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## Anticipated acquisition by A.S. Watson (P&C U.K.) Limited of Merchant Retail Group plc

The OFT's decision on reference under section 33 given on 5 July 2005. Full text of decision published 14 July 2005.

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Please note square brackets indicate text either removed or placed in a range for reasons of commercial confidentiality

### PARTIES

1. **A.S Watson (P&C) UK Limited (ASW)** is part of the A.S Watson Group, the retailing and manufacturing arm of Hutchison Whampoa Ltd. In the UK, the A.S Watson Group operates over 1000 health and beauty stores under the trade names Savers and Superdrug. The Savers and Superdrug retail outlets offer a range of products including cosmetics, perfumes, toiletries and health products (such as vitamins and pharmaceuticals).

**Merchant Retail Group PLC (Merchant)** operates as a specialist perfumery retailer in the UK under the name, The Perfume Shop (TPS). The UK turnover of Merchant in the year ending 26 March 2004 was £102.8million.

### TRANSACTION

2. ASW proposes to acquire the entire issued and to be issued share capital of Merchant for a consideration of approximately £221.9 million. The transaction was notified to the OFT by means of a merger notice and the statutory deadline for consideration of this notice expires on 7 July 2005.

### JURISDICTION

3. As a result of this transaction ASW and Merchant will cease to be distinct. The UK turnover of Merchant exceeds £70 million, so the turnover test in section 23(1) (b) of the Enterprise Act 2002 (the Act) is satisfied. Arrangements are in

progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

## **RELEVANT MARKET**

4. The parties overlap in the UK in the retail sale of perfumes (also termed fragrances). ASW believes that the relevant market affected by this merger is the retail sale of health and beauty products in the UK, where the range of health and beauty products includes cosmetics, fragrances, toiletries, skincare, health products (such as vitamins, minerals, prescription medicines, over the counter medicines and dietary supplements), as well as baby and child products.
5. Perfumes may be purchased from a range of different retail outlets, such as specialist health and beauty retailers, discount health and beauty retailers, perfumeries, supermarkets, department stores, duty free shops, and home shopping suppliers. These different retailing outlets target, or appeal to, slightly different consumer groups, for example, in terms of age range and social status, but still place some competitive constraint on each other. This has been backed up by third party responses to this enquiry which confirm that fragrance consumers are price sensitive and compare prices between a range of different retailers.
6. There may be some demand side substitution within the broad range of perfumes available (from 'fine' fragrances supplied by leading cosmetic and fragrance houses at one end to mass market perfumes with less focus on brand imagery at the other). Customers may switch between purchasing premium price and lower price brands and vice versa depending on impulse or occasion. However, demand side substitution between fragrances and other health and beauty products is considered less likely given the different functions for which they are intended. There may, however, be scope for supply side substitution by retailers of other health and beauty products into perfumes.
7. The OFT has considered the impact of this merger on the supply of perfumes. Noting that the TPS format is focused on branded fragrances and aftershaves we have also looked at the impact of the merger in the fine and branded perfumes sector. As no concerns arise on the basis of these narrow frames of reference, there is no need to conclude as to whether a wider frame is more appropriate.

## **Geographic market**

8. ASW believes that competition between retailers occurs at a national level. It claims that parameters of competition, such as range of products, image, store layout, marketing and prices are decided and advertised by the market players on

a national level. Third party responses, however, suggest that competition also occurs at the local level. A number of third party competitors who responded to OFT enquiries on this merger said that they do take account of local market conditions when setting prices.

9. As the parties were able to provide details of all local overlaps it has been possible for the OFT to consider a very narrow geographic basis (limited to a 1km radius). However, no conclusion is necessary on the appropriate geographic frame of reference given the lack of concerns at this level.

