally have less than 10 per cent of floor space devoted to food. Two of the four overlapping stores have a floorspace devoted to grocery of below 280 square metres. The remaining two stores have food offerings that are marginally larger in size ([less than 450] and [less than 400] square metres respectively). In its *Safeway Report*<sup>9</sup>, the CC noted that for those stores which are closer in size to 280 square metres it may be appropriate, for the purposes of the competitive analysis, to consider them in terms of convenience retailing rather than mid-range grocery retailing (previously

---

<sup>6</sup> This includes the Dobbies store at Balborough, near Sheffield, which is due to open in September 2007.

<sup>7</sup> For example, see Supermarkets Report 2000, Cm 4842; the CC report on the proposed mergers involving Safeway plc and Asda Group Limited (owned by Wal-Mart Stores Inc), Wm Morrison Supermarkets plc, J Sainsbury plc, and Tesco plc, Cm 5950 (the Safeway Report); the OFT's decision on the anticipated acquisition by Tesco plc of assets of Adminstore Limited (5 March 2004) (Tesco/Adminstore) and the Deputy Director-General of Fair Trading's advice on the proposed acquisition by Tesco plc of T&S Stores Limited (T & S) (9 November 2002) (Tesco/T&S).

<sup>8</sup> Tesco/Adminstore.

<sup>9</sup> Paragraph 5.344

defined as those stores between 280 and 1,400 square metres in size). Therefore the relatively small size of the food offering in these two Dobbies' stores suggest that they should also be treated as convenience stores for the purposes of the OFT's analysis in this case. This is particularly the case given the limited range of products stocked by the Dobbies food halls which is more comparable to that found in a convenience store.

14. In *Tesco/T&S* the relative frequency of visits and the fact that stores often have extended opening hours were identified as some of the main features of convenience retailing. In this case, the Dobbies stores with food halls do not have extended opening hours nor does it appear that customers visit the store frequently.<sup>10</sup> Rather, a significant proportion of customers would appear to shop at the Dobbies food halls as part of their wider shopping trip to the garden centre or other out-of-town facilities.
15. On balance, although the Dobbies stores do not possess all the characteristics of a convenience retailer which have been identified in past cases, the OFT has taken a cautious approach and treated them as convenience stores for the purposes of our analysis.

## **Geographic market**

### Garden retailing

16. The parties submitted that the retailing of garden products may be assessed at both the national and local level. The parties submitted that each determined price, product range, quality and service at a national level. However, for those elements which are not set at a national level it is reasonable to expect some variation depending on competition at a local level. Furthermore, it is reasonable to expect that consumers are only prepared to travel a limited distance to purchase their gardening needs.
17. In *Travis Perkins/Wickes*<sup>11</sup> the OFT used a catchment area of 10 miles around the parties' stores to assess local competition. The parties provided data on the distances travelled by customers to each of the Dobbies

---

<sup>10</sup> The parties have submitted that customers visit a store an average of [0 – 10] times a year.

<sup>11</sup> Decision dated 4 February 2005, a case involving DIY stores which the parties submit form a competitive constraint on the parties.

stores.<sup>12</sup> While there was some significant variation between the distances customers travelled to each Dobbies store, generally the OFT considers that the data supported the use of a 10 mile radius around the stores. There were two Dobbies stores<sup>13</sup> where, according to the parties data, almost 80 per cent of customers travel five miles or less to the store. However, this may be more indicative of the variety of local choice available to the consumer, and does not preclude the possibility that they may be willing to travel further in the event of a price increase. Nonetheless, the OFT has taken a cautious approach and analysed each of the overlap areas on both a five and 10 mile basis.

### Convenience retailing

18. Previous investigations by the OFT and CC have concluded that the scope of the geographic frame of reference is essentially local, as most consumers are prepared only to travel a limited distance for their grocery shopping, and that distance may vary according to the type of shopping trip required, which is partly related to the size of the store in question.<sup>14</sup> The OFT and CC have in the past found that the appropriate catchment area for convenience stores is up to one mile from the target store.<sup>15</sup> The OFT considers that there is no reason to depart from this basis of analysis in this case.

## HORIZONTAL ISSUES

### Garden product retailing

#### National

19. Within garden product retailing, which makes up the parties main area of overlap, the parties' shares of supply are low at a national level. For specific overlap areas within garden product retailing, the only area where the parties would have a significant share of supply is in barbeques and

---

<sup>12</sup> The parties submitted data collected by Dobbies in January 2006 detailing the distance that nearly 60,000 customers travelled to 17 of its stores based on postcode collection from customers at tills.

<sup>13</sup> Aberdeen, over [60 to 80 per cent] per cent live within five miles and Paisley, where [60 to 80] per cent live within five miles.

<sup>14</sup> See for example, The Safeway Report 2003.

