

Celesio AG and Sainsbury's Supermarkets Limited

A report on the anticipated acquisition by
Celesio AG of Sainsbury's Pharmacy Business

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The Competition and Markets Authority has excluded from this published version of the report information which the Inquiry Group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [X]. Some numbers have been replaced by a range. These are shown in square brackets. Non-sensitive wording is also indicated in square brackets.

Contents

Page

Summary	3
Findings.....	14
1. The reference	14
2. Industry background	14
Community pharmacies	15
Types of prescriptions.....	15
UK market size.....	16
Turnover/expenditure	16
History of pharmacy openings	17
Regulatory framework.....	17
Distance selling pharmacy contracts	18
Pharmacy funding and pricing	19
Hospital pharmacy services – outpatient dispensary	20
Pharmaceutical wholesaling	21
3. The companies	23
Celesio and Lloyds.....	23
AAH.....	24
Sainsbury’s pharmacy business	24
Other parties.....	25
4. The Transaction and relevant merger situation.....	26
Rationale for the Transaction	26
The Cooperation Agreement.....	27
Jurisdiction.....	27
Enterprises ceasing to be distinct.....	28
Turnover test	28
Conclusion on jurisdiction	28
5. Market definition.....	29
Product market.....	29
The Parties’ views	29
Our assessment	29
Customer markets.....	31
Our assessment	31
Geographic market	31
The Parties’ views	32
Our assessment	32
Conclusion on market definition	33
6. Counterfactual.....	34
The Parties’ views.....	34
Our assessment.....	34
Outpatient dispensary	35
7. Assessment of the competitive effects of the merger.....	35
Pre-merger competition in community pharmacies	36
The Parties’ views on pre-merger competition.....	36
Our assessment of pre-merger competition	44
Effect of the merger on competition in community pharmacies.....	88
How the merger would affect the Parties’ ability to compete locally	89
The incentive on Lloyds to deteriorate the offer at its stores	89

Identifying local areas where there may be a substantial lessening of competition	96
Other competitive constraints which might offset the effect of the merger in community pharmacies.....	132
Adverse effects on customers	132
Effect of the merger on outpatient dispensary	133
Vertical effects of the merger	134
Conclusion on the effects of the merger	137
8. Findings on the statutory questions	138
9. Remedies.....	139
Remedy options	140
Assessment of remedy options	142
The Celesio behavioural remedy proposal.....	142
Our assessment of the effectiveness of the behavioural remedy proposal..	143
Effectiveness of the structural remedy options	144
Prohibition of the merger	144
Divestitures in each of the local markets where we had found an SLC	145
Purchaser risk.....	153
Conclusion on effective remedies	163
Proportionality	163
Relevant customer benefits	164
Conclusion on remedy options.....	164

Appendices

- A. Terms of reference and conduct of the inquiry
- B. Industry background
- C. Summary of the constraints under the Cooperation Agreement between Lloyds and Sainsbury's
- D. DJS consumer survey report and diversion ratios
- E. Econometric demand estimation at the local level
- F. Pre-merger competition in pharmacies
- G. Empirical analysis of quality and margins
- H. Econometric analysis of the impact of entry and exit
- I. Determining the initial filter
- J. Relationship between survey diversion and distance between pharmacies
- K. Maps of areas where we have found an SLC

Glossary

Summary

1. On 29 December 2015, the Competition and Markets Authority (CMA) referred the anticipated acquisition by Celesio AG (Celesio) of Sainsbury's Supermarkets Limited UK Pharmacy Business (collectively 'the Parties') for an in-depth phase 2 investigation. In exercise of its duty under section 33(1) of the Enterprise Act 2002 (the Act), the CMA made a reference to its Chair for the constitution of a group¹ in order to investigate and report on the following questions in accordance with section 36(1) of the Act:
 - (a) whether arrangements are in progress or contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and
 - (b) if so, whether the creation of that situation may be expected to result in a substantial lessening of competition (SLC) within any market or markets in the UK for goods or services.

The Parties

2. Lloyds Pharmacy Limited (Lloyds) owns and operates the pharmacy chain branded LloydsPharmacy across the UK. It is a wholly owned subsidiary of Celesio, which is in turn ultimately controlled by the McKesson Corporation (McKesson).
3. Celesio acquired Lloyds in 1997. Lloyds has around 1,540 pharmacies in the UK, and operates 25 contracts for outpatient dispensary (OPD) pharmacies with 24 NHS trusts and a number of contracts with prisons, mental health trusts, private hospitals and community hospitals. Celesio also owns AAH Pharmaceuticals Limited (AAH), which it acquired in 1995. AAH is a wholesale supplier to pharmacies (including Lloyds), hospitals, GP practices and other healthcare establishments across the UK.
4. Sainsbury's pharmacy business is owned and operated by Sainsbury's Supermarkets Ltd (Sainsbury's), a wholly owned subsidiary of J Sainsbury plc. Sainsbury's operates 277 pharmacies and three OPD hospital trust contracts in four hospitals. Sainsbury's pharmacy is the second largest supermarket pharmacy chain, after Tesco. 21% of Sainsbury's stores (46% of Sainsbury's supermarkets) have a pharmacy.

¹ Section 33(1) of the Act provides that the group is to be constituted under [Schedule 4](#) to the Enterprise and Regulatory Reform Act 2013.

Industry background

5. Pharmacies dispense or sell medicines and non-pharmaceutical products (such as toiletries, beauty products and other consumer goods). Medicines are categorised into three groups by the Medicines and Healthcare products Regulatory Agency (MHRA):
 - (a) Prescription-only medicines (POMs or ethicals): pharmaceutical drugs that require a prescription from a GP or other prescribing healthcare professional.
 - (b) Pharmacy-only medicines (or P-medicines): pharmaceutical drugs that do not require a prescription but can only be sold under pharmacist supervision.
 - (c) General sales list (GSL) medicines: medicines that can be bought from pharmacies, supermarkets and other retail outlets without a prescription or the supervision of a pharmacist.
6. Community pharmacies² provide a range of services which can be broadly categorised as essential services, commissioned services and private services. All pharmacies must provide essential services. These vary slightly between the UK nations but include the core services of dispensing medicines and appliances. Pharmacies can choose whether to provide commissioned services if they meet the specified requirements. The range of commissioned services provided and how they are commissioned varies according to the UK nation in which the services are offered. Private services, such as travel vaccinations, are outside the NHS.
7. The UK pharmacy market was estimated to be worth around £14.5 billion in 2014. Growth in 2014 was estimated to be 2.1%. NHS receipts account for the majority of the market, and have been estimated at £10 billion. At present there are some 14,250 pharmacies in the UK.
8. There are a number of large pharmacy groups which together with Lloyds have around a 44% retail pharmacy market share. These are: Boots, Well (formerly Co-operative Pharmacy), Rowlands and Superdrug. Boots (a subsidiary of Alliance Boots, acquired by US drugstore operator Walgreens in 2014) is the largest single chain, with the highest market share. The four largest supermarket chains in the UK – Asda, Morrisons, Sainsbury's and Tesco – together have around 12% market share. Independent pharmacies,

² We have used the term 'community pharmacy' to mean all pharmacies that provide services for the NHS, excluding outpatient and inpatient dispensaries (which are situated in hospitals). Unless we are explicitly referring to outpatient dispensary all references to pharmacies are to community pharmacies.

which range from substantial regional operators with many pharmacies to single pharmacies, account for the remaining 44% market share.

9. To operate a pharmacy in the UK a licence³ is required and the granting of these licences is subject to strict criteria. In April 2005, the government relaxed some of the entry restrictions in England. Applications for new pharmacy contracts were then considered against a criterion of whether customers had 'reasonable choice' in an area. There were four circumstances where applicants were exempt from the control of entry test. The exemption that accounted for the most new entries was the condition that the pharmacy store would be open for at least 100 hours a week. The number of pharmacies in England subsequently increased by 19.6% between 2004 and 2014, from 9,736 to 11,647.⁴ In 2012 these exemptions were abolished.
10. We note that in England a consultation exercise is underway on changes to the community pharmacy contractual framework for 2016/17 and beyond. However the exercise did not affect our conclusions.

Hospital pharmacy services – outpatient dispensary

11. NHS commissioning bodies have in recent years begun to outsource OPD pharmacies. The move to outsourcing has arisen as NHS trusts look at potential ways to increase efficiency.⁵ Generally it has been larger NHS trusts to date that have decided to outsource OPD services. The main OPD operators are Boots and Lloyds. Lloyds has 25 NHS Trust OPD contracts with 24 NHS trusts. Boots has 20 different NHS trust OPD contracts, some of which operate at more than one site within the trust.
12. A number of other companies, including Sainsbury's, operate a smaller number of contracts and a number of NHS trusts have set up wholly owned subsidiaries to provide OPD services within their trusts.

Pharmaceutical wholesaling

13. In the UK most pharmaceuticals are distributed through wholesalers to pharmacies. There are around 44 pharmaceutical wholesalers in the UK. The largest are Alliance Healthcare (Distribution) Limited (Alliance Healthcare) (part of Walgreens Boots Alliance), AAH (Celesio) and Phoenix (Rowlands), which in total account for around 79% of the prescription-only market by

³ We use the term licence to mean when a pharmacy is listed on the relevant Nation's Pharmaceutical List and is able to provide services under that nation's pharmaceutical contract, for example in England the Community Pharmacy Contractual Framework.

⁴ General Pharmaceutical Services in England 2004-05 to 2013-14, Appendix 1.

⁵ There are also VAT benefits.

value. In P-medicines these three wholesalers account for around 75% of the market by value.

14. In 2007 Pfizer started supplying its products through a single wholesaler (Unichem – part of Alliance Boots) to pharmacies. This is known as direct-to-pharmacy (DTP). The role of a wholesaler in this model is purely as a logistics service provider (LSP), where it is simply paid a fee to deliver the medicines and the wholesaler is acting as an agent of the manufacturer. Several other manufacturers have subsequently introduced DTP distribution.

Regulation

15. There is a range of regulations that apply to pharmacies which restrict their freedom to change elements of their offering. In particular, there is limited price competition between pharmacies because NHS POMs, which make up the bulk of their business, are either free at the point of delivery or are charged at the fixed NHS prescription levy. There are also regulatory constraints on certain quality parameters. For example, a pharmacy must open for a core number of hours (usually core hours are either 40 hours or 100 hours depending on the pharmacy's licence), must employ a qualified pharmacist and must be licensed to operate in a given location.

The Transaction and relevant merger situation

16. Following a review of Sainsbury's pharmacy business in 2014, informal discussions were held with Celesio (Lloyds) and other pharmacy operators to assess their interest in acquiring the Sainsbury's pharmacy business. A formal sales process commenced in April 2015. Celesio was selected as the preferred bidder and the business sale agreement (BSA) was signed at the end of July 2015. Alongside the BSA, a Cooperation Agreement was also signed. This was necessary to cover the ongoing relationship between the Parties, as the Lloyds pharmacies would operate within the Sainsbury's supermarkets. The purchase price was [REDACTED]. [REDACTED] would also be paid by Celesio to Sainsbury's. We refer to these agreements collectively as the Transaction in this report.
17. We concluded that, by virtue of the Transaction, arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation. Consequently, we concluded that the jurisdictional test is satisfied in this case.

Market definition

18. We assessed the relevant market definition for the inquiry. We first considered the product market and concluded that it is appropriate to aggregate the markets for POMs, P-medicines and pharmacy services and to assess retail competition at the level of the pharmacy.
19. Pharmacies do not appear to adopt a conscious policy of targeting specific types of customers in a way that directly affects their ability to compete for other customers. We concluded that the differences between various groups of customers and the ways they are targeted by pharmacies did not require the definition of separate customer markets.
20. We then considered the appropriate scope of the geographic market. We looked at the distance between a pharmacy and its customers' homes when defining the relevant geographic market. We estimated the radius of the circle centred on each pharmacy that would include 80% of the pharmacy's prescription customers and calculated the radius separately for Lloyds and for Sainsbury's pharmacies.
21. Table 1 summarises the average radius of the catchment areas for the various area types. We have therefore identified the average customer catchment area of any of the Parties' pharmacies as being the circle centred on the pharmacy with radius as shown in Table 1. Depending on the type of analysis, the relevant competitors were defined either as those rival pharmacies located within the catchment area around the pharmacy being considered, or the rival pharmacies whose catchment areas intersect that of the pharmacy being considered.

Table 1: Average radius of catchment areas

Area type	miles	
	Lloyds	Sainsbury's
Conurbation	1.4	2.4
City and town	1.4	3.4
Rural	2.3	4.7
Very rural	3.6	4.7

Source: CMA analysis.

* The four types of area were defined by aggregating in four groups the ten rural/urban categories defined by the Office for National Statistics (ONS).

Counterfactual

22. We assessed what would have happened in the absence of the merger (the counterfactual). We concluded that the counterfactual was the continuation of the pre-merger situation in retail pharmacy and OPD.

Competitive effects

23. We assessed the competitive effects of the acquisition and considered whether the merger may be expected to result in an SLC within any market or markets in the UK for goods or services.⁶ The Parties' combined national market share in community pharmacy, and the small increment to Lloyds' market share as a result of the merger, led us to conclude that national effects on retail competition were unlikely. We therefore focused on local competitive effects. For vertical aspects of competition and OPD we considered national effects.

Pre-merger competition

24. We first considered the way that pharmacies compete presently (ie pre-merger).
25. We recognise that this is a market in which regulation plays an important role. As noted in paragraph 15 several of the quality parameters we have considered are subject to minimum levels below which quality cannot be reduced. The prices of POMs are regulated. We consider that regulation may inhibit to some extent the degree of competition compared with some other retail operations. However the amount of competition may still be sufficiently significant that its loss would be a matter of concern to us. Regulations set a minimum standard for some quality parameters but pharmacies are free to offer higher levels of service.
26. We considered evidence on customer preferences. Convenience of location is the most important driver of pharmacy choice for both Parties' customers. However, there are a number of other drivers of choice which customers of both Parties also value, including quality and speed of service, opening hours, stocking levels and waiting times. Customers take these elements of the offering into account when choosing which pharmacy to visit. Although there are some differences in the demographics between Sainsbury's and Lloyds, they did not point to significantly different customer preferences and we found that supermarket and non-supermarket pharmacies are regarded by customers as substitutes. We also found that customer diversion between the Parties was high in some local areas, particularly where they were close geographically.
27. Internal documents from across both Sainsbury's and Celesio collectively show that although there is some differentiation between their offerings, both

⁶ Section 36 of the Act.

Parties consider that non-supermarket and supermarket pharmacies can compete. Third party comments also supported the view that Lloyds and Sainsbury's (and supermarket and non-supermarket pharmacies more generally) compete with one another to attract prescriptions and that consistent with the consumer evidence, closeness of competition depends on local market characteristics.

28. We found that Lloyds has the ability to compete at a local level by flexing parameters which customers value of quality, range and service (QRS) in response to their competitors, including Sainsbury's. Sainsbury's also has the ability to flex competitive parameters at a local level, but to a more limited extent. In addition there is an incentive for individual Lloyds and Sainsbury's pharmacies to compete to maximise their share of the number of prescriptions in the local area in order to increase profits. We also consider that the remuneration structure for Lloyds' local management gives them the incentive to ensure that the offering is strong where there is more competition while also giving the incentive to reduce the level of offer, to cut costs and increase profitability where there is less competition.
29. We found examples from internal investment documents showing that Lloyds responds to competition from other pharmacies in a local area and, in areas where supermarkets are present in the area, responds to competition from supermarkets. We found that there were no references in the documents to Lloyds taking specific action in response to a Sainsbury's pharmacy, although in several instances Sainsbury's is mentioned in the review of local competitors. However, we have not found in our investigation that Sainsbury's pharmacies are different to other supermarket pharmacies and we concluded that Lloyds competes at a local level by flexing parameters which customers value of QRS in response to their competitors, including Sainsbury's.
30. We consider that the above provides clear evidence that the Parties compete pre-merger and that the extent of the competitive constraint imposed by Sainsbury's on Lloyds would be material in particular local areas where the two are in each other's catchment areas and where there are few other competitors nearby to constrain the Parties.

Effect of the merger on competition

31. We then assessed the likely effect of the proposed merger against the situation in the counterfactual. Our assessment indicated that there would be an incentive for Lloyds to deteriorate aspects of its offer in certain local areas. We found that this would be most likely in the Lloyds pharmacies rather than the Sainsbury's stores given the effect of the Cooperation Agreement, which

constrains Lloyds' ability to reduce QRS in the Sainsbury's pharmacies after the merger.

32. We sought to identify the local areas where the merger would cause an SLC as a result of the reduction in the number of pharmacy operators in the area. Out of the 1,816 Sainsbury's and Lloyds total pharmacies, the catchment areas of 929 overlap (ie the Sainsbury's and Lloyds pharmacy catchment areas overlap). We conducted a consumer survey in 16 local overlap areas which we used as case studies to illustrate the features causing customers to divert between the Parties in particular locations. We then applied these features to other areas using available data, and used this assessment to identify areas of possible concern.
33. Our overall approach was to look first for mechanistic rules which could filter out unproblematic areas, and then to carry out more detailed local area assessments in the remaining local areas. We adopted a conservative approach to the selection of the mechanistic rules so that we were confident we would identify all the potentially problematic areas. We focused mainly on the Lloyds pharmacies because of the effect of the Cooperation Agreement. Using the mechanistic rules, we filtered the 929 overlaps into 171 stores of potential concern. We also included Cardiff as an area for further investigation, even though this was not identified as potentially problematic through use of the filter. We chose to include Cardiff as the area was characterised by high diversion between the Parties and the consumer survey revealed that the nearest competitor to the Sainsbury's store received little diversion.
34. By looking in detail at maps of the local markets we surveyed in our consumer survey we identified the local market features that were associated with high diversion ratios. We then used these features to assess the characteristics of the areas around the 171 stores that had been identified using the initial filters. We examined maps of each area (plus the additional area within Cardiff) and examined the specific circumstances of each store. We considered characteristics of the areas in detail including:
 - (a) the location of customers and GP practices relative to pharmacies in the area and whether the Parties were materially closer to each other, their customers and GPs than other competitors (note that this applied even if a competitor(s) was within the radius of a catchment area but significantly further away). This identified whether, within the catchment area, a substantial proportion of customers would only be able to choose between the Parties, or the Parties and a small number of other pharmacies;

- (b) specific geographic features associated with the location of the pharmacies that could affect the ease with which customers could access specific pharmacies;
 - (c) journey routes and other relevant factors (such as local bus services) that could also affect the ease with which customers could access specific pharmacies. This included identifying where the Parties were not particularly close but there was a direct road route between the Parties' stores and another competitor would not be passed before reaching the other party; and
 - (d) finally, where available we considered diversion ratios.
35. Our assessment required an exercise of judgement and the level of detail required in the assessment depended on the specific characteristics of each area. In some cases it was easy to dismiss areas as not representing a concern (for example, where the proximity filter identified two stores as close in straight-line distance but the road network meant that they were unlikely to be close competitors). In other cases each aspect detailed above had to be assessed in detail in order to allow us to form a view of whether we would expect there to be a competitive problem.
36. We also assessed further information provided by the Parties after we had published our provisional findings, including a consumer survey that the Parties had commissioned in six of the areas where we had provisionally identified SLCs but had not surveyed the area: Christchurch; Leeds; Liverpool; Luton; Sandy/Potton/Biggleswade; and Sutton Coldfield.
37. As a result of our assessment we found SLCs in 12 areas: Beaconsfield; Bracknell; Cardiff; Christchurch; Kempston; Kidlington; Leeds; Liverpool; Luton; Reading/Theale; Sandy; and Warlingham. In these local areas the Parties are the closest competitors with very few alternatives. We found that in these areas Lloyds has the ability to compete at a local level by flexing the parameters which customers value of QRS. These were the same areas where we had provisionally found that the merger may be expected to result in an SLC, except that we no longer found an SLC at Sutton Coldfield.

Competitive effects of the merger on outpatient dispensary

38. We examined the effects of the merger on OPD. In view of the limited competitive constraint exerted by Sainsbury's on Lloyds and the presence of alternative bidders, we concluded that the merger may not be expected to result in an SLC in the provision of outsourced OPD services to NHS trusts.

Vertical effects of the merger

39. We examined the vertical effects of the merger. We did not consider that the merger has substantially increased Lloyds' ability and incentive to foreclose rival retailers or rival pharmaceutical wholesalers and concluded that the merger may not be expected to result in an SLC as a result of foreclosure.

Other competitive constraints which might offset the effect of the merger

40. We assessed whether entry by new companies or expansion by existing ones might mitigate the effect of the merger on competition. We noted that regulation controlling entry to pharmaceutical lists acted as a high barrier to entry, although the extent of the barrier depends on local conditions. We have not been provided with any evidence that entry may mitigate the effects of the merger in any of the local areas listed above and concluded that entry is unlikely to mitigate the SLC in any of these local areas.
41. We did not find any other competitive constraints that might offset the effects of the merger.

Remedies

42. We considered whether action should be taken for the purpose of remedying, mitigating or preventing the SLC or any adverse effects which may be expected to result from such an SLC, having regard to the effect of any action on any relevant customer benefits (RCBs) (as defined in the Act) in relation to the merger.
43. In our notice of possible remedies (Remedies Notice) we invited views on potential structural remedies involving prohibition of the merger or requiring the divestiture of one or more Lloyds pharmacies (licence with premises) in each local market where we had provisionally found that the merger may be expected to result in an SLC as a result of the Transaction. We also invited views on behavioural remedies.
44. Celesio initially submitted a behavioural remedy consisting of an undertaking not to reduce the opening hours at any Lloyds pharmacy in the affected areas. Later, Celesio said that the remedy could be expanded to cover the range of pharmacy services offered at Lloyds' stores in the SLC areas and suggested that such a remedy would be proportionate. Celesio submitted that this would address the CMA's concern about the possible deterioration of the competitive offer at these Lloyds stores.

45. We considered the behavioural remedy proposal carefully. We note that our guidance sets out that the CMA generally prefers measures that remove obstacles to competition rather than those that control market outcomes. Remedies must be practical and capable of effective implementation, monitoring and enforcement. In addition, remedies that act quickly in addressing competitive concerns are preferable to those which take longer to implement or where the timing of the effect is uncertain. Remedies must be in place for the likely duration of any SLC. The behavioural remedy proposed by Celesio seeks to control market outcomes. We considered that the remedy would be difficult to specify and there would be no obvious end date for the remedy. We were concerned that the remedy may cause significant market distortions over time, such as inhibiting innovation. We therefore did not consider that the behavioural remedy proposed would be an effective remedy.
46. In our view prohibition of the merger would be an effective remedy. We also considered that divestiture of a Lloyds pharmacy in each of the 12 local markets where we had found an SLC would also be an effective remedy. We decided that the divestiture of a Lloyds pharmacy in each of the 12 local markets where we had found an SLC would be more proportionate and we decided to apply this remedy. We did not consider that there are any RCBs which are relevant to our assessment.
47. We decided that the appropriate time frame for completion of the 12 local divestitures was [X]. We have also decided that a number of other safeguards are required to protect the pharmacies to be divested to ensure that there are no risks of asset deterioration occurring during the sale process. Undertakings would be required pending the divestitures and a monitoring trustee would be required, with a suitably focused brief to ensure that the trustee concentrates on key areas of potential harm. We did not consider that a divestiture trustee would be required but reserved the right to appoint one if we have reason to expect that Celesio will not divest the relevant pharmacies to a suitable purchaser within [X].

Findings

1. The reference

1.1 On 29 December 2015, the CMA referred the anticipated acquisition by Celesio of Sainsbury's for an in-depth phase 2 investigation. In exercise of its duty under section 33(1) of the Act, the CMA made a reference to its Chair for the constitution of a group⁷ in order to investigate and report on the following questions in accordance with section 36(1) of the Act:

- (a) whether arrangements are in progress or contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and
- (b) if so, whether the creation of that situation may be expected to result in an SLC within any market or markets in the UK for goods or services.

1.2 Our terms of reference, along with information on the conduct of the inquiry, are set out in Appendix A.

1.3 This document, together with its appendices, constitutes our findings. Further information, including non-commercially-sensitive versions of the Parties' submissions and summaries of evidence from third parties, can be found on our website.⁸

2. Industry background

2.1 Pharmacies dispense or sell medicines and non-pharmaceutical products (such as toiletries, beauty products and other consumer goods). Medicines are categorised into three groups by the MHRA:

- (a) POMs (or ethical):⁹ pharmaceutical drugs that require a prescription from a GP or other prescribing healthcare professional. Prescriptions can be either NHS or private. NHS prescriptions come under the essential services the pharmacist provides.
- (b) P-medicines: pharmaceutical drugs that do not require a prescription but can only be sold under pharmacist supervision.¹⁰

⁷ Section 33(1) of the Act provides that the group is to be constituted under [Schedule 4](#) to the Enterprise and Regulatory Reform Act 2013.

⁸ [Celesio Sainsbury's pharmacy business merger inquiry](#).

⁹ POMs may be further segmented into Branded (product is branded according to the pharmaceutical company that initially developed and has/had the patent for the product) and Generic (where the patent has expired and the product may be produced by a number of manufacturers under licence).

¹⁰ Examples of P-medicines include antibiotic eye drops and pharmacy-strength treatments for excessive sweating or fungal infections.

- (c) GSL medicines: medicines that can be bought from pharmacies, supermarkets and other retail outlets without a prescription or the supervision of a pharmacist.

Community pharmacies

- 2.2 Pharmacies come in a range of different types and formats. They vary in terms of location, size of store, and the product categories that they sell alongside pharmaceuticals. We have used the term ‘community pharmacy’ to mean all pharmacies that provide services for the NHS irrespective of where they are situated, excluding outpatient and inpatient dispensaries.¹¹
- 2.3 Community pharmacies provide a range of services, which can be broadly categorised as essential services, commissioned services and private services. All pharmacies must provide essential services. These vary slightly between the UK nations but include the core services of dispensing medicines and appliances. Pharmacies can choose whether to provide commissioned services if they meet the specified requirements. The range of commissioned services provided and how they are commissioned varies according to the UK nation in which the services are offered. Local services such as needle exchange, sexual health services, support to stop smoking, support for weight loss, alcohol advice, etc are commissioned to target local health priorities. Private services, such as travel vaccinations, are outside the NHS. For further details on the variations by nation see Appendix B.
- 2.4 The large majority of pharmacies provide NHS services.¹²

Types of prescriptions

- 2.5 Traditionally, patients have been given a paper prescription by their GP, which they then physically take to any pharmacy of their choice. In cases where the patient wishes to use the Electronic Prescription Service (EPS),¹³ and the GP practice has the technology to use EPS, the patient may nominate a pharmacy to which the prescription is sent.¹⁴ This system is most suitable for patients who repeatedly require the dispensing of medicines. Sainsbury’s told us that, in October 2015, 37% of medicines in England were dispensed

¹¹ Outpatient and in-patient dispensaries are located in hospital premises.

¹² A minority of pharmacies do not hold a NHS pharmacy licence and so do not provide NHS services.

¹³ Strictly speaking, this is the second release of the Electronic Prescription System, which differs from the first release in that the prescription is sent from the prescriber to the dispensary, without the patient needing to carry a paper form that is scanned in by the dispensary. All references to EPS imply EPS2.

¹⁴ In January 2016 around 98.5% of pharmacies were able to use EPS and 74% of GP practices. See the [Health & Social Care Information Centre](#).

through EPS. This system has not been rolled out to the same extent in Wales and Scotland,¹⁵ and electronic prescriptions are not available in Northern Ireland. To encourage free patient choice, the GP may not influence a patient to nominate a particular dispensing site.¹⁶ If a patient asks for a recommended pharmacy, the GP must provide a list of all pharmacies that can accept electronic prescriptions in the area.

- 2.6 Patients may also nominate a pharmacy to receive their EPS medicines when they are in a pharmacy, and pharmacies try to convert as many of their customers into nominating customers as possible. [X] told us that most nominations were secured in this way. Pharmacies may not however offer inducements to encourage patients to make a particular choice.¹⁷

UK market size

Turnover/expenditure

- 2.7 The UK pharmacy market was estimated to be worth around £14.5 billion in 2014.¹⁸ Growth in 2014 was estimated to be 2.1%. NHS receipts account for the majority of the market, and have been estimated at £10 billion. The number of NHS prescriptions has grown by some 4% per year over the last ten years but NHS receipts have grown by only 1% per year over the same period, indicating that NHS expenditure is decreasing in spend per item dispensed.

Pharmacy numbers

- 2.8 At present there are some 14,250 pharmacies in the UK. The larger specialist operators¹⁹ (Boots, Lloyds, Rowlands, Superdrug and Well) account for some 44% of pharmacy licences. Within this, Lloyds has a share of [X] [10–20]% of UK licences. Major supermarkets account for some 12%, of which Sainsbury's has a share of [X] [0–5]% of UK licences. Independents and others account for 44% of UK licences.

¹⁵ In Scotland and Wales patients are given a paper prescription which also includes a bar code for pharmacies to download information.

¹⁶ [The National Health Service \(Primary Medical Services\) \(Miscellaneous Amendments\) Regulations 2005](#), Regulation 39B(4)(a).

¹⁷ [The National Health Service \(Pharmaceutical and Local Pharmaceutical Services\) Regulations 2013](#), Regulation 30.

¹⁸ Verdict (14 January 2015), Health and Beauty, Pharmacy UK market report.

¹⁹ Generally we have classified larger operators as those with over 500 pharmacies. Independent/other operators range from single store owners to operators with a significant number of stores (but fewer than 500) – for example Day Lewis plc has just under 250 stores.

Table 2: Market shares

<i>Retailer</i>	<i>Retail pharmacy market share (%)*</i>	<i>Market share of NHS revenue (%)†</i>
Independent/other	44	43
Boots	[20–30] [⊗]	[20–30] [⊗]
Lloyds	[10–20] [⊗]	[10–20] [⊗]
Well	[5–10] [⊗]	[5–10] [⊗]
Rowlands	[0–5] [⊗]	[0–5] [⊗]
Superdrug	[0–5] [⊗]	[0–5] [⊗]
Larger operators	44	49
Tesco	[0–5] [⊗]	[0–5] [⊗]
Sainsbury's	[0–5] [⊗]	[0–5] [⊗]
Asda	[0–5] [⊗]	[0–5] [⊗]
Morrisons	[0–5] [⊗]	[0–5] [⊗]
Big 4 supermarkets	12	8
Combined Lloyds/Sainsbury's	14	16

Source: Verdict UK pharmacy report (2015).

* Calculated on the basis of percentage of licences.

† Calculated on the basis of sales revenue.

History of pharmacy openings

- 2.9 In April 2005, the government relaxed entry restrictions in England. Applications for new pharmacy contracts were then considered against a criterion of whether customers had ‘reasonable choice’ in an area. There were four circumstances where applicants were exempt from the control of entry test entirely. The exemption that accounted for the most new entry was the condition that the pharmacy store would be open for at least 100 hours a week. The number of pharmacies in England subsequently increased by 19.6% between 2004 and 2014, from 9,736 to 11,647.²⁰ In 2012 the exemptions were abolished. There were much smaller changes in pharmacy numbers in Scotland, Wales and Northern Ireland where no similar exemptions were available. In Wales, for example, the number of pharmacies remained relatively stable throughout the period 2004/05 to 2014/15, increasing by only 11 from 705 to 716.²¹

Regulatory framework

- 2.10 Pharmacies in the UK are subject to specific regulatory and licensing arrangements. England, Scotland, Wales and Northern Ireland each have their own regulatory controls. These are set out in Appendix B. The regulations are similar, though not identical, by nation: the licensing authority must be satisfied that the pharmacist is fit to practise and, in the case of an application for a new pharmacy, that there is an unmet need that the pharmacy will satisfy.

²⁰ General Pharmaceutical Services in England - 2004-05 to 2013-14 Appendix 1.

²¹ StatsWales website: Community pharmacies by LHB and year.

- 2.11 All pharmacy premises in Great Britain must be registered with the General Pharmaceutical Council (GPhC), which is the regulator that enforces standards and regulates the pharmacy profession. In Northern Ireland the regulator is the Pharmaceutical Society of Northern Ireland. Pharmacies must comply with the Terms of Service. These govern a variety of the terms of services for pharmacies, including opening hours, access, professional standards and suitability of the premises. A pharmacy could be removed from the Pharmaceutical list due to failure to comply with the Terms of Service.
- 2.12 In addition to community pharmacies, certain individuals are also able to obtain prescriptions from dispensing doctors who are licensed to dispense pharmaceuticals to patients who live in areas with few or no community pharmacies. There are approximately 1,233 dispensing doctors, who dispense approximately 6% of prescriptions based on volume of products purchased.²² Dispensing doctors require a licence from the NHS to dispense pharmaceuticals in this way, and must confirm that patients are eligible to receive prescriptions from them.^{23,24} In these circumstances a patient is free to choose to have their prescription dispensed by another pharmacy, but they are also able to choose for their prescription to be dispensed at the GP practice, even if the GP practice is in direct proximity to another pharmacy.

