

## Anticipated acquisition by Tesco Plc of 45 outlets from Adminstore Ltd

The OFT's decision on reference under section 22(1) given on 5 March 2004

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Please note text in square brackets indicates range inserted at request of parties.

### PARTIES

1. **Tesco PLC (Tesco)** is the UK's largest grocery retailer. Tesco operates a variety of store formats, each of which is active in convenience retailing. **Adminstore Limited (Adminstore)** is a small private company whose principal activity is convenience retailing predominantly in central London.

### TRANSACTION

2. Tesco will acquire 45 grocery stores operated by Adminstore (the Adminstore stores). The turnover attributable to these 45 stores for the year ended 28 September 2003 is [less than £70 million]. 43 of the stores that Tesco proposes to acquire are small stores.<sup>1</sup> Two stores, however, are larger than small stores and smaller than 1,400 square metres (mid-range stores).<sup>2</sup> No large stores (defined as 'one-stop stores' by the Competition Commission (CC) in the Safeway Report)<sup>3</sup> are part of this transaction.
3. The extended statutory deadline is 5 March 2004.

### JURISDICTION

4. As a result of this transaction Tesco and the Adminstore stores will cease to be distinct. The parties overlap in the supply of grocery retailing in Great Britain and the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is

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<sup>1</sup> Defined by Mintel / IDG definition as convenience stores (of less than 3,000 square foot (280 square metres)): (i) with extended opening hours (including Sundays); (ii) offering a range of products; and (iii) serving a local community.

<sup>2</sup> As used in the Executive Director's advice on the proposed acquisition by J Sainsbury plc of 171 Somerfield stores from the Springwater bidding vehicle

<sup>3</sup> The CC report on the proposed acquisitions of Safeway plc and Asda Group Limited (owned by Wal-mart Stores Inc); Wm Morrison Supermarkets PLC; J Sainsbury plc and Tesco plc – A report on the mergers in contemplation (Cmnd 5950).

met. The OFT therefore believes that it is or may be the case that a relevant merger situation will be created.

## RELEVANT MARKETS

### Product markets

5. The parties overlap in grocery retailing, specifically for the purposes of this case in convenience grocery retailing. Grocery retailers cater for a complex range of grocery shopping needs. The range of types of grocery shopping acknowledged previously<sup>4</sup> includes: 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; and one-stop shopping, which can include a major replenishment of supplies. It is clear that the nature of a shopping trip is not dictated (but is influenced) by the size of store used. To analyse the competitive constraints on an individual grocery store, one must identify the types of shopping undertaken in that store and from that, derive the effective competitors to that store (for those forms of shopping) and what constraints they place on that store.
6. Small stores (i.e., those generally below 280 square metres) can only carry a limited range of products. Because of this, they generally meet customers' needs for convenience shopping only. However, convenience shopping is undertaken by customers in a wide range of retail outlets. Convenience shopping is undertaken in small stores, but some is also undertaken in mid-range and large stores. Evidence from the Safeway Report and our own investigations indicates that mid-range and large stores represent a competitive constraint on small stores. As in previous cases, the focus of our analysis for considering the competitive constraints on small stores would appear to be convenience shopping in all grocery outlets.<sup>5</sup>
7. Mid-range stores typically cater for a wider range of shopping trips than small stores. In its Safeway Report, the CC considered that there was likely to be a continuum of competitive constraints moving from stores close to 1,400 square metres (for which the issues would be similar to the issues set out for its one-stop shop analysis), to stores close to 280 square metres (for which the issues would be more similar to the issues pertaining to small stores).<sup>6</sup> One-stop shopping has been used by the CC to mean large, typically weekly shopping trips in grocery stores of 1,400 square metres and above which require a large range of groceries to be on offer. The CC recognised that mid-range stores in some areas may act as 'one-stop stores', but more generally place a limited constraint on 'one-stop stores'.<sup>7</sup> For its analysis of mid-range stores, the CC cautiously concluded that a limited number of fascia were effective competitors

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<sup>4</sup> See the Supermarkets Report (2000, Cm 4842), the Safeway Report and the Deputy Director-General of Fair Trading's advice on the proposed acquisition by Tesco plc of T&S Stores Limited (Tesco / T&S).

<sup>5</sup> Excluding small specialist shops (bakers etc.) that are not small stores as defined in this decision (i.e. 'convenience stores' as defined by Mintel / IGD).

<sup>6</sup> Para. 5.344 Safeway Report.