<sup>15</sup> Tesco/ T & S; Completed acquisition by J Sainsbury plc of Jacksons Stores Ltd, 26 October 2006; Tesco/Adminstore.

accessories where the parties will have a combined share of [10 to 20] per cent. However, given that the increment is far less than one per cent and that the individual products within this category that the parties retail are different, the OFT considers that no competition concerns are considered to arise.

#### Local

20. On the basis of a 10 mile radius, the OFT considers that no competition concerns are considered to arise given that, on the basis of the evidence before the OFT, there are a wide range of competitors present including DIY stores (B&Q, Focus, Wickes and Homebase), other garden centres, horticultural retail nurseries, department stores (John Lewis Partnership and Argos) and large supermarket chains (Asda, Sainsbury's, Morrison). Clearly, not all these types of stores carry the full range of products, but as noted earlier the OFT believes that it will generally be the case, that retailers have the ability to supply side substitute. Third parties have confirmed that the strongest constraint comes from DIY stores and other garden centres.
21. Similarly, no competition concerns arise on the basis of a five mile radius, as there are at least three or more competitors present. In relation to the Dobbies store at Cirencester, the parties initial analysis showed that there would be a reduction in the number of competitors present from three to two following the acquisition. However, the parties submitted information which shows there is a further garden centre located approximately one mile from the target store. One third party identified two further competitors in the local area. Therefore, we believe that sufficient competitive constraints would remain post-merger. In addition, further information requested from the parties indicates that assessing this particular store based on a five mile radius may be inappropriate and that the more correct measure would be 10 miles. In any case, the OFT considers that the acquisition of this store raises no issues on either basis.
22. Despite having tested on both narrow and wide radii around the target stores, in all cases, on the basis of the evidence before it, it is the OFT's view that a significant amount of competition remains in local areas. Furthermore, based on the information available it would appear that the parties are not particularly close competitors (which is supported by the

parties' internal documents<sup>16</sup>). Some third parties considered that the parties were close competitors in relation to some garden products, however, supply side substitution by existing competitors would appear to provide a strong constraint in respect of these product areas. Therefore, even on a cautious approach, the OFT considers that this transaction is not considered to raise any competition concerns in relation to garden product retailing.

### **Convenience retailing**

23. The parties submitted that Tesco and Dobbies are not close competitors in convenience retailing in that Dobbies differentiates itself from convenience retailers by selling foods for special occasions and as such it considers itself to compete more closely with specialist delicatessens. In general, third parties did not comment on this, however, one third party who did comment confirmed the parties' assertion.
24. There are four instances where Dobbies stores with food halls are located one mile or less from a Tesco store. In three out of the four of these areas there are more than four competing fascia remaining present post-merger, and therefore the OFT considers on the basis of the evidence before it that no competition concerns arise in relation to these three areas.
25. In the case of the remaining store (Cirencester), there will be a fascia reduction of four to three. However, the Dobbies store in question is not located in a densely populated area, but rather an out-of-town retail area (as is the case with many of its garden centres). When the one mile radius is re-centred to a more densely populated area half a mile to the north-west of the Dobbies store, which may more accurately reflect the centre for travel to stores, up to seven competing fascia are captured. Given that the parties do not appear to be close competitors, in combination with the constraint imposed from the other competitors present locally and relatively low barriers to entry (discussed below) the merger is not considered to give rise to competition concerns in the local area.

---

<sup>16</sup> The parties submitted that Dobbies primarily benchmarks itself against [ ]. They also submitted that because customers use garden centres relatively infrequently and given the types of purchases made, they are not direct competitors. Tesco's documents indicate that in terms of garden products it benchmarks itself against [ ].



## Barriers to entry and expansion

### (i) Convenience grocery retailing

26. Past OFT decisions have found that barriers to entry are low in convenience retailing. In *Tesco/Adminstore*, although the OFT did not reach a conclusion on barriers to entry it noted that for convenience retailing barriers do not appear to be insurmountable. However, the decision noted that within certain localities it may be difficult to find rental space of a suitable size to operate a profitable small store.

### (ii) One stop grocery stores

27. One third party raised concerns that the transaction will add to Tesco's existing 'land bank', thus raising barriers to entry for larger one stop grocery stores.<sup>17</sup> Tesco informed the OFT that, [ ]. It submitted that the transaction was in line with Tesco's strategy of improving and expanding their offering to UK customers in the non-food segment and that the main motivation behind the transaction was that it would enable Tesco to provide customers with greater access to products which help reduce their impact on the environment.

28. Tesco also submitted that changing the use of a garden centre into a grocery retailer would entail obtaining planning permission, which would be extremely difficult, and that the use of most Dobbies sites is subject to strict planning conditions that restrict the amount of grocery sales that can be made from each site, ensuring that it remains ancillary to the primary purpose of the sites as garden centres. Other sites' planning conditions state that the site is to be used only as a garden centre.