Distance selling pharmacy contracts

- 2.13 Regulation 25 (and the conditions set out in Regulation 64) of the Pharmaceutical Services 2013 Regulations provide for distance selling pharmacy (DSP) (often commonly referred to as ‘internet pharmacy’) contracts. Within the UK, DSP contracts are only currently differentiated in England (pharmacies in other parts of the UK can offer internet services on top of their ‘bricks and mortar’ offering, but cannot offer internet pharmacy services in isolation to NHS patients). DSPs must ensure no face-to-face access to essential pharmaceutical services, and the services must be made available to any part of England. There are no equivalent regulations in Scotland, Wales or Northern Ireland.

²² [Parties’ initial submission](#), paragraph 6.1.2.

²³ Dispensing doctors dispense approximately 6% of prescriptions based on volume, according to the Parties.

²⁴ This may be the case where a patient satisfies the local health authorities that they would have serious difficulty in obtaining any necessary drugs or appliances from an NHS pharmacist by reason of distance or inadequacy of means of communication or a patient is resident in an area which is rural in character, known as a controlled locality, at a distance of more than 1 mile (1.6 km) from pharmacy premises (excluding any distance selling premises). The pharmacy premises do not have to be in a controlled locality.

Pharmacy funding and pricing

- 2.14 Pharmacies receive funding through the respective nation's NHS, for example NHS Scotland. Funding includes:
- (a) reimbursement for POMs and appliances, which includes retained buyer margin;²⁵ and
 - (b) fees and allowances.
- 2.15 The reimbursement amount and fees and allowances are set out in each nation's own Drug Tariff. The Drug Tariff sets out the rates payable for the provision of pharmaceutical services and the way in which reimbursement is calculated for drugs (both generic and proprietary products) and appliances supplied, and it lists those appliances which are approved for supply. It also sets out the remuneration (professional fees/allowances) which is paid as part of the pharmacy contract.
- 2.16 Whereas the reimbursement amount a pharmacy receives from the government is set through the Drug Tariff, the price paid by a pharmacy for a medicine is determined through negotiation with the wholesaler or the manufacturer. The government caps the profit that the pharmacy can make by buying products at a price lower than the reimbursement price (the retained buyer margin). This is done through the retained buyer margin mechanism. The retained buyer margin in England, for example, is a capped fund set at £800 million for both 2014/15 and 2015/16. In Scotland the equivalent Retained Purchase Profit in 2013/14 was around £82 million.
- 2.17 The pricing of P-medicines and GSL products are not regulated and are therefore set by the pharmacy. We understand that prices are usually uniform across a company's estate. The cost of P-medicines and GSL products is negotiated between the pharmacy and the supplier.
- 2.18 Prescription charges only apply in England. There are no prescription charges in Scotland, Wales and Northern Ireland. The prescription charge – currently £8.40 per item (if a customer is not exempt from payment) – does not affect the revenue the prescription generates for the pharmacy. It is simply collected by the pharmacies and paid over to the UK government.
- 2.19 Fees and allowances cover funding for general service provision including: Item Fees, Establishment Payments, the Repeat Dispensing Annual Payment,

²⁵ In Scotland the equivalent is Retained Purchase Profit.

and Additional Fees. In England funding for fees and allowances is currently set at £2.0 billion for both 2014/15 and 2015/16. In Scotland funding in 2013/14 was around £200 million.²⁶

- 2.20 In England, on 17 December 2015, the Department of Health and NHS England sent a letter to the Pharmaceutical Services Negotiating Committee (PSNC)²⁷ inviting it to enter into discussions with the Department of Health, supported by NHS England, on changes to the community pharmacy contractual framework for 2016/17 and beyond. The letter suggested there was a need for a clinically focused community pharmacy service that was better integrated with primary care. It also stated that the funding commitment for pharmacies in England would reduce from £2.8 billion in 2015/16 to £2.63 billion in 2016/17.²⁸ The consultation period extended to 24 May 2016. The letter noted that 40% of pharmacies are in a cluster where there are three or more pharmacies within 10 minutes' walk and that the development of large-scale automated dispensing, such as 'hub and spoke' arrangements, provides opportunities for efficiencies. Some pharmacies expressed concern at the proposed changes.²⁹ However, the exercise did not affect our conclusions.

Hospital pharmacy services – outpatient dispensary

- 2.21 The outsourcing of OPD is a relatively new development in the market, and NHS commissioning bodies have only recently begun to outsource OPD pharmacies. The move to outsourcing has arisen as NHS trusts look at potential ways to increase efficiency.³⁰ Generally it has been larger NHS trusts to date that have decided to outsource OPD services.
- 2.22 OPD pharmacy contracts are publicly tendered, usually under the terms of the public procurement rules. OPD pharmacy contracts are awarded for pharmacies located within hospitals. Most OPD pharmacies do not hold community pharmacy licences, and are therefore prevented from dispensing prescriptions other than for ethical medicines to customers of that hospital. Consequently, most OPD pharmacies cannot compete with community retail

²⁶ In Scotland funding for retained purchase profit, fees and allowances was £279.6 million in 2013/14 with funding set to increase by 1.74% in 2014/15. [Community Pharmacy Scotland: Financial Framework 2015/16](#).

²⁷ [Department of Health and NHS England letter to Pharmaceutical Services Negotiating Committee on community pharmacy](#).

²⁸ The Department of Health proposed that the establishment payment would be phased out over a number of years. The existing value of the establishment payment in England is £270 million. The median average pharmacy receives £220,000 a year in NHS fees and allowances (including margin). See [Community pharmacy in 2016-17 and beyond - proposals - stakeholder briefing sessions](#).

²⁹ Day Lewis described the proposals as 'frightening'. WR Evans said that the Chief Pharmaceutical Officer had commented that there were 3,000 too many pharmacies in the UK.

³⁰ There are also VAT benefits.

pharmacies. A small number of OPD pharmacies may also, in addition to their OPD pharmacy contract, have obtained a community pharmacy contract allowing them to fulfil other NHS prescriptions – but this is rare.

2.23 The main players in this sector are Boots and Lloyds:

(a) Boots has 20 different NHS trust OPD contracts, some of which operate at more than one site within the trust.

(b) Lloyds has 25 different NHS trust OPD contracts.³¹

2.24 In addition to contracts operated by Boots and Lloyds, Sainsbury's, Well and Rowlands each operate three contracts, Healthcare at Home operates one and at least six NHS trusts have set up wholly owned subsidiaries to provide OPD services within their trusts.

2.25 On 5 February 2016, Lord Carter published a report on productivity and performance in English NHS acute hospitals.³² Part of the report concerned hospital pharmacy services. It noted that, on average, 55% of pharmacy staff time (43% of costs) is spent on infrastructure services,³³ with the largest element being supply chain activities (at 45% of staff time), encompassing the buying, making and supplying of medicines. The report highlighted a need for NHS trust hospital pharmacies to optimise the use of NHS personnel on the delivery of pharmacy services rather than on infrastructure services. The report noted that some trusts had outsourced outpatient dispensing to community pharmacy providers and stated that this was cost-effective and freed up clinical pharmacy staff to focus on clinical services.

Pharmaceutical wholesaling

2.26 In the UK most pharmaceuticals are distributed through wholesalers to pharmacies. There are around 44 pharmaceutical wholesalers in the UK.³⁴

2.27 Wholesalers divide into 'broad-line' wholesalers (that supply a broad range of products – around 12,000) and 'short-line' wholesalers (that supply a more limited product range). Broad line wholesalers are further segmented into national and regional. Wholesalers supplying the UK market include:

³¹ With 24 NHS trusts.

³² [Operational productivity and performance in English NHS acute hospitals: Unwarranted variations. An independent report for the Department of Health by Lord Carter of Coles.](#)

³³ Infrastructure services include procurement and dispensing of medicines, homecare, training provided to pharmacists and technicians, and medicine information. Ibid, p31.

³⁴ BMI Research.

- (a) Broad-line – national: Alliance Healthcare (Distribution) Limited (Alliance Healthcare) (part of Walgreens Boots Alliance), AAH (Celesio) and Phoenix (Rowlands).
 - (b) Broad-line – regional: Maltby, United Drug Sangers, Norchem, Sants, Mawdsley Brookes, Sangers (Maidstone).
 - (c) Short-line: include De Louis, Colorama/Waymade, Sigma, Ethigen, DE Pharms, Lexon, Trident and OTC Direct.
- 2.28 The market for distribution of medicines changed in 2007 when Pfizer started supplying its products through a single wholesaler (Unichem – part of Alliance Boots) to pharmacies. This is known as DTP. The role of a wholesaler in this model is purely as an LSP, where it is simply paid a fee to deliver the medicines and the wholesaler is acting as an agent of the manufacturer. Following Pfizer's decision, AstraZeneca, GlaxoSmithKline plc, Eli Lilly and others have also introduced DTP distribution. In addition, a number of manufacturers have adopted a Restricted Wholesaler Model (RWS), where a limited number of wholesalers are selected by the manufacturer.
- 2.29 Within the supply chain there are a number of independent pharmacy networks/groups which provide buying group services as well as providing business advice to their members. A large proportion of single-owner independents and small chains belong to these buying groups.
- 2.30 Table 3 shows estimates of market shares from the three main players (Alliance Healthcare, AAH and Phoenix).³⁵ These three account for around 79% of the prescription-only market by value, with regional broad line wholesalers making up around 6% and short line 12%. Others make up the remaining 3%. In P-medicines the main three wholesalers make up around 75% of the market by value (including manufacturer direct sales), regional broad line 8%, short line 16% and others 1%.

³⁵ Note that Phoenix did not provide an estimate for pharmacy only medicines.

Table 3: Pharmaceutical market shares estimates

				%	
Wholesaler	POMs (value)			P-medicines (value)	
	Alliance estimate	AAH estimate	Phoenix estimate	Alliance estimate	AAH estimate
AAH	[X]	[X]	[X]	[X]	[X]
Alliance	[X]		[X]	[X]	
Phoenix		[X]	[X]		[X]
National total	79.0	80.3	79.3	75.2	57.9
Regional broad line	[X]	[X]	[X]	[X]	[X]
Short line	[X]	[X]	[X]	[X]	[X]
Others incl manufacturer direct sales	[X]	[X]	[X]	[X]	[X]

Source: the Parties and third parties.

3. The companies

Celesio and Lloyds

- 3.1 Lloyds owns and operates the pharmacy chain branded LloydsPharmacy across the UK. It is a wholly owned subsidiary of Celesio, which is in turn ultimately controlled by the McKesson.³⁶ McKesson is a healthcare service business based in the USA with a turnover for the year ended 31 March 2015 of \$179 billion.
- 3.2 Celesio provides traditional prescription pharmaceuticals and non-prescription products and medical services. It operates under the Lloyds pharmacy brand in the UK, which it acquired in 1997.
- 3.3 Lloyds has around 1,540 pharmacies in the UK,³⁷ and operates 25 contracts for OPD pharmacies with 24 NHS trusts and a number of contracts with prisons, mental health trusts, private hospitals and community hospitals. Lloyds classifies its pharmacy business into Health and Medical pharmacies (located near a GP practice); Health and Community pharmacies (neighbourhood or village location where GP practices are present); Health and Skin Extra pharmacies (high street/town centre locations); and OPD pharmacies. Turnover for the 15 months ending 31 March 2015 was £2.3 billion.³⁸

³⁶ Celesio AG was acquired by McKesson in February 2014.

³⁷ [X]

³⁸ The FY end was moved to 31 March to bring it into line with McKesson's FY end.

AAH

- 3.4 Celesio also owns AAH (acquired in 1995). AAH is a wholesale supplier to Lloyds pharmacies, third party pharmacies, hospitals, GP practices and other healthcare establishments across the UK. AAH is currently the main supplier to the Sainsbury's pharmacy business (the Target Business) for POMs and P-medicines. The AAH group is a full-line wholesaler³⁹ but also operates DTP and RWS models. Turnover for the 15 months ending 31 March 2015 was £3.6 billion.

Sainsbury's pharmacy business

- 3.5 Sainsbury's pharmacy business is owned and operated by Sainsbury's Supermarkets Ltd, a wholly owned subsidiary of J Sainsbury plc. Sainsbury's opened its first in-store/retail community pharmacy in Penzance in 1995, and its first hospital pharmacy OPD in South Tees in 2012. Sainsbury's operates 277⁴⁰ community pharmacies and three hospital trust OPD contracts in four hospitals.
- 3.6 The UK turnover of Sainsbury's pharmacy business was £[X] million in Financial Year (FY) 2015. This revenue was split between (a) retail pharmacy – approximately £[X] million, and (b) hospital OPD – approximately £[X] million (excluding convenience retail sales). Sainsbury's pharmacy is the second largest supermarket pharmacy chain, after Tesco. The hospital OPD contracts are with three NHS trusts (South Tees, Guy's & St Thomas', and King's College) at four sites. At Guy's & St Thomas' hospitals Sainsbury's also offers a convenience retail proposition.
- 3.7 46% of Sainsbury's supermarkets⁴¹ have a pharmacy (21% of total Sainsbury's stores). Pharmacies tend to be in the larger stores, with 192 out of the 277 Sainsbury's pharmacies (69%) in stores over 3,700 sq metres. Around 50% of Sainsbury's pharmacies operate with 100-hour licences and typically open for 101 hours per week. All these 100-hour pharmacies were opened between 2004 and 2014, when entry restrictions were relaxed (see

³⁹ Pharmaceutical wholesalers can be broadly categorised as full-line, which carry up to 12,000 prescription medicine lines, and short-line which may stock just 2,000 items.

⁴⁰ At the time the BSA was entered into Sainsbury's had 278 stores. However its Nine Elms pharmacy currently has its licence suspended.

⁴¹ Supermarkets are larger grocery stores – for example the Competition Commission (CC) [Groceries market investigation report](#) defined supermarkets as 'store where the space devoted to the retail sale of groceries exceeds 280 sq metres and which stocks a range of products from more than 15 product categories' (report glossary, p14).

paragraph 2.9). The remaining Sainsbury's pharmacies operate with 40-hour licences, but on average these are open for around 84 hours per week.

- 3.8 Sainsbury's website⁴² shows that its pharmacies provide a standardised wide range of services including, for example, EPS, repeat prescriptions and new medicine reviews. Sainsbury's offers Stop Smoking services in selected pharmacies and prescription collection services in all but one of its retail pharmacies. Sainsbury's pharmacies do not generally offer a delivery service.
- 3.9 AAH supplies over 90% of the medicines dispensed by Sainsbury's pharmacies.

Other parties

- 3.10 There are a number of larger pharmacy groups, which together with Lloyds have around 44% retail pharmacy market share (see Table 2). These are: Boots, Well (formerly the Co-operative Pharmacy), Rowlands and Superdrug. Of these, Boots (a subsidiary of Alliance Boots, acquired by US drugstore operator Walgreens in 2014) is the largest single chain, with over 2,400 pharmacy stores, ranging from small community and high street pharmacies to town centre outlets and large out-of-town retail outlets. It has a national share in the UK of [X] [20–30]%. Boots also provides an online pharmacy service. Well (acquired by Bestway in 2014) has around 780 pharmacies and a national share of [X] [5–10]%. Rowlands operates over 500 pharmacies throughout England, Scotland and Wales, as well as providing an online pharmacy service. Rowlands has a national share in the UK of [X] [0–5]%. Superdrug has around 200 stores with a [X] [0–5]% national share offering both a pharmacy service and a wider retail offering, and 15 stores also offering nurse clinics providing health checks. Superdrug also provides an online doctor service.
- 3.11 The four largest supermarket chains in the UK – Asda, Morrisons, Sainsbury's and Tesco – together have around 12% retail pharmacy market share (see Table 2). The largest supermarket pharmacy operator is Tesco, with 375 in-store pharmacies; 353 in England, 15 in Wales and seven in Scotland. Around 40% of its contracts are 100-hour opened under the relaxed entry restrictions in England (paragraph 2.9). Tesco has not opened any new pharmacies since the 100-hour exemption was removed. Morrisons operates 118 pharmacies in the UK; 98 in England, 13 in Scotland and seven in Wales. It has no 100-hour contracts. Asda operates 255 pharmacies. Between 2005 and 2012/13 Asda opened 156 new pharmacies, taking advantage of the 100-hour contract

⁴² Sainsbury's website: [Sainsbury's Pharmacy](#).

exemption. Since the 100-hour exemption was removed, Asda has not introduced any further pharmacies into its stores.

- 3.12 As shown in Table 2, 44% of the retail pharmacy market comprises independents. These range from UK wide chains such as Cohens, with around 160 stores, to national operators such as Day Lewis, with 250 stores in England, to regional operators such as Weldricks (South Yorkshire and North Lincolnshire) and Gordon's Chemist (Northern Ireland), with around 60 stores each, to single-store operators.

4. The Transaction and relevant merger situation

- 4.1 Following a review of Sainsbury's pharmacy business in 2014, informal discussions were held with Celesio (Lloyds), [X] and [X] to assess their interest in acquiring the pharmacy business. A formal sales process commenced in April 2015. Bids were made by Celesio and [X]. The level of the Celesio bid and the attractiveness of the longer-term, post-deal partnership with Celesio were considered superior. Celesio was selected as the preferred bidder and the BSA was signed at the end of July 2015. Alongside the BSA a Cooperation Agreement was also signed. This agreement was necessary to cover the ongoing relationship between the Parties, as the Lloyds pharmacies would operate within the Sainsbury's supermarkets.⁴³ We refer to these agreements as the Transaction in this report. The purchase price was £[X] and this was paid to Sainsbury's on 29 February 2016. [X] will also be paid.

Rationale for the Transaction

- 4.2 We were told that for Lloyds the acquisition would complement Lloyds' existing business, enabling it to expand its format offering to include pharmacy store services within Sainsbury's grocery stores and realise a number of synergies across the business, as well as entering a number of new local markets where it currently does not compete. In addition, the acquisition enabled AAH, a subsidiary of Celesio, to retain its wholesale supply relationship with the Target Business.⁴⁴
- 4.3 We were told that for Sainsbury's the Transaction would provide its customers with an enhanced pharmacy service and ensure that the future services that are required can be delivered with expertise and confidence. Additionally, the Transaction would provide its staff with the benefit of enhanced training and

⁴³ Usually the pharmacies would operate around the middle of the Sainsbury's stores.

⁴⁴ Parties' initial submission, Part F, paragraph 1.

specialist expertise, and the benefit of an ongoing partnership with a provider with significant industry expertise.⁴⁵

The Cooperation Agreement

- 4.4 The Cooperation Agreement concerns the arrangements for the continuing relationship that will exist between the Parties and is for an [X]. The Cooperation Agreement details the products that may be sold by each party, aspects of the operation of the pharmacies in the Sainsbury's stores such as opening hours, exclusivity arrangements and the future development of the business. Appendix C contains a summary of the constraints on how Lloyds can operate the Sainsbury's pharmacy business post-merger under the Cooperation Agreement.

Jurisdiction

- 4.5 Under the Act⁴⁶ and our terms of reference (see Appendix A) we are required to decide whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation. We have considered whether certain events that have taken place since the Transaction was entered into (satisfaction of conditions precedent and payment of consideration) mean that the Parties are bound to such an extent as will result, on effect being given to their obligations, in the enterprise ceasing to be distinct. If that were the case, the point in time when that occurred is taken to be the time at which two enterprises cease to be distinct and a merger would be deemed to be completed.⁴⁷ In such circumstances, we have an ability to treat the reference of an anticipated merger⁴⁸ as if it had been referred to us as a completed merger.^{49,50} However, it appears that this would not have any material impact on our analysis in this case and, as a result, we have decided not to exercise our discretion to treat the reference as if it had been referred to us as a completed merger. Accordingly we have concluded that the Transaction described in paragraphs 4.1 to 4.4 above constitutes arrangements in progress or contemplation for the purposes of the Act.

⁴⁵ Parties' initial submission, Part F, paragraph 1.

⁴⁶ Section 36 of the Act.

⁴⁷ Section 27(2) of the Act.

⁴⁸ ie under section 33 of the Act.

⁴⁹ ie under section 22 of the Act.

⁵⁰ Section 37(2) of the Act.

- 4.6 A relevant merger situation is created if two or more enterprises cease to be distinct enterprises (within the relevant statutory time frame) and either the UK turnover test or the UK share of supply test or both are satisfied.⁵¹

Enterprises ceasing to be distinct

- 4.7 The Act defines an ‘enterprise’ as ‘the activities or part of the activities of a business’. A ‘business’ is defined as including a professional practice and includes any other undertaking which is carried on for gain or reward or which is an undertaking in the course of which goods or services are supplied otherwise than free of charge.⁵² The Jurisdictional and Procedural Guidance in paragraph 4.6 also makes it clear that the enterprise in question need not be a separate legal entity.⁵³
- 4.8 The Target Business comprises 277 retail pharmacies (within or adjacent to Sainsbury’s supermarkets) and the transfer of three existing contracts for pharmacies located in hospitals. The purchase will be made by Lloyds. Each of Lloyds and the Sainsbury’s pharmacy business sells goods in retail outlets for reward and we are satisfied that each is an enterprise for the purpose of the Act. We are also satisfied that, as a result of the Transaction described in paragraph 4.1, both enterprises would be brought under the control of Lloyds and would therefore cease to be distinct for the purposes of the Act.

Turnover test

- 4.9 The second limb of the jurisdictional test seeks to establish that the Transaction has sufficient connection with the UK on the basis of the turnover test or share of supply test. The turnover test is satisfied where the value of the turnover in the UK of the enterprise acquired exceeds £70 million.
- 4.10 The turnover of the Target Business in the year ending 15 March 2015 was around £[X] million. In light of this, we consider that the turnover test is satisfied and we are not required to consider the application of the share of supply test to the Transaction.

Conclusion on jurisdiction

- 4.11 In the light of the above assessment, we conclude that, by virtue of the Transaction, arrangements are in progress or in contemplation which, if

⁵¹ Section 23 of the Act.

⁵² Section 129(1).

⁵³ *Mergers: Guidance on the CMA’s jurisdiction and procedure (CMA2)*. Nor is there a requirement that the transferred activities generate a profit or dividend for shareholders: indeed, the transferred activities may be loss-making or conducted on a not-for-profit basis.

carried into effect, will result in the creation of a relevant merger situation. Consequently, we conclude that the jurisdictional test is satisfied in this case.

5. Market definition

- 5.1 We considered the appropriate product and geographic market definitions. The purpose of market definition is to provide a framework for assessing the competitive effects of a merger. It contains the most significant competitive alternatives available to customers of the merged companies. However, market definition is not an end in itself and the boundaries of the market do not determine the outcome of the CMA's analysis of the competitive effects of the merger, as there can be constraints on merger parties from outside the relevant market.⁵⁴

Product market

- 5.2 The Parties overlap in the retail supply of POMs, P-medicines and pharmacy services. Although the Parties also overlap in GSL items, Sainsbury's will retain its GSL business and therefore this is not relevant for our analysis of the merger (see also paragraph 5.5). This section discusses the definition of the relevant product markets, looking at decisional precedents, at the Parties' views and at other evidence collected in the course of the investigation.

The Parties' views

- 5.3 The Parties considered it appropriate to define three separate product markets for POMs, P-medicines and retail pharmacy services to customers.⁵⁵ The Parties suggested that GSL products should not be considered as the sale of GSL products was not part of the Target Business, but noted that the prices of many pharmacy medicines were constrained by the sales of GSL products, and that this should be taken into account by the CMA.⁵⁶

Our assessment

- 5.4 There appears to be limited demand-side substitution between POMs and P-medicines. It may sometimes be possible for a customer to substitute a P-medicine for a POM, but the Parties told us that this would typically only be a consideration for customers in England who did not benefit from an exemption

⁵⁴ [Merger Assessment Guidelines \(CC2 / OFT1254\)](#), paragraph 5.2.2. This was originally published jointly by the Office of Fair Trading (OFT) and the CC and has been adopted by the CMA board.

⁵⁵ [Parties' initial submission](#), Part G, sections 1.1 & 1.3.

⁵⁶ [Parties' initial submission](#), Part G, sections 1.2.

from the prescription levy (currently the case for only 11.5% of items dispensed).⁵⁷

- 5.5 Lloyds will not, in general, be able to sell GSL products or non-pharmaceutical products within Sainsbury's.⁵⁸ The Parties told us that some P-medicines were substitutable with GSL products, as the GSL product was either the same product in a smaller pack size, or a similar product to treat the same symptoms.⁵⁹ As a result, the Parties and some third parties considered that in some cases the pricing of P-medicines was constrained by that of GSL products.⁶⁰ However, there are many P-medicines for which a GSL substitute is not available. We therefore consider it appropriate to exclude GSL products from the relevant product markets, but their substitutability for P-medicines is taken into account where appropriate in our competitive assessment. Neither POMs nor P-medicines are alternatives for pharmacy services (either for end customers or the commissioning bodies of these services).
- 5.6 The boundaries of a relevant product market are generally determined by reference to demand-side substitution alone. However, there are circumstances where several narrow relevant markets can be aggregated into a broader one on the basis of supply-side considerations. In particular, this is appropriate when the same firms compete to supply these different products and the conditions of competition between the firms are the same for each product.⁶¹ In this case, POMs, P-medicines and pharmacy services are only or predominantly supplied by pharmacies and the set of competitors supplying each product in any local area will largely be the same.⁶² Furthermore, many of the competitive parameters are determined at the store level, although some can be set centrally and rolled out locally, and even those that are set at the product level (for instance, quality of pharmacy services) can have a knock-on impact on the other products sold by the pharmacy.⁶³

⁵⁷ For example, for minor health conditions there might be a P-medicine which is similarly effective as a POM, and whose price might be lower than the prescription levy.

⁵⁸ [X]. Parties' initial submission, footnote 10.

⁵⁹ Parties' initial submission, Part C, section 2.4.

⁶⁰ Parties' initial submission, Part G, section 1.2; Morrisons. [X]

⁶¹ CC2, paragraph 5.2.17.

⁶² There are some limited exceptions that, however, do not change our assessment: patients living further than a mile from a pharmacy or having serious difficulties in obtaining medicines from pharmacies can obtain them from prescribing doctors (6% of prescription medicines are dispensed in this way); P-medicines can be fulfilled through a pharmacy that does not hold an NHS pharmacy contract (Boots has a limited number of such stores). The principal difference is with respect to pharmacy services, where there may be a greater overlap between GPs, health centres and pharmacies for some commissioned services.

⁶³ For instance, if a pharmacy reduces the quality or number of its medicine use reviews, customers may switch to obtaining their prescription from another pharmacy. We note, however, that price is a competitive parameter that only applies to P-medicines and to privately offered pharmacy services.

- 5.7 We therefore consider it appropriate to aggregate the markets for POMs, P-medicines and pharmacy services and assess retail competition at the level of the pharmacy.

Customer markets

- 5.8 Our Merger Assessment Guidelines state that we can define relevant markets for separate customer groups if the effects of the merger on competition to supply a targeted group of customers may differ from its effects on the other groups of customers, and require a separate analysis.⁶⁴ The Parties identify care homes as a customer group significantly different from individual customers. However, they note that, with respect to care homes, the overlap between the Parties is minimal,⁶⁵ as Sainsbury's does not target care homes.^{66,67}

Our assessment

- 5.9 The differences between various groups of customers and the ways they are targeted by pharmacies do not appear to require the definition of separate customer markets. Any difference in pharmacies' focus towards specific types of customers is taken account of in the competitive assessment. Care homes present characteristics that set them apart from pharmacies' individual customers (see paragraph 5.8). However, as noted in paragraph 5.8, the overlap between the Parties in this segment is minimal. As a result, the merger may not be expected to have any significant impact on the supply to care homes and we do not consider this customer segment further in this report. Prisons and mental health trusts could also be seen as separate customer groups, but we do not consider it necessary to examine the impact of the merger on them, since Sainsbury's does not serve them.

Geographic market

- 5.10 Our Merger Assessment Guidelines state that, when assessing mergers involving a large number of local geographic markets, we may examine the geographic catchment area within which the great majority of a store's custom is located. Catchment areas are a pragmatic approximation for a candidate market to which the hypothetical monopolist test can be applied.⁶⁸

⁶⁴ CC2, paragraph 5.2.28.

⁶⁵ Sainsbury's only serves [X] care homes.

⁶⁶ [X]. Parties' initial submission, Part C, section 4.2.

⁶⁷ The Parties also consider prisons and mental health trusts as other separate customer groups, but note that no overlap exists between the Parties. Initial submission, Part C, section 4.1.

⁶⁸ CC2, paragraph 5.2.25.

The Parties' views

- 5.11 In previous OFT decisions the geographic market was considered to be a 1-mile radius around each of the relevant pharmacies. The Parties said that there was no reason to depart from the 1-mile radius catchment area for Lloyds' pharmacies, but suggested that for Sainsbury's we should adopt the standard catchment areas used for large grocery stores (10-minute drive-time in urban areas and 15-minute drive-time in rural areas).⁶⁹

Our assessment

- 5.12 We have calculated, for each Lloyds pharmacy and for a sample of Sainsbury's pharmacies,⁷⁰ the radius (in miles) of the area that includes 80% of the pharmacy's prescription customers.⁷¹ We have used this information to calculate the average radius from which Lloyds and separately Sainsbury's pharmacies draw 80% of their prescription customers, for each of four types of areas: 'conurbations', 'cities and towns', 'rural' areas, and 'very rural' areas. These area types were derived by aggregating the ten rural/urban categories defined by the ONS into four broader groups.⁷²
- 5.13 In principle, the data could allow us to use individual catchment areas for each Lloyds pharmacy rather than using averages across different types of areas. Individual catchment areas will vary across local areas as a result of the specific characteristics of each area. However, we have chosen to adopt a more pragmatic approach in defining geographic markets, using average catchment sizes as a starting point for assessing competitive constraints and developing the analysis of specific local features in the competitive assessment.⁷³ This approach allows us to treat Sainsbury's and Lloyds catchments in the same way (given that we do not have customer catchment data for all Sainsbury's pharmacies), and is also easier to apply across a large number of overlap areas instead of calculating individual customer catchment

⁶⁹ [Parties' initial submission](#), Part G, section 2.1.

⁷⁰ The Parties were able to provide data on customer location for 40 Sainsbury's stores only.

⁷¹ As noted in paragraph 5.7, we consider that the conditions of competition are very similar for POMs, P-medicines and pharmacy services, all of which we include in the same product market. Prescription medicines account for the vast majority of retail pharmacies' total revenues from medicines and services (92% for Lloyds in 2015, 83% for Sainsbury's between January and October 2015) and we consider that catchment areas determined using data on prescription customers are broadly applicable to a pharmacy's customers more generally. As noted above, price competition is only relevant for P-medicines and privately supplied pharmacy services.

⁷² The ONS produces a rural/urban classification of output areas, which classifies each area as urban or rural, with 4 urban and 6 rural subcategories. An output area is based on census information and contains between 100 and 625 people, or between 40 and 250 households. There are 181,408 output areas in England and Wales. For more information, see [Rural/urban definition \(England and Wales\)](#).

⁷³ It should be noted that looking at information on individual customer location is more powerful than using information on individual catchment areas, as customers can be concentrated at any point within the catchment area rather than being spread uniformly.

areas in each case. We assume that other non-supermarket pharmacies have similar catchment sizes to Lloyds pharmacies, and that other supermarket pharmacies have similar catchment sizes to Sainsbury's.

- 5.14 These average catchment areas are only intended as a starting point for our competitive assessment. In our competitive assessment we assess, for local areas, the features (and in particular, for the areas of potential concern, the locations of customers) which affect the extent of competition between pharmacies in that area. We note that, in general, customer catchment areas may be narrower than the geographical market identified using a hypothetical monopolist test,⁷⁴ and, where relevant, we consider the constraints posed on the Parties by rivals located further away in our competitive assessment.
- 5.15 Table 4 summarises the average radius of the catchment areas for the various area types. We have therefore identified the average customer catchment area of any of the Parties' pharmacies as being the circle centred on the pharmacy with radius as in Table 4. Depending on the type of analysis, the relevant competitors are defined either as those rival pharmacies located within the catchment area around the pharmacy being considered, or the rival pharmacies whose catchment areas intersect that of the pharmacy being considered.

Table 4: Average radius of catchment areas

Area type	miles	
	Lloyds	Sainsbury's*
Conurbation	1.4	2.4
City and town	1.4	3.4
Rural	2.3	4.7
Very rural	3.6	4.7

Source: CMA calculations.

* The estimate for 'rural' areas is based on the only observation available; in the absence of observations, the estimate for 'very rural' areas is set equal to that for 'rural' areas.

Conclusion on market definition

- 5.16 For product market definition we conclude that it is appropriate to aggregate the markets for POMs, P-medicines and pharmacy services, and assess retail competition at the level of the pharmacy.
- 5.17 We conclude the relevant geographic markets are those local areas being a circle centred on the pharmacy with a radius as set out in Table 4.

⁷⁴ For example, we note that the radius capturing 80% of customers in [X] is 0.5 miles.