<sup>7</sup> Para. 5.11 Safeway Report.

for one another in these range of stores.<sup>8</sup> The focus of our analysis for these stores has been the CC's approach in the Safeway Report.

8. Large stores cater for the full range of grocery shopping trips, including convenience shopping and one-stop shopping. Typically in a local area, only large stores cater for one-stop shopping, and thus are not generally constrained effectively by mid-range and small stores for customers of this type of shopping. On the other hand, a large store is very likely to compete effectively with small and mid-range stores for the shopping types such stores offer.
9. It has been put to us that, in contrast to the position taken in Tesco / T&S and the CC's Safeway Report, there is a single 'market' for the supply of all groceries, rather than analysing competition in light of the differing types of grocery shopping outlined above. In particular, it is said that the growth of 'repertoire shopping' – in which customers do not confine themselves to one type of shopping – has blurred distinctions between convenience, secondary/top-up and one-stop shopping. Although some limited evidence has been put to us to support this contention, it is not sufficiently persuasive to warrant departing from the approach we set out in the paragraphs above. Furthermore, the totality of the available evidence suggests that, while larger stores do appear to constrain competition in small stores, the reverse is not true; especially in light of the differences in catchment area, proportions of different types of shopping undertaken in different outlets, and the different competitor sets for each type of shopping.
10. In light of the above, the focus of our analysis of the competitive constraints for the 43 small stores is convenience shopping and for the two mid-range stores is competitors who cater for the same types of shopping as these stores. In any event, the conclusions would not differ in this case were the focus of our analysis to be the supply of all groceries.

## **Geographic markets**

### *National and local competition*

11. There are both national and local elements to competition among grocery retailers. Tesco and other major grocery retailers undertake much of their procurement and set many of their competitive strategies (e.g. core product ranges, some or all prices, branding and advertising) at national level. At a local level, however, stores appear to tailor their offerings in response to demographic and other factors in a number of ways, including local variations in opening hours, ranges, or promotional offers. The scope of local competition in types of grocery retailing depends, to some extent, on the distance consumers are able or willing to travel to shop for groceries, which depends to a degree on the type of shopping trip to be undertaken (which in part is related to the size of store in question).

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<sup>8</sup> The CC defined effective competitors for Safeway's mid-range stores for the purposes of the first stage of its local competitive analysis as Asda, Booths, Budgens, Co-op, Iceland, Sainsbury, Safeway, Somerfield (including Kwik-Save), Morrison, Tesco and Waitrose. The competitor set for convenience shopping appears to be not limited to any particular retailers.

12. In Tesco / T&S, the frame of reference used for a small store was a one mile radius, although it was suggested that a wider radius would be appropriate for larger stores offering convenience shopping. However, in a densely populated area such as central London, a catchment area for convenience shopping outlets may be even smaller than this. Third parties have suggested that a half mile radius might be more appropriate in London. Some research indicates that, whilst for the UK on average the amount of spend in a small store attributable to people living within a quarter of a mile of the shop is 57 per cent, in London the spend value is 72 per cent. This research further indicates that the amount of spend attributable to people living within half a mile of a small store is 83 per cent. On the evidence put to us, a half mile radius may be a more appropriate focus for analysis in London. Competition in convenience shopping has, therefore, been analysed on a national basis and a local basis using a mile radius and a half mile radius of relevant stores.
13. In the Safeway Report, the CC analysed local competition in mid-range stores on a five-minute drive time isochrone in urban areas reflecting the range of shopping undertaken in such stores. Given that the two mid-range stores being acquired by Tesco are located within central London and neither store has a car park, a five-minute drive time isochrone may overestimate the local catchment areas in this case. Allowing for this, analysis for these two stores has therefore been carried out not only nationally and on a five-minute drive time isochrone, but also using a mile radius and a half mile radius in order to reflect the fact that these stores cater for a range of shopping requirements.

#### *Regional competition*

14. Given the closeness of stores located in an urban area such as London, it is possible that chains of substitution might operate between adjacent catchment areas. For this reason, the competitive effects of the transaction on a wider area, the area within the M25, have also been examined. No conclusions need be drawn on whether this represents a proper geographic parameter of competition as it does not affect the decision in this case.

