OFFICE OF FAIR TRADING

Completed acquisition by Musgrave Investments plc of Londis (holdings) Limited

The OFT's decision on reference under section 22 given on 30 September 2004

Please note that square brackets indicate figures replaced by a range at the request of Musgrave.

PARTIES

1. **Musgrave Investment plc (Musgrave)** is a wholly owned subsidiary of Musgrave Group plc, an Irish grocery and food wholesale distributor. Musgrave Group plc is active in the GB through Budgens' chain of 234 grocery stores. 65 of these are owned and operated by independent retailers supplied by Budgens. Budgens plans to extend this scheme to all its currently owned stores. **Londis (Holdings) Limited (Londis)** is a wholesale supplier, mostly of groceries, to 1,947 member grocery store operators. Some operators trade under the Londis fascia. Londis's UK turnover for the year to 30 January 2004 was £515.9m.

TRANSACTION

2. Musgrave acquired Londis by way of a scheme of arrangement on 23 July 2004. The administrative deadline is 30 September 2004 and the statutory deadline is 22 November 2004.

JURISDICTION

3. As a result of this transaction Musgrave and Londis have ceased to be distinct. The UK turnover of Londis 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 a relevant merger situation has been created.

THEORY OF COMPETITIVE HARM

4. The parties overlap in the wholesaling of groceries in GB. However, since Musgrave only undertakes such activities in the GB to supply Budgens retail stores[1] and Londis distributes and supplies only to its own members, there is little possibility of actual direct competition between the parties. In any case, Musgrave estimates that the merged entity has a combined share in the distribution and wholesale supply of groceries in Great Britain of only approximately [0-5 per cent]. This overlap is therefore not considered further.

5. There is, however, a theoretical possibility that the merger could result in a reduction in competition in areas of concentration where there are both Budgens and Londis convenience stores. This is not a concern that has been raised by any third parties nor has any other evidence emerged to support such a theory.

6. As the owner of the wholesaler supplying the local Londis store and the owner and operator of the local Budgens store,[2] the incentives for Musgrave might be changed relative to the pre-merger situation. In theory, there are two ways in which Musgrave's incentives might change, to the detriment of consumers in local areas where both a Londis outlet and Budgens store are present.

- First, Musgrave might have greater incentives to increase its wholesale prices (and so its margins) to a local Londis store in the expectation that a proportion of any displaced sales will be won by the Budgens store. However, this scenario appears to be unrealistic, as there is little to prevent the Londis store from switching away from the merged entity to an alternative wholesaler, in particular given the levels of churn for Londis members currently. [3]

- Second, Musgrave might be able to increase its profit level by raising its retail prices in the local Budgens store. This might be a profitable strategy in that a proportion of the profits lost on reduced sales volumes through the Budgens store might be recouped from increased sales at the wholesaler level to local Londis store owners. Overall, in local areas where Londis and Budgens stores were closely competing with few alternatives, the merger could in theory lead to increased prices in the local area. This theory of harm is examined further below.

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[1] Both the stores it owns and the 65 independent stores owned by Budgens Members.
[2] Although an increasing number of the stores are franchised. [See note 1]
[3] Londis member stores are free to source from competing suppliers or join competing symbol groups. There is a high level of churn among Londis members: since November 2003, [150-250] new members have joined the Londis group, and around [50-150] have left, representing a churn of [10-20 per cent]. [See note 2]

COMPETITION ASSESSMENT

RELEVANT MARKET

Product market

7. The OFT has considered convenience grocery retailing in a number of previous cases, most notably Tesco/T&S and Tesco/Adminstore.[4] In the latter case, it was found that small stores (i.e., those generally less than 280 square metres) can only carry a limited range of products and, as a result, can generally only meet a consumer's needs for convenience shopping. However, convenience shopping is undertaken in a range of stores and therefore medium-sized and large stores also compete with small stores to meet a consumer's convenience shopping needs. Given that all Londis stores are 280 square metres or less and therefore small stores, this case has focussed on convenience grocery shopping.

Geographic market

8. In Tesco/T&S, the geographic frame of reference used for a small store was a one-mile radius. In Tesco/Adminstore, however, evidence suggested that a half-mile radius may be more appropriate for stores in London and local overlaps were considered on each basis. In this case, a similar approach has been used: a one-mile radius for stores outside the M25 and for stores within the M25 both a half- and one-mile radius used for considering the competitive impact of the transaction. As in Tesco/Adminstore, competition has also been considered at a national and regional level.