6. Counterfactual

- 6.1 The application of the SLC test involves a comparison of the prospects for competition with the merger against the competitive situation without the merger. The latter is called the ‘counterfactual’.⁷⁵ Our Merger Assessment Guidelines set out that, to help determine ‘the likely future situation in the absence of the merger, the CMA may examine several possible scenarios ... but ultimately only the most likely scenario will be selected as the counterfactual.’ In the assessment the CMA will ‘typically incorporate into the counterfactual only those aspects of scenarios that appear likely on the basis of the facts available to it and the extent of its ability to foresee future developments.’⁷⁶

The Parties’ views

- 6.2 The Parties said that, if a sale to Lloyds had not been agreed, Sainsbury’s would most likely have [X].

Our assessment

- 6.3 We considered the alternative bidders that Sainsbury’s could have sold the business to, and what would have been likely to happen in the event a sale would not have taken place.
- 6.4 We considered a sale of the business to [X]. The size of [X] means that a sale to [X] would be likely to raise competition concerns which would have led to a significant risk that the duty to refer the Transaction for an in-depth phase 2 investigation would have been triggered, unless suitable phase 1 undertakings in lieu of a reference were accepted. In a case of two possible counterfactuals, one being a sale to an alternative bidder whose bid is likely to raise competition concerns and the other being the prevailing conditions of competition, our practice is not to have as the counterfactual a sale to a bidder that would itself be likely to require remedies to eliminate competition concerns.⁷⁷ As a result we do not consider that a sale to [X] would be the counterfactual in this case.

⁷⁵ CC2, paragraph 4.3.1.

⁷⁶ CC2, paragraph 4.3.6.

⁷⁷ CC2, paragraphs 4.3.22 & 4.3.23. ‘If only one merger is referred, the counterfactual used by the [CMA] may be the pre-merger competitive situation or the sale of the target firm to one of the alternative purchasers. When deciding on the most appropriate counterfactual, the [CMA] will consider the circumstances of the sale, including the offers of the alternative purchasers ... Depending on the circumstances, the appropriate counterfactual may be based on either the sale to an alternative bidder whose bid has not been referred or the prevailing conditions of competition. The [CMA] would not take into account the possibility of remedies being implemented to address competition concerns raised by the alternative mergers, ie a sale to a “remedied bidder” would not become the counterfactual situation’.

- 6.5 We considered other potential acquirers. We note that [X] and that Sainsbury's [X]. We note Sainsbury's view that, if a sale had not occurred, it would have most likely [X].
- 6.6 The evidence suggests that other parties would have been unlikely to have acquired the Sainsbury's pharmacy business in the short term. The bid from [X] would have been likely to raise substantial competition issues. [X]. If no sale had occurred, we consider that Sainsbury's would have continued to operate the pharmacy business. Therefore we conclude that the counterfactual is the continuation of the pre-merger situation.

Outpatient dispensary

- 6.7 Given the conclusion in paragraph 6.6, we assessed OPD under the counterfactual of the pre-merger situation. Sainsbury's said that it had [X]. We consider that under a continuation counterfactual Sainsbury's would have continued to run its three contracts with no foreseeable changes. It would have also continued to tender for OPD contracts as and when they fell due and were commercially attractive.

7. Assessment of the competitive effects of the merger

- 7.1 In this section we assess the competitive effects of the acquisition and consider whether the merger may be expected to result in an SLC within any market or markets in the UK for goods or services.⁷⁸ We first consider the way that community pharmacies compete presently (ie pre-merger). We then assess the effects of the merger against the competitive position in the absence of the merger.
- 7.2 Given the national market shares and the small increment to Lloyds' market share as a result of the merger, detailed in paragraph 2.8, we do not consider that national effects on community pharmacy competition are likely and so focus in this section on local competitive effects.
- 7.3 We then consider the effect of the merger in the OPD market (paragraphs 7.344 to 7.349) and vertical effects of the merger (paragraphs 7.350 to 7.359). In contrast to our assessment of the effect of the merger on community pharmacies, when considering competition in the OPD market and vertical effects we have considered national effects as:

⁷⁸ Section 36 of the Act.

- (a) Wholesalers are active in the supply of drugs on a regional or national basis, with three large national players.
- (b) Although OPD contracts are typically for a single hospital site, competition to be the OPD supplier to a particular hospital occurs between larger regional or national players.

Pre-merger competition in community pharmacies

- 7.4 As set out in Section 2, there is a range of regulations which apply to pharmacies and which restrict their freedom to change elements of their offering, in a way not commonly seen in other retail markets. In particular, there is limited price competition between pharmacies because NHS POMs, which make up the bulk of their business, are either free at the point of delivery or are charged at the fixed NHS prescription levy. There are also regulatory constraints on certain quality parameters. For example, a pharmacy must employ a qualified pharmacist and must be licensed to operate in a given location.
- 7.5 This means that there are fewer competitive parameters that a pharmacy may flex than is usually the case when analysing a merger between local retail chains. For this reason, we have considered what factors influence customers' choice of pharmacy. We consider that assessing the effect of the merger on the factors that are important to customers provides an appropriate benchmark for assessing whether the merger may be expected to result in customer detriment. We then proceeded to assess the extent to which pharmacies can compete on these parameters given the regulatory constraints.
- 7.6 In assessing the nature and extent of pre-merger competition between pharmacies we first set out the Parties'⁷⁹ views on how pharmacies in general compete, and on the closeness of competition between Lloyds and Sainsbury's pharmacies in particular (paragraphs 7.7 to 7.26). We then set out our assessment of pre-merger competition (paragraphs 7.27 to 7.161).

The Parties' views on pre-merger competition

- 7.7 In summary, the Parties told us that:

⁷⁹ We received several joint submissions from the Parties. Generally where we refer to what the Parties told us the response was in one of the joint submissions.

- (a) There were few competitive parameters which could be flexed at a local level because of pharmacy regulations – for example, pharmacies could not compete on price;
- (b) Lloyds and Sainsbury's both have national policies governing many of the parameters of QRS which might, in principle, be flexed at a local level;
- (c) Where Lloyds does flex parameters of QRS at a local level, this is generally not in response to competition and Sainsbury's does not as a matter of policy (or knowingly in practice) ever flex any aspects of its pharmacy offer in response to local competition;
- (d) Lloyds does flex a very limited number of parameters in response to competition from other non-supermarket rival pharmacies who also pursue a strategy of co-location with GP surgeries, but not in response to competition from Sainsbury's as it operates in a different channel (supermarkets), and has a different offering, different customer base and different format.
- (e) Sainsbury's does not flex any competitive parameters at a local level in response to competition from pharmacies. The Parties told us this was for a number of reasons including but not limited to: (i) it is prevented from flexing some parameters at the local level at all due to its nature as a supermarket pharmacy (eg store location, opening hours and refurbishments, all of which are set based on the needs of the wider supermarket business and not the pharmacy section); (ii) as a supermarket pharmacy, it is only seeking to provide a 'basic' pharmacy offering, and does not have the desire or the resources to challenge the offerings of dedicated pharmacy specialists such as Boots; and (iii) its key focus is to encourage its existing grocery customers to visit the in-store pharmacy by raising awareness levels through in-store initiatives [§].

Impact of pharmacy regulation

7.8 The Parties told us that there was limited scope for price competition in pharmacies. In particular the Parties said the following:

- (a) They could not charge a fee for any medicines dispensed under an NHS prescription as the NHS set the fee at either zero or £8.40 depending on whether the patient is entitled to free prescriptions and the home nation in which the pharmacy is located.

(b) The scope for price competition in P-medicines was limited as a result of GPhC ethical standards⁸⁰ and Advertising Standards Authority (ASA) regulations. They said that it was difficult to compare the pricing of P-medicines,⁸¹ which limited the extent to which pharmacy operators could vary their pricing in response to the activities of their rivals.

(c) Reimbursement prices for services were generally fixed either nationally by the NHS (eg for Medicine Use Reviews (MURs) and New Medicine Service (NMS)) or locally by Clinical Commissioning Groups (CCGs) (eg for smoking cessation services).

7.9 The Parties said that aspects of service were also regulated and that these aspects could not be varied below the regulated service standards.⁸² These included opening hours and professional standards (including having a staffing and staff management programme and requiring that a pharmacist and a counter assistant must be present during all operating hours). In addition other aspects such as location could only be varied, in the case of minor relocations, where it could be demonstrated that the relocation would not significantly change the provision of pharmaceutical services and would not be significantly less accessible for patient groups used to accessing the current premises. There were also, typically, service level agreements in place for the provision of pharmacy services which set out key standards. Applications for major relocations were subject to more stringent criteria, and were treated more like new licence applications.

National policies governing parameters of QRS

7.10 The Parties said that they both set their prices for P-medicines centrally, without any local or regional variation.

7.11 The Parties said that ranging decisions were determined centrally and applied uniformly throughout each party's pharmacy estate. The Parties said that [REDACTED].

Where Lloyds and Sainsbury's do flex parameters of QRS at a local level, this is generally not in response to competition

7.12 Celesio said that many of its service offerings were not dependent on local competition – for instance Lloyds had a waiting time target of [REDACTED] for every pharmacy, regardless of the number of local competitors. It said that it used a

⁸⁰ See General Pharmaceutical Council (July 2012), [Standards of conduct, ethics and performance](#).

⁸¹ The Parties said this was because there is a lack of comparable data on price because pharmacies are disinclined to publish prices due to the GPhC standards of conduct, ethics and performance.

⁸² [Parties' initial submission](#), p10.

national staffing model that was based on the level of business at the pharmacy and that it operated a centralised training scheme (access to which did not vary at the local level). It also said that it refurbished its stores on a [X]-year cycle and had never accelerated a refurbishment in response to competitive pressure from Sainsbury's (although it might take such action in response to local competition from other competitors with offers that were closer to its own). Similarly it said there was no evidence that the Parties flexed product range in response to local competition in general (or each other in particular). Prescription stocks were determined by local need. With respect to P-medicines, both Parties said they adopted a standard [X] approach to range (in Lloyds' case, P-medicine ranging decisions were determined [X], with the size of range determined by [X]), which was [X].

Parameters over which competition may take place

7.13 The Parties said that, taking the above factors into account, the residual variables over which competition may take place were broadly:

- (a) the location of the pharmacy;
- (b) the pharmacy format/environment, including consultation space;
- (c) opening times;
- (d) the provision of services, including health services and other services such as prescription collection and home delivery services; and
- (e) the provision of staff over and above the regulatory minimum (and the quality and experience of those staff).

Differences between the Parties in how they set their offer

7.14 The Parties said that Lloyds' offerings were differentiated from those of Sainsbury's and supermarkets in general in terms of locations and formats. Lloyds' branches were located within the community and were often within or very close to a GP practice, whereas Sainsbury's pharmacies were located in larger grocery stores,⁸³ which were often out of town.

7.15 As a result of the different store formats the Parties said there were a number of differences between the characteristics of the stores and the customer shopping mission. As supermarket pharmacies were located in grocery stores they normally offered customer parking, which was generally free of charge.

⁸³ Sainsbury's pharmacies are typically located in stores in excess of 30,000 sq ft that had sufficient space for a pharmacy to be added without impinging upon the core grocery offering.

Supermarket pharmacies tended to mirror the opening hours of the store at large, with customers visiting on a grocery shopping mission and using the pharmacy as it was convenient. In contrast, Lloyds' stores did not consistently offer parking, and the hours were typically set to mirror those of the local GP practice(s), with customers visiting on a stand-alone shopping mission, or in combination with a visit to another store or the GP practice.

- 7.16 The Parties said that these differences in setting led to differences in their customer acquisition strategy and by implication the customer acquisition strategy of supermarket pharmacies and non-supermarket pharmacies more generally. The Parties said that Sainsbury's focused on converting existing in-store grocery customers into pharmacy customers, whereas Lloyds sought to establish links with GP practices and offered a wide range of additional services to try to entice additional customers to visit its stores.
- 7.17 The Parties said that there were demographic differences between their customers. The Parties said that they offered differentiated customer propositions and were perceived differently by customers. In particular, they said that Lloyds' customers were often aged over 55 and from lower socio-economic groups than Sainsbury's customers, who tended to be more representative of the population as a whole. This was reflected in the proportion of customers who paid the NHS prescription levy at each of the Parties, with approximately [REDACTED]% paying the levy at Sainsbury's compared with approximately [REDACTED]% at Lloyds.⁸⁴
- 7.18 The Parties considered that Lloyds and Sainsbury's differed in how they set the different elements of their offer, due to differences in the nature of their offering and their customers. These differences are set out in Table 5.

⁸⁴ Parties' initial submission, Part H, section 3.5.

Table 5: Parties' comparison of how they set the variables above

<i>Proposition</i>	<i>Sainsbury's</i>	<i>Lloyds</i>
Location/format	Within/adjacent to supermarket Counter + consultation room	High street/community/health centre Range of formats
Access	More customers access by car Car parking at all stores (usually free of charge) Wider catchment area Minimal home delivery*	More customers access on foot or by public transport Limited parking available Narrower catchment area Home delivery
Opening hours (regulated)	Longer, but driven by supermarket hours (not in response to other pharmacies or GP practices)	Not open as long, driven by local GP practice hours (no competition for 'after-hours')
Customer demographic	Generally representative of population (consistent with profile of grocery shoppers)	Older demographic/lower socio-economic profile. Higher proportion of repeat prescriptions/free prescriptions.
Customer acquisition strategy	[REDACTED]	[REDACTED]
Prescription collection (GP practice)	Yes	Yes/more broadly
Enhanced facilities/services	[REDACTED]	[REDACTED]
Staff	[REDACTED]	[REDACTED]

Source: The Parties.

* [REDACTED]

Responding to potential entry

- 7.19 The Parties said that neither of them reacted to the proposed entry of the other to any greater extent than to another competitor. The Parties suggested that, when they became aware of a potential new entrant in an area in which they operated, they would always object to the licence application. [REDACTED].

Responding to local competitors

- 7.20 Lloyds said it considered that its key competitors were Boots and independent pharmacies. Lloyds considered that [REDACTED] were one of the key differentiators of its stores and that one of the main drivers for customers using independent pharmacies was [REDACTED].
- 7.21 If a new pharmacy was granted a licence in an area, then Lloyds said it might compete with it on [REDACTED] variables that it sometimes flexed in response to local competition. These were [REDACTED] and [REDACTED].
- 7.22 Lloyds stated that [REDACTED] were primarily driven by the [REDACTED] of the GP practice or practices in the area, from which the pharmacy drew a significant volume of prescriptions.

- 7.23 To the extent that Lloyds would flex [X] in response to competition, it stated that it would only consider non-supermarket rivals and never in response to the [X] of a Sainsbury's pharmacy. Lloyds might also alter its [X] in a local area in response to a competitor, but said that this would only occur in response to a non-supermarket rival. Lloyds said that it did not vary its offering in response to what supermarket pharmacies were doing and it did not flex any aspects in response to the entry of a Sainsbury's store. Sainsbury's said it did not flex any aspects of its offer in response to local competition.
- 7.24 The Parties argued that there was no evidence that Lloyds would depart from this existing, mainly national strategy and consequently there was no scope for a lessening of competition in any individual local area.
- 7.25 Table 6 summarises the Parties view on which parameters are set at the national level and which are set at the local level.

Table 6: Lloyds' view on local parameters of competition

<i>PQRS</i>	<i>PQRS parameter</i>	<i>Lloyds' approach to strategy on this variable?</i>	<i>Does Lloyds flex local store offer due to local competition?</i>	<i>Does Lloyds flex local store offer due to Sainsbury's?</i>	<i>Potential harm to customers</i>
Price	Prescription prices	[X]	[X]	N/A	N/A
	P-med prices	[X]	[X]	N/A	Higher prices
	GSL prices	[X]	[X]	N/A	Higher prices
Quality	Staff training	[X]	[X]	No	Service quality/ patient health
	Quality of advice	[X]	[X]	No	Service quality/ patient health
	Permanent/locum mix	[X]	[X]	No	Service quality
Range	P-med range	[X]	[X]	No	Smaller range/GSL substitution
	Prescription stocking	[X]	[X]	No	Need to return/go elsewhere
Service	Staffing levels	[X]	[X]	No	Inconvenience: longer wait
	Waiting times	[X]	[X]	No	Inconvenience: longer wait
	Opening hours	[X]	[X]	No	Inconvenience: store closed
	Refurbishments	[X]	[X]	No	Store ambience
	Additional services	[X]	[X]	No	Inconvenience: service unavailable
	Prescription collection	[X]	[X]	No	Inconvenience: no collection
	Home delivery	[X]	[X]	No	Inconvenience: no home delivery
	Information to GPs	[X]	[X]	No	Unclear
Convenience	Site location (proximate to GP practice)	Local	[X]	No	Inconvenience: location
	Site format: large free car park	N/A (outside LP control)	N/A	N/A	N/A
	Site format: one stop/large grocery offer	N/A (outside LP control)	N/A	N/A	N/A

Source: The Parties.

Note: PQRS = price, quality, range and service.

7.26 In response to our provisional findings the Parties submitted that they did 'compete' to some extent, notwithstanding the generally limited scope for competition in the highly regulated pharmacy sector. However, the Parties said the evidence supported their contention that they were not 'close' economic rivals in any local areas, and that competitive 'pressure' from Sainsbury's was not making Lloyds stay open longer or otherwise tangibly enhance its competitive offer (or vice versa).

Our assessment of pre-merger competition

7.27 Having set out the Parties' views on how pharmacies compete we now set out our assessment of the nature of pre-merger competition.

- (a) We begin by assessing what matters to customers when choosing a pharmacy, which we expect to be an important driver for pharmacies in setting their offer to attract customers (paragraphs 7.28 to 7.56).
- (b) We then set out our assessment of competition between pharmacies:
 - (i) We consider evidence on overall competition between non-supermarket pharmacies and supermarket pharmacies (paragraphs 7.57 to 7.72).
 - (ii) We then assess the ability and incentive for competition to occur at a local level. We assess whether there are any parameters that the Parties can flex at the local level in principle, before going on to consider the incentives for pharmacies to flex these parameters (paragraphs 7.73 to 7.85).
 - (iii) We then consider what evidence exists that shows whether the Parties have flexed these parameters to compete locally, including a review of internal investment documents that highlight specific instances of local initiatives in response to local competition (paragraphs 7.87 to 7.159).
- (c) Finally we conclude on the extent of pre-merger competition (paragraphs 7.160 to 7.161).

What matters to customers when choosing a pharmacy?

7.28 How pharmacies compete with each other at a local level will depend on what matters to customers and how they choose their pharmacy. We have used two main sources to inform our views about customer preferences: our own consumer survey,⁸⁵ and surveys conducted by the Parties in the normal course of business. We have also taken account of the findings of our econometric model of pharmacy demand.

7.29 In the following section:

⁸⁵ Conducted by [DJS Research](#). See [DJS research report into Cellesio/Sainsbury's merger](#) on the CMA case page.

- (a) we first consider what parameters are important to customers when choosing between pharmacies;
- (b) we then consider whether there are significant differences in consumer characteristics or preferences between customers who choose to fulfil their prescription at Lloyds and Sainsbury's pharmacies; and
- (c) finally we set out evidence from our consumer survey on whether customers would be willing to substitute between Lloyds and Sainsbury's pharmacies in a sample of local areas.

- *What parameters are important to customers in choosing between pharmacies?*

- *Evidence from the CMA commissioned survey*

7.30 We commissioned a consumer survey to understand the characteristics of Sainsbury's and Lloyds' pharmacy customers. The survey was based on face-to-face interviews with customers within Lloyds and Sainsbury's pharmacies. Interviews were completed at 32 stores across 16 areas across the UK. The areas were selected to include a disproportionate number of areas with a high concentration of the Parties' pharmacies. A total of 2,167 interviews were completed in Lloyds, and 3,059 were completed in Sainsbury's. Detail on the methodology and findings of the survey is included in Appendix D.

7.31 The results of our survey suggest that, for both Lloyds and Sainsbury's customers, 'convenience of location' is the most important factor driving pharmacy choice. However, quality of service and a range of other factors also play a part in determining customers' preferences.

7.32 Figure 1 shows how customers responded when asked which factors were most important when deciding which pharmacy to visit. Over 85% of customers mentioned 'Convenience of Location' as one of the top three most important factors in determining their choice of pharmacy. 73% of Lloyds' customers and 57% of Sainsbury's customers considered 'Convenience of Location' as most important.⁸⁶

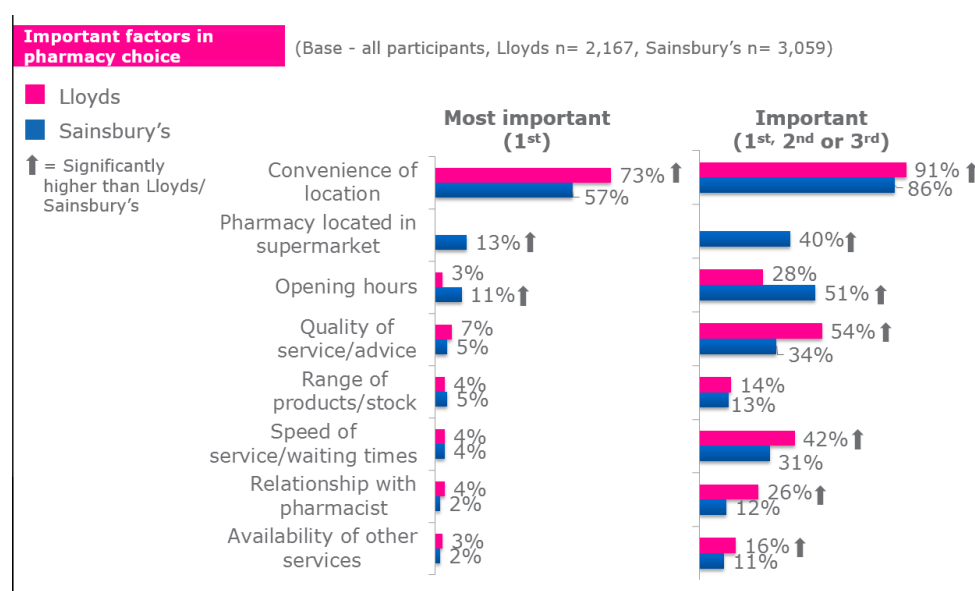
7.33 The Parties submitted that the nature of 'convenience' differed for Sainsbury's and Lloyds customers. We agree that, for some customers of Sainsbury's, convenience will relate to being able to combine visiting the pharmacy with

⁸⁶ Customers were also asked for the reason they chose a Sainsbury's or Lloyds pharmacy on that particular day. A higher percentage of respondents mentioned convenience, although other factors which received a notable proportion of responses were related to service and staff quality, habit and (for Sainsbury's) late/weekend opening hours.

their grocery shop. For example, as noted in Figure 1, in our survey 13% of Sainsbury's customers considered 'Pharmacy located in supermarket' the most important factor, and 40% said that it was in the top three reasons influencing their choice. However, the CMA survey also found that 26% of Sainsbury's pharmacy customers would not have visited the grocery store if it did not have a pharmacy,⁸⁷ and 17% of Sainsbury's pharmacy customers did not make any other purchases.⁸⁸

- 7.34 Aside from convenience, a range of other factors were also considered important when customers first chose their pharmacy.⁸⁹ 'Opening hours' was in the top 3 for 28% of Lloyds' customers and 51% of Sainsbury's customers; 'Quality of advice/service' was in the top 3 for 54% of Lloyds' customers and 34% of Sainsbury's customers; and 'Speed of service/waiting times' was in the top 3 for 42% of Lloyds' customers and 31% of Sainsbury's customers.

Figure 1: Results for Question 17 of our survey showing the drivers of pharmacy choice



Source: DJS Research (DJS) analysis of data collected in our survey.

Note: Question 17 read: 'Which of these factors are most important to you when deciding which pharmacy to visit? Please tell me your top 3 in order of importance, with 1 being the most important.'

- *Evidence from surveys conducted by the Parties*

- 7.35 Evidence from the Parties' internal consumer surveys conducted in the ordinary course of business was consistent with the findings of the CMA

⁸⁷ Response to question 9.

⁸⁸ Response to question 11.

⁸⁹ Customers were asked for the reasons that drove their 'original' choice of pharmacy, rather than why they visited on that particular occasion, as some customers will have a repeat prescription and only be visiting the pharmacy on a particular occasion as their prescription is there.

survey. When reviewing these surveys, we found that customers of Lloyds and Sainsbury's valued similar parameters and assigned a similar weight to each factor.

7.36 For example, Sainsbury's research shows that the factors which Sainsbury's **grocery** customers rank in the top four are the same across users of Sainsbury's pharmacy, [REDACTED]⁹⁰ [REDACTED]. These factors are:

(a) [REDACTED]⁹¹

(b) [REDACTED]

(c) [REDACTED]

(d) [REDACTED]

7.37 We have also reviewed Lloyds' internal documents, including [REDACTED]. This survey contained a prompted question for prescription customers which, like the Sainsbury's survey, asked for the reasons which drove respondents' choice of pharmacy. The document compared Lloyds' respondents with all respondents. Lloyds' customers' rankings were [REDACTED], with the largest differences being a [REDACTED] and a [REDACTED]. While there were differences in the options given to respondents across the Lloyds survey and the Sainsbury's survey, the overall picture is similar.

○ *Evidence from the demand estimation model*

7.38 In addition to considering survey evidence, we have also analysed data on the volume of prescriptions for each GP practice in England broken down by the pharmacy that fulfilled the prescription. This has allowed us to model the factors driving customer demand, as described in Appendix E. There are a number of important limitations of the model, including:

(a) We do not have information on customer location, so the model uses GP location as a proxy for customer location.

(b) We have limited data on pharmacy quality at a local level. The model includes information on pharmacy opening hours (which is the only variable for which we have data for all pharmacies) and controls for

⁹⁰ [REDACTED]

⁹¹ Of course, different types of locations may be differently convenient for different customers. Specifically, regular supermarket shoppers may consider supermarket pharmacies to be convenient, while others who work in town centres may consider the non-supermarket pharmacies to be conveniently located.

differences between pharmacy brands, but these brand effects do not capture quality differences at a local level.

- 7.39 Given these limitations, we have put limited weight on the results of the demand estimation model in individual local areas. However, we consider that the aggregate results of the model can provide an indication of the factors driving consumer choice of pharmacy.
- 7.40 The results suggest that when choosing a pharmacy, customers trade off the distance to a pharmacy and the quality of the pharmacy (as proxied by opening hours⁹²). We find that our distance variable and quality variable, as measured by opening hours, both have statistically significant coefficients, which suggests that they are important factors in a customer's choice of pharmacy.
- 7.41 We consider that the results of the demand estimation support the findings from the consumer survey evidence that customers primarily value location and convenience, but also consider other elements of QRS in choosing a pharmacy.
- *Conclusion on what parameters are important to customers*
- 7.42 The results of both the CMA survey, the Parties' surveys and our demand estimation model suggest that convenience of location is the most important driver of pharmacy choice for both Parties' customers. However, there are a number of other drivers of choice which customers of both Parties also value, including quality and speed of service, opening hours, stocking levels and waiting times. We infer from the evidence that customers take these elements of the offering into account when choosing which pharmacy to visit.
- *How different are customers of Lloyds and Sainsbury's pharmacies*
- 7.43 In this section we analyse the Parties' arguments in paragraphs 7.13 to 7.17 that there are differences between the overall characteristics of their customers such that they (and customers of supermarket and non-supermarket pharmacies generally) are different and would be unlikely to view them as alternatives.

⁹² We only have limited data on quality parameters which might be driving customer choice. We have used data on store opening hours as a proxy for quality due to the unavailability of other quality statistics at a local level for the cross-section of English stores.

- 7.44 Our consumer survey found that, although the majority of Sainsbury's customers are on a 'grocery-led' shopping mission,⁹³ 13% of customers indicated that the ability to combine a pharmacy purchase with grocery shopping was the most important factor for visiting Sainsbury's and 40% indicated it was one of the three most important factors.⁹⁴ Furthermore, 26% of Sainsbury's pharmacy customers said they would not have visited the grocery store if it did not have a pharmacy, and 17% of Sainsbury's pharmacy customers did not make any other purchases. This suggests that a significant proportion of customers are willing to visit the store solely in order to visit the pharmacy, which may suggest that their preferences are similar to those visiting a stand-alone pharmacy (ie one not located in a grocery store).
- 7.45 The survey suggests a similar age distribution for Lloyds' and Sainsbury's customers.⁹⁵ Sainsbury's attracted a slightly higher proportion of women than Lloyds (67% against 59%). Around one-third of both Parties' customers are retired, with a higher percentage of Sainsbury's customers in full- or part-time employment than Lloyds' (55% against 43%).
- 7.46 Sainsbury's pharmacy customers were more likely to travel to the store by car (85% against 53%) and were more likely to buy a pharmacy-only product (29% against 11%). In contrast, Lloyds' customers were more likely to travel to the store by foot than Sainsbury's customers (38% against 11%). But for both Parties the majority of customers travelled to the store by car, from their home, and did so to drop-off/collect a prescription.
- *Conclusion on how different are customers of Lloyds and Sainsbury's pharmacies*
- 7.47 In our view, the survey evidence shows that although there are some differences in the demographics between Sainsbury's and Lloyds, they do not point to significantly different customer preferences or suggest segmentation of the market.

⁹³ The CMA consumer survey suggested that 73% of Sainsbury's pharmacy customers would have still visited the store if it did not have a pharmacy (question 9).

⁹⁴ Response to question 17.

⁹⁵ 21% of Lloyds' customers were 18-35 vs 19% of Sainsbury's; 39% of Lloyds' customers were 36-59 vs 44% of Sainsbury's; 40% of Lloyds' customers were 60+ vs 36% of Sainsbury's. This appears slightly different to the view set out in Table 5, where the Parties consider that Lloyds customers are an older demographic.

- *Evidence that customers would substitute between Lloyds and Sainsbury's pharmacies*

7.48 As part of our survey customers of Lloyds and Sainsbury's were asked whether, in the event of one party's store being closed, they would consider switching to the other's pharmacy. This can be used to compute the diversion ratio between the Parties.⁹⁶ By analysing this measure of the willingness of customers in a local area to substitute between Lloyds and Sainsbury's we can assess whether Sainsbury's and Lloyds (and supermarkets and Lloyds more generally) are likely to be close or distant competitors in particular local markets. In particular, the diversion ratio can give an indication of the ranking of customer preferences within a local area.

7.49 We have calculated the diversion ratio (excluding own party diversion)⁹⁷ in the surveyed areas between the Parties' stores and, separately, to third party stores for each area.^{98,99,100} The diversion ratios between the Parties are shown in Figure 2. The blue bars represent diversion from Lloyds to Sainsbury's and the red from Sainsbury's to Lloyds.

⁹⁶ The diversion ratio is constructed to give an estimate of the percentage of customers who would divert from retailer A to retailer B, as a proportion of those customers who would switch in response to a reduction in the competitive offering. The diversion ratio from a Lloyds pharmacy to a Sainsbury's pharmacy store provides us with an estimate of the percentage of customers switching from Lloyds to Sainsbury's in response to a deterioration in the competitive offering. By construction, the diversion ratio must sum to 100%.

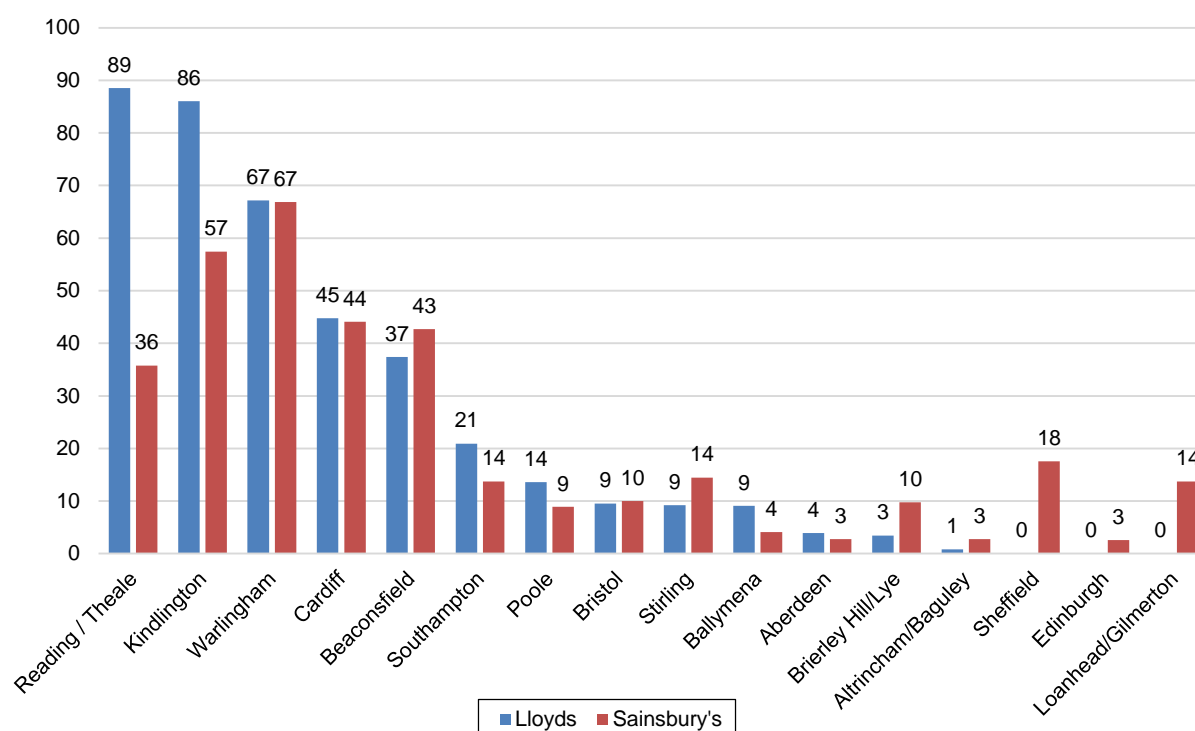
⁹⁷ The Parties said we should use diversion ratios including own party diversion to identify problem areas in our assessment of the effect of the merger. This is discussed in paragraph 7.201 and in our local effects assessments, where we consider whether to use diversion including or excluding own party diversion depending on the characteristics of each local area. In the analysis in this section we consider it appropriate to use diversion excluding own party diversion to assess the extent that customers would substitute between Lloyds and Sainsbury's pharmacies in each survey area.

