Anticipated acquisition by 3i Group plc of Shearings Group Holdings Ltd

The OFT's decision on reference under section 33 given on 16 March 2005. Full text of decision published 23 March 2005.

PARTIES

1. **Shearings Group Holdings Ltd (Shearings)** provides coach touring holidays to the UK, Europe and a number of long haul destinations as well as self drive holidays throughout the UK. It also owns 36 hotels throughout the UK.

2. **3i Group plc** (**3i**) is a venture capital company listed on the London Stock Exchange. 3i holds a 82.32 per cent stake in **Coach Holiday Group Ltd** and a 37.5 per cent stake in **Leger Holidays Ltd (Leger).**

   Coach Holiday Group Ltd (CHG) consists of three businesses:

   - **Wallace Arnold (WA),** which provides coach touring holidays in the UK, Europe and to long haul destinations, and owns 20 travel agency shops and 9 hotels throughout the UK

   - **National Holidays (NH),** which provides coach touring holidays in the UK and Europe to customers in Tyne Tees, Teeside, Hull, Yorkshire and Manchester and

   - **Caledonian Travel (CT),** which also provides coach touring holidays in the UK and Europe but only to customers in Scotland.

TRANSACTION

3. 3i proposes to bring Shearings and CHG under common management by forming a new entity, Newco, which will acquire Shearings and CHG. The statutory deadline expires on 16 March 2005.

JURISDICTION

4. As a result of this transaction, CHG, Leger and Shearings will cease to be distinct and will be controlled by 3i. The UK turnover of Shearings exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. 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.

RELEVANT MARKET

5. The parties overlap in the supply of coach touring holidays in the UK, Europe and long haul destinations, as well as the provision of bed spaces to self drive holidaymakers in the UK.

Product market

6. The overlap in the supply of hotel accommodation (0.7 per cent of beds available in UK hotels, guest houses and B&Bs in 2002) is very small. Additionally, although the parties overlap in a few locations where they both own hotels, a number of alternative providers exist. This overlap is therefore not expected to result in a substantial lessening of competition and it is not considered further.

   The key issues to consider in determining the relevant frame of reference are:

   - other types of holidays as substitutes for coach touring holidays
   - coach touring holidays to the UK as substitutes for overseas holidays
   - packaged and independent UK coach touring holidays as substitutes, and
   - segmenting coach touring holidays by distribution channels.

7. Taking each in turn, the parties consider that coach holidays compete in a wider holidays market, particularly in relation to the core customer group of over-55s. However, evidence available to us suggested that in the event of a 5-10 per cent price increase, the vast majority of customers would not switch to other types of holidays. Holidaymakers may take more than one holiday per year and may prefer a range of different holiday experiences, and these different types of holidays could therefore be complementary rather than substitutable.

8. With regard to substitutability between coach touring holidays to the UK and overseas, a recent Mintel report[1] notes that the prime target group for domestic inclusive coach travel is now healthier and more affluent and will therefore be increasingly tempted to venture outside of the UK. However, within this group, less affluent members were unlikely to venture outside the UK. This suggests that that they are not substitutes for many customers and that it is appropriate for present purposes to consider UK and overseas coach touring holidays separately because their core customer bases appear to differ.

9. Coach touring holidays to UK destinations fall into two groups:

- packaged all inclusive coach holidays – includes local pick up of passengers, coach travel and hotel accommodation sold in a package with excursions

- independent coach holidays – holidaymakers book their own coach travel, e.g. on National Express, and accommodation separately.

10. During this investigation, the OFT did not receive any evidence to suggest that independent coach holidays were a viable substitute for packaged all inclusive coach holidays for a sufficient number of customers.

11. Finally, the main distribution channels used by the parties is through travel agents. Different operators utilize different forms of distribution channels, such as: newspapers, direct mail, internet, local retailers and newsagents as well as post offices. Regional operators use regional and local newspapers. Shearings submits that, on the supply side, even the smallest operator is able to use most distribution channels. Likewise, on the demand side, customers are free to switch between the various distribution channels.

12. On the basis of the above, the appropriate frame of reference appears to be the supply of packaged all-inclusive UK coach touring holidays; and the supply of overseas packaged all-inclusive coach touring holidays.