## **HORIZONTAL ISSUES**

### **Shares of supply**

10. Following the merger, the parties estimate that they will have a combined share of the supply of fragrances in the UK of [20-30] per cent (increment [1-10] per cent) with competitor shares of supply including [30-40] per cent for Boots, [10-20] per cent for Debenhams, [1-10] per cent for House of Fraser, [1-10] per cent each for Tesco and Asda and [1-10] per cent for John Lewis and the Fragrance Shop. It has not proved possible to find comparable publicly available data on the share of supply for fine and branded perfumes alone. However, information obtained by the OFT during this enquiry suggests that 75 per cent - 80 per cent of fragrance sales are of fine and branded fragrances and that under an analysis of such perfumes alone the parties' combined share would be limited to below 30 per cent.
11. The above share of supply figures suggest that the merged entity will be the second largest supplier of perfumes in the UK. However, given the presence of strong competitors such as Boots and Debenhams and a tail of competitors of some scale (such as House of Fraser, John Lewis, The Fragrance Shop and the supermarkets amongst others), the OFT does not consider that there will be a significant reduction in competition on a national basis.

### **Local competition**

12. As noted above, the parties have provided details which has enabled the OFT to consider all local overlaps. In many instances sufficient competition exists even in the shopping centre concerned<sup>1</sup> (for instance Boots is present in at least two thirds of all the shopping centres where there is an overlap; and where there is no Boots the other retailers in the centre include in almost all cases a department store and/or a health and beauty discounter). The parties have also provided data which shows that in all instances additional competitors are present within a 1km radius of where an overlap occurs. In any event, in assessing whether the merger

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<sup>1</sup> All TPS stores are located in shopping centres or shopping malls.

results in a substantial lessening of competition in areas where competitors may be limited in number, consideration must be given to the level of barriers to entry and expansion in the sector.

### **Barriers to entry and expansion**

13. There are two ways by which a retailer may supply fine or branded perfumes: one of which is by obtaining an exclusive contract with authorized wholesalers or brand owners to distribute their products. The other is by obtaining supplies from the 'grey market'. Some retailers obtain a proportion of their supplies from authorized distributors but the remainder from the grey market where products can be bought more cheaply.<sup>2</sup>
14. Some third parties mentioned that the need to obtain exclusive contracts with authorized distributors or brand owners constituted entry barriers. However, any retailer who fulfills certain criteria, which relate to the retail environment and to the level of service provided to consumers, may obtain these contracts and start supplying fine and branded perfumes. This is evidenced by the fact that [ ]. Therefore, although the criteria for obtaining exclusive contracts may raise entry costs it does not constitute a barrier to entry.
15. It is arguable that the grey market allows only limited market entry, given the range of products available and uncertain supply. However, third parties have indicated that the range of products available and the consistency of supply from the grey market has improved over time, with, for example, retailers being able to secure longer term supply contracts. The evidence also suggests that retailers who have entered the market this way have been successful and are increasing their share of supply.

### **Buyer power**

16. Customers are individual consumers and so are unlikely to have buyer power. In terms of procurement, the OFT does not consider that this merger will increase the parties' buyer power significantly, given the limited increment. In any event, the continued presence of competition at both the national and local level should ensure that there remains an incentive for any such benefits to be passed through to consumers.

### **VERTICAL ISSUES**

17. No vertical competition concerns are raised by this transaction.

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<sup>2</sup> The grey market is formed by authorized distributors, wholesalers and retailers selling-on excess stock. Brand owners with excess stock may also sell into the grey market directly.

### **THIRD PARTY VIEWS**

18. As it is not possible to consult directly with customers in sectors such as this, third party enquiries were focused on competitors. While many suggest that the merger would not adversely affect competition, some were concerned that the merged entity would possess buyer power vis-à-vis the grey market, giving them access to a wider range of grey market stock, and also vis-à-vis authorized suppliers. Some competitors also expressed concern that an increase in the merged parties' buyer power vis-à-vis authorized suppliers would have the effect of lowering standards of the retail supply of fine fragrances. The issue of the parties' increased buyer power is addressed in the above assessment.

### **ASSESSMENT**

19. The parties overlap in the retail supply of perfumes in the UK. At both a national and local level the merged entity will face a number of competitors in the form of Boots, department stores, specialist perfume retailers, health and beauty discounters and supermarkets amongst others. Even in the event that the merged entity was subject to limited competition in a particular area barriers to entry and expansion in the sector are low. The OFT therefore considers that sufficient competitive constraints will exist on the merged entity post-merger.
20. 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**

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