⁹⁸ Where a customer indicated that they would divert to a different branch of the same fascia we have used the response to questions 21 and 22.

⁹⁹ Following the publication of provisional findings, we have updated the diversion ratios to account for a recoding exercise undertaken by the CMA. In the original DJS data set there were over 800 responses to the diversion question coded as 'other' (meaning that they were not on the lookup sheet used by the interviewer or the interviewer was unable to identify the store from the information given by the respondent). The CMA undertook a recoding exercise, which involved checking against a full list of pharmacies using the information provided by the respondent and Google maps, and allocated to a particular pharmacy where possible. If it was not possible to allocate to a pharmacy, then these were treated as a 'don't know', and reallocated proportionately.

¹⁰⁰ Further details of the calculation are in Appendix D.

Figure 2: Diversion ratio – all parties' stores closed



Source: CMA calculations based on DJS survey.

7.50 We make a number of observations about these diversion results:

- (a) The diversion ratios between the Parties are very high in a small number of the surveyed local areas. The survey shows that diversion between the Parties was high in Kidlington, Reading/Theale, Cardiff, Beaconsfield and Warlingham. This indicates that customers consider a Lloyds pharmacy to be a good alternative to a Sainsbury's pharmacy and vice versa in order to fulfil a prescription, depending on the local convenience of doing so.
- (b) The diversion ratios are broadly symmetric between Lloyds and Sainsbury's in some areas – ie a broadly similar proportion of customers would divert from Lloyds to Sainsbury's and from Sainsbury's to Lloyds. This is particularly the case in Warlingham (67%¹⁰¹ in both directions) and Cardiff (45%¹⁰² and 44%¹⁰³). This symmetry indicates that customers in these areas consider Lloyds and Sainsbury's pharmacies to be strong alternatives to one another.
- (c) Diversion between the Parties was low in a number of areas, suggesting that in these areas they are at least no closer competitors to each other

¹⁰¹ When own party diversion is excluded.

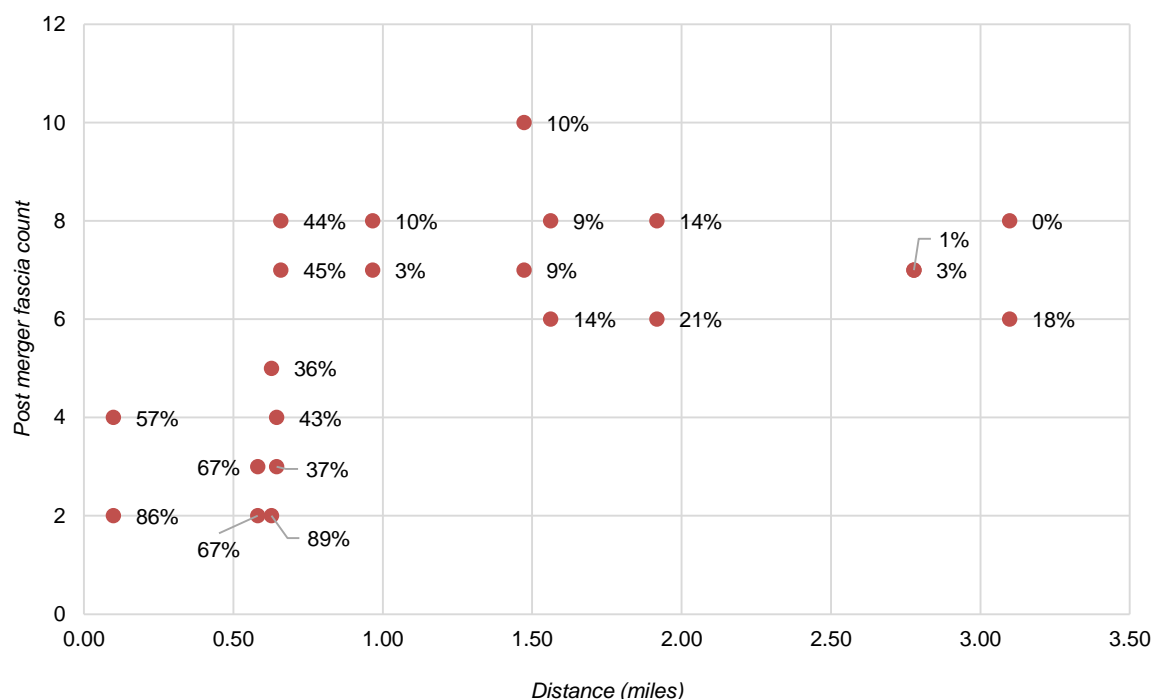
¹⁰² When own party diversion is excluded.

¹⁰³ When own party diversion is excluded.

than to other pharmacies. If the Parties were very close competitors in those areas we would expect to see high diversion between them even where there are a number of other rivals in the area in question.

7.51 Figure 3 shows, for the England and Wales local areas we surveyed, how the estimated diversion ratio from the survey varies with the number of competitors in a local area and with the distance between the surveyed stores. Figure 3 suggests that the Parties' customers consider them to be strong alternatives to one another (with high estimated diversion between them) in areas where the pharmacies are close together (within less than a mile) and where there are relatively few other competitors in close proximity. While these results are based on a relatively small number of local areas, we consider that they give a clear indication of the situations in which we would expect the Parties to be close competitors in particular local markets. We consider diversion in more detail in our assessment of the effect of the merger below.

Figure 3: Relationship between survey diversion ratio, distance between surveyed stores, and number of competitors in the local catchment area – England and Wales



Source: CMA calculations based on consumer survey findings and data on local pharmacy location.

Note: The percentages on the chart represent estimates of diversion based on survey responses at each of the individual surveyed pharmacies in England and Wales. Surveyed stores in Scotland, and Northern Ireland are not included.

- *Conclusion on whether customers would substitute between Lloyds and Sainsbury's pharmacies*

7.52 Our assessment of diversion behaviour shows that, in local areas where the Lloyds and Sainsbury's pharmacies are close and there are few third party

pharmacies in the area, the Parties' customers consider them to be strong alternatives to one another. Accordingly, in those areas customers are likely to substitute between Lloyds and Sainsbury's pharmacies (and between Lloyds and supermarket pharmacies more generally).

- *Conclusion on what matters to customers when choosing a pharmacy*

- 7.53 The results of our own and the Parties' surveys and of our demand estimation model suggest that, although convenience of location is the most important driver of pharmacy choice for both Parties' customers, there are a number of other drivers of choice which customers of both Parties also value. These include quality and speed of service, opening hours, stocking levels and waiting times. We infer from the evidence that customers take these elements of the offering into account when choosing which pharmacy to visit.
- 7.54 We considered whether there are differences in the value customers of Lloyds and Sainsbury's place on different parameters. We find that although there are some differences in the demographics between Sainsbury's and Lloyds, they do not point to significantly different customer preferences or suggest segmentation of the market.
- 7.55 Our assessment of diversion behaviour shows that, in local areas where the Lloyds and Sainsbury's pharmacies are close and there are few third party pharmacies in the area, customers are likely to substitute between Lloyds and Sainsbury's pharmacies (and between Lloyds and supermarket pharmacies more generally).
- 7.56 Therefore, we conclude that customers view Sainsbury's pharmacies and Lloyds pharmacies, and supermarket pharmacies and non-supermarket pharmacies more generally, as substitutes.

Our assessment of competition between pharmacies

- 7.57 As set out in paragraph 7.27, in this section we assess the evidence of competition between pharmacies. We begin by assessing the evidence on competition between non-supermarket pharmacies and supermarket pharmacies. We then assess the ability and incentive for competition to occur at a local level. Finally we assess the evidence that shows whether the Parties have flexed these parameters to compete locally, including a review of internal investment documents.

- *Evidence on overall competition between non-supermarket pharmacies and supermarket pharmacies*

7.58 Having concluded that customers view Sainsbury's and Lloyds, and supermarket pharmacies and non-supermarket pharmacies more generally as substitutes, this section considers evidence on whether non-supermarket pharmacies compete in practice with supermarket pharmacies and if so, how closely they compete. We have considered evidence from:

- (a) the Parties' internal documents;
- (b) third parties;
- (c) our entry/exit model.

- *Evidence from internal documents*

7.59 The Parties submitted research on customer perceptions and their use of supermarket pharmacies and non-supermarket pharmacies conducted during the normal course of business. The results of the research appear to suggest that on average the closest competitors to Lloyds are independent pharmacies along with other major chains, rather than supermarket pharmacies. For example, when Lloyds asked customers about the type of healthcare purchases they would make at each store, Lloyds was perceived as [REDACTED]. Similarly, Sainsbury's research found that [REDACTED].

7.60 In another piece of analysis, Sainsbury's considered the disadvantages it faced compared with specialist pharmacies and identified several ways in which its services were differentiated from businesses such as Lloyds, including [REDACTED]. Further details are shown in Appendix F.

7.61 The Parties said that there were no internal documents which suggested that, at a national level or in any local area, Lloyds considered Sainsbury's to be a close competitor (or vice versa). However, we note that Lloyds told us that in its regular monthly reports it monitored [REDACTED].^{104,105} [REDACTED] but that no competitor profile had ever been produced in relation to supermarket pharmacies.¹⁰⁶ We note that for pharmacy retail, many of the reports included a section on the relevant competitor's strengths and weaknesses. We also note that the Celesio internal report on [REDACTED] detailed comparisons across the [REDACTED] competitors above plus [REDACTED] and stated that the latest NHS data for MURs

¹⁰⁴ Celesio told us the [REDACTED]

¹⁰⁵ In general the reports were factual.

¹⁰⁶ Celesio provided examples of reports on [REDACTED]. The reports varied between companies but generally contained [REDACTED]

indicated that [X] [two supermarkets] were becoming strong competition for Boots and Lloyds.

- *Evidence from third parties*

7.62 Third party information suggested that other supermarkets also seek to convert existing grocery customers into pharmacy customers. Asda stated that it assumed that Asda pharmacy customers were mostly existing grocery customers. Tesco stated that a pharmacy was the additional service most requested by customers, so the introduction of a pharmacy was driven by the customer.

7.63 The general view among competitors was that the main determinant of choice for pharmacy customers was location and that competition between supermarket pharmacies and non-supermarket pharmacies was no different from competition between any two pharmacies. In particular:

- (a) Tesco told us that supermarket pharmacies 'certainly competed' with high street, health centre, community and all other types of pharmacies. Tesco said that all had the same offer. It said that it had been a growing business over the last ten years and had seen customers switch from competitors to Tesco and, equally, customers switch from Tesco back to competitors.
- (b) Boots said that there would be some supermarket pharmacies that were extremely well run and close to a Boots store and, therefore, would be very important to it. Equally, there would be some supermarket pharmacies that were not as well run or not as close to a Boots store and would therefore present less of a threat. It said that this could be the same for Lloyds or Day Lewis or Superdrug or any other part of the pharmacy profession. Boots said that pharmacies were a very localised business, so it would not consider one particular pharmacy chain a bigger threat than another. Boots also said that supermarket pharmacies had a share of the UK pharmacy prescription market and therefore, by default, they were competitors within that market. It said that the customer offer of supermarkets was more towards a dispensing service of prescriptions than a range of over-the-counter (OTC), GSL and pharmacy medicines products. Boots thought that supermarkets would provide some pharmacy services, but on the whole fewer than Boots.
- (c) Day Lewis said that competition from supermarkets was felt from further away than a mile. It said that when a supermarket added a pharmacy it would affect other pharmacies within 3, 4, or 5 miles, because the grocery

offer would attract a lot of footfall; prescriptions would get diluted and all the pharmacies would feel ‘a little bit of a pinch.’

- (d) Well noted that, while the entry of a non-supermarket pharmacy tended to have an impact on its sales when the pharmacy was located within 1 mile, there was an impact from supermarket pharmacies which were located up to 1.5 to 2 miles away.

7.64 Several third parties, however, also pointed out that the Parties’ propositions were somewhat differentiated. Asda and Day Lewis noted that traditional pharmacies could offer more services than supermarket pharmacies. Day Lewis and W R Evans noted that supermarkets, on the other hand, might be more popular with younger generations and, having longer opening hours, had greater opportunities to convert customers to their pharmacies using the EPS. Well told us that the Parties were not close competitors to one another, as they had different business models; similarly, Boots noted that the Parties’ pharmacies tended to be in different locations.

- *Entry and exit analysis*

7.65 By using an econometric model to analyse the impact of entry or exit of pharmacies on incumbent pharmacies across different local markets, we can assess the extent to which customers are willing to switch in response to entry. We have tested the effect of entry and exit on volumes of prescription items dispensed at an individual pharmacy, because pharmacies are generally remunerated on a per-item basis.¹⁰⁷

7.66 Full results can be found in Appendix H. In summary the analysis suggests that:

- (a) Lloyds stores experienced a statistically significant decline in prescription volumes when independent, small multiple or large multiple pharmacy chains opened a store within 1.4 miles of an existing store in urban areas and within 1.6 miles in rural areas.
- (b) We did not observe a statistically significant effect of supermarket entry on Lloyds’ volumes when all supermarket entry events were pooled together. When we separate the supermarkets to estimate the effect for each individually, rather than pooling them together, we find some

¹⁰⁷ The analysis is able to demonstrate that two parties or types of store do compete with one another, but it is not able to prove that they do not compete with one another. Therefore, if the model does not find an effect of entry (or exit) by one party on another, it should be interpreted as the model being unable to prove an effect, not that the model has proved there is no effect.

evidence that Lloyds experienced a statistically significant decline in volume in rural areas when there was entry by Tesco.¹⁰⁸

- (c) Sainsbury's stores experienced a statistically significant decline in prescription volumes when other supermarket pharmacies opened a store within 2.4 miles of an existing store in urban areas.
- (d) When we separate the supermarkets to estimate the effect for each individually, rather than pooling them together, we find that Sainsbury's experienced a statistically significant increase in volume in urban areas when there was entry by Lloyds,¹⁰⁹ and a decrease when there was entry by Asda or another Sainsbury's pharmacy.

7.67 We note that there are a much more limited number of entry and exit events involving Sainsbury's¹¹⁰ or supermarkets than by independents¹¹¹ or large chains.¹¹² As a result, the model is less able to identify an impact of entry by Sainsbury's pharmacy on Lloyds or by supermarket pharmacies on Lloyds than to find an impact of independents or large chains on Lloyds, as there are insufficient observations to isolate and identify the impact. Furthermore, Lloyds often has more than one pharmacy in an area. This, coupled with Sainsbury's larger catchment area, means that one Sainsbury's pharmacy often overlaps with multiple Lloyds branches, which results in multiple entry events. In such circumstances the effect of entry will be more difficult to identify as the impact will be spread across all stores in the area.

7.68 Further, to the extent that entry of a supermarket pharmacy involved the opening of a new grocery store rather than the opening of a new pharmacy in an existing store, this could lead to a footfall effect that would increase the volume of customers attracted into the area. This makes it more difficult to identify the competitive constraint imposed by supermarket pharmacies on Lloyds.

7.69 Overall, the entry/exit analysis suggests that customers are willing to switch to independents and multiple pharmacies from Lloyds, and provides some evidence that customers are willing to switch to some supermarket pharmacies. For the reasons outlined in paragraphs 7.67 and 7.68, the fact

¹⁰⁸ We do not find statistically significant coefficients on any other supermarket in either rural or urban areas.

¹⁰⁹ Although this result is statistically significant, it has the incorrect sign. All things being equal an increase in the number of pharmacies in an area will spread a fixed number of prescriptions over a greater number of stores resulting in a decline in volumes in existing stores. Estimates of the opposite sign are evidence of unobserved factors that the analysis has not adequately controlled for.

¹¹⁰ 25 Lloyds stores in urban areas and 35 in rural areas experienced entry between the last quarter of 2011 and the first quarter of 2016.

¹¹¹ 1,867 entry events in urban areas and 1288 in rural areas.

¹¹² 152 entry events in urban areas and 175 in rural areas.

that the model fails to identify an effect of entry by Sainsbury's pharmacies may be a function of lack of entry/exit events and the complications arising from footfall effects.

- *Conclusion on evidence on overall competition between non-supermarket pharmacies and supermarket pharmacies*

7.70 In our view, the internal documents from across both Sainsbury's and Celesio collectively show that there is some differentiation between their offerings, which may affect how closely they compete. However, Lloyds benchmarks its performance at a national level against [X] competitor pharmacies, of which [X] are supermarket pharmacies ([X]).

7.71 Third party comments add further support to the proposition that Lloyds and Sainsbury's pharmacies and supermarket pharmacies and non-supermarket pharmacies more generally compete with one another to attract prescriptions. However, some third party comments suggest that the offer of supermarket pharmacies may be differentiated to some extent from non-supermarket pharmacies. They also suggest that, consistent with the consumer evidence, closeness of competition will depend on local market characteristics.

7.72 The entry/exit analysis suggests that customers are willing to switch to independents and multiple pharmacies from Lloyds, and provides some evidence that customers are willing to switch to some supermarket pharmacies. The model fails to identify an effect of entry by Sainsbury's. This may be a function of the lack of entry/exit events and complications arising from footfall effects.

- *Our assessment of the ability and incentive for competition to occur at a local level*

7.73 We now assess the evidence on whether the Parties have the ability and incentive to compete on the parameters which matter to customers at a local level, and evidence that such competition currently occurs. We analyse:

- (a) whether the Parties have the ability to flex parameters that are important to customers at a local level; and
- (b) whether the Parties have the incentive to flex these parameters at a local level to compete.

- *What parameters do the Parties have the ability to flex at a local level?*

7.74 We agree with the Parties that, since regulations place minimum quality levels on some dimensions of competition, competition on these parameters is likely

to be more muted than would otherwise be the case. However, such competition may still be sufficiently significant that its loss would be a matter of concern to us. We have investigated the extent to which regulation fixes the absolute level of a competitive parameter or sets a minimum level for a parameter. We note that the Parties have told us that they have a national strategy for setting some of these parameters. The current section considers their ability to flex parameters. The evidence on local variation in these parameters is considered from paragraph 7.87.

7.75 Appendix F sets out in detail the evidence on existing pre-merger competition in the pharmacies market.¹¹³ In particular, we find that:

- (a) Non-supermarket pharmacies including Lloyds can apply to be allowed to relocate their licence, for example to be closer to a GP.
- (b) Pharmacies can improve the information given to GP practices in order to attract higher numbers of prescription customers.
- (c) Some pharmacy services such as MURs are essential, and must be offered by all pharmacies. However, there are no restrictions on the range of P-medicines or services which can be offered, except to the extent that local commissioning arrangements may limit the funding for NHS services in any given local area.
- (d) Pharmacies can determine their own stocking practices for POMs (although they must be able to provide the full list, and comply with the obligation under the terms of the NHS pharmacy licence to provide prescriptions medicines with 'reasonable promptness').
- (e) Pharmacies appear also to be able to influence waiting times, which are not regulated.¹¹⁴
- (f) Opening hours are in practice often substantially above minimum levels, (termed core hours; additional hours above core hours are termed supplementary hours), particularly for pharmacies which have a standard (40-hour) licence. Although changes in core hours must be approved by

¹¹³ Note that we do not consider that the existence of an overall national strategy or target precludes local competition concerns where the competitive offering varies at a local level in response to competition (see paragraph 7.88).

¹¹⁴ These may be of lesser importance in supermarket pharmacies, some of whose customers drop off their prescriptions at the start of their grocery shopping and collect at the end.

the NHS, changes in supplementary hours are approved automatically by the NHS after three months' notice.¹¹⁵

- (g) Pharmacies are able to flex the number and quality of staff, for instance by providing more or less training to staff.
- (h) Pharmacies determine the coverage and quality of prescription delivery/collection services at a local level.
- (i) Pharmacies also have the ability to make changes to the pharmacy environment above the minimum standards set by regulation through refurbishments, for example in response to local competition.

7.76 The ability to flex the offering at Sainsbury's is somewhat more limited than at Lloyds because of the particular characteristics of supermarket pharmacies. In particular:

- (a) The location of the pharmacy is determined by the physical location of the grocery store. Sainsbury's can decide whether to open a pharmacy in an existing store in response to local market conditions, but cannot practically relocate the licence to an alternative location outside of the grocery store.
- (b) Sainsbury's has a higher proportion of 100-hour contracts than Lloyds: approximately 2% of Lloyds stores have licences acquired under the 100-hour exemption whereas this figure is almost 50% for Sainsbury's. Where a pharmacy has a 100-hour licence, it has significantly less flexibility to respond to competition by changing opening hours since it is already open for long hours.¹¹⁶ However, in this case its opening hours are likely to already be at least as long as its competitors'. We also note that, for Sainsbury's non-100 hour pharmacies, these are likely to be open for considerably longer than the regulated minimum to reflect store opening hours. Therefore on this aspect of the offer Sainsbury's is already likely to be strong.

7.77 However, Sainsbury's pharmacies still have the ability to flex other parameters of QRS at a local level, as set out in paragraph 7.79.

¹¹⁵ The National Health Service (Pharmaceutical and Local Pharmaceutical Services) Regulations 2013; Part 3, paragraph 23, also see [NHS England document: Policy for dealing with changes to pharmacy and dispensing appliance contractors' opening hours](#).

¹¹⁶ A very small proportion of pharmacies with a 100 hour licence open for more than the hours mandated in their licence.

7.78 We therefore conclude that Lloyds has the ability to compete at a local level by flexing the parameters which customers value of QRS listed in paragraph 7.75 in response to its competitors, including Sainsbury's. It has the ability to flex:

- (a) location;¹¹⁷
- (b) information provided to GPs;
- (c) range of pharmacy only medicines and services;
- (d) stocking practices for prescription medicines;
- (e) waiting times;
- (f) opening hours;
- (g) number and quality of staff;
- (h) coverage and quality of delivery/collection services; and
- (i) pharmacy environment.

7.79 Sainsbury's also has the ability to flex competitive parameters at a local level, but to a more limited extent as set out in paragraph 7.76. It has the ability to flex:

- (a) information provided to GPs;
- (b) range of pharmacy only medicines and services;
- (c) prescription medicine stocking practices;
- (d) waiting times;
- (e) opening hours (to a limited extent – although Sainsbury's offer in this regard is already likely to be strong);
- (f) number and quality of staff;
- (g) coverage and quality of delivery/collection services;¹¹⁸ and

¹¹⁷ We note that location is not a variable over which firms compete in the short run. Competition over location will occur in the medium term and could be triggered, for example, by the entry of a new pharmacy or relocation of a GP surgery. This could include relocations in response to a GP surgery being closer to a supermarket pharmacy (see, for example, paragraph 7.107(c)).

¹¹⁸ We note, however, that only [X] and acknowledge that to introduce a home delivery service may require significant investment, [X]

(h) pharmacy environment.

- *Incentive for the Parties to compete at a local level*

7.80 We next considered whether Lloyds and Sainsbury's have an incentive to change the parameters listed in paragraphs 7.78 and 7.79 in response to changes in local competitive conditions.

7.81 The NHS is currently consulting on changes to the pharmacy payment structure which will reduce or remove the fixed element of the payment in favour of variable payments linked to dispensing volume. Therefore, if a pharmacy is able to increase the number of prescriptions it dispenses it will increase its revenue.

7.82 Lloyds and Sainsbury's will have an incentive to compete on these parameters if they are able to increase their profits by attracting additional pharmacy customers.¹¹⁹ Since customers place value on elements of the competitive offering, pharmacies can attract more customers by improving their performance on these parameters.

7.83 We note that many of the costs of operating a pharmacy do not directly vary with prescription volumes:

- (a) There is only limited flexibility in staffing costs if the pharmacy is open as the pharmacist must be on site for prescriptions to be dispensed.
- (b) There are regulations which determine the minimum amount of stock and range that a pharmacy must hold.

7.84 We also note that local managers are responsible at a local level for the sales and profit performance of the pharmacies covered by the manager. The bonus structure of the area manager incentivises [X]. The bonus structure of the pharmacy manager incentivises [X].¹²⁰ We consider that this incentivises local management to respond to competition at a local level where the level of competition is high. It also gives the incentive to improve financial performance by reducing the level of offer, and thereby reducing costs, where the level of competition is low.

¹¹⁹ Pharmacy revenue is principally received from dispensing prescriptions and could be grouped into two main categories: pharmacies receive a fixed payment of £25,100 once they achieve a volume of 3,150 prescriptions per month. Pharmacies receive a further series of payments that are linked to the number of prescriptions they dispense, this includes a dispensing fee of 90p per prescription and a practice payment of 54.6p per prescription. There are variants beyond this, for example payment may be lower where staffing numbers are below the profile expected for a store of a given volume. For further information see the [NHS drug tariff](#).

¹²⁰ The area manager bonus scheme has the following elements: [X]. The pharmacy manager is [X]

7.85 In our view there is a strong economic incentive for individual Lloyds and Sainsbury's pharmacies to maximise the number of prescriptions they dispense (by maximising their share of the number of prescriptions in the local area) since this is likely to increase profits.¹²¹

7.86 In areas where there are no competitors there will be relatively little incentive to provide a high-quality offering, as customers would use the pharmacy in any event in the absence of convenient alternatives. However, where there are competitors, so that customers can choose between pharmacies, the pharmacies will have an incentive to offer a better quality of service to try to increase customer numbers and revenues. Therefore there is a strong incentive for the pharmacy to compete in the local area.

- *Evidence of current competition at a local level*

7.87 In paragraphs 7.74 to 7.85 we concluded that pharmacies in general, and the Parties in particular, had the ability and the incentive to compete at the local level.

7.88 The Parties have argued that the majority of the elements of their local offering are subject to some form of national target or strategy. They believe that as a result of this there is limited or no local competition between them on these elements, and that the merger would not give them the incentive to depart from their current national strategy. However, the existence of an overall national strategy or target does not preclude local competition concerns where the competitive offering is varying at a local level in response to competition.

7.89 This section considers evidence on whether pharmacies in general and the Parties in particular do compete at a local level. We have focused on how Lloyds competes with other pharmacies in a local area because of the more limited ability of Sainsbury's pharmacies to flex local parameters of competition.

(a) We set out evidence from internal documents suggesting that Lloyds and Sainsbury's respond to competition from pharmacies in the local area. This includes:

- (i) evidence of advice given to local pharmacy managers on how they should respond to competition; and

¹²¹ We note that local investment documents frequently refer to the capture rate of available prescriptions. See, for example, paragraphs 7.116(b), 7.122 & 7.136.

- (ii) evidence of competition on specific QRS parameters in particular local areas.
- (b) We then set out quantitative evidence on how quality parameters and margins relate to the level of competition.
- (c) We then consider how far this evidence suggests that Lloyds currently competes with Sainsbury's at a local level.
- *Internal documents – 'Competitive Edge'*

7.90 The Parties told us that neither Lloyds nor Sainsbury's pharmacy business regularly produced any reports which detailed local competition conditions. It said that neither of them regularly produced any reports which actually discussed or monitored the competitive conditions in local areas. Lloyds' regional managers did produce reports regarding new developments in relation to Lloyds' own pharmacies in their areas (such as planned refurbishments of existing Lloyds stores, potential opportunities to open new Lloyds stores, possible disposals of existing Lloyds stores, etc). These reports might occasionally reference the local activities of a competitor in a purely incidental way – for instance, if Lloyds was acquiring a new pharmacy licence from someone. The Parties also confirmed that no reports which detailed or monitored local competition conditions were produced (regularly or otherwise) by Lloyds or Sainsbury's pharmacy business in 2012 or 2015. Lloyds said that the closest it came to producing such reports were the investment board proposals concerning store refurbishments, relocations or new builds.

7.91 However, the Lloyds 'Competitive Edge' document, dated June 2011 (the Competitive Edge document) was created to assist Lloyds' local managers in responding to competitor applications for pharmacy licences; to protect at-risk pharmacies in advance of applications being made; and then, where applications are granted, to defend existing prescription volumes. We reviewed this and other material provided by the Parties about how pharmacies compete locally. The Competitive Edge document sets out how field managers (who the document states have responsibility for maximising the sales and profitability of their pharmacies) should respond to entry. It states that a new pharmacy opening in close proximity can have a 'devastating' effect on a pharmacy's business.

7.92 The Parties said that this document described the review process for Lloyds' field managers on how to deal with the entry of a competitor into a local market and how to maintain their competitive edge. The Parties said that the focus of the document was on dealing [X]. The Parties said that the Competitive Edge document was historical (created in 2011) and was related

only to the significant change in regulation (the advent of 100-hour pharmacies). They said it was used in connection with that event only, and had not been used by the Lloyds business in any formal sense for a number of years.

- 7.93 Celesio said the document was a field manager's tool that was about doing the things that should be done very well, by reviewing what was being done currently and how it could be done better 'so, in essence, about being good at what you do'. It said that the document was about making sure every Lloyds store was meeting the normal, consistent standards that Lloyds set for its entire portfolio, rather than attempting to meet a higher standard in response to local competition. The Parties said the document did not constitute evidence of closeness of competition between the Parties nor of how Lloyds would react to new entry by a Sainsbury's pharmacy. The Parties argued that the document did not provide a summary of Lloyds' current strategy and said that the document was effectively superseded by a portfolio strategy analysis carried out by Lloyds the next year (2012), in which Lloyds assigned a [REDACTED].
- 7.94 The Competitive Edge document appears to have been created to address issues that arose from the change in regulation related to the 2005 relaxation of entry restrictions for pharmacies (see paragraph 2.9). However, as the Parties said initially, the document sets out in some detail the tools available for a pharmacy to compete locally and suggests how these tools should be used to respond to competition at a local level. It appears that these tools were in use generally and were not developed specifically for local managers dealing with the entry of a 100-hour pharmacy. In our view, at least some of these tools would be likely to be used whether or not the pharmacy entering (or already present) in an area was a 100-hour pharmacy. In addition, the document does not distinguish between different types of competitors (for example, supermarket pharmacies or non-supermarket pharmacies) in terms of local competitive response.
- 7.95 Celesio's 2012 portfolio strategy analysis assigned [REDACTED] a supermarket 100-hour pharmacy compared with [REDACTED] to a non-supermarket 100-hour pharmacy. It does not appear that the portfolio analysis is the same tool as the Competitive Edge document. While the Competitive Edge document set out specific actions that could be taken locally in response to the entry of a competitor, the portfolio strategy – as its name suggests – is a document for assessing the portfolio. Secondly the rating was only concerned with [REDACTED]. Since the change in legislation that allowed the influx of exempt pharmacies, Celesio's current analysis appears to have removed the differential weighting between supermarket pharmacies and non-supermarket pharmacies. Celesio said that the current approach to risk weighting prioritised whether the Lloyds pharmacy was [REDACTED] relative to [REDACTED] and whether the [REDACTED]. We recognise that

this suggests that, in terms of [redacted] at least, supermarket pharmacies were considered by Celesio to be less of a threat. There may be a number of reasons why this was considered to be the case:

- (a) Across the portfolio, supermarket pharmacies may have usually been further away from Lloyds pharmacies than other non-supermarket competitors even though in some local instances this may not have been the case and the threat from the supermarket pharmacy then may have been higher.
- (b) As set out above (paragraphs 7.78 and 7.79) a non-supermarket pharmacy may be able to flex some parameters to compete (in particular [redacted]) which a supermarket pharmacy would not be able to.

7.96 Notwithstanding the Parties' submissions we consider that the Competitive Edge document, although a historical document created in response to a particular event, provides relevant evidence of ability and incentive to flex certain parameters in response to competitive conditions at a local level that is still relevant as detailed further below.