Geographic market

13. Shearings submits that competition takes place on a regional or local level as most suppliers of UK coach holidays operate at a local or regional level; and customers tend to only travel a limited distance to join a UK coach holiday. Both Shearings and CHG price regionally and have separate brochures for different regions, suggesting that competition takes place at a regional, rather than national, level.

[1] Mintel Report: Coach Holidays, Leisure Intelligence, January 2005

14. Overall, the weight of the evidence suggests that competition takes place regionally. However, for completeness, we also consider the national picture below.

HORIZONTAL ISSUES

Market shares

Coach touring holidays overseas

15. Post transaction, the merged entity will hold a national share of supply of 5.7 per cent and will continue to face competition from a number of large operators such as Saga, Page & Moy, Titan, Ingrams and Travelsphere. By region, the highest combined share is only 12.2 per cent by turnover, increment 4.8 per cent; and 15.9 per cent by passengers, increment 5.9 per cent. We received no third party concerns in relation to overseas coach holidays. The relatively small shares of supply and existing competition in this sector further suggest that competition concerns are not present and overseas holidays are therefore not considered further.

Coach touring holidays in the UK

16. The parties note that this sector is highly fragmented in the UK with over 1000 operators. Post transaction, the combined entity would supply 9.4 per cent of UK packaged coach holidays by turnover and 14.4 per cent by passenger volume.[2] There are however two regions in which the merged entity will represent over 25 per cent of supply – the North East and Yorkshire. In the North East, the merged entity would supply 21.2 per cent by value, increment 5.1 per cent and 48.8 per cent by volume, increment 9.2 per cent. In Yorkshire, the merged entity would supply 20.5 per cent by value, increment 6.0 per cent and 38.5 per cent by volume, increment 8.1 per cent. CHG is mainly active in the North East through NH who is only active in Tyne Tees, Teeside, Hull, Yorkshire and Manchester.

17. In both regions, Shearings argue that the merged entity will continue to face competition from numerous alternative operators. Based on the Little Red Book 2005, Passenger Transport Industry 2005 and Bonded Coach Holidays members list, the parties list around 40 operators in the North East and around 130 operators in Yorkshire. The parties were unable to estimate the shares of supply of their competitors. Out of the five main competitors listed by the parties, two are regional operators, while the rest are local operators or newspaper reader holiday clubs. The high volume shares in both regions relative to value shares appear to reflect that the parties offer lower-cost lower-service holidays. In this

[2] Leger does not supply UK holidays.

sector, however, shares by value may be a better guide of suppliers' competitive positions given the differentiated service offerings of suppliers. Third parties contend that customers consider value for money when deciding on a coach holiday. National operators such as Shearings offer a lower priced, less personalised service where customers have to change coaches at major hubs. Regional and local operators offer a higher priced, personalized service, where customers do not have to change coaches ('line of route'). Third parties have indicated that customers do switch between national and regional/local operators and that many customers prefer the more personalised, convenient elements offered by smaller line of route operators.

18. Shearings argue that in order to ascertain if their prices are competitive, they compare their pricing with competitors offering comparable holidays. They submit that they do not benchmark their prices against CHG's as they are too expensive, however they do consider local and regional competitors whose prices they consider more comparable to their prices (including NH, also owned by CHG but who are a regional line of route operator). This appears consistent with the fact that market research carried out by Shearings for the North East appears to monitor regional and local operators (including NH).

19. Some competitors and travel agents considered that the parties' were each others closest competitors because they were the only operators to offer nationally branded UK coach touring holidays. However, one such concerned competitor also noted that holidaymakers who have had bad experiences with lengthy transfers and lack of personalized services with national operators have switched to regional and local operators who may charge higher prices but offer a more convenient, personalized and relaxed holiday experience.

20. Overall, while the parties are both well-known nationally-branded rivals, evidence available suggests both that competition is best understood as regional in scope, and that the merged entity will be constrained by other suppliers post merger in every region in which they compete, including the North East and Yorkshire. In other words, if the merged entity reduced the value for money for customers (e.g. by raising prices), it can be expected that customers would switch to rivals that offer better value for money (e.g. better service for a small price differential) sufficient to render such conduct unprofitable.