29. The importance of planning as a barrier to entry was confirmed by a number of third parties and also by the OFT in its May 2006 decision to refer the groceries market to the Competition Commission.<sup>18</sup> The OFT stated that the planning system can be reasonably suspected of adding to barriers to entry or restricting or distorting competition by raising the cost

---

<sup>17</sup> Defined by the CC in the Safeway Report as stores greater than 1400 square metres.

<sup>18</sup> The OFT stated that: '*There are reasonable grounds for suspecting that the land holdings of the large supermarket multiples may reinforce their existing market position in some local areas. The OFT has also found evidence of practices that could have an anti-competitive effect, including the use of restrictive covenants in relation to sites sold by the big supermarkets.*'

of, and also limiting the scope for, new local market entry, particularly by way of new large format stores. The OFT has not received any persuasive evidence in this case which would lead us to deviate from this view.

30. Therefore, even absent the transaction, there would still be significant barriers to entry in terms of planning permission for a rival trying to turn any of the sites into large supermarkets. Therefore, the relevant question is whether the acquisition by Tesco of the particular pieces of land where the Dobbies stores are situated would, in of itself, raise the existing barriers to entry to such an extent that competition concerns arise.
31. It is notable that despite the [ ] number of acquisitions of different types of properties that Tesco has made over the years, it is only aware of one case where it has bought a garden centre and turned it into a supermarket. No third party has suggested that the sites of any of the Dobbies stores are of particular strategic importance to other supermarket chains or potential entrants.
32. Given that barriers to entry for one stop grocery stores are already high, and in the absence of supporting evidence, the OFT does not consider that any incremental effect on existing barriers to entry created by this merger could be considered so significant as to give rise to competition concerns. This is particularly the case, given that no competition concerns arise at the horizontal level.<sup>19</sup>

## **VERTICAL ISSUES**

33. Several competitors have raised concerns about the potential of the merger to increase Tesco's buyer power in garden product retailing. Some have argued that Tesco's increased buyer power will translate into higher prices to competitors, as Tesco suppliers will seek to recoup, from those competitors, profits lost as a result of the exercise of Tesco's buyer power.
34. However in this case, there is no evidence to suggest that suppliers have any ability to raise prices to other competitors above current levels. Furthermore, at the national level, which is the appropriate level to consider

---

<sup>19</sup> In particular, the OFT's Substantive Merger Guidance states: The effect of a merger on the possibility and/or likelihood of new entry might itself contribute to a substantial lessening of competition where a merger increase barriers to entry or otherwise reduces/eliminates the competitive constraint represented by new entry. (para 4.25)

changes in buyer power, the increment to Tesco's size as a buyer will be small.

35. Overall, the OFT does not believe there is a reasonable prospect that the merger will lead to a substantial lessening of competition through any increased buyer power of the merged entity.

### **THIRD PARTY COMMENTS**

36. The views of large competitors such as the national DIY chains and supermarkets were mixed. One third party raised land use issues and these are addressed above.
37. A large number of local garden centre competitors also expressed concerns, mainly in relation to Tesco extending its market power into garden centre retailing and undercutting its rivals on price.
38. One third party raised concerns that Tesco might use any land associated with Dobbies stores to operate as a grocery retailer, which would increase Tesco's market share on a local and national basis. This speculative scenario, on which the OFT has no evidence before it, is not relevant to our merger analysis. The purpose of the OFT's assessment as set out in our Guidance at paragraph 3.8 is to 'compare the prospects for competition with and without the merger'. In this case, the prospects with the merger focus on the loss of any constraint currently imposed on Tesco's by Dobbies.

### **ASSESSMENT**

39. The parties overlap in the retailing of some garden products. They also overlap in the retailing of some grocery products and in a small number of diverse and unrelated non-gardening non-food products. At a national level the increment from each of these affected sectors is low and does not raise any concerns. At the local level the OFT found that, in the retailing of garden products, there were sufficient remaining competitors present to constrain the parties behaviour post-merger. In convenience grocery retailing one local area was identified where the number of fascia would reduce from four to three, however, taking account of the local population centre and the fact that the OFT does not consider the parties to be close

competitors in convenience retailing in any case, the OFT does not believe that the fascia reduction would lead to a substantial lessening of competition.

40. In non-gardening non-food retailing the parties share of supply is low (with increments of a fraction of one per cent), nor do the parties appear to be close competitors. Given this, and the fact that such products are sold in a wide variety of competing outlets, the OFT does not consider that competition concerns arise in relation to the supply of these products.
41. Although it is not necessary to conclude on barriers to entry, the evidence from the parties, third parties and from past cases suggests that barriers to entry are not high for each of these specific product categories.
42. A third party raised a number of concerns relating to Tesco's use of Dobbies sites for grocery retailing or to prevent entry by rival grocery retailers. Several third parties also raised concerns that the acquisition would harm competition by increasing Tesco's buyer power. It was not considered that either of these concerns was capable of leading to a substantial lessening of competition.
43. 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**

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