- *Internal investment documents*

7.97 In order to see whether there was evidence in internal documents of investments being made in response to local competition we requested local internal investment documents from Celesio for 2012 and 2015. In response to this request Celesio provided 139 investment proposals.¹²² These documents detailed local investment cases mostly around the refurbishment or relocation of specific branches. Since these documents concerned all local investment cases we found that many of them did not specifically concern investments made because of competitors and did not find that to be surprising. Many of these documents contained sections specifically listing under local competition the competitors present in the local area. Others listed under a more general heading the other pharmacies in the local area.¹²³ A number of the documents detailed specific local interventions such as the introduction of a service in response to the actions of a competitor. These instances are highlighted where appropriate below. Of the [redacted] documents:

- (a) [redacted] either referred specifically to competition in the local area or noted the presence of other pharmacies proximate to Lloyds' stores;

¹²² These were usually documents presented to the Investment Board of Celesio UK or to the Progress & Investment Board of Celesio UK.

¹²³ In some instances the sections were titled competitors and in others this was included in the background sections of the paper.

- (b) of these [REDACTED] referred to supermarkets, either specifically as local competitors [REDACTED] or made a point of noting their presence [REDACTED] (with no distinction between the supermarket and other pharmacies in the area); and
- (c) of these [REDACTED] specifically referred to Sainsbury's, of which [REDACTED] specifically linked Sainsbury's to the competitor set and [REDACTED] mentioned Sainsbury's on a map of local pharmacies or noted their presence elsewhere. No distinction was made between Sainsbury's, other supermarkets and non-supermarket pharmacies.

7.98 We note that some of these references to competition are simply listing the competitors in the area. We find that even this is indicative of local competition being relevant to the decision of whether to invest in the local Lloyds pharmacy. The share of the available business in the area that is captured by the Lloyds pharmacy is also reported in some instances. Some set out more specifically that local competition is a major factor behind the investment and some specify that the investment is in particular due to competition from a supermarket pharmacy (for example, see paragraph 7.107(c)).

- *Evidence of local responses to competition*

7.99 Overall the evidence suggests that pharmacies respond to competition at a local level in the following ways:

- (a) by objecting to applications for new pharmacies;
- (b) by relocating the pharmacy licence; and
- (c) by varying QRS parameters.

- ◦ *Objections to new pharmacy licences*

7.100 The Competitive Edge document sets out that:

- (a) [REDACTED]
- (b) [REDACTED]
- (c) [REDACTED]

- 7.101 We note in paragraph 7.19 that Lloyds said its response to entry depended on whether [redacted]. Lloyds has provided us with a sample of letters¹²⁴ to the local NHS board in response to an application for entry. In this sample we note that the responses to Sainsbury's entry applications were generally [redacted] than the responses to [redacted]. They frequently amounted to asking the local NHS board to make sure that [redacted]. However, in our view, [redacted].
- 7.102 For example, when Sainsbury's appealed against a decision to refuse it a licence for a supermarket pharmacy in Wolverhampton Lloyds submitted a letter to the local health authority. According to the appeal decision Lloyds noted (a) that the appellant focused on opening hours as part of its appeal; (b) said that the applicant did not propose to provide any core hours after 5pm on weekdays nor any core hours over the weekend and failed to provide any supporting evidence as to why such extended hours were required; and (c) said there was no evidence that the current opening hours of existing pharmacies were not sufficient to meet patient needs. Lloyds said it failed to see how the application could be approved to secure improvements or better access to pharmaceutical services and asked for the appeal to be dismissed. The Parties argued that this underlined that the Parties did compete to an extent but were not close competitors (or else Lloyds would have objected more strenuously). Lloyds also said that the objection did not relate to any specific parameter of the competitive offers that could be worsened and it had not initiated the appeal.
- 7.103 We consider that Lloyds' objection was more than a template asking the body to follow the proper process. While the objection may be less detailed than an equivalent objection for an independent, it was sufficiently strong to request that the application should be rejected. We note that Lloyds said it did not initiate the appeal but since it is an appeal by Sainsbury's against a rejection of a licence application we can see no reason why Lloyds would have initiated the appeal.¹²⁵
- 7.104 Other pharmacies also told us how they reacted to new entry by a competitor. Several said they would object to the application for a pharmacy licence.¹²⁶

¹²⁴ This was a small sample. We asked Lloyds if it could provide letters associated with ten specific applications over a number of years that we randomly selected. Lloyds was able to provide six of them.

¹²⁵ See NHS Litigation Authority, [Ref SHA/17690](#): Appeal against Birmingham, Solihull & The Black Country Area Team, NHS Commissioning Board ("NHS England") Decision to refuse an application by Sainsbury's supermarkets Ltd for inclusion in the Pharmaceutical List offering unforeseen benefits under Regulation 18 at Sainsbury's supermarket, Raglan Street, Wolverhampton, West Midlands WV3 0ST.

¹²⁶ Boots told us that it would object to an application depending on the circumstances, if it thought that would threaten its business or if it thought it was not in the right interests of health provision in a particular location.

Sainsbury's said that it would object to applications for new pharmacy licences in areas where it currently operated.¹²⁷

- ○ *Relocating the pharmacy licence*

- 7.105 The majority of pharmacy revenue is derived from NHS prescription customers. Before receiving their medicine, these customers need a prescription, which must be issued by a health professional, most often a GP. By locating closer to a GP practice, a pharmacy may be expected to receive a higher share of prescriptions from that GP practice.
- 7.106 Although relocations of pharmacies are regulated and require approval before a move takes place, the Competitive Edge document suggests that Lloyds may respond to entry (or the threat of entry) by relocating. In particular, it states that an appropriate response to possible entry in a local area may be to [X], where [X]. However, we note that relocation decisions would typically be part of a longer-term dynamic strategy and would occur primarily in response to the entry or relocation of another pharmacy or a decision of a GP practice to move to a new premises.
- 7.107 There is evidence in Celesio's internal documents that Lloyds' relocation decisions can be driven by entry (or threat of entry) by other pharmacies. For instance:
- (a) [X], when deciding whether to relocate, Lloyds noted: 'Concern that pharmacy is poorly performing and that another pharmacy might relocate onto a nearby health centre if the Lloyds does not.'
 - (b) [X], Lloyds noted: 'We strongly believe that this proposal to relocate [X] will prevent a new contract from being granted to [X] and will protect our current businesses to secure their longevity.'
 - (c) There are also specific instances of relocation proposals in response to loss of sales to supermarket pharmacies. These show that in these local areas the constraint from the supermarket was considered to be material and provided further evidence that in certain circumstances supermarkets exercise a competitive constraint on Lloyds in local areas:
 - (i) [X], the Lloyds investment proposal when considering a branch relocation noted: 'In May 2011 a Tesco Express adjacent to our

¹²⁷ Boots, Day Lewis. Sainsbury's said that it would object to every application for an independent or a Boots because it is just what the market does and it is just the 'nature of the thing'.

branch expanded into new premises (ex Somerfield behind the parade) to become a Tesco Metro and opened a 100 hour pharmacy contract the following November. Consequently the branch is trading 17% down on items and 10% down on sales to last year.^{128,129}

- (ii) [X], Lloyds stated: 'The "do nothing" assumes that [X] does not relocate to the new medical centre and continues to trade in its current location. In the first year, it is predicted that items would reduce by 20% with further impacts as more patients chose to use Asda, which is closer to the new medical centre development.'

7.108 Furthermore, we note that in a number of areas where Lloyds decided to relocate a pharmacy such as [X], Sainsbury's was noted as a competitor, although it was not listed as the specific reason for relocating the branch.

7.109 As discussed earlier we do not consider that Sainsbury's, in common with other supermarkets, would relocate its stores to benefit pharmacy customers, given that this business represents a small part of its turnover.¹³⁰ However, as noted in paragraph 7.107(c) if a GP surgery relocates closer to a supermarket Lloyds may seek to move closer to the GP to compete.

- ○ *Opening hours*

7.110 If a store is closed when customers need to fulfil a prescription they will either need to travel further to visit an alternative pharmacy or will have to return at another time when the pharmacy is open. Lloyds said that its opening hours were always set at the local level, and were generally set to be consistent with those of local surgeries. The Competitive Edge document states that opening hours should be reviewed following new entry, and [X] Moreover, Boots told us that, in response to the entry of a competitor, it might, on occasions, change opening hours to better match a GP surgery or to make sure the Boots pharmacy was open longest with the ultimate focus of providing the best customer care within that pharmacy.

7.111 Almost all Lloyds pharmacies open for more than the minimum number of hours (around 90% open for at least 45 hours and less than 100 hours), and therefore are in principle subject to a reasonable degree of flexibility. Lloyds stated that it had a practice of setting the core hours for a pharmacy at the

¹²⁸ We note that while a Tesco Express would usually be smaller than 280 sq metres and would therefore not be considered to be a supermarket, a Tesco Metro is larger and would be considered to be a supermarket.

¹²⁹ Celesio told us that [X].

¹³⁰ As noted in paragraph 3.6 the UK turnover of Sainsbury's pharmacy business was £[X] million in FY 2015. Sainsbury's plc retail sales in total were £25.8 billion.

beginning and the end of the day, with supplementary hours in the middle of the day as this reduced the possibility of entry in to the area.¹³¹ We note that Sainsbury's pharmacies are usually very competitive with respect to opening hours because their opening hours tend to reflect those of the supermarket.

7.112 The Celesio investment board documents provided to the CMA contain a specific reference to adjusting opening hours in response to competition: [REDACTED]:

The 100 hour pharmacy that opened in December 2012 on the estate a few hundred metres from the shopping centre is also starting to have an increasing impact. In an attempt to claw back items from local competitors, it has been agreed to increase the opening times of the pharmacy to 7pm in line with the health centre and take advantage of our position located outside of the shopping centre. Year 2 items are projected to increase by 5.2%, as the pharmacy starts to take items from the local 100 hour and capture patients who leave the surgery after 6.30pm.

7.113 Furthermore, in [REDACTED], Lloyds relocated its branch and increased its hours to match the health centre. This occurred after the local GP practices relocated to a new site which was closer to an Asda branch than the old Lloyds site. The investment documents do not make it clear whether the GP practices changed their hours when they relocated, as such, it is not clear if Lloyds was matching the hours of the old GP surgeries before it relocated:

It is also proposed to increase opening hours upon relocation to match the surgery. The branch is currently open for 47.5 hours per week. It is proposed to extend this to 54 hours per week. This has resulted in an increase in Pharmacist and staff costs.

The 'do nothing' assumes that [REDACTED] does not relocate to the new medical centre and continues to trade in its current location. In the first year, it is predicted that items would reduce by 20% with further impacts as more patients chose to use Asda, which is closer to the new medical centre development.

○ ○ *Store ambience and refurbishments*

7.114 A store refurbishment can be conducted for many reasons, and can interact with a number of the other quality variables that we discuss. For instance, if

¹³¹ The Parties told us that since core hours were subject to less flexibility than supplementary hours, they could hold more weight with the local NHS Commissioning Board when deciding on applications for new pharmacy licences.

the current premises are poorly laid out, waiting times could be long. Refurbishments can improve dispensing efficiency, thereby improving customer service. As such, there is a relationship between refurbishments and other quality variables.

7.115 The Parties noted in Table 6 (paragraph 7.25) that refurbishments affect ambience, and research conducted by Lloyds also suggests that a refurbishment can [REDACTED].¹³² Lloyds said that ‘refurbishment of stores is undertaken for the purpose of increasing a pharmacy’s competitive position.’ Lloyds also told the CMA that it operated a regular refurbishment schedule for its stores, but that it might [REDACTED]. Lloyds also later told us that its quantitative analysis showed that there was local variation in refurbishments but its assessment was consistent with Lloyds not varying refurbishments (together with some other quality aspects it assessed) in response to local competition (see paragraph 7.145), and that there was no analysis of what costs would be saved by postponing a refurbishment, nor any consideration of the sensitivity of customer demand to refurbishments or whether the Transaction would make a material difference to whether or not it would be profitable for Lloyds to delay any refurbishments. Third parties told us that they considered the environment and facilities offered in store to be relevant to local competition.

7.116 The investment board documents provided to the CMA contain a number of instances where a pharmacy refurbishment has been approved. At least one of the examples we saw was where a key reason for the refurbishment was in response to competitors winning volume from Lloyds:

(a) [REDACTED], Lloyds noted: ‘there are 4 pharmacies in the town, Lloyds Pharmacy, Boots, Tesco and an independent. Boots is the nearest competitor approximately 400m away in the town centre. The 33 sqm OTC space [in the Lloyds branch] has old and battered mahogany wood fixturing which together with its low level lighting makes the unit feel dark and gloomy. Patients often go elsewhere as the pharmacy feels claustrophobic even though queues are given prompt attention.’

(b) In discussing the refurbishment of [REDACTED] Lloyds noted:

The dispensary is far too small for the volume of items and only having one till impedes customer service at peak times. The branch captures 56.5% of the surgeries items but there is potential to capture more if the right environment is provided ... negotiations have resulted in an agreement to expand the

¹³² In a research report dated January 2015 customers identified these and other benefits as resulting from refurbishments ([REDACTED]).

pharmacy to 67 sqm with access immediately off the surgery waiting room and two service points meaning patients will be served more efficiently and there will also be ample waiting space at peak times.

[X]. There are no adjacent retailers and the closest competitors are Boots and Superdrug 500m away in the town centre. [X] surgery has 13,300 patients and prescribes 211,000 items per annum. The population of [X] continues to grow and there is potential to capitalise on an increased surgery output given the correct environment.

Only having one till point to serve and limited standing space at the counter results in patients by-passing the pharmacy, leaving the surgery and having their prescription dispensed at another pharmacy (Boots, Superdrug and [X] are all only about 500m away). Therefore the improved dispensing and store environment will allow the team to improve service and reverse the items decline so market share will improve.

7.117 In contrast, Sainsbury's said that pharmacy refurbishments were carried out as part of an overall store refurbishment, and that [X].¹³³

○ ○ *Staffing and quality of advice*¹³⁴

7.118 Table 6 notes that staffing and quality of advice can affect customers in various ways such as service quality, patient health and waiting times (causing inconvenience). Lloyds said it determined its staffing levels according to a [X] model that was consistently applied in [X] of its stores. This model is based on a model that looks at [X] (with a particular emphasis on [X]). However, in an earlier submission Lloyds had said the model is a guide and local amendments can be made where appropriate: 'A [X] tool is used as a guide for the staffing profile of each store. The [X] tool uses the [X] of the store and, based on [X], recommends a staffing profile. The Head of Region and Area Managers own and review the outputs of the [X] tool, and make any [X] amendments where appropriate. The model is reviewed on a [X] basis.'

¹³³ [X]

¹³⁴ By regulation, pharmacies may only operate if there is a pharmacist present, and must fulfil prescriptions with 'reasonable promptness'.

7.119 The Parties also told us that staffing levels and quality were regulated, that there was no variation in the type, quality or availability of training, given to Lloyds' staff at a local level, that they operated centralised training schemes which were rolled out to all pharmacy staff and that any deliberate reduction in the quality of staff training would be highly unethical.¹³⁵

7.120 The Competitive Edge document states that area managers should consider [redacted] if another pharmacy has or might set up in the area. Lloyds also said that staffing was crucial to overall customer satisfaction. It said that 'the quality of its staff is a highly positive distinguishing factor, in terms of their availability, ability to listen to customer needs, and the quality of their advice'. The Competitive Edge document states that area managers should [redacted] where there is potential for new entry.

7.121 Third parties also suggested that staffing levels could be changed as a result of local competition. Tesco said that in response to the entry of a competitor in a local area it would [redacted]. Boots said it would ensure that all staff were properly trained.

7.122 The Celesio investment board documents provided to the CMA contain a reference to flexing staff levels at a local level in [redacted]:

Recently, our capture rates [from the health centre] declined from 74% to 60% following the opening of a new competitor pharmacy in May 2011. This pharmacy opened between us and the new surgery site and we believe he is attempting to relocate into the new medical practice ahead of Lloyds. Further to new competition, we have successfully concentrated our efforts on providing excellent service. With greater staffing levels, Lloyds has retained more items than originally forecast.

7.123 By contrast, there is no evidence in any Sainsbury's internal document seen by the CMA that Sainsbury's flexes staffing levels in response to competition. Sainsbury's told us that staffing above the minimum was determined by [redacted].

- ○ *Provision of additional services*

7.124 The provision of additional services by pharmacies is likely to benefit some customers who would otherwise not have access to the service or have to seek it elsewhere. Pharmacies have some flexibility in the range of NHS and private services they offer. Pharmacies must provide a set of 'essential

¹³⁵ Further submission of the Parties in relation to possible remedies and in response to the provisional findings

services',¹³⁶ but not all services are commissioned in every local area. The Competitive Edge document indicates that Lloyds pharmacies should provide as [REDACTED].

7.125 Sainsbury's told us that its range of services might vary from area to area to meet the needs of the local populations, and that it placed reliance on local pharmacy managers to assess risk and decide if they could provide enhanced services. A Sainsbury's internal document stated that [REDACTED] and outlined an intention to [REDACTED].

- ○ *Waiting times*

7.126 As noted above the longer the waiting time the more customers will be inconvenienced. Lloyds said that it had a consistent national target for waiting times of [REDACTED], but did not flex its position on this target in response to local competitive conditions. Lloyds said it aimed to ensure that all its pharmacies had an average customer waiting time of [REDACTED] or less, regardless of how many (or how few) competing pharmacies were nearby. Lloyds said it set this target because it believed waiting times were important to its customers, and that if a customer waited for too long at any Lloyds pharmacy (including one with no other competing pharmacies nearby), then the experience might undermine the customer's perception of the Lloyds pharmacy brand.

7.127 We note that there is substantial variation in performance on waiting times across local areas (see Appendix G, Figure 1). This demonstrates that waiting times do vary at a local level.¹³⁷ Lloyds noted that this variation was to be expected depending on the location of the store, level of throughput etc and that the variation did not reflect level of competition. Lloyds also noted that its quantitative analysis did not show a relationship between waiting times and local competition and that our quantitative analysis also did not find a relationship.

7.128 The Competitive Edge document shows that, where there has been a store opening, pharmacies are encouraged to review their performance to ensure they are meeting their target of [REDACTED] average waiting time. Lloyds told us that waiting and dispensing times were key differentiators against competitors – particularly those that were not purely health or pharmacy focused. Lloyds also told us that decisions on whether to make additional expenditure ([REDACTED]) with the aim of reducing waiting times were managed locally (at store level),

¹³⁶ Such as: promotion of healthy lifestyles, disposal of unwanted medicines, support for self-care, and signposting.

¹³⁷ The total variation in waiting times is between [REDACTED] with the bulk between [REDACTED]

using local knowledge. Lloyds said a business case must be prepared and approved by the Head of Region in order for [REDACTED].

7.129 The investment board documents provided to the CMA contain some references to waiting times resulting in changes in prescription flows and appear to take account of local competition. [REDACTED], when considering a refurbishment Lloyds noted: ‘This disparity between budget and actuals is due to the pharmacy being hindered by dispensing capacity constraints (which leads to long wait times at peak periods), coupled with the Co-Op improving their own wait times (market data shows the Co-Op have increased their items by 11.5%).’

○ ○ *Prescription collection and delivery*

7.130 A prescription collection service involves the pharmacy collecting prescriptions from a GP practice, which means customers do not have to travel to the pharmacy to lodge their prescription. This service increases customer convenience, particularly for those with repeat prescriptions who can then attend the pharmacy at their leisure to collect their prescription without having to wait for it to be dispensed.

7.131 The prescription collection service is set at the local level for Sainsbury’s stores, although it is run more informally than at Lloyds, with Sainsbury’s staff using their own vehicles to collect prescriptions. Further, the Competitive Edge document states that Lloyds’ area managers should [REDACTED].

7.132 Lloyds said it had a consistent national approach to its universal prescription collection service. It said it aimed to collect from as many GP surgeries as it could, in order to [REDACTED].

7.133 In an earlier response Lloyds told us that the prescription collection service was typically undertaken in relation to the surgery most local to the pharmacy. It said there were no set rules, and the provision of this service was a local decision made by the pharmacy manager.

7.134 A prescription delivery service involves the pharmacy delivering prescription medicines to the customers’ chosen address. This increases convenience, as customers do not have to attend the pharmacy to collect their prescription.

7.135 Lloyds also noted that the decision to offer delivery services was taken locally by the pharmacy manager where they felt the service was appropriate and would add value. Lloyds said that typically, the service would be offered to customers with mobility problems. Lloyds also noted that all care homes would have a delivery service as part of the service level agreement, which would typically be daily.

7.136 The Celesio investment board documents provided to the CMA contain instances where collection and delivery services have been introduced or improved in response to competition:

(a) In [REDACTED]

An independent pharmacy, [REDACTED] is co-located with [REDACTED]. It is one of a group of 5 pharmacies which uses AAH as 1st line wholesaler. Tesco has an in-store 100hr pharmacy within its 24hr store. The [proposed] new unit is 149sqm and has a car park directly opposite with additional car parking to the side. It will be visible to those coming from [REDACTED] by car and by foot. It will also be visible to those accessing [REDACTED] from outlying towns. The current capture of the available prescriptions is 33% despite the poor current location and premises. This is due to the work done on the prescription collection service by the good pharmacy team in advance of the Tesco 100hr contract opening.

(b) In [REDACTED]

There are two competitors within [REDACTED], both located in the town centre, 1/2 mile away; Boots and independent operator, [REDACTED]. [REDACTED]. They also offer a delivery service, as do Boots Pharmacy. There are various other surrounding pharmacies who all also offer a collection and delivery service. It is therefore proposed that a delivery service is introduced to ensure we remain competitive.

(c) In [REDACTED] 'There are two competitors located in [REDACTED] (Boots and Rowlands), both of which are situated in the town centre itself. Both of these pharmacies offer a delivery service, which we intend on matching should the project be successful.'

7.137 In relation to delivery, we acknowledge that both investment proposals outlined above were produced in 2012, and that in 2016 almost all Lloyds stores offer delivery although this appears to be to a subset of customers (those with mobility problems (paragraph 7.135)).¹³⁸ Prescription collection services are likely to be more flexible, given that parameters such as the collection radius vary with profitability, of which competition is a determinant. We also noted in paragraph 7.79(g) that since only [REDACTED]. However this would

¹³⁸ In relation to [REDACTED] the Parties said [REDACTED]. However, we infer from this example that a prescription collection service may be used in some circumstances to improve customer retention.

not prevent Lloyds from introducing or enhancing its delivery service as a differentiating factor, including when competing against Sainsbury's pharmacies.

- ◦ *Relationships with GPs*

7.138 In Table 6 Lloyds said that its approach to providing information to local GP practices was [REDACTED].

7.139 We regard seeking to improve relationships with local GP practices as a benefit of local competition. Lloyds earlier said that the decision whether to review outreach efforts to GP practices, other prescribing organisations and CCGs was managed [REDACTED].

7.140 An internal document also mentions seeking to improve Lloyds' relationship with a local GP practice.

Within a 1-mile radius of [REDACTED] there are eight other competitor pharmacies, and within 1 mile of [REDACTED] there are nine. A branch of Boots operates in [REDACTED] and another Boots licence in [REDACTED]. Co-op operates two licences, [REDACTED]. LP operates at [REDACTED] operates another contract at [REDACTED] and there are two additional independent operators to [REDACTED].

[REDACTED] is a 100-hour operating pharmacy that opened in 2009. In 2011, the branch made a loss of [REDACTED] through excessive costs relating to a service contract which is no longer operated by Lloyds. An action plan is seeking to improve relationships with the Practice, improve the visual impact of the pharmacy, review the skill mix in the pharmacy, and increase prescription capture using an incentive scheme ([REDACTED]). These actions aim to reduce the business losses and achieve profitability in two years. The action plan is intended to increase capture to 35% in year 1 and 40% in year 2. Acquisition of this standard hours licence would make the branch profitable in the first year post acquisition through immediate reduction in staff costs.

- ◦ *Other parameters which pharmacies have the ability to flex at a local level*

7.141 There are other parameters which pharmacies have the ability to flex at a local level. However, we found that it was unlikely that decisions to flex these parameters were currently related to local competition:

- (a) Range of prescription medicines – There are no minimum stocking requirements for pharmacies, although they must be able to source ‘a full range of prescription products’.¹³⁹ Although a pharmacy may have the incentive to hold a larger range of prescription medicines in stock where customers could easily go somewhere else as opposed to areas where there are no alternatives, we have not seen evidence that stocking decisions for prescription medicines are related to local competition. We also note there are local deliveries of medicines twice a day to Lloyds’ stores.
- (b) P-medicines – Pharmacies do not face restrictions on the range of P-medicines and GSL items that they can stock. [REDACTED].¹⁴⁰ We consider that pharmacies do not currently compete by setting range differently in response to local competition for these products.
 - ◦ *Internal documents showing general competition between pharmacies at a local level*

7.142 As discussed in the previous section pharmacies are able to respond to competition by flexing multiple parameters of their competitive offer. We have highlighted examples in the above text of instances where Lloyds has flexed specific elements of its local competitive offering. However, it is not possible to categorise all documents in this way, as some detail the process of local competition rather than the flexing of specific local parameters. The example below from [REDACTED] shows where the Lloyds pharmacy has attempted to cause a competitor to exit the local market.

The new Health Centre is located at the eastern edge of the village 500m from the existing pharmacy location. A competitor 100 hour pharmacy opened between the current locations of [REDACTED] and the GP surgery in April 2011 and has therefore had 12 months to build prescription capture ahead of the Lloydspharmacy Health Centre relocation. This has reduced the level of NHS items dispensed by [REDACTED] in the last 12 months by 27k items and it is estimated that the 100hr competitor only dispensed [REDACTED] NHS items in that period and so must be under financial pressure. Lloyds pharmacy now proposes to [REDACTED]. Four options have been considered:

(a) [REDACTED].

¹³⁹ Parties’ initial submission, section 2.1.

¹⁴⁰ Parties’ initial submission, Part H, 2.2.

(b) [REDACTED].

(c) [REDACTED].

(d) [REDACTED]. This option seeks to maximise prescription retention and pressurise our competitor into closure as shown in the table.

○ ○ *Conclusions on evidence of local responses to competition*

7.143 We consider that the evidence from internal documents shows that Lloyds responds to competition from other pharmacies in a local area and, in areas where supermarket pharmacies are present in the area, responds to competition from supermarket pharmacies. We note that there are no instances of Lloyds taking specific action in response to a Sainsbury's pharmacy, although in several instances Sainsbury's is mentioned in the review of local competitors. We do not take the lack of evidence from these documents of Lloyds taking specific action in response to Sainsbury's pharmacies as evidence that Lloyds does not compete with Sainsbury's, for the reasons set out in paragraphs 7.153 to 7.159.

○ *Empirical evidence of change in quality in response to competition*

7.144 As discussed above, we have found that pharmacies have the ability and incentive to compete at a local level, and there is documentary evidence suggesting that Lloyds flexes (or would flex) elements of its competitive offering in response to changes in local competitive conditions, whether these changes are caused by non-supermarket or supermarket pharmacies. In addition to the documentary evidence on local competition between pharmacies, we have analysed data on quality parameters to determine whether there is variation in any of these quality parameters at a local level and whether we can link such variation to local levels of concentration. The analysis is described in more detail in Appendix G.

7.145 The Parties submitted their own analysis, plotting the relationship between four quality parameters at Lloyds pharmacies and the fascia count in the local catchment of each store. The quality parameters they considered were: average waiting time; years since refurbishment; locum hours; and mystery shopper ratings. The Parties found no significant relationship between these individual quality indicators and fascia count. The Parties also found that there were no significant differences between the performance of Lloyds stores in monopoly and non-monopoly areas for these quality indicators. They said that this indicated that there was no evidence of a relationship between Lloyds' performance on these QRS parameters and competition at a local level.

7.146 The Parties' analysis is only capable of showing that there is a relationship between quality and concentration but cannot prove that a relationship does not exist. Two principal issues with the Parties' analysis are:

- (a) It does not take into account factors which might influence the quality parameters aside from the strength of competition.¹⁴¹
- (b) The Parties model individual quality parameters separately, whereas in practice pharmacies would set different elements of quality together and may flex different parameters of competition in response to local competitive situations. This makes it difficult to identify a systematic relationship between individual quality parameters and levels of competition.

7.147 Despite these weaknesses, the Parties' analysis indicates that there is significant variation in quality parameters at a local level. As noted above, the Parties' own documents and statements indicate that a number of these parameters (specifically opening hours, waiting times, delivery and collection services, staffing, location and store condition) are flexed in response to competition. This suggests that the lack of an empirical relationship may be due to omitted variables, rather than no relationship existing between the variable and competition.

7.148 We carried out our own analysis on a range of other quality parameters, outlined in Appendix G. We present the results of the analysis in a series of plots, including a line for the estimated relationship between the quality indicator and the number of competitors a pharmacy faces. We also estimate a simple regression model, accounting for some of the factors which could lead to either higher or lower quality of a pharmacy.¹⁴² We note that although we have attempted to account for some area-specific factors that could influence quality, we have not been able to account for all factors and we have only been able to estimate models for each quality parameter individually. Bearing in mind these caveats, our analysis suggests that:

- (a) Lloyds has longer opening hours when there are more independent stores in the area, both urban and rural areas in our main model specification, although we do not find a statistically significant result in some alternative specifications of the model.¹⁴³ We do not find a statistically significant

¹⁴¹ For example, some elements of quality parameters might be affected by the level of demand in a local area, which in turn might be correlated with the number of fascia in the area.

¹⁴² In response to comments from the Parties we developed our analysis to allow for the effect of quality on concentration to differ depending on the number of fascias.

¹⁴³ When we allow for non-linear effects we only found a statistically significant coefficient in urban areas for the second competitor and in rural areas for the first and only at the 90% significance level. Most of the coefficients have the correct sign, ie negative.

positive relationship between opening hours and the number of competitors for multiple pharmacies or supermarkets (either as a class or independently).

- (b) In our main model specification, Lloyds pharmacies are more likely to offer an extended hours service where there are more independent competitors in a local area.¹⁴⁴
- (c) Lloyds pharmacies are more likely to have lower waiting times when there are more multiple stores in an urban area. When we estimated the basic model with supermarket pharmacies independently, we found that the presence of a Tesco pharmacy in an urban area may¹⁴⁵ lead to lower waiting times at Lloyds.

7.149 We also tested whether the timing of refurbishment of Lloyds pharmacies differed in areas where a competitor had entered. We found that Lloyds refurbished 2.4 years earlier when a supermarket pharmacy entered within 0.2 miles of its location than when another Lloyds entered within that same distance, although this result was only marginally significant.¹⁴⁶

7.150 Finally we considered whether there is any relationship between margins and concentration. Since an increase in quality at a pharmacy is generally associated with an increase in costs, we would expect margins to be lower in areas where quality is high and vice versa. We analysed the relationship between Lloyds' margins and the number of stores in a local area. The results of our analysis did not identify a clear relationship between margin and concentration. We acknowledge that this might indicate that competition has a limited impact on QRS at the local level. However, in interpreting the results we also considered that the results were likely to reflect a combination of poor quality¹⁴⁷ margin data and a quantity effect – a large proportion of costs are fixed in the short run¹⁴⁸ so the margin increases as quantity increases.

¹⁴⁴ We have also found that Lloyds pharmacies are more likely to offer an extended hours service where there are more multiple pharmacies in local rural areas.

¹⁴⁵ The coefficient is statistically significant only at the 90% level.

¹⁴⁶ The coefficient was statistically significant just below the 95% level (94.6% significance level). We did not find a statistically significant result for Sainsbury's alone, but could not conclude that the time taken to refurbish in areas where Sainsbury's entered was different to the time taken to refurbish when any of the other three supermarkets entered.

¹⁴⁷ Only costs that are variable in the short to medium term should be included when calculating margins, however the margin data that we had available for store-level margins, gross margins and EBIT, did not allow us to accurately distinguish between short to medium term and long-term costs. The gross margins (sales minus wholesale cost and other staff costs) did not reflect accurately pharmacies' ability to flex locally the parameters of competition, because both sales price and wholesale costs of prescription medicines are regulated at the national level. EBIT data may have included information on costs that pharmacies cannot flex in response to entry in the short run, but only in the medium to long run.

¹⁴⁸ A pharmacist must be present if the pharmacy is dispensing, so a significant proportion of costs are fixed in the short term.

Consequently stores with a higher prescription volume are likely to have a higher margin, and we are not able to adequately control for this relationship.

7.151 The Parties have suggested using the margin relative to the number of prescriptions as the dependent variable. We do not agree with this approach because it results in an ambiguous effect of entry/exit on relative margin, which is assumed to be a function of the prescription quantity at a pharmacy. For example, entry of a pharmacy close to the focal pharmacy results in a decrease in the prescription volume and a decrease in the margin. Therefore the relative effect is ambiguous.

○ ○ *Conclusions on empirical analysis*

7.152 Overall, our own empirical analysis and the analysis provided by the Parties suggests that there is substantial variation in quality parameters between local Lloyds stores, including on: opening hours; average waiting times; years since refurbishment; locum hours; and mystery shopper ratings. We did not find any consistent clear relationships between individual quality variables and indicators of competition in a local area. However, we note that neither our analysis nor that of the Parties has been able to control adequately for other local factors which might be affecting levels of quality. It is also difficult to identify a systematic relationship between multi-dimensional quality and competition.