Barriers to entry and expansion

21. Shearings estimates that it would cost a new entrant in a region £60,000 to start operating coach touring holidays and gain a 5 per cent market share. This cost consists of hiring coaches, booking hotels, setting telephone and reservation systems and renting office space. Advertising would cost a further £150,000 per

year; more may be needed in the first year to raise initial awareness[3]. They estimate smaller operators will likely spend less for local and regional campaigns

22. One third party, however, estimated that to grow a position by 5 per cent would cost in excess of £150,000 per year for three years in extra brochures, newspaper advertising, incentives, local travel promotions, extra staffing. Another third party estimated from previous experience that it would cost £500,000 - £1 million to achieve a 5 per cent share in a local catchment area. To set the above entry costs in context, one third party indicated that regional operators have a turnover of around £20-30 million.

23. Shearings submits that over the last five years there have been a number of new entrants. This was supported by one third party who agreed that there have been numerous new entries but pointed out that none has been able to grow to a significant size. Some third parties felt the need to establish a good reputation and achieve a critical mass of customers would mean new entry would be costly and take a relatively long time to break even. Shearings however believes that any such brand loyalty incumbents may enjoy could be overcome by new entry that offers a lower price or higher quality of service. In support, they cite independent research carried out in the South East of England in 2003 which shows passengers with a preference for Shearings nonetheless compared prices, destinations, hotels and itineraries of other coach tour operators. One third party believed that customers in the North East and Yorkshire were likely to be price sensitive and would switch to other operators if the merged entity raised prices.

24. The parties point to other national brands that they compete against in the wider national sector in relation to overseas coach holidays such as, Thomson, MyTravel, Thomas Cook and First Choice. Although not a proposition advanced by the parties or third parties, it may be possible for these companies to leverage their brand into the UK coach touring holiday sector.

25. On balance, the evidence suggests that barriers to entry or expansion are surmountable and that the potential for entry or expansion will also constrain the merged entity.

Buyer power

26. Holidaymakers purchase through travel agents or via other channels listed above. While travel agents may possess buyer power due to their size, overall, the evidence suggests that buyer power will not act as a constraint on the merged entity

[3] This estimate is based on Shearings' own experience.

VERTICAL ISSUES

27. Some third parties expressed concerns that the merged entity would use its increased buyer power to extract lower prices from hotels and in turn offer lower prices to customers as a way of foreclosing the market to smaller competitors. However, evidence on new entry or expansion suggests that the merger will not increase the ability or incentive of the parties to support such a foreclosure strategy.

28. One third party considered that there may be a 'waterbed' effect, where hotels would recoup their lost revenue on sales to the merged entity (as a result of its increased upstream buyer power) by increasing prices to other smaller operators. However, economic reasoning suggests if hotels could increase prices to other smaller operators post merger, they would have already done so prior to the merger.

THIRD PARTY VIEWS

29. With regard to travel agents, three of the five travel agents who responded raised concerns that the two largest coach touring suppliers were merging. However, these concerns appear to relate to the reduction in the number of operators whose main distribution channel is via travel agents rather than a reduction in the number of operators available to end customers.

30. With regard to competitors, of the few who responded, two raised concerns that the merging parties are each others closest competitors and smaller operators may not provide effective constraint on larger operators mentioned above. They also felt that barriers to entry were significant. These concerns have been dealt with above.

ASSESSMENT

31. The OFT's investigation has focused on the merger's impact on coach touring holidays in the UK, a highly fragmented sector with over 1000 operators. Post transaction, the merged entity will supply 9.4 per cent of UK coach holidays (packaged, by turnover) and 14.4 per cent by passengers. The only regions where the parties will hold a share of supply over 25 per cent are in the North East and Yorkshire, and then only on a volume rather than value basis. Post transaction, the merged entity will in all regions continue to face existing competition from numerous alternative operators offering differentiated services that compete on a value for money (service and price) basis. In addition, expansion or entry by rivals appears to a further source of competitive pressure.

Together these factors appear to continue to provide an effective constraint on the merged entity.

32. 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

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