#### **Conclusion on relevant markets**

15. The focus of our analysis for each store has therefore been the constraints placed on that store by its competitors, more specifically: (a) for small stores, convenience shopping (in all grocery stores) nationally and within one mile and half a mile radii; and (b) for mid-range stores, the alternative fora for the shopping trips such stores cater for nationally and within 5 minute drive-time isochrones and one mile and half a mile radii. The competitive effects of the transaction on the area within the M25 have also been examined

#### **HORIZONTAL ISSUES**

##### **National competition**

16. We have used a variety of criteria to assess the national effects of the merger. Tesco's share of all grocery retailing in GB can be calculated as being 26.85 per cent (any increment would be substantially less than 1 per cent) on the basis of

TNS data.<sup>9</sup> We estimate the Tesco's national share of convenience shopping post-merger will be between [5-10 per cent] and [10-15 per cent] with a very small increment (less than 1 per cent) depending on the methodology used. On each of these measures, the increment from this transaction to Tesco's national share is very low and would not lead to a significant HHI in the context of its existing shares and the concentration in these sectors. On this basis, no national concerns arise as a result of this transaction.

### **Regional competition**

17. Tesco's share of supply is not more than 29 per cent (increment less than 1 per cent) of the total grocery sector (i.e. one-stop and secondary shopping) within the M25.<sup>10</sup>

### **Local competition: small stores**

18. In the Safeway Report, the CC identified that potential competition concerns arise in local areas with two or fewer fascia competing with the merged parties post-merger (i.e. a 4 to 3 or less).<sup>11</sup> Of the 35 Adminstore stores which overlap with a Tesco store (of any size), there are none on either one mile radius or a half mile radius where there are two or fewer fascias (including small stores, mid-range stores and large stores) competing with the merged entity post-merger. There are only three areas where there will be only 3 competing fascia (other than the merged entity) within a half mile radius post-merger (and none in which there will less competing fascia than this). There is no evidence to suggest that if a fascia-based rule is right, the CC's (4 to 3) fascia rule is wrong. On this basis, no local competition concerns arise.
19. Some third parties have commented that analysis by number of competing fascia is an imperfect way of measuring loss of competition as it does not reflect the size and number of stores belonging to that fascia in the local area. One third party estimated that Tesco's shares of total grocery retail sales space post-merger within a one mile radius of Adminstore stores in overlap areas will exceed 25 per cent in 10 areas, the highest share being 53 per cent. We have serious reservations about the basis on which these data have been calculated. These figures include all types of grocery retailing including one-stop shopping.<sup>12</sup> As some of the sales from this retail floor space will be related to neither convenience retailing nor populations within a mile radius of an Adminstore store, these figures overstate Tesco's share of convenience retailing to a significant degree. Our analysis suggests that Tesco's shares of convenience retailing in these local areas are significantly lower than the third party figures. Tesco has commented that our analysis omits a number of competing stores. For the above reasons, we are not persuaded that the floor space figures provided to us are an accurate measure of the competitive effect of this merger in local areas.

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<sup>9</sup> Tesco's share would be considerably less using IGD data.

<sup>10</sup> Source: Experian survey. Similarly, on a three month rolling average in the twelve weeks to 7 December 2003, Tesco had a 28.9 per cent share of grocery sales according to TNS Superpanel for the south-east of England.

<sup>11</sup> Para. 5.342 Safeway Report.

<sup>12</sup> It may also include non-grocery sales from some stores.

20. No local competition concerns therefore arise as a result of the acquisition of the small stores from Adminstore.

#### **Local competition: mid-range stores**

21. Using a 5 minute drive time isochrone, the merger will lead to a reduction in the number of effective competitors from 5 to 4 in one area. On the basis of the CC's methodology, this would not be a problem area. Moreover, the Adminstore store in this area is 511 square metres in size, which is substantially closer to 280 square metres than 1,400 square metres. This implies that the issues for this store might be more similar to those for small stores, and thus the list of effective competitors to this store could in any case be larger than that identified by the CC. For the other mid-range store (837 square metres) being acquired by Tesco there is no overlap in the primary isochrone with a reduction in fascia of 6 to 5 on recentring on effective competitors following the CC's methodology in the Safeway Report.
22. For each of the two stores concerned, on a one mile radius the number of competing fascia (including small stores) does not reduce as a result of the merger, and on a half mile radius there is no overlap.
23. No local competition concerns therefore arise as a result of the acquisition of the mid-range stores from Adminstore.