○ *Assessment of the constraint by Sainsbury's on Lloyds*

7.153 As noted in paragraph 7.143 although we have found instances in the internal documents of specific parameters being flexed by Lloyds pharmacies in response to non-supermarket pharmacies and supermarket pharmacies other than Sainsbury's, we do not have examples of where QRS was flexed in response to competition from Sainsbury's.

7.154 The Parties told us that this lack of evidence showed that competitive pressure from Sainsbury's did not drive Lloyds to improve its QRS offering at a local level. Lloyds said that its pharmacies did flex a limited number of competitive parameters at a local level, but only in response to non-supermarket rivals and not in response to Sainsbury's pharmacies. Sainsbury's said that it did not flex its retail pharmacy offering in response to competitive pressure from Lloyds at all at a local level. The Parties also argued that our empirical analysis suggested that Sainsbury's was different to other supermarket pharmacies because the analysis found that the entry of other supermarkets had an impact on refurbishments or prescription volumes at nearby Lloyds pharmacies but did not find such an effect for Sainsbury's. The Parties said that the overwhelming weight of evidence in this case clearly

confirmed that the Parties were not close competitors in the economic sense and that Sainsbury's in particular did not drive Lloyds tangibly to improve quality, so the removal of their rivalry would not create incentives to worsen quality.

7.155 We considered these arguments carefully. Sainsbury's operates a total of 287 pharmacies in the UK, out of over 14,000, and the relevant internal documents only cover 139 local areas, of which only one (Kempston) is an area where we provisionally found an SLC. Given the relatively small number of overlaps compared with the total number of pharmacies, we would not expect to see a large number of documents setting out how Lloyds responds to Sainsbury's. Sainsbury's pharmacy is mentioned in seven of the internal documents as either a competitor or is included in a map of the area. In the Kempston document Sainsbury's is mentioned, which indicates that it is treated as a competitor along with other supermarket pharmacies. Therefore, we consider that the relatively small number of documents referencing Sainsbury's does not mean that it does not provide a competitive constraint on Lloyds.

7.156 As noted in paragraphs 7.53 to 7.56, while there are some differences in characteristics between Lloyds and Sainsbury's pharmacies, we found that customers view the two as substitutes where they are located close together. We noted that some of the internal documents discussed in paragraphs 7.88 to 7.142 did contain a number of references to Lloyds responding to competition from other supermarket pharmacies. The relatively small number of supermarket pharmacies compared with non-supermarket pharmacies means that we would expect to see substantially more evidence of Lloyds responding to competition from other non-supermarket pharmacies rather than to competition from supermarket pharmacies. As Sainsbury's accounts for an even small number of pharmacies we would expect to see even less evidence in the internal documents of Lloyds responding to competition from Sainsbury's pharmacies specifically.¹⁴⁹ However, we consider that Lloyds would still have an incentive to respond where a Sainsbury's pharmacy is an important alternative for its customers.

7.157 The balance of the evidence from Lloyds' internal documents and from third parties suggests that Lloyds would compete in a very similar way with Sainsbury's pharmacies as with other supermarket pharmacies including Tesco, Asda and Morrisons. For example:

¹⁴⁹ The retail market share of the Big 4 supermarket pharmacies is only 12% (and Sainsbury's only [X]%).

- (a) Lloyds' internal documents do not distinguish between individual supermarket pharmacies, instead referring to supermarket pharmacies as a category (for example, the 2012 Lloyds portfolio strategy analysis discussed in paragraph 7.92).
- (b) As noted in paragraph 7.61 Lloyds' internal monitoring documents at a national level include [X] competitors of which [X].
- (c) Third parties noted that supermarket pharmacies had slightly different operating models, but viewed them all as substitutes for non-supermarket pharmacies at a local level (paragraphs 7.62 to 7.64).

7.158 We do not consider that the empirical evidence supports the Parties' argument that Sainsbury's is different to other supermarkets. Specifically, as set out in paragraph 7.66(b), the entry/exit modelling only identified an impact of entry by one supermarket pharmacy fascia (Tesco) on Lloyds and that effect was only found in rural areas. Furthermore, as set out in paragraph 7.148, the results of the refurbishment analysis find a marginally significant effect for all supermarket pharmacies when pooled together, but the model was not estimated individually for each supermarket group, due to low sample sizes. We note that our empirical analysis is likely to be confounded by footfall effects and the small number of entry events for supermarket pharmacies in general and Sainsbury's in particular. This reduces the ability of the econometric models to find a statistically significant effect for any individual supermarket. Therefore, we consider that any differences in the results for different supermarket pharmacies are likely to be driven by the ability of the model to consistently detect an effect, rather than reflect genuine differences in the way Lloyds responded at a local level to different supermarket pharmacies.

7.159 We therefore conclude, based on our assessment of the evidence and incentives, that Lloyds competes pre-merger at a local level by flexing the parameters which customers value of QRS listed in paragraph 7.75 in response to their competitors, including Sainsbury's pharmacies and supermarket pharmacies in general. These parameters include: opening hours, store ambience, staffing and quality of advice, provision of additional services, waiting times, prescription collection and delivery, and relationships with GPs.¹⁵⁰ We accept, however, that there may be some differences in the intensity of competition between Lloyds and non-supermarket pharmacies and between Lloyds and supermarket pharmacies. This was suggested by third

¹⁵⁰ As noted in paragraph 7.75 we consider that location is not a variable over which firms compete in the short run. Competition over location will occur in the medium term and could be triggered for example by the entry of a new pharmacy or relocation of a GP surgery.

parties and by the results of our entry/exit analysis. However, our assessment has shown that the extent of the competitive constraint imposed by Sainsbury's pharmacies on Lloyds would be material in local areas where there are few other competitors.

Conclusion on our assessment of pre-merger competition in community pharmacies

7.160 We have assessed pre-merger competition in paragraphs 7.27 to 7.159 and have concluded the following:

- (a) We recognise that this is a market in which regulation plays an important role. Several of the quality parameters we have considered are subject to minimum levels below which quality cannot be reduced, and there are well-defined assurance procedures to ensure that pharmacies adhere to regulations. The prices of prescription goods are regulated. We consider that regulation may inhibit to some extent the degree of competition compared with some other retail operations.¹⁵¹ However, the amount of competition may still be sufficiently significant that its loss would be a matter of concern to us. Regulations set a minimum standard for some quality parameters but pharmacies are free to offer higher levels of service.
- (b) Convenience of location is the most important driver of pharmacy choice for both Parties' customers. However, there are a number of other drivers of choice which customers of both Parties also value, including quality and speed of service, opening hours, stocking levels and waiting times. Customers take these elements of the offering into account when choosing which pharmacy to visit (paragraphs 7.28 to 7.42). This means that where two stores are located close to one another customers are likely to view them as strong alternatives, particularly where there are few/no other stores nearby
- (c) Although there are some differences in the customer demographics between Sainsbury's and Lloyds, they do not point to significantly different customer preferences or suggest segmentation of the market. Customers of both parties value broadly the same range of parameters. Although there are some differences in store setting (ie generally the Lloyds pharmacy is situated on the high street while the Sainsbury's pharmacy is in the grocery store) and shopping mission (ie a supermarket pharmacy visit is frequently combined with a supermarket groceries shop),

¹⁵¹ However, we recognise that in many other retail businesses local prices do not vary because prices are set nationally by the company.

supermarket and non-supermarket pharmacies are regarded by customers as substitutes (paragraphs 7.43 to 7.47).

- (d) An analysis of diversion ratios at a local level has allowed us to assess whether the differences that do exist in the preferences of Sainsbury's and Lloyds customers mean that they are not close competitors in some local markets. We have found that diversion between the Parties is high in some local areas, particularly where they are close geographically (paragraphs 7.48 to 7.55).
- (e) The internal documents from across both Sainsbury's and Celesio collectively show that although there is some differentiation between their offerings, both Parties consider that non-supermarket and supermarket pharmacies can compete. We also note that Lloyds benchmarks its performance at a national level against [X] competitor pharmacies, of which [X] are supermarket pharmacies ([X]). Third party comments add further support to the view that Lloyds and Sainsbury's and supermarket and non-supermarket pharmacies more generally compete with one another to attract prescriptions. They also suggest that, consistent with the consumer evidence, closeness of competition will depend on local market characteristics (paragraphs 7.58 to 7.71).
- (f) Lloyds has the ability to compete at a local level by flexing parameters which customers value of QRS in response to their competitors, including Sainsbury's. Sainsbury's also has the ability to flex competitive parameters at a local level, but to a more limited extent (paragraphs 7.74 to 7.79).
- (g) There is also an economic incentive for individual Lloyds and Sainsbury's pharmacies to compete to maximise the number of prescriptions they dispense (by maximising their share of the number of prescriptions in the local area) in order to increase profits. We consider that the incentives on Lloyds' local management to seek to maximise sales and (in the case of area management) to control costs, give local management a strong incentive to compete locally, and suggest that Lloyds is likely to respond to competition at a local level. This gives an incentive to the local manager to ensure the offering is strong where competition is stronger while also giving the incentive to reduce the level of offer, to cut costs and increase profitability where competition is reduced (paragraphs 7.80 to 7.85).
- (h) The evidence from internal documents shows that Lloyds responds to competition from other pharmacies in a local area and, in areas where supermarkets are present in the area, responds to competition from

supermarkets. Sainsbury's operates a small proportion of UK pharmacies, but is referenced in seven internal documents, including one in an area identified as an SLC. We note that there are no instances in these documents of Lloyds taking specific action in response to a Sainsbury's pharmacy. We do not take the lack of documentary evidence of Lloyds taking specific action in response to Sainsbury's pharmacies as evidence that Lloyds does not compete with Sainsbury's (paragraphs 7.87 to 7.143).

- (i) The evidence from internal documents showing that Lloyds responds to competition from other pharmacies in a local area suggests that Lloyds will also respond in a similar way to Sainsbury's pharmacies where Sainsbury's is a competitor in a particular local area. We conclude that Lloyds has the ability and incentive to compete at a local level by flexing parameters which customers value of QRS in response to their competitors, including Sainsbury's (paragraphs 7.153 to 7.159).
- (j) Our empirical analysis and that of the Parties suggests that there is substantial variation in quality parameters between local Lloyds stores. However, neither our analysis nor that of the Parties has been able to control adequately for other local factors which might be affecting levels of quality (paragraphs 7.144 to 7.152).
- (k) We conclude that Lloyds competes at a local level by flexing parameters which customers value of QRS in response to their competitors, including Sainsbury's. As discussed in paragraph 7.159 these parameters include: opening hours, store ambience, staffing and quality of advice, provision of additional services, waiting times, prescription collection and delivery, and relationships with GPs.

7.161 We consider that the above provides clear evidence that the Parties compete pre-merger and that the extent of the competitive constraint imposed by Sainsbury's on Lloyds would be material in local areas where there are few other competitors.

Effect of the merger on competition in community pharmacies

7.162 In this section we assess the effects of the merger against the situation in the counterfactual. Since our counterfactual is the continuation of the pre-merger situation in which Lloyds and Sainsbury's competed in the pharmacy market we first examine how existing competition at a local level would be affected by the merger. We then identify the geographic areas where we conclude that competition would be adversely affected such as to cause us to find that the merger may be expected to result in an SLC in that area.

How the merger would affect the Parties' ability to compete locally

- 7.163 We concluded in paragraph 7.161 that the extent of the competitive constraint imposed by Sainsbury's on Lloyds would be material in local areas where there are few other competitors. After the merger, the Parties will no longer compete with one another. In areas where the Parties were close competitors before the merger, this is likely to provide an incentive (see paragraphs 7.80 to 7.85) to deteriorate some aspects of a pharmacy's local offer, to the detriment of customers.
- 7.164 In this case, although Sainsbury's is selling its entire pharmacy operation to Lloyds, the pharmacies will continue to be located within the main floor space of the supermarket and share both the store premises and a relatively common pool of customers. It is possible that if Sainsbury's altered some element of the grocery offering, or if Lloyds altered some element of the pharmacy offering, it would have an impact on the sales of the other party. For instance, if Lloyds worsened the quality of the pharmacy this may result in customers going elsewhere and Sainsbury's losing associated grocery sales.
- 7.165 In view of this continuing interaction between them, the Parties have put in place a Cooperation Agreement which places constraints on how Lloyds can operate the Sainsbury's pharmacy business post-merger. These constraints are summarised in Appendix C and reduce Lloyds' ability to degrade competitive parameters at Sainsbury's, although it still has some ability to change the offering.^{152,153} Therefore a reduction in competition as a result of the merger is less likely to lead to QRS degradation in the relevant Sainsbury's pharmacies. We also note that part of the rationale for Sainsbury's to enter into the Transaction was [X].

The incentive on Lloyds to deteriorate the offer at its stores

- 7.166 In paragraphs 7.27 to 7.161 we conclude that Lloyds has the ability and incentive to compete in a local area to maximise the number of prescriptions dispensed. In paragraphs 7.28 to 7.42 we conclude that customers value elements of the pharmacy QRS offering. Lloyds will have an incentive to provide a higher quality offering in areas where customers have a greater choice of pharmacy to visit. We consider that elements of its offer that Lloyds could vary include (see paragraph 7.160) opening hours, store ambience,

¹⁵² There is scope for either store closures or reductions in opening hours, but these have to be evidenced and agreed by Sainsbury's, and there is a limit on the number of stores at which these changes can be made.

¹⁵³ However, [X] suggests that Lloyds will have the ability to worsen some of the quality and service parameters at Sainsbury's as a result of a reduction in competition.

staffing and quality of advice, provision of additional services, waiting times, prescription collection and delivery, and relationships with GPs.

- 7.167 Conversely Lloyds will have an incentive to reduce quality where customers have little or no choice of pharmacy to visit as it will receive their business in any event and providing a lower quality offering is likely to reduce costs. We also note that local management are incentivised to reduce costs.
- 7.168 In our provisional findings we conducted an illustrative profitability analysis on the incentive for Lloyds to deteriorate one aspect of the competitive offer – a reduction in opening hours.¹⁵⁴ The indicative calculation assumed that a reduction in opening hours would lead to a reduction in payroll costs. It conservatively assumed that for every 1% reduction in opening hours payroll costs would reduce by only 0.5%. The indicative calculation suggested that if diversion from Lloyds to Sainsbury's was 40% this would mean that after the merger it would be profitable for a pharmacy to close an hour earlier (at 5pm rather than 6pm).
- 7.169 Since the provisional findings the Parties have responded to this indicative calculation:
- (a) The Parties have proposed some adjustments to the calculation which they argued meant customer diversion would have to be 65% rather than 40% before it was hypothetically profitable for a pharmacy to close at 5pm rather than 6pm.¹⁵⁵
 - (b) The Parties have also argued that our consumer survey showed that customers did not consider opening hours to be an important quality parameter, and therefore were unlikely to switch away from the store in response to a reduction in hours. They argued that the results from the CMA consumer survey and their own survey¹⁵⁶ for the 11 surveyed areas with a provisional SLC finding suggested that the proportion of customers naming late opening/weekend opening as a reason for choosing their

¹⁵⁴ As we note in paragraph 7.75(f), most stores which are not 100-hour contract stores operate for supplementary hours above their core hours. The vast majority of these pharmacies have 40 core hours but some have either more or less than 40 core hours. In England the supplementary hours can be reduced by giving 3 months' notice to NHS England and no approval is required.

¹⁵⁵ This assumes, in line with our assumption, that a 1% reduction in opening hours leads to a 0.5% reduction in payroll costs. Using an assumption of 0.75% savings in staff costs for each 1% reduction in opening hours suggests that a 47% diversion would be required to make the earlier closure profitable. Using an assumption of 1% savings in staff costs for each 1% reduction in opening hours suggests that a 30% diversion would be required to make the earlier closure profitable.

¹⁵⁶ See paragraph 7.242.

pharmacy was only 1% (when unprompted).^{157,158} In addition the Parties said that those who chose opening hours as one of their top three factors from a prompted list of eight possible factors was only 28%.^{159,160}

- (c) The Parties therefore argued that it seemed likely that there would be substantial internal diversion, where customers would return to the pharmacy at a different time when it was open.
- (d) The Parties have also argued that our calculation did not consider the materiality of the alleged adverse effect. They said that a modest reduction in hours would, by definition, occur where there would still be a Sainsbury's pharmacy open close by, so consumers would not be significantly worse off as there would still be an open pharmacy available.

7.170 The Parties have also taken some actions with respect to opening hours in pharmacies in the areas where we had provisionally found an SLC. Celesio told us that it had applied to reallocate its core hours in these pharmacies so that the core hours, although the same in total as before, would include the opening and closing time of the pharmacy, including weekend opening and closing times. Celesio said that it had already received approval in respect of a number of the pharmacies for which it made these applications. Celesio said it believed it would be highly unusual for a local authority to prevent a broadening of core hours (which is clearly beneficial for customers), which is the aim of all the relevant applications. It said it therefore expected to receive approval for the remaining applications very shortly.

7.171 We broadly agreed with the Parties' views on the calculation. However we noted that, given the substantial levels of internal diversion argued by the Parties, diversion to Sainsbury's may need to be much lower than the 65% proposed by the Parties to make the reduction in opening hours profitable.¹⁶¹ This is because the profitability of a change in opening hours will be determined by the amount of costs saved from closing an hour earlier minus the revenue lost. Where internal diversion is high, less revenue will be lost from closing earlier.

¹⁵⁷ Further submission of the Parties in relation to possible remedies and in response to the provisional findings, 17 June, Section 10.7.

¹⁵⁸ Based on DJS and ABA survey responses to Q15 and Q17 respectively, only for those surveyed Lloyds stores located in one of the 13 areas provisionally identified as subject to an SLC.

¹⁵⁹ Based on DJS and ABA survey responses to Q15 and Q17 respectively, only for those surveyed Lloyds stores located in one of the 13 areas provisionally identified as subject to an SLC.

¹⁶⁰ The Parties' submission on survey evidence and its implications for the CMA's theory of harm, 19 June.

¹⁶¹ We cannot estimate what the critical increment is without more data however, as there are a range of plausible values for the percentage of people who would visit the store at a different time.

7.172 We recognise that the specific actions taken by the Parties to move their core hours in the areas where we had provisionally found that the merger may be expected to result in an SLC reduce (but do not eliminate entirely) their ability to vary opening hours. We note that several of the applications have already been approved. Where applications are approved we note that an application could later be made to change the core hours again (although we recognise that it may be difficult to obtain approval for doing this). In addition we note that moving core hours may not prevent a pharmacy closing at other times – for example, a pharmacy could close at lunchtime.¹⁶² We also saw some examples in the internal investment documents of another licence being acquired to change opening hours – although in these instances the original licence was a 100 hours pharmacy.

7.173 We consider that, taking account of all these factors, we should not rely on what was always an indicative calculation that related to only one aspect of the incentive for Lloyds to deteriorate its offer. We note, as set out in paragraph 7.166, that there are several other QRS parameters that Lloyds has the ability and incentive to vary in response to local competition. We consider that there is the scope for Lloyds to reduce its costs by setting a lower level of QRS in these parameters while still remaining above any relevant regulatory standards.

7.174 In general, where our consumer survey suggests the Parties are close substitutes in the eyes of customers (as evidenced by high diversion ratios), we also consider that the merger would imply a smaller revenue loss from setting lower QRS levels than pre-merger and there is therefore the incentive to reduce QRS in order to reduce costs where the absence of effective competition allows.

7.175 The Parties have challenged our view that their costs would be lower were they to reduce the level of some QRS parameters identified above.¹⁶³ The Parties made these points in relation to waiting times, refurbishments, prescription collection services and range of services.

7.176 In relation to waiting times, Lloyds told us that ‘it is far from clear that accepting an increase in waiting times would result in significant cost savings’

¹⁶²We note that, although the Parties submitted that customers would no longer accept lunchtime closing, there are instances of Lloyds branches closing during the middle of the day. In November 2015, 1.49% of the Lloyds estate closed for a lunch break.

¹⁶³ These points are set out clearly in the [Further submission of the Parties in relation to possible remedies and in response to the provisional findings](#), 17 June, pp22–27.

and therefore “there is no evidence that the merged firm might have an increased incentive to alter waiting times as a result of the transaction”.¹⁶⁴

- 7.177 Considering this, we noted that Lloyds had told us that they may make decisions on additional expenditure with the aim of reducing waiting times at the local level by reference to the impact on [X]. They gave the example of [X] (paragraph 7.128).
- 7.178 Aside from this, we also noted in our review of the 139 investment documents that expenditure was frequently approved seemingly in response to waiting times. One example is [X], where a refurbishment was approved partly because of dispensing capacity constraints which led to long wait times at peak periods (see paragraph 7.129).
- 7.179 We therefore consider that expenditure could be saved were Lloyds to permit waiting times to rise following a reduction in competition, and this could give rise to an incentive to do so where a sufficient number of patients would be recaptured post-merger. Waiting times could increase if staffing levels were reduced. Making savings through reduced staffing levels could also affect other areas such as quality of advice and the relationship with the pharmacist.
- 7.180 In relation to refurbishments, we consider that postponing a refurbishment may save costs if, over a given cycle, fewer refurbishments would then need to be made in a given store.
- 7.181 In relation to prescription collection services, we consider that a smaller collection radius, for example, would reduce fuel costs, van depreciation and staff time.¹⁶⁵ Similar savings would also arise if the scope of delivery services were to be reduced or these services were no longer provided.
- 7.182 In relation to the range of services, we consider that there may be savings to staffing costs where adding additional services would make it necessary to employ an extra unit of staff time for example, although we accept this may not always be the case where there is spare staff capacity in a pharmacy. [X].¹⁶⁶ This suggests that costs may be incurred (at least in the short term) from providing a greater range of services.

¹⁶⁴ Further submission of the Parties in relation to possible remedies and in response to the provisional findings, 17 June, p22.

¹⁶⁵ We note that the increase in EPS may reduce the need for collection services over time and that the penetration of EPS is increasing (see paragraph 2.5).

¹⁶⁶ Further submission of the Parties in relation to possible remedies and in response to the provisional findings, 17 June, p27.

7.183 Furthermore, we consider that cost savings are available to the Parties were they to flex other parameters of competition. Specifically, we consider as examples the following:¹⁶⁷

- (a) Reducing staffing would reduce the wage bill. A lower emphasis on staff training would also reduce the wage bill since staff would have less time off the job; and
- (b) Reducing the restocking frequency of infrequently ordered or particularly perishable prescription medicines would reduce wastage and therefore costs.

7.184 Overall, in relation to these examples, we consider that costs could therefore generally be saved by reducing the level of some parameters of service. Therefore in those areas where diversion is high, we consider that the Parties would be incentivised to reduce the level of QRS, as providing high-quality service is costly and the merger increases the proportion of customers who would be recaptured following a reduction in QRS levels, therefore increasing revenues relative to costs.

7.185 We consider that such reductions in QRS are more likely in the Lloyds pharmacies rather than the Sainsbury's pharmacies, not least given the existence and effect of the Cooperation Agreement.

7.186 The Parties have stated that the appropriate application of the SLC test requires the CMA to establish the likelihood of material adverse effects resulting from the Transaction and asserted that this had not been done in this case.¹⁶⁸

7.187 It is clear from the case law¹⁶⁹ that whether the reduction in rivalry expected to result from a merger amounts to a substantial lessening of competition within the meaning of the Act, is a matter of judgement. The word substantial in this context does not mean large, considerable or weighty. The word substantial is capable of covering a broad range from 'not trifling' to 'nearly complete' and in the Global Radio case the Competition Appeal Tribunal (CAT) endorsed the

¹⁶⁷ We also note that avoiding relocating a licence would save staff time and expense sourcing new premises, ensuring compliance with the relevant regulation, and informing customers about the move. Were Lloyds to move to higher-quality premises, as often appears to be the case having considered its investment documents, the cost differential between these better premises and its existing ones would also be saved (minus any refurbishment required to comply with regulation). However, relocating the licence is typically a medium-term decision, in contrast to short-term decisions to flex QRS. The merger may affect incentives on the Parties in individual local areas to relocate in response to relocation of a GP or entry by another competitor.

¹⁶⁸ See, in particular, the [Parties' response to provisional findings](#), 23 May 2016, section C. 3.

¹⁶⁹ *Global Radio Holdings Limited v Competition Commission* [2013] CAT 26.

approach taken by the House of Lords¹⁷⁰ that the word substantial could be taken to mean ‘worthy of consideration for the purposes of the Act’.

7.188 In considering how this concept should be applied in this case, we have had regard to the factors that consumers have indicated are important to them in choosing between pharmacies. We consider this to be an appropriate basis for identifying whether the impact of the merger could be worthy of consideration for the purposes of the Act.

7.189 Our own consumer research and that of the Parties has shown that customers value aspects of the offer besides opening hours such as quality of advice, speed of service/waiting times and the availability of other services (see paragraphs 7.28 to 7.37). We also note the consumer research conducted by Lloyds that showed customers value refurbishments (see paragraph 7.115). If the quality of these and other aspects of QRS were to be reduced, customers would be adversely affected and we consider that this would cause consumer detriment.

7.190 It is clear from our Guidelines that adverse effects on customers on non-price aspects such as service quality may be taken into account in assessing the impact of a merger¹⁷¹. While the impact of competition based on quality parameters (as opposed to price) is inherently difficult to quantify, we consider that there is clear evidence in this case of ability and incentive to flex QRS parameters at a local level in response to competition, including competition from supermarket pharmacies (paragraphs 7.27 to 7.161). We have also found that since many aspects of QRS are maintained above the regulatory threshold it is possible for QRS to be reduced across a number of parameters while maintaining it above the relevant regulatory thresholds (paragraph 7.173). We have found that local managers are incentivised to take steps in relation to QRS to respond to competition at a local level to defend or increase prescription volume. We have also found that local managers have the incentive to reduce the level of the offer, to cut costs and increase profitability, where there is less competition (paragraphs 7.80 to 7.85).

7.191 In our view, in those local areas where as a result of the merger there will be materially reduced competition faced by Lloyds pharmacies, the merger may be expected to result in a material loss of competitive constraint. We consider that the adverse effects on consumers that may be expected to result from this, on aspects of the competitive offer that consumers regard as important,

¹⁷⁰ *R v Monopolies and Mergers Commission ex p South Yorkshire Transport Ltd* [1993] 1 WLR 23.

¹⁷¹ CC2, paragraph 4.2.3.

is sufficiently material for us to find that the merger may be expected to result in an SLC.

Identifying local areas where there may be a substantial lessening of competition

7.192 In this section we:

- (a) set out our overall strategy for identifying potentially problematic local areas;
- (b) establish a preferred filtering methodology to screen out non-problematic areas and identify local areas where we consider that the merger might lead to an SLC and further analysis is required; and
- (c) set out our more detailed analysis of individual local areas where we find that the merger is likely to lead to an SLC.

Approach for identifying potentially problematic local areas

7.193 Out of the 1,816 Sainsbury's and Lloyds combined total of pharmacy stores, the catchment areas of 929 stores overlap with each other based on the average catchment sizes for different types of areas shown in Table 4. There is a range of different types of overlaps, from areas where the Parties are very close together and there are few competitors to areas where they are far apart and there are many competitors. Our overall approach has been to look first for mechanistic rules which can filter out unproblematic areas, and then to carry out more detailed competitive assessments in the remaining local areas.

7.194 Given the number of overlaps we considered it impractical to survey all of the potentially problematic local areas to obtain direct estimates of diversion between the Parties' stores. Instead we surveyed a sample of potentially problematic areas, using these as case studies to illustrate the factors causing customers to divert between the Parties in particular locations.

7.195 In developing filtering rules, we have taken account of all the evidence that informed our assessment of pre-merger competition – the consumer survey and wider evidence on pre-merger competition. We adopted a conservative approach to the initial screening process so that we were confident we would identify all the potentially problematic areas. However, we recognised that, in view of our conservative initial approach and the asymmetry in the catchment areas of the Parties, a large number of these areas were likely to be unproblematic after more detailed scrutiny.

7.196 We then examined the surveyed areas in more detail to determine features of the local markets that could explain the closeness of competition between the

Parties. We have taken account of these features when conducting our detailed local assessment. We then looked in detail at the areas that failed the filter further examining detailed maps of the areas, considering in detail more granular features such as the locations of customers in relation to the wider features and considering submissions from the Parties, in order to decide whether the merger may be expected to result in an SLC in any given area.

7.197 The following sections set out in more detail how we applied this approach.

Initial filters to identify potentially problematic local areas

7.198 The first stage in our approach has been to identify mechanistic rules which could filter out unproblematic areas. We have used evidence from the consumer survey, our demand estimation model and the other evidence on pre-merger competition to inform our choice of filters. The aim has been to come up with a set of filters which could identify areas where the Parties might be particularly close competitors and where the merger might therefore lead to an SLC, so that we could analyse these individual local areas in more detail.

- *Using survey diversion results to test possible filters*

7.199 As described in paragraphs 7.48 to 7.52 and Figure 2 the survey showed that diversion¹⁷² between the Parties was high in some local areas – in particular in Kidlington, Reading/Theale, Cardiff, Beaconsfield and Warlingham.

7.200 Initial filters are commonly based on the readily observable characteristics of an area, such as the level of concentration, as more detailed information (such as surveys) is only collected once the initial screening process has been conducted. In this case, we had access to survey results from a sample of areas when we were constructing our initial filter. We were able to take this information into account by evaluating how different initial filters correlated with the results of the survey. This section describes the competition metrics that we used to identify other local areas of possible concern. Further detail is provided in Appendix J.

7.201 The Parties argued that we should use the demand estimation to produce an estimate of diversion, rather than the consumer survey. The Parties considered that the main parameter of competition was opening hours, and since the demand estimation was based primarily on opening hours, it provided an estimate of diversion in response to a change in competition.

¹⁷² Excluding diversion to other stores of the same fascia.

However, as set out in paragraph 7.166 we consider that opening hours is only one element of the competitive offering which can be flexed at a local level. Therefore it would not be appropriate to use a diversion ratio derived solely from opening hours. We also note that the results from the demand estimation are broadly consistent with those of the consumer survey and consider that the limitations of the demand model described in Appendix E mean that we should place reliance on the implied diversion estimates in individual local areas.

7.202 The Parties said that when considering the CMA-surveyed areas the more appropriate survey diversion ratio to use was generally the diversion in response to a single store closure. The Parties said this was because the CMA had not identified any likelihood of multiple Lloyds store closures. They said that our analysis had focused on possible variations in opening hours at the individual pharmacy level. They said that our analysis had not focused on other potential reductions in QRS, and that we had not substantiated our analysis in relation to any other such QRS parameters (eg by showing how the Transaction would create an incentive to worsen those parameters in certain areas).

7.203 We have used the diversion ratio excluding own party diversion to inform our filtering approach. This ensures that we are capturing all areas where the merger might change the competitive constraint across a group of pharmacies in a local area. This is particularly relevant where there are several Lloyds pharmacies close to a Sainsbury's pharmacy, such that the merger might affect the competitive constraint across a group of pharmacies rather than just a single store. In our more detailed local area assessments of the filtered pharmacies, we have gone on to consider the extent to which the competitive constraint on individual Lloyds pharmacies in an area is similar. We have used this assessment to inform our choice of the appropriate diversion ratio in each case.

7.204 The Parties also argued that the consumer survey was based on an unrepresentative sample of stores across a relatively small number of local areas, so there was no reliable means to draw broader conclusions from the survey results to non-surveyed stores.¹⁷³ In particular, they argued that it was not possible to extrapolate estimates of diversion from the surveyed areas to other non-surveyed stores.

7.205 We agree with the Parties that there is insufficient variation between the different survey areas in the relevant characteristics which might determine

¹⁷³ See also the comments on survey methodology in Appendix D.

diversion in order to model diversion ratios across all non-surveyed areas quantitatively. However, we consider that the cross-section of areas surveyed provided a good basis for evaluating which initial set of filters work best to exclude unproblematic local areas. We also consider that examining the characteristics of the individual areas surveyed provided valuable qualitative information to allow the identification of the features of local areas that are likely to lead to close competition between the Parties' stores. We consider these characteristics in more detail after explaining our initial filtering approach.

- *Filter based on share of stores weighted by distance*

7.206 We have considered a number of different competition indicators which might form the basis for a local area filter, as described in more detail in Appendix I. The competition indicators we have used are based on readily observable characteristics of the local areas and contain concentration measures that have been used in previous merger investigations.¹⁷⁴ These indicators include:

- (a) fascia count within the catchment area of each of the Parties' stores – measuring the number of separate pharmacy fascia within the local market; and
- (b) store count within the catchment area of each of the Parties' stores – similar to the fascia count, but counting the number of individual stores, rather than separate fascia.

7.207 We have chosen to focus on the store count measure rather than fascia count for two main reasons. First, the store count is particularly appropriate in markets where customers choose between individual stores rather than brands, and where the offering at different stores is similar – this broadly matches our understanding of how local pharmacy markets operate. Second, the store count measure correlates closely with the level of diversion measured in the survey areas, as explained in Appendix I.