HORIZONTAL ISSUES

9. Musgrave estimates that the merged entity represents at most only [5-10 per cent] of the national convenience grocery retailing (increment [0-5 per cent]) if the Londis member stores are treated as being controlled by Londis. It further estimates that its combined share of supply in the London region is at most [5-10 per cent] (increment [0-5 per cent]). Due to the relatively small shares of supply of both the Londis and Budgens chains on a national and regional level, this transaction will not be expected

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[4] Respectively, the Deputy Director-General's advice on the proposed acquisition by Tesco plc of T&S Stores Limited and the OFT's decision on the anticipated acquisition by Tesco plc of 45 outlets from Adminstore Ltd. Convenience shopping was also considered by the Competition Commission (CC) in its report on the proposed acquisitions of Safeway plc and Asda Group Limited (owned by Wal-mart Stores Inc); Wm Morrison Supermarkets PLC; J Sainsbury and Tesco plc – A report on the mergers in contemplation (Cmnd 5950).

to have any impact on convenience retailing at the national or regional level under the above theory of competitive harm.

10. Musgrave has argued that this merger gives rise to no local competition concerns. Third parties have raised no such concerns. However, to test this, given the potential for competitive harm mentioned above, the OFT has used a sample of 93 Budgens stores (around 40 per cent of the total number of Budgens stores). This sample raised only four areas of potential competition concerns where there would be three or less convenience shopping outlets post-merger.

11. Previous investigations by the OFT have not concluded that barriers to entry to small stores are substantial. No third party has raised concerns about barriers to entry in this case and Musgrave has provided specific examples of the potential for entry into each of the four areas of potential competition concerns identified.

12. In these circumstances, the prospects of Musgrave being able to recoup a sufficient amount of profits lost from the Musgrave (Budgens) store through increased wholesaler sales to the Londis outlet are considered to be low. In order for such a strategy to be profitable, sufficient revenue would need to be diverted to the local Londis store rather than customers switching to alternative shopping outlets not linked to the parties. The available evidence indicates that the merged entity would continue to face local (actual or potential) competition.

13. This conclusion is reinforced by an examination of the margins achieved by Musgrave at the retail level (through Budgens) and by Londis at the wholesale level. Musgrave makes approximately a [20-30 per cent] margin on its retail sales whilst Londis' margin on its wholesale supplies to its member stores is approximately [5-10 per cent].[5] This significant difference between wholesale and retail margins lends weight to Musgrave's argument that the merger raises no competition issues in these local areas. Furthermore, Londis estimates that only [60-70 per cent] of sales in Londis stores are of goods acquired from Londis, so an even lower percentage of lost profit from sales diverted to Londis would be internalised by the merger. In light of this evidence, the OFT believes that the prospects of such a strategy being profitable for Musgrave are so low that no competition issue can reasonably be expected to arise from the merger.

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[5] Musgrave's margin on its wholesale supplies to the 65 independently owned stores is approximately [5-10 per cent].

Countervailing buyer power

14. The buyer power of individual consumers is considered to be minimal.

VERTICAL ISSUES

15. A potential vertical issue exists as Londis is a wholesale business supplying independent retailers and Musgrave is a vertically integrated grocery retailing business. The higher margins obtained by Musgrave through sales in its own stores may give it the incentive to worsen its offer to independent retailers, such that these will be disadvantaged at the downstream retail level relative to the Budgens stores. Such behaviour is not credible in the presence of a range of symbol groups and other wholesaling alternatives competing vigorously to operate as the wholesaler to additional independent retailers and Musgrave's stated intention to extend its franchising of Budgens stores. Musgrave would expect to lose its symbol group customers if it were to deteriorate the quality of its offer, as suggested by its levels of customer churn and the relative ease of switching suppliers. Retailers agreed that they have alternative options and would look to switch if the Londis offer were to deteriorate.

Upstream buyer power

16. Musgrave estimates that the merged entity accounts for [0-5 per cent] of the upstream grocery purchases nationally. The merger therefore raises no concerns in this regard.

THIRD PARTY VIEWS

17. No third party raised substantial concerns about this merger.

ASSESSMENT

18. A number of potential competition concerns have been investigated; none give rise to a realistic prospect of a substantial lessening of competition. In particular, we have considered whether Musgrave would have the incentive to raise prices from Budgens stores in certain areas of overlap with Londis stores. On the evidence provided in this case, there would be appear to be no reasonable prospect of it having such incentives, as the margin data and the survey of actual and potential competition at the retail level indicate that such a strategy would not be profitable.

19. 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

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

Notes

1. Musgrave would like to clarify that these stores are owned and independent stores, operated by Budgens Members.

2. Musgrave would like to clarify that there is a relatively high level of churn in the industry as a whole.