#### **Barriers to Entry**

24. Previous investigations by the OFT have not concluded that barriers to entry for small stores are substantial.
25. In the present case, some third parties have argued that barriers to entry in the convenience sector are high, particularly within London. One of the main reasons suggested for high barriers to entry is that within certain localities, it is difficult to find rental space of a suitable size to operate a profitable small store. The vast majority of the barriers to entry suggested by third parties would not appear to be barriers to a large grocery retailer. Moreover, we have received evidence of recent examples of new store openings by all sizes of operators. Analysis provided by Tesco indicates that, in a number of central London locations, the average annualised 'churn' is 7.7 per cent of all properties, and 8 per cent of food-only stores.<sup>13</sup> A council has indicated that, although more expensive and time-consuming, nothing prevents companies from acquiring two or more adjacent retail units and converting them into suitable sized small stores, which could be a viable alternative in areas where suitably sized sites are scarce.
26. Local planning regulations might create barriers to entry. In Tesco / T&S, no evidence was identified which indicated substantial difficulties in gaining planning permission at a local level. This has also been the experience of the parties in London. Furthermore, in this case no third party identified planning permission difficulties. Once premises has been granted A1 planning permission,

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<sup>13</sup> Tesco calculates these figures to be 9.1 per cent and 8.7 per cent respectively.

it can be used for a wide variety of purposes, including grocery retail and most other retailing, without requiring further planning permission. Local planning regulations do not therefore appear to create barriers to entry for convenience retailing.

27. Barriers to entry for mid-range stores appear to vary with the size of store in question, reflecting the continuum between large and small stores.<sup>14</sup> It appears that the larger the size of store sought the more difficult it is to find a suitable store. This implies that barriers to entry for mid-range stores of the sizes in question are likely to be higher than for small stores. In any event, there is no need to conclude whether the barriers to entry in relation to the two mid-range stores are substantial given that no horizontal concerns have arisen in this case.

## **VERTICAL ISSUES**

28. Upstream buyer power, particularly negotiating strength, was considered in depth by the CC in the Safeway Report in relation to the supply of all groceries (without reference to type of consumer grocery shopping). This acquisition, however, is unlikely to have any material impact on Tesco's negotiating strength as Adminstore's annual spend on groceries has been estimated as [0-0.1 per cent] of Tesco's purchases.
29. Some wholesalers are concerned that the loss of the Adminstore contract will make deliveries to Central London uneconomic. This could, in turn, it is said, lead to price rises to other buyers. However, Adminstore estimates that for the majority of its top 10 suppliers, it does not account for a high proportion of sales – the highest being less than [20-30 per cent]. The risk that the loss of an Adminstore contract would in itself foreclose a supplier from grocery supplies therefore appears minimal.
30. Some third parties have alluded to the possibility of 'waterbed' effects arising from this merger, i.e. as suppliers would expect lower prices from the merged entity, they would expect to obtain higher prices from other grocery retailers. We have however received no evidence to support the assertion that suppliers could increase prices to other retailers. In any event, the size of the increment to Tesco's purchasing volumes is so small that vertical competitive concerns as a result of the merger are not judged to be credible.

## **THIRD PARTY VIEWS**

31. Many third parties have expressed their concerns about this merger. However, many of these concerns do not relate specifically to this merger, but more to Tesco's existing size. The main concerns raised by third parties are addressed above. Third parties were to an extent concerned about the possibility of Tesco's future growth and acquisitions. The possibilities put to us were hypothetical and cannot form the basis of an evidence-based merger analysis. We have received no evidence to suggest that Tesco's landbanks<sup>15</sup> would bar entry for small and mid-range stores. Others, including the Consumers Association, welcomed the merger.

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<sup>14</sup> Para. 5.344 Safeway Report.

<sup>15</sup> Property holdings for future development.

## ASSESSMENT

32. The parties overlap in grocery retailing, primarily convenience retailing. Due to the small increment, no national concerns arise as a result of this merger. No local areas have been identified where, as a result of the merger, there will be two or fewer fascia competing with the merged entity post-merger and there are only three areas where there will be only three competing fascia other than the merged entity post-merger. On this basis, there are not considered to be horizontal competition concerns. Generally, even within central London, barriers to entry for convenience retailing do not appear to be insurmountable. However, within certain localities, it might be difficult to find rental space of a suitable size to operate a profitable small store. No conclusion has been drawn whether the barriers to entry in relation to the two mid-range stores are substantial given that no horizontal concerns have arisen in this case. The acquisition will lead to only a tiny increment to Tesco's upstream buyer power. Although third parties have expressed concerns about Tesco's existing purchasing power, any change in its position in this respect as a result of this acquisition is negligible.
33. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

## DECISION

34. This merger will therefore **not be referred** to the CC under section 22(1) of the Act.