7.208 In addition, we observe that distance is an important driver of competition in many retail markets.¹⁷⁵ In this case the consumer survey has shown that 73% of respondents indicated that convenience was the most important reason for them deciding to visit the pharmacy on that day.¹⁷⁶ This is also consistent with

¹⁷⁴ For instance, fascia counts have been used in [Rank/Gala](#) and [Somerfield/Morrisons](#). Share of stores have been used in a number of cases including [Greene King/Spirit](#) and [Ladbrokes/Coral](#).

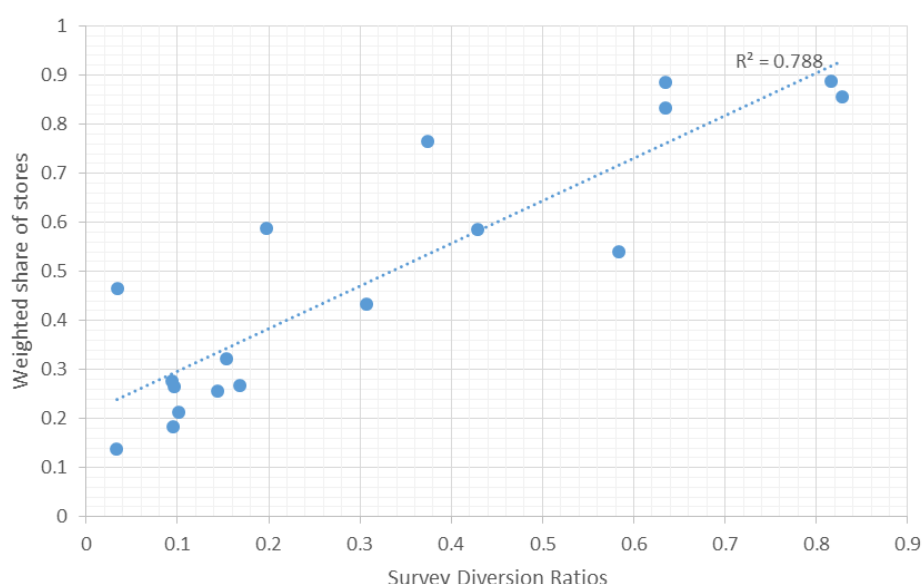
¹⁷⁵ OFT/CC (March 2011), [Commentary on retail mergers](#).

¹⁷⁶ We note that convenience can have many different elements, however the most important individual element of convenience for customers of both Parties was close to home/work.

broader evidence from internal documents and third party evidence suggesting that proximity and location is a key parameter of competition. Therefore we have tested different approaches to weighting the share of stores to take account of distance between a given focal store and its competitors, giving more weight to stores that are closer to the focal store.

7.209 Figure 4 shows the relationship between the share of stores, weighted according to linear distance¹⁷⁷ for England, and the estimates of diversion for each of the survey areas.¹⁷⁸ The Figure shows a strong relationship between this weighted share of stores measure and estimated diversion from the survey.¹⁷⁹ We tested alternative approaches to weighting the share of stores, as described in Appendix I, but these were less closely correlated with the survey diversion estimates. Therefore we have chosen to use weighted share of stores to form part of our initial filter to identify potentially problematic areas.

Figure 4: Relationship between share of stores weighted by linear distance and diversion (England)



Source: CMA analysis.

¹⁷⁷ We apply a decreasing weight to each competitor located within the catchment area of the focal store based on its straight-line distance from the focal store. This means that a store located near the edge of the catchment area counts for less when calculating the share of stores than a store located near the focal store. For example, in an urban area a Lloyds has a catchment area of 1.4 miles, each non-supermarket pharmacy in its catchment area is weighted by dividing the distance that it is from Lloyds by 1.4 and subtracting this from 1. So a pharmacy located 1 mile from Lloyds will receive a weighting of 29%. See Appendix I for further details.

¹⁷⁸ In each of the following charts the concentration variable is plotted against the diversion ratio. Each chart is fitted with a trend line, which shows the relationship between the two variables and reports an R^2 value. The R^2 value is a measure of how well the trend line fits the data. If it is 100% the line fits perfectly and passes through all of the points. As the number of points lying a long way from the line increases, the R^2 value falls.

¹⁷⁹ There is also a strong relationship across the UK, with R^2 of 69%, however we are only concerned with applying the filter in England and Wales since the overlaps in Scotland and Northern Ireland were surveyed.

7.210 The Parties argued that our measure of weighted share of stores would overweight Sainsbury's and other supermarkets relative to a non-supermarket pharmacy because the supermarket had a larger catchment area. In order for the supermarket weighting not to drop to zero between 1.4 and 2.4 miles, the supermarket must have a higher weighting than the non-supermarket pharmacy, at least for a proportion of distances.

7.211 We accept the Parties' argument that weighting supermarkets' share of stores in this way risks flagging more areas as potentially problematic than is actually the case, given the nature of the Parties' businesses. However, at this stage we are considering an initial filter to identify areas for further analysis, and any over-weighting at this stage does not affect our ultimate assessment of whether the merger may be expected to result in an SLC in an area, since the individual areas from the filter are then subject to a detailed competition analysis. The overweighting suggests that there will be a number of areas that we can screen out based on an inspection of the local topography. Furthermore, it should be noted that the initial filter includes a requirement for a market share increment of 15% (see paragraph 7.229). This imposes a requirement about the materiality of the overlap between the Parties and helps to mitigate the impact of the overweighting of supermarkets' share of stores.

- *Relative proximity of pharmacies*

7.212 In addition to measures of concentration such as the share of stores or the fascia count, we have considered other metrics which might reflect other important factors that determine the strength of competition between pharmacies.

7.213 Based on the evidence on pre-merger competition including from internal documents and third party evidence, we would expect that the Parties are more likely to be close competitors in areas where they are geographically close together, particularly when there are few rivals between them.

7.214 This is supported by the findings of our consumer survey, which suggest that convenience of location is the most important factor when deciding to visit the store for 73% of Lloyds' customers and 57% of Sainsbury's customers. It also ranked among the top three reasons for 91% of Lloyds' customers and 86% of Sainsbury's customers. The survey indicated that proximity to home/work and proximity to a GP practice were the most important convenience factors for both Sainsbury's and Lloyds.

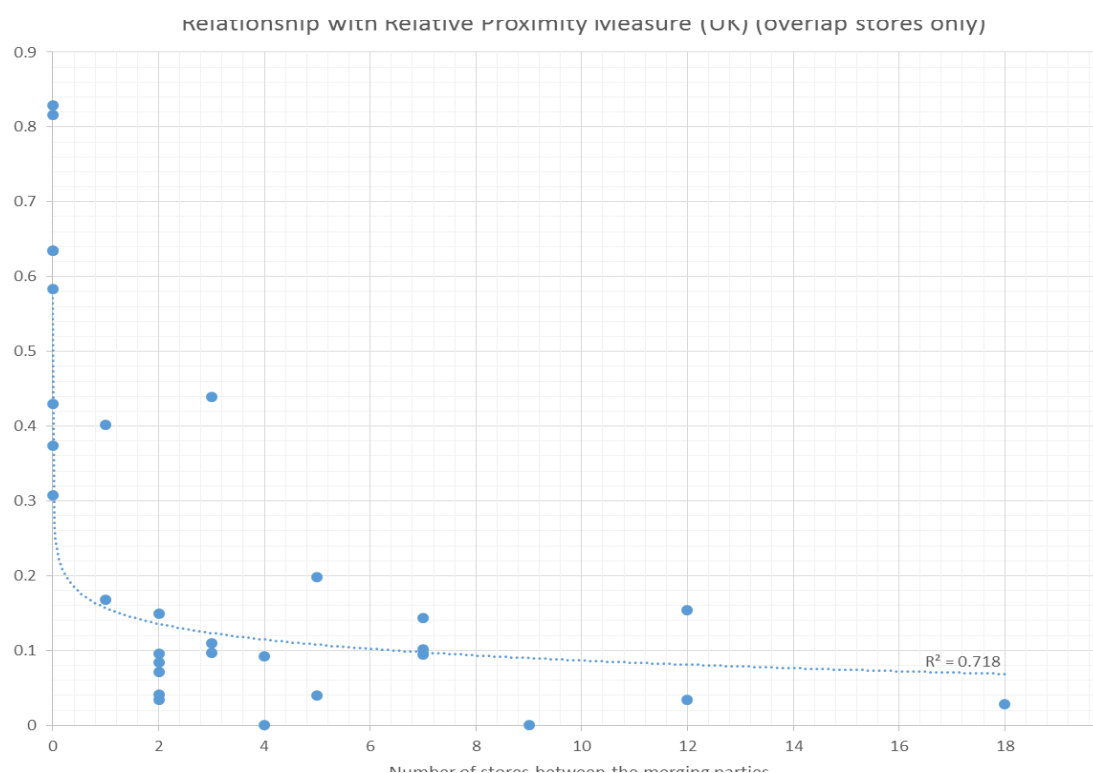
7.215 We used an econometric model to analyse the relationship between survey diversion estimates and distance between the Parties. This is set out in detail

in Appendix J. The model shows a strong relationship between diversion and distance, particularly when the other merging party is the closest geographic competitor.

7.216 Taken together, this evidence suggests that there is more likely to be a reduction in competition as a result of the merger in cases where the Parties are geographically close competitors in a local area. In order to develop a filter to reflect this, we have used data on the straight-line distance between a focal pharmacy and a competitor to identify whether there were other pharmacies closer to the Parties than the Parties were to each other.¹⁸⁰

7.217 We can compare this ‘relative proximity filter’ with the diversion estimates in the survey areas. Figure 5 shows that there is a relatively strong correlation between the two.

Figure 5: Relationship between relative proximity and diversion ratio



Source: CMA analysis.

¹⁸⁰ Note at this stage the filter did not account for the spatial location of the pharmacies and could not say whether the competitors were located between the Parties.

- *The demand estimation model*

- 7.218 In our provisional findings we used the demand estimation model¹⁸¹ to give an alternative estimate of the likely diversion between the Parties in each local area in England.¹⁸² The demand estimation model uses information on where customers pick up their prescriptions to model how customers on average choose their pharmacy. Among other things, the model can be used to predict how demand will shift in response to a change in quality at a particular pharmacy, which can in turn be used to estimate diversion ratios in response to a change in quality at a local level. The model does this by attempting to control for factors which influence choice: if all the reasons customers choose a pharmacy are controlled for, it is possible to infer what they would do if the quality of their first choice pharmacy changed.
- 7.219 The main quality factor used in the model was pharmacy opening hours, as opening and closing hours are recorded by the NHS so there is comprehensive data on this parameter for all pharmacies. Although in principle we could gather information on other quality parameters (and did so for some other Lloyds and Sainsbury's quality parameters), it was not feasible for us to collect comprehensive quality data from all pharmacies, particularly given the very large number of independents. Hence, although we are concerned about a deterioration in a number of quality parameters, we could only include opening hours in our demand estimation model.¹⁸³ A further important limitation of the model is that we do not have information on the location of individual customers, so we have had to treat GP practice locations as a proxy for customer locations.
- 7.220 Diversion ratios were estimated by looking at the sensitivity of customers to a change in the opening hours of the pharmacy, controlling for distance and other unobserved quality factors. In our provisional findings we used these diversion ratio estimates to provide a cross-check on the other filters, to flag any additional areas which required analysis. However, we noted that the diversion ratios produced by the demand estimation were substantially lower than those calculated from the survey. For instance, in Reading the merger results in a two to one reduction in fascias in the catchment area around the Lloyds Theale branch, with survey diversion from Lloyds to Sainsbury's of

¹⁸¹ The demand estimation model is described in detail in Appendix E.

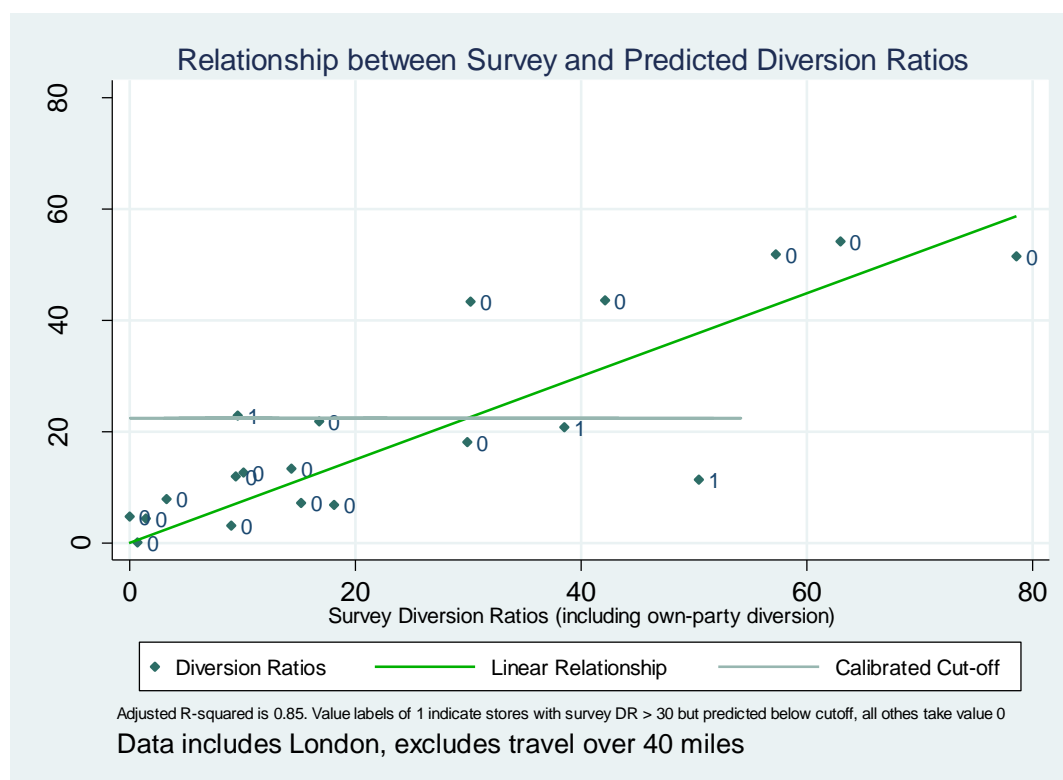
¹⁸² The demand estimation is based on data from England, so we do not have diversion ratio estimates for Scotland, Wales and Northern Ireland.

¹⁸³ We included fixed effects in the model to account for wider differences in quality between pharmacy brands. However, those pharmacy fixed effects do not control for local level differences in quality.

82%.¹⁸⁴ However, the demand estimation in our provisional findings suggested diversion ratios would only be 1.2%.

7.221 Following publication of our provisional findings, we conducted additional analysis of the demand estimation and have corrected the calculation methodology. As a result the demand estimation diversion ratios match those from the survey much more closely (see Figure 6).¹⁸⁵

Figure 6 Relationship between survey diversion ratios and those from the demand estimation model



Source: CMA analysis.

7.222 We recognise that the lack of data on the location of individual customers and the factors that have driven their choices is likely to introduce two forms of systematic error into the calculation:

- (a) GP location is an imperfect proxy for customer location: since we only observe the location of the GP practice we can only measure the distance from the GP practice to the pharmacy and cannot measure the distance from the home or work address.

¹⁸⁴ There was diversion to eight other competitors, six of which received less than 1% of diverting customers, and two of which received around 3%.

¹⁸⁵ Note that the demand estimation includes own party diversion but the survey diversion figures exclude own party diversion.

(b) We do not have information on the factors that have driven customers to travel to a particular pharmacy. For example, some customers might choose to visit a pharmacy close to their work (or other location), which may be a long way from their home (and GP). Since we are unable to control for these choice factors, the model is likely to overestimate the willingness of customers to travel to pharmacies that are located a long way away from their home/GP, and so underestimate diversion to pharmacies that are located close by.

7.223 In spite of these caveats, we consider that the results of the model can be used as part of an initial filter, by identifying those areas where the estimated level of diversion between the Parties is high relative to the average across all areas. This can provide a cross-check on the other filters, minimising the risk of inadvertently excluding an area which might raise competition concerns. However, we placed relatively less weight on the demand estimation model results in considering competition in the individual local areas which were filtered in for more detailed analysis.

- *Conclusion on which filters to use*

7.224 Given the assessment in paragraphs 7.206 to 7.223 we have decided to use the share of stores weighted by the linear distance from the focal store as the primary filter. To avoid the risk that this filter alone might fail to capture some problematic areas where competition issues could arise we have supplemented this with two secondary filters – the geographical proximity filter; and the diversion ratio predicted by the demand estimation model.

7.225 In response to provisional findings, Boots suggested that the relatively complex filtering approach made it difficult to predict how the CMA might assess future pharmacy mergers. We acknowledge that there is a trade-off between simple rules which are easy to apply and more complex filters which make use of additional information about market characteristics. We consider that our approach to filtering is appropriate to a phase 2 investigation, in order to make best use of the information we gathered including from our own consumer survey and from the demand estimation model.

- *Thresholds for use in the filter*

7.226 Since the diversion ratio is a measure of closeness of competition in a local area, we can use the diversion ratio to infer a threshold for the filter, using the line of best fit, which is shown on each figure.

7.227 In a more traditional retail merger where diversion thresholds have been used in the initial filter, such as supermarkets, a diversion threshold of around 15%

was used.¹⁸⁶ In the current merger, the Parties do not have the ability to flex the price of the majority of their products (as prices are fixed for prescriptions) and regulation also reduces their scope to flex some, but not all, other elements of their offering. Therefore the Parties compete over a narrower range of parameters than in many other retail mergers.

7.228 In deciding on the level of the threshold we consider that we should take into account the more limited range of parameters over which the Parties are able to compete. In addition, as discussed in paragraph 7.159, there may be some differences in the intensity of competition between Lloyds and non-supermarket pharmacies and between Lloyds and supermarket pharmacies. Therefore we consider that we should use a higher threshold than in a conventional retail merger to filter the initial set of overlap areas for further analysis. Furthermore, we consider that we should require that the merger results in a significant increment to the share of supply to partially offset the overweighting of Sainsbury's.

7.229 We have decided that we should filter in local areas for more detailed assessment where one or more of the following conditions is met:

- (a) The Parties have a combined distance weighted share of stores of at least 40% following the merger, with an increment of 15% (the 'share of stores' filter). This reflects our view that in this case it is unlikely that the merger may be expected to result in an SLC in areas where the Parties have a weighted share of stores below 40%, or where the merger gives rise to a low increment. It is also consistent with filtering in areas where the estimated diversion ratio from the consumer survey is around 30% or higher, based on the relationship we observe between weighted share of stores and diversion across the survey areas.
- (b) The Parties are either the geographically closest competitors or there is only one competitor closer than the merging party, and where the Parties have at least a 30% combined share of stores with an increment of 10% from the merger (the 'proximity' filter).¹⁸⁷ This reflects the fact that we observe a strong relationship between closeness of competition and relative location of the Parties and other competitors. Therefore, even where the Parties' market shares are below the level that would meet the first condition, there might be a substantial reduction in competition if they are geographically very close and there are limited alternative pharmacies in the area.

¹⁸⁶ See [Somerfield/WM Morrisons plc](#) (and subsequent supermarket mergers).

¹⁸⁷ This would be consistent with a diversion ratio of between 40 and 50%.

(c) The diversion ratio calculated by the demand estimation model is above 25%.

7.230 Table 7 sets out the results of our initial filtering. 171 overlaps, out of the initial 929, were not excluded by the filters and required further assessment.¹⁸⁸

Table 7: Initial filtering of stores

		<i>Number failing filter</i>	<i>Remaining overlaps</i>
Total stores	1,816		
Overlap stores	929		
Share of stores filter		112	817
Proximity filter		33	784
Demand estimation filter		26	758
Totals		171	758

Source: CMA analysis.

7.231 We included one additional area for further analysis that did not fail the initial filter – this was Cardiff. We chose to include this area as we conducted a consumer survey which revealed that there was high diversion between the Parties. Given the need to adopt an approach which included any areas where there was evidence that competition concerns could arise we assessed this area in more detail.

Further assessment of filtered areas to identify the areas where we find the merger may be expected to result in an SLC

7.232 The initial filter was used to identify areas for further analysis.¹⁸⁹ We used the survey case studies with maps of each surveyed area to identify local market features that are associated with high diversion ratios and used these features to assess the characteristics of the areas around the 171 stores that failed our filters plus Cardiff.

7.233 We continued to focus mainly on the Lloyds pharmacies because we considered that the effect of the Cooperation Agreement (see paragraph 4.4) would be to constrain the ability of Lloyds to deteriorate the offer at the Sainsbury's stores. It would be easier, and therefore more likely, that the offer would be degraded at the Lloyds pharmacy. By looking in detail at the local markets we surveyed we identified the local characteristics which were likely to affect closeness of competition between parties. We found that:

¹⁸⁸ Note that the number each filter fails is dependent on the order they are applied.

¹⁸⁹ We also included Cardiff in our assessment although it did not fail the filter (see paragraph 7.231).

- (a) Geographic closeness¹⁹⁰ is clearly very important and we found that in like-for-like cases the closest pharmacy receives the highest diversion, but we also found that overall convenience needs to be considered:
- (i) Diversion to a geographically close competitor is higher if it is located on the same road as the target pharmacy.
 - (ii) Conversely, diversion to a geographically close pharmacy is lower than in (i) above if the route to it is not direct and, in particular, if it requires customers to first drive towards the town centre and then away from it.
 - (iii) For longer distances, diversion from Lloyds to supermarkets tends to be higher than from Lloyds to other pharmacies.
 - (iv) In some cases Sainsbury's pharmacy customers appear to divert either to local pharmacies close to their homes (which may not be close to Sainsbury's), or to choose another supermarket if this is very close. Sainsbury's customers appear reluctant to drive to another retail park, even if very close, if this has a pharmacy but not a supermarket.
 - (v) Diversion to some pharmacies is lower than would be expected based on proximity where the pharmacy has a relatively poor location, for example where it has poor visibility from the street.
 - (vi) Where several pharmacies are clustered close together diversion is spread across the individual pharmacies in the cluster.
- (b) We also noted that diversion appears to be higher to Boots than to other pharmacies, for equivalent distances. This may be because the particularly strong brand of Boots means that it tends, for equivalent distances, to attract a higher customer diversion than other brands. This is particularly the case for Boots pharmacies located in shopping centres. On the other hand, diversion to Superdrug is low.

7.234 As a result of this analysis we examined maps of the areas that included the 171 stores that had been identified as potentially problematic through the application of the initial filters (plus the additional area within Cardiff) and

¹⁹⁰ We note our survey report, which stated that: overall, convenience is the primary reason why customers choose to visit Sainsbury's and Lloyds. More specifically, convenience tends to mean the location of the pharmacy (particularly for Lloyds' customers), although it also includes opening hours and car parking (particularly for Sainsbury's).

examined the specific circumstances of each store. We considered characteristics of the local areas in detail including:

- (a) the location of customers and GP practices relative to pharmacies in the area and whether the Parties were materially closer to each other, their customers and GPs than other competitors (note that this applied even if a competitor(s) was within the radius of a catchment area but significantly further away). This identified whether, within the catchment area, a substantial proportion of customers would be able to choose only between the Parties, or between the Parties and a small number of other pharmacies;
- (b) specific geographic features associated with the location of the pharmacies that could affect the ease with which customers could access specific pharmacies;
- (c) journey routes and other relevant factors (such as local bus services) that could also affect the ease with which customers could access specific pharmacies. This included identifying where the Parties were not particularly close but there was a direct road route between the Parties' stores and another competitor would not be passed before reaching the other party; and
- (d) finally, where available we considered diversion ratios.

7.235 This assessment required an exercise of judgement and the level of detail required in the assessment depended on the specific characteristics of each area. In some cases it was easy to dismiss areas as not representing a concern (for example, where the proximity filter identified two stores as close in straight-line distance but the road network meant that they were unlikely to be close competitors). In other cases each aspect described in paragraph 7.234 had to be assessed in detail in order to allow us to form a view of whether there was a competitive problem.

7.236 As a result of this analysis, at provisional findings we identified 13 areas where we considered the Parties to be sufficiently close competitors such that we found that the merger may be expected to result in an SLC in those areas. These local areas were: Beaconsfield; Bracknell; Cardiff; Christchurch; Kempston; Kidlington; Leeds; Liverpool; Luton; Reading/Theale; Sandy/Potton/Biggleswade; Sutton Coldfield; and Warlingham.

7.237 In response to our provisional findings the Parties made specific arguments on many of the individual areas. These arguments are reflected in paragraphs 7.247 to 7.338.

7.238 The Parties also made some arguments which were similar across many of the provisionally identified SLC areas. They argued that the number of prescriptions per square mile for Sainsbury's was low and said that this showed that the competitive pressure that Sainsbury's exerted on other pharmacies in its catchment area was therefore low. In addition the Parties said that the number of prescriptions was different at the Parties' pharmacies and typically lower at Sainsbury's than at Lloyds. Finally the Parties argued that the opening hours were different (typically shorter at Lloyds than Sainsbury's) and this difference was inconsistent with the existence of a competitive rivalry on this parameter.

7.239 We considered these arguments carefully but did not find them persuasive for the following reasons:

- (a) The number of prescriptions per square mile at Sainsbury's is low as the catchment area is large. The analysis relies on simple geometry (the area of a circle) and assumes that customers are uniformly distributed throughout the catchment area. Our analysis of customer locations has shown that customers tend to be clustered. This is illustrated in Appendix K (eg the map showing the locations of Sainsbury's Biggleswade pharmacy customers), which shows that a large proportion of Sainsbury's pharmacy customers are located in similar areas to the Lloyds customers. Our detailed area assessment considered the actual locations of customers in reaching its provisional findings on the SLCs.
- (b) We consider that, while the number of prescriptions fulfilled by a pharmacy is a relevant factor it may not be a good predictor of diversion from one pharmacy (in the event that quality, range or service had deteriorated) to another. In this case evidence from the demand estimation and from the consumer survey indicates that pharmacies which are geographically close and conveniently located tend to receive markedly more diversion than would be predicted by looking at the number of prescriptions they currently fulfil.
- (c) Supermarket pharmacy opening hours are typically correlated with the opening hours of the wider store. We do not agree that the existence of a significant differential between the opening hours of Sainsbury's and Lloyds precludes rivalry between the Parties as we are not able to observe whether Lloyds opening hours would be lower absent the presence of Sainsbury's.

7.240 The Parties also argued that we should primarily have reference to the diversion ratio produced by the demand estimation when looking at local areas, rather than the diversion ratios derived from the consumer survey. The

Parties said that when considering the incentive to flex opening hours in response to the merger, it was appropriate to use the demand estimation as this was based on customers' sensitivity to changes in opening hours. In contrast the survey diversion ratio is based on a store closure question, which does not focus on opening hours.

7.241 We accept that if we were solely or primarily concerned about a reduction in opening hours, it may be appropriate to use the demand estimation to derive diversion ratios, although we note there are a number of important limitations to the model that mean we put limited weight on its results in individual local areas (see paragraph 7.38). However, opening hours is just one of the parameters of competition where we have seen evidence of flexing at local level in response to competition (see paragraphs 7.87 to 7.143). Since we are concerned that the Parties would have the ability and incentive to deteriorate any one, or combination, of these parameters as a result of the merger, it is not appropriate in this case to use a measure of diversion derived from only one parameter. Since the survey asks a store closure question, it allows us to estimate a diversion ratio based on customer preferences from the consumer survey over all elements of the competitive offering and as such provides a more pertinent measure of the closeness of competition at a local level.

7.242 In addition, following our provisional finding the Parties conducted a consumer survey¹⁹¹ in six of the areas where we had provisionally identified SLCs but had not surveyed the area: Christchurch; Leeds; Liverpool; Luton; Sandy/Potton/ Biggleswade; and Sutton Coldfield.

7.243 The results of the survey are shown in Table 8.

¹⁹¹ Conducted by [ABA Research](#).

Table 8: Diversion ratios from the Parties' consumer survey

<i>Store</i>	<i>Diversion ratio (%)</i>	
	<i>Including own party diversion</i>	<i>Excluding own party diversion</i>
Christchurch (Lloyds Highcliffe BH235ET)	16	57
Christchurch (Lloyds Highcliffe BH23 5EY)	27	49
Christchurch (Sainsbury's BH23 4RY)	26	26
Leeds (Lloyds LS17 7BE)	40	48
Leeds (Sainsbury's LS17 5NY)	36	36
Liverpool (Lloyds L9 1AD)	25	44
Liverpool (Sainsbury's L9 1NL)	43	43
Luton (Lloyds LU3 4AD)	59	62
Luton (Sainsbury's LU3 4AB)	60	60
Sandy/Potton/Biggleswade (Sandy, Lloyds, 4 Market Square SG19 1HU)	16	45
Sandy/Potton/Biggleswade (Sandy, Lloyds, 5 Market Square SG19 1HU)	12	48
Sandy/Potton/Biggleswade (Potton, Lloyds, SG19 2NP)	29	32
Sandy/Potton/Biggleswade (Biggleswade, Lloyds, SG18 0JH)	12	16
Sandy/Potton/Biggleswade (Biggleswade, Lloyds, SG18 8AS)	12	18
Sandy/Potton/Biggleswade (Biggleswade, Sainsbury's, SG18 0NA)	54	54
Sutton Coldfield (Lloyds B74 2UG)	27	30
Sutton Coldfield (Sainsbury's B75 5BT)	45	45

Source: CMA analysis of the Parties' consumer survey.

7.244 We consider the diversion ratios calculated from the Parties' survey strongly support the conclusions we reached in our provisional findings. In the Sandy/Potton/Biggleswade area for the reasons set out in paragraphs 7.319 to 7.328 we have refined our concern to the Lloyds Sandy pharmacies. In Sutton Coldfield, the diversion from Lloyds to Sainsbury's is 30%. While still significant, we have decided, due to the specific circumstances of this area discussed in paragraphs 7.329 to 7.333 below, to reverse our provisional finding for this area and we find that the merger may not be expected to result in an SLC in Sutton Coldfield.

7.245 However, we continue to find that the merger may be expected to result in an SLC in the following areas: Beaconsfield; Bracknell; Cardiff; Christchurch; Kempston; Kidlington; Leeds; Liverpool; Luton; Reading/Theale; Sandy; and Warlingham. In these local areas the Parties are close competitors with very few alternatives. We found that Lloyds has the ability to compete at a local level by flexing the parameters which customers value of QRS listed in paragraph 7.81 in response to their competitors, including Sainsbury's.

7.246 A summary of the key features in each area (including Sutton Coldfield) is shown below and maps of each area where we have found that the merger may be expected to result in an SLC are shown in Appendix K.

Summary of the key features in each area

- *Beaconsfield*

7.247 Three pharmacies are present in the new town centre: a Sainsbury's, a Boots and a Lloyds. There is also a Lloyds pharmacy located approximately a mile away in Beaconsfield old town. A Tesco is located 2.7 miles by road to the West of Lloyds old town, near the M40 exit to Loudwater.

7.248 Lloyds' customers are spread throughout Beaconsfield, with two areas of higher concentration, one in Beaconsfield old town to the East of the Lloyds branch and the other in Beaconsfield new town to the South of Sainsbury's. The Lloyds pharmacy in the old town is co-located with a GP practice. There is a further GP practice in the new town near the train station. Boots and a second Lloyds are located on the high street in the new town, around 70 to 80 metres apart. The Sainsbury's, while only around 200 metres away, is not on the same road.

7.249 Given the location of the customers, GP practices and competitors in this area, we consider that Sainsbury's and Lloyds would be close competitors in the local area, with Boots the only other significant competitor.

7.250 Consumer surveys were conducted at the Lloyds in the old town and at Sainsbury's. The diversion ratio was found to be as shown in the table below.

Table 9: Beaconsfield customer diversion ratios

	%	
	<i>Including own party</i>	<i>Excluding own party</i>
Lloyds to Sainsbury's	30	37
Sainsbury's to Lloyds	42	43

Source: CMA consumer survey.

7.251 For Sainsbury's, around half of all customers would divert towards the Lloyds and Boots pharmacies in the town centre, with fewer diverting to the Lloyds in the old town and Tesco Loudwater. For Lloyds (in the old town), 85% of customers would choose to divert to one of the three pharmacies in the new town (ie Lloyds, Sainsbury's or Boots). This would be in almost equal proportions. However, if people could not divert from the Lloyds in the old town to the Lloyds in the new town, 47% of survey respondents said they would then divert to Boots and 37% to Sainsbury's. Therefore, although Boots may be the closest competitor to Lloyds, Sainsbury's is a significant competitor and the only other pharmacy in Beaconsfield.

7.252 In its response to the provisional findings the Parties noted that the survey diversion from Lloyds to Sainsbury's of 37% was less than the 40% diversion threshold that we said in our provisional findings would be necessary for a reduction in opening hours to be profitable. However the 40% figure relates to an indicative calculation done on only one aspect of QRS, opening hours. We note in paragraph 7.159 that there are several other aspects of QRS that could be varied by Lloyds to compete at a local level. In practice there was a clear delineation in diversion ratios between the surveyed areas where we considered there was an SLC and those where we did not.¹⁹² Therefore we did not consider it necessary to specify the exact level of the survey diversion ratio threshold where we considered the merger may be expected to result in an SLC.

7.253 In our discussion of thresholds to use in the initial filter we noted in paragraph 7.227 that in a more traditional retail merger a diversion ratio threshold of around 15% was used but that in this case we should apply a higher threshold. Our initial filters broadly equated to a survey diversion ratio of around 30% (paragraph 7.229(a)).

7.254 Given our assessment we conclude that the merger may be expected to result in an SLC in the area shown on the map of Beaconsfield set out in Appendix K.

- *Bracknell*

7.255 There are three Lloyds branches in Bracknell. Two were identified as potentially problematic through the filtering process and one was not.

7.256 We are primarily interested in one store, 97 Liscombe.¹⁹³ This store is located 0.9 miles by road from Sainsbury's. There is one competitor fascia in the catchment area, Boots, with two stores, one located 2 miles by road (although 1.2 miles by foot) and the other located 2.4 miles by road.

7.257 We note that a significant proportion of Lloyds' customers are located to the immediate south of Lloyds. Furthermore, we note that the two closest GP practices to Lloyds (out of five) in the area are located closer to Sainsbury's than to Lloyds. This is potentially reflected in the overall prescription volumes for the Parties, with Sainsbury's fulfilling 13,380 prescriptions per month, compared with 8,436 for Lloyds.

¹⁹² The lowest diversion from Lloyds to Sainsbury's in the surveyed areas where we considered the merger may be expected to result in an SLC was 37%. The highest in the areas where we did not consider the merger may be expected to result in an SLC was 21%.

¹⁹³ 97 Liscombe, Bracknell, Birch Hill, Berkshire.

7.258 Given the location of the customers, GP practices and competitors in this area, we consider that Sainsbury's and Lloyds would be the closest competitors in the local area, and that Boots would exert a relatively weak competitive constraint on the Parties in this area as it is located over 2 miles from Lloyds. Therefore, we consider that the Parties are close competitors in the area.

7.259 Given our assessment we conclude that the merger may be expected to result in an SLC in the area shown on the map of Bracknell set out in Appendix K.

- *Cardiff*

7.260 Cardiff was surveyed and the diversion ratios were found to be as shown in the table below.

Table 10: Cardiff customer diversion ratios

	%	
	<i>Including own party</i>	<i>Excluding own party</i>
Lloyds to Sainsbury's	37	45
Sainsbury's to Lloyds	44	44

Source: CMA consumer survey.

7.261 The surveyed pharmacies are both located in a residential area north of Cardiff, less than a mile from each other. The area presents a large number of other pharmacies; one (Insync) is located in a medical centre in front of the Sainsbury's store.

7.262 We note that the Lloyds and Sainsbury's stores are linked through a local, but almost direct route. There is also a bus connection, although this does not take a straightforward route. A nearby Boots and another Insync pharmacy, located on the main road towards Cardiff's centre, also get significant diversion. The 'pharmacy' closer to the Sainsbury's gets only 10% diversion but we understand that this operates as a collection point for prescriptions which are then processed at the Insync pharmacy and delivered back for collection the next day. However, it is used by a small proportion¹⁹⁴ of the customers of the medical centre within which it is located.

7.263 The Parties said that Insync was seeking to expand in the area and this would be likely to impact on the Lloyds Llanishen pharmacy. Insync confirmed that it had applied for a NHS pharmacy licence in Lisvane (1.3 to 1.5 miles from the Lloyds pharmacy to the east). However the application was still pending. Even

¹⁹⁴ We understand that less than 10% of the medical centre's customers use the collection service.

if the application were to be granted the majority of the Lloyds customers were situated closer to the existing Lloyds pharmacy and would be unlikely to be affected. The Parties also suggested that Insync may operate a prescription collection service in Lisvane if the application was refused. However, we consider if this were to happen it would have less impact on the Lloyds pharmacy than if Insync opened a full NHS pharmacy.

- 7.264 The Parties noted that this area had a complicated history, given that Lloyds sold Sainsbury's its licence in 2010, and also moved its pharmacy from the location of the Boots to its new location.¹⁹⁵ Lloyds considered that this explained the diversion between the Parties (which was higher than might be expected looking at the geography of the area), although it did not dispute that many customers appeared to have Sainsbury's as their second preference pharmacy.
- 7.265 The Parties argued that we should use the diversion ratio including own party diversion in this area. We have analysed the competitive conditions and note that the nearest alternative Lloyds branch is some distance from the surveyed Lloyds store and lies substantially further from the Sainsbury's. We note that Insync and a Day Lewis pharmacy are located relatively near to this alternative Lloyds and it is likely to face different competitive conditions than the surveyed Lloyds. Therefore, we agree that we should use the diversion ratio including own party diversion (see paragraph 7.203) in this area, which is 37%.
- 7.266 Lastly we note that most of the Lloyds customers would divert to either the nearby Boots or the Sainsbury's. This suggests that Sainsbury's is one of the main competitive constraints on the Lloyds branch in this local area.
- 7.267 Given our assessment we conclude that the merger may be expected to result in an SLC in the area shown on the map of Cardiff set out in Appendix K.

¹⁹⁵ Lloyds sold Sainsbury's its business (licence, employees, and patient records) in 2010, and sold a second licence to Boots (which it relocated to the nearby retail park), while acquiring a third business (licence, employees, patient records, and premises) of an independent pharmacy which was converted to the LloydsPharmacy format. It considered that these unique circumstances could explain the diversion between the Parties (which is higher than might be expected looking at the geography of the area), as they may have led to greater awareness of the LloydsPharmacy brand among customers in this local area than one might otherwise have expected.

- *Christchurch (Highcliffe)*

7.268 There are two Lloyds pharmacies located close to one another in Christchurch, with no other pharmacies within their 1.4-mile radius. The principal alternative pharmacies in this area are:

- (a) Sainsbury's located 1.9 miles by road to the west of Lloyds;
- (b) Wessex pharmacy located 2 miles by road to the west of Lloyds;¹⁹⁶ and
- (c) Day Lewis located 1.8 miles by road to the east of Lloyds.

7.269 The majority of the customers of both Lloyds branches are located in the Highcliffe area, which is the residential area in the centre of the catchment area. Of customers not located in this area more lie to the west than to the east. There is a single GP practice in the catchment area, which is located near or within the same premises as one of the Lloyds branches.

7.270 The nearest supermarket grocery store to Lloyds is Sainsbury's, although there is a Co-operative and a Tesco Express in Highcliffe. Alternative large grocery stores are a Lidl 2.1 miles to the west or a Tesco 2.9 miles to the west, which has a pharmacy.

7.271 In the event of a deterioration of quality at one or both Lloyds branches sufficient to cause customers to divert, we consider that they are most likely to visit Sainsbury's as there are no non-supermarket pharmacies within the Lloyds catchment area. Since Sainsbury's is also the nearest supermarket for individuals living in Highcliffe, it is likely that a reasonable proportion of Lloyds' customers are already visiting Sainsbury's.

7.272 For those customers who do not already shop in Sainsbury's, the Day Lewis pharmacy may represent a constraint for those whose daily routes take them to the east rather than the west of Highcliffe, although we note the Day Lewis pharmacy is outside the catchment area of the Lloyds pharmacies. The Parties said that there was a Tesco in New Milton which also drew customers from Highcliffe alongside others, although these stores were further away from the Lloyds pharmacies. However, the Parties said that once a customer was travelling by car it was not much further to travel 3 miles to the Tesco than 2 miles to Sainsbury's. In response to the provisional findings the Parties said that there was no impact on either Lloyds pharmacy from when the Sainsbury's pharmacy opened. This analysis plotted sales over the two years before and after the Sainsbury's pharmacy opened. However, sales volumes

¹⁹⁶ There is a second Wessex pharmacy 2.3 miles away in Mudeford however we considered that this was not a relevant competitor since it is outside the Lloyds catchment and not readily accessible.

were extremely variable over the whole period, with significant variations between peaks and troughs. The analysis did not attempt to control for these variations to identify the impact of the Sainsbury's pharmacy entry and as such we were not able to draw any conclusions from it.

7.273 The Parties also said that a number of pharmacies in the area offered collection and home delivery services. However, a significant number of customers may not use the collection service and while we do not have details of the delivery service offered by competitors, we note that in Lloyds' case, the delivery service is usually only offered to customers with mobility problems (see paragraphs 7.135).

7.274 We also note that the NHS litigation authority also considered that the Sainsbury's store represented the most likely alternative destination for pharmacy customers in Highcliffe. In a recent decision¹⁹⁷ concerning an application by another pharmacy to enter Highcliffe it said:

Whilst there is a Tesco Express and a Co-op store located on Lymington Road the nearest 'major' supermarket to Highcliffe is the Sainsbury's store located at Lyndhurst Road. It therefore seems likely that many residents do their main shop at this supermarket and of course they are able to access pharmaceutical services whilst they do their weekly shop.

7.275 The Parties' consumer survey showed diversion ratios as shown in the table below.

Table 11: Christchurch customer diversion ratios

	%	
	<i>Including own party</i>	<i>Excluding own party</i>
Lloyds Highcliffe BH235ET to Sainsbury's	16	57
Lloyds Highcliffe BH23 5EY to Sainsbury's	27	49
Sainsbury's BH23 4RY to Lloyds	26	26

Source: CMA analysis of the Parties' consumer survey.

7.276 In this area, the Lloyds branches are located close together and we consider that they face similar competitive conditions and it is relevant to consider the diversion ratio excluding own party diversion. The diversion ratios suggest that Lloyds and Sainsbury's would be close competitors in this area.

¹⁹⁷ REF: SHA/18250. Appeal against NHS Commissioning Board ("NHS England") decision to refuse an application by Twelvers Connect Limited for inclusion in the Pharmaceutical List offering unforeseen BENEFITS under Regulation 18 for premises in the vicinity of Highcliffe Medical Centre, 248 Lymington Road, Highcliffe, Christchurch, BH23 5ET, bound by Holme Road at one end and Wharnclyffe Road at the other end (24 March 2016).

7.277 In this case, despite the Parties being located more than 1.4 miles apart, Sainsbury's is the nearest alternative pharmacy. Furthermore, Sainsbury's is also the nearest large supermarket to Highcliffe and likely to be drawing a large number of shoppers from Highcliffe. Consequently it is likely that it would represent an obvious alternative for customers in Highcliffe. We consider that Lloyds and Sainsbury's would be close competitors in this area.

7.278 Given our assessment we conclude that the merger may be expected to result in an SLC in the area shown on the map of Christchurch set out in Appendix K.

- *Kempston*

7.279 Lloyds has three pharmacies in Kempston. The Sainsbury's and the three Lloyds are located on the same road. Two of the Lloyds pharmacies are located within 140 metres, one within 0.5 km. Of particular interest is the Lloyds branch in 242 Bedford Road, which is located next to the Sainsbury's. There are four independent pharmacies and one Boots within the catchment area of the Lloyds which is nearest to the Sainsbury's. However:

- (a) All of the independents are situated near the edge of the Lloyds catchment area, with the closest being 1.4 miles away by road. The others are located 1.9, 2 and 2.4 miles away by road. Since the Lloyds pharmacies are located far closer we do not consider that any of these pharmacies are a competitive constraint.
- (b) Boots is located on a retail park around 1 mile from the nearest Lloyds as the crow flies, but since it is the other side of a railway line, it is 1.9 miles away by road. For this reason we do not consider it is a close competitive constraint.
- (c) Lloyds' data shows that, for all three of its pharmacies, the large majority of its customers live on the same side of the railway line as both merging parties (and the opposite side to Boots), and many live within a very short walk of both Sainsbury's and Lloyds.

7.280 The Parties said that Sainsbury's customers on a 'mixed shopping mission' in Kempston could go to the M&S Food Hall and the Boots which are located on the same retail park. Using similar intuition, we consider that Lloyds customers on a mixed shopping mission may similarly use the Sainsbury's located close to the Lloyds and could therefore easily use Sainsbury's pharmacy, were the quality at the Lloyds to fall.

- 7.281 Therefore, we consider that the vast majority of the diversion in this area will be between the merging parties, as in this case the nearest alternative pharmacy is 1.4 miles away.
- 7.282 Given our assessment we conclude that the merger may be expected to result in an SLC in the area shown on the map of Kempston set out in Appendix K.
- *Kidlington*
- 7.283 There are 4 pharmacies located in Kidlington, a Lloyds branch with a Sainsbury's located opposite and a further Lloyds branch located 1 mile to the north on the same road, with an independent located nearby. The only other pharmacy within a 1.4 mile radius of Lloyds is an independent in the village of Yarnton, which is located 2.4 miles to the West by road, with some further pharmacies located outside of this radial along the road leading to Oxford.
- 7.284 Lloyds and the adjacent Sainsbury's fulfil a similar number of prescription items per month, 4,726 and 4,123 respectively. Lloyds' customers are located mainly in the area around Sainsbury's and Lloyds, and around a GP practice that lies 0.4 miles to the North.
- 7.285 Due to the proximity of Lloyds and Sainsbury's and the location of customers and GPs in the area, we consider that the Parties are likely to be close competitors. Kidlington was surveyed and the diversion ratios were found to be high, as set out in Table 12:

Table 12: Kidlington customer diversion ratios

	%	
	<i>Including own party</i>	<i>Excluding own party</i>
Lloyds to Sainsbury's	50	86
Sainsbury's to Lloyds	56	57

Source CMA consumer survey.

- 7.286 Half of the surveyed Lloyds' customers would divert to the nearby Sainsbury's, but 40% would choose the other Lloyds, although further away. While an independent is located very close to that Lloyds, very few would choose it, based on the responses to the Lloyds store closure or Lloyds fascia closure questions, with customers preferring to divert to Sainsbury's if the second Lloyds was unavailable. This may suggest that the independent is an unattractive option for those not using the GP practice it is located in. In any event, given the high level of diversion under either measure we do not have to take a view in this area whether we should include or exclude own party diversion.

7.287 Given our assessment we conclude that the merger may be expected to result in an SLC in the area shown on the map of Kidlington set out in Appendix K.

- *Leeds*

7.288 In the area of interest, (Alwoodley, some 5 miles north of central Leeds), there are four pharmacies within a 1.4-mile radius of the Lloyds pharmacy of interest (2 the Avenue, Leeds, Alwoodley). These are:

(a) Sainsbury's, 1.1 miles away by road;¹⁹⁸

(b) Living Care, 1 mile away by road;

(c) Adel, 1.4 miles away by road; and

(d) Living Care (south), 1.4 miles away by road.

7.289 Lloyds is the largest of these pharmacies in terms of prescription volume, fulfilling 9,073 prescriptions per month, it is followed by Sainsbury's with 5,650, Adel 3,803 and Living Care with 3,049 and 3,380 prescriptions per month.

7.290 Lloyds' customers are primarily located around King Lane, which runs north to south between Lloyds and Sainsbury's and around the A6120, which again runs north to south, but is located to the east of both stores. The three GP practices in the Lloyds catchment area are also spread along King Lane, between Lloyds and Sainsbury's.

7.291 Due to the location of customers and GP practices in this area, we do not consider that Adel pharmacy will compete closely with Lloyds. This is because it is located on the edge of the village of Adel, where very few Lloyds' customers are located. We consider that diversion from the Lloyds would primarily be split between Sainsbury's and the two Living Care pharmacies, although there may be some customers that go outside the Lloyds catchment area.

7.292 Of the two Living Care pharmacies, the southern one is located south of both the main areas of Lloyds' customers and the three GP practices nearest Lloyds. It is also located on the opposite side of the A6120, which is a dual carriageway, although there is a direct driving route to it from Lloyds. For

¹⁹⁸ The Parties said that Sainsbury's is 1.6 miles from the Lloyds store, however the distance to the customer entrance is 1.1 miles.

these reasons, we do not consider that it will receive significant diversion from Lloyds.

7.293 Therefore, we consider that the Lloyds presently competes most closely with the northern Living Care pharmacy and the Sainsbury's. Although Living Care is closer to Lloyds than Sainsbury's, at the time of provisional findings we noted that the pharmacy was located in a small self-enclosed residential area, with only a single entry and exit point. In contrast we considered that Sainsbury's can be accessed from both King Lane and the A6120 and is more likely to be more convenient for customers. There is also a bus route which connects the Sainsbury's and the Lloyds, both of which have nearby stops. For these reasons we considered that Sainsbury's would receive more diversion than Living Care.

7.294 In response to our provisional findings the Parties noted that there had been a material change of circumstance, because this Living Care pharmacy had relocated to be co-located with a GP practice on King Lane, directly between the Lloyds and Sainsbury's pharmacies and on the same bus route as that connecting the Lloyds and Sainsbury's pharmacies. The new location of the pharmacy, and the location it moved from, are shown in the map of Leeds in Appendix K.

7.295 The Parties' consumer survey showed diversion of:

Table 13: Leeds customer diversion ratios

	%	
	<i>Including own party</i>	<i>Excluding own party</i>
Lloyds to Sainsbury's	40	48
Sainsbury's to Lloyds	36	36

Source: CMA analysis of the Parties' consumer survey.

7.296 We consider that this confirms that Lloyds and Sainsbury's would be close competitors in this area. However, given that the Living Care pharmacy relocated in March and the survey was conducted in May/June we considered whether customers may be unaware of the new location. To test this we assessed whether there was a difference in the diversion ratio for repeat prescription customers than other customers. Repeat prescription customers may be less likely to have considered the Living Care pharmacy so we would expect that if diversion from repeat prescription customers was lower this may provide evidence that customers were unaware of the new location. The

results are shown in the table below and show that diversions from repeat prescription customers are not lower than for other customers.¹⁹⁹

Table 14: Diversion ratios for repeat and non-repeat prescription customers from the Lloyds pharmacy

	<i>Repeat</i>	<i>Non-repeat</i>	<i>Other</i>
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
Sample size	118	36	23

Source: CMA analysis of the Parties' consumer survey.

7.297 The number of customers diverting to Alwoodley Medical Centre is low. However, this may have been due to coding issues, as the Alwoodley Medical Centre is located on King Lane, and was not individually named on the showcard. Therefore, given that there is another Livingcare pharmacy on King Lane, customers could have easily indicated this was the one they used when they in fact used Alwoodley Medical Centre. For instance, one respondent refers to Alwoodley Medical Centre as the new medical centre on King Lane. We consider that, in spite of the move of the Livingcare pharmacy, Livingcare is not a significantly larger constraint on the Parties than before the move.

7.298 Given our assessment and the high levels of diversion from Lloyds to Sainsbury's that the Parties' survey showed, we conclude that the merger may be expected to result in an SLC in the area shown on the map of Leeds set out in Appendix K.

- *Liverpool*

7.299 The pharmacy of particular interest is the Rice Lane pharmacy. There are a number of pharmacies in the 1.4-mile catchment area around the Lloyds branch, but in the centre of the catchment area there are only another Lloyds branch (County Rd) and a Sainsbury's (also on Rice Lane). In this case the customer data is incomplete and we cannot infer much from the customer locations that we have been able to plot. The pharmacies we consider to be most relevant are located as follows:

- (a) Sainsbury's, which is located 0.3 miles to the north of Lloyds by road.

¹⁹⁹ We note that a small percentage of customers surveyed (4% of repeat and 0% non-repeat customers) mentioned the old location for the Livingcare pharmacy (ie before it had relocated to its location in the GP practice on King Lane). These customers are not included in the table and the results did not affect our analysis.

(b) A second Lloyds branch is located 0.2 miles to the south on Country Road.

(c) Walton pharmacy is located 0.6 miles to the east by road and 0.5 miles by foot.

7.300 The Lloyds branch in Rice Lane, which is co-located with a GP practice, receives the most prescriptions of these four pharmacies, fulfilling 14,998 prescriptions per month. The other three pharmacies fulfil similar numbers, between 6,000 and 6,800.

7.301 We noted in our provisional findings that the cluster of GP practices and pharmacies located to the west of Lloyds would seem to form a natural micro-market, as there are a number of pharmacies and GP practices all located close to one another. The Parties disagreed, and noted that all of the pharmacies in this area collected prescriptions from the Breeze Hill Health Centre in which the Lloyds is located. The Parties also noted that all of the pharmacies in the local area collected prescriptions from the local area and offered free home delivery to customers. However, a significant number of customers may not use the collection service and while we do not have details of the delivery service offered by competitors, we note that in Lloyds' case, the delivery service is usually only offered to customers with mobility problems (see paragraph 7.135).

7.302 The Parties' survey showed diversion at set out in the table below.

Table 15: Liverpool customer diversion ratios

	%	
	<i>Including own party</i>	<i>Excluding own party</i>
Lloyds to Sainsbury's	25	44
Sainsbury's to Lloyds	43	43

Source: CMA analysis of the Parties' consumer survey.

7.303 In this area, the Lloyds branches are located 0.2 miles apart, on the same road. Although slightly further from the Sainsbury's store the second Lloyds branch is a similar distance from Walton pharmacy, which lies to the East, although slightly closer to an independent in the south than the surveyed Lloyds store. Thus, we consider that the competitive conditions faced by the second Lloyds branch are likely to be similar to the first, such that we should consider the diversion ratio excluding own party diversion.²⁰⁰ We note that this

²⁰⁰ This is in contrast to our approach in Cardiff because of the difference in the local environment of the pharmacies – see paragraph 7.265.

is around the same level as diversion from Sainsbury's to Lloyds. We consider that this provides further evidence suggesting that Lloyds and Sainsbury's would be close competitors in this area.

7.304 Given our assessment we conclude that the merger may be expected to result in an SLC in the area shown on the map of Liverpool set out in Appendix K.

- *Luton*

7.305 In the area of interest, to the north of Luton, Lloyds has two pharmacies. We are primarily interested in the Lloyds Bramingham Park pharmacy.²⁰¹ This has volume of 4,926 prescriptions per month and is located 0.2 miles by road from the nearest Sainsbury's. There are a number of other pharmacies in the catchment area, including:

(a) Featherfield Pharmacy, 0.8 miles away by road;

(b) Warden Hill pharmacy, 1 mile away by road; and

(c) Calverton pharmacy, 1.3 miles away by road.

7.306 The majority of Lloyds' customers are located in the immediate vicinity of the Lloyds and Sainsbury's stores, as are two GP practices, one of which is co-located with Lloyds. Lloyds is the larger of the two pharmacies fulfilling 7,916 prescriptions per month, compared with 3,901 for Sainsbury's, likely due to Lloyds' location within a GP practice.

7.307 The two nearest independent pharmacies fulfil a similar number of prescriptions per month to Sainsbury's. However, they are located further away. The nearest one to the Lloyds store when walking is 0.7 miles away. Therefore the Sainsbury's store, which is more convenient, would be likely to capture a higher proportion of customers diverting from the nearby Lloyds in the event of a quality drop. The Parties have said that there are a number of bus routes that connect the pharmacies, the Lloyds pharmacy, the local GPs and the Sainsbury's pharmacy. However, given that the Sainsbury's is well positioned both relative to Lloyds and the local GP practices, we consider that it would capture a high proportion of customers diverting from the nearby Lloyds in the event of a quality drop.

7.308 This is also shown by the Parties' survey – see the table below.

²⁰¹ 2 Whitehorse Vale, Luton, Bramingham Park Centre.

Table 16: Luton customer diversion ratios

	%	
	<i>Including own party</i>	<i>Excluding own party</i>
Lloyds to Sainsbury's	59	62
Sainsbury's to Lloyds	60	60

Source: CMA analysis of the Parties' consumer survey.

7.309 The diversion ratio is similarly high whether own party diversion is included or excluded and we do not have to take a view in this area whether we should include or exclude own party diversion.

7.310 The Parties also noted that seven of the pharmacies in the local area collected prescriptions from the local area and offered free home delivery to customers. However, a significant number of customers may not use the collection service and while we do not have details of the delivery service offered by competitors, we note that in Lloyds' case, the delivery service is usually only offered to customers with mobility problems (see paragraph 7.135).

7.311 Given our assessment we conclude that the merger may be expected to result in an SLC in the area shown on the map of Luton set out in Appendix K.

- *Reading/Theale*

7.312 Lloyds is located in Theale to the West of Reading, with Sainsbury's located 0.9 miles away by road in Calcot on the outskirts of Reading. There are no further NHS pharmacies located within the Lloyds catchment area. We note that there is a Boots located in the same retail park as Sainsbury's, but that this does not have an NHS licence.

7.313 Lloyds' customers are primarily located in Theale, with a small number located in Calcot. Sainsbury's draws customers from a wider area including from Theale. There is a single GP practice located in Theale, a short distance to the West of the Lloyds branch.

7.314 The Lloyds pharmacy (High Street Theale) and the Sainsbury's pharmacy (Bath Road, Calcot) were surveyed and the diversion ratios were as shown in the table below.

Table 17: Reading/Theale customer diversion ratios

	%	
	<i>Including own party</i>	<i>Excluding own party</i>
Lloyds to Sainsbury's	85	89
Sainsbury's to Lloyds	35	36

Source: CMA consumer survey.

7.315 The diversion ratio is similarly high whether own party diversion is included or excluded and we do not have to take a view in this area on whether we should include or exclude own party diversion.

7.316 It is not surprising that almost all of Lloyds' customers would divert to the Sainsbury's. Only 35% of Sainsbury's customers would divert to the Lloyds; this is also unsurprising given the location of the Sainsbury's customers. Many live in Reading, which is in the opposite direction to the Lloyds Theale pharmacy.

7.317 We note that 15% of Sainsbury's customers said they would divert to a Boots located in the same retail park as the Sainsbury's. However, that Boots pharmacy does not have an NHS contract. It is likely that most of the respondents were not aware of this. The Parties said that this pharmacy still provided P-medicines and some services, and therefore posed some constraint on the Parties. We consider that this constraint will be small given that prescriptions account for the vast majority of pharmacy medicines.

7.318 Given our assessment we conclude that the merger may be expected to result in an SLC in the area shown on the map of Reading/Theale set out in Appendix K.

- *Sandy/Potton/Biggleswade area*

7.319 There are two Lloyds branches and a Boots branch located close together in the centre of Biggleswade. Sainsbury's is located on the northern edge of the town, by the main road leading to Sandy with an independent located to the east of the town. Two GP practices are located in the centre of the town, with a further GP practice somewhat isolated to the north-west. In this area we have customer location data for both Sainsbury's and Lloyds.

7.320 The customer location data shows that Sainsbury's and Lloyds both draw customers from the same area. Despite this we consider that the proximity of Boots to the Lloyds branches in the centre of Biggleswade means that Boots would receive the majority of the diversion from Lloyds. However, since most Lloyds customers are not located near to the independent, we do not consider

this will receive significant diversion, therefore we consider that Sainsbury's is the main alternative destination other than Boots.

- 7.321 A particular concern is Lloyds Sandy, which is located 3.4 miles to the north of Sainsbury's by road. There are two Lloyds pharmacies on Market Square within 20 metres of each other. Sainsbury's is the closest alternative pharmacy to Lloyds, with customer location data showing that Sainsbury's draws a reasonable proportion of its pharmacy customers from Sandy, despite the presence of a Tesco (non-pharmacy) superstore in the town. Therefore we concluded at provisional findings that, despite the distance between the Parties, Sainsbury's would be the major constraint on the Lloyds branches in Sandy.
- 7.322 To the north-east of Biggleswade is the village of Pottun. This has another Lloyds pharmacy with volume 7,409 prescriptions per month and no alternatives in the village itself. To the north of this lies an independent, which may be the second choice of those living in the village who commute along the road going northwards. Sainsbury's may be the second preference for those going southwards, particularly as it has parking and already draws some pharmacy customers from the village. Others may use the Sainsbury's for the grocery store even if they do not currently use the pharmacy.
- 7.323 An unusual complicating factor is that Lloyds has a very high share of stores within the Sainsbury's radial catchment area. There appear to be more alternatives in the south: there is a Boots and two independents in or near Biggleswade (where the majority of Sainsbury's customers live), and a further independent right on the edge of the catchment area. The Sainsbury's also draws a significant proportion of its customers from close to the villages of Sandy and Pottun in the north however, where we do not consider there to be much choice for customers. Nevertheless we consider there to be less scope for the Parties to weaken the competitive offering at Sainsbury's post-merger and note that a 100-hour licence currently exists in the store, which reduces this flexibility further.
- 7.324 The Parties conducted consumer surveys in this area, the results of which are shown below.

Table 18: Sandy/Potton/Biggleswade customer diversion ratios

	%	
	<i>Including own party</i>	<i>Excluding own party</i>
Sandy, Lloyds, 4 Market Square SG19 1HU	16	45
Sandy, Lloyds, 5 Market Square SG19 1HU	12	48
Potton, Lloyds, SG19 2NP	29	32
Biggleswade, Lloyds, SG18 0JH	12	16
Biggleswade, Lloyds, SG18 8AS	12	18
Biggleswade, Sainsbury's, SG18 0NA	54	54

Source: CMA analysis of the Parties' consumer survey.

- 7.325 In Sandy, the Lloyds branches are located close together and we consider that they face similar competitive conditions and it is relevant to consider the diversion ratio excluding own party diversion. This suggests that diversion from Lloyds Sandy to Sainsbury's is above 45%. We also note that diversion from Sainsbury's to Lloyds is 54% in this area, which reflects the strong position of Lloyds in the area pre-merger. Based on this we conclude that Sainsbury's is the closest competitor to the two Lloyds branches in Sandy.
- 7.326 In response to our provisional findings, the Parties said that GP practices in Sandy were dispensing GPs, and that one dispensed to 17.3% of its patients and the other dispensed to 12.2% of its patients. The Parties argued that this meant that customers in this area would have a choice between Lloyds, the GP dispensary or another pharmacy. We do not agree that dispensing GPs can, in general, be considered as providing a competitive constraint to retail pharmacies, as dispensing GPs are only allowed to dispense to customers located more than a mile from a pharmacy. In Sandy, most Lloyds customers are located within 1 mile of the pharmacy, so cannot use the services of a dispensing GP. Thus, we do not consider that the presence of dispensing GPs in this area imposes a significant competitive constraint on Lloyds.
- 7.327 The Lloyds Potton store is located in a village with no immediate competitors, the nearest Lloyds branch is located 3.5 miles away in Sandy. Therefore, in this case, we consider that it is appropriate to use the diversion ratio including own party diversion, which suggests that diversion to Sainsbury's is under 30%. Given that an independent lies to the North of Lloyds Potton, with Boots providing an alternative for customers travelling in to Biggleswade, we consider that the merger may not be expected to result in an SLC in Potton.
- 7.328 However, given our assessment we conclude that the merger may be expected to result in an SLC in Sandy (the area shown on the map of Sandy set out in Appendix K).

- *Sutton Coldfield*

7.329 There are two Lloyds pharmacies located in Sutton Coldfield (228 and 290 Lichfield Road) along with a Boots (Mere Green Close) and a Sainsbury's (30 Mere Green Road). The other pharmacy of relevance is also a Boots which is located 1 mile to the north-west of the middle Lloyds branch.

7.330 Customers are primarily located either to the north-west, or to the north-east of Lloyds. The Lloyds branch at 228 Lichfield Road is co-located with a GP practice, with another GP practice co-located with the Boots in the centre of the catchment area. The Boots pharmacy received lower volumes than each Lloyds and the Sainsbury's, however we note that it is currently being refurbished and may therefore pose a stronger constraint once this is completed. Customers travelling from the north-west are likely to either divert to the Boots branch on their route or to visit Sainsbury's, although there is also a Waitrose supermarket in the local area, which may affect the number of customers visiting Sainsbury's for their grocery purchases. Customers living to the north-east are likely to divert either to Sainsbury's or Boots. Therefore in our provisional findings we considered that diversion from Lloyds to Sainsbury's in this area is likely to be high.

7.331 The Parties' survey showed that diversion was as follows.

Table 19: Sutton Coldfield customer diversion ratios

	%	
	<i>Including own party</i>	<i>Excluding own party</i>
Lloyds to Sainsbury's	27	30
Sainsbury's to Lloyds	45	45

Source: CMA analysis of the Parties' consumer survey.

7.332 The two Lloyds branches are located close together, and are likely to face similar competitive conditions. Consequently we consider that the diversion ratio excluding own party diversion is relevant. Under this measure, diversion is 30%. However, we also note that diversion to a nearby Boots is high, at 48%. At present this Boots is located in a temporary location (in a Portakabin) located between the Parties. A refurbished Boots is scheduled to open in the same location in September 2016. We noted in paragraph 7.115 that refurbishments are valued by customers and, in particular given the present Boots is situated in a Portakabin, we expect the refurbished Boots would be likely to attract additional customers and cause the diversion ratio from Lloyds to Sainsbury's to fall.

7.333 Given our assessment we have decided to reverse our provisional finding. We conclude that the merger may not be expected to result in an SLC in Sutton Coldfield.

- *Warlingham*

7.334 Warlingham is a village south of Croydon. There is a Lloyds branch, which was surveyed by the CMA, located in the centre of the village, while the Sainsbury's is less than a mile away along the road. Another Lloyds is located on the road leading to Croydon. The only other pharmacy in the surveyed Lloyds catchment area is an independent near the train station.

7.335 There is a GP practice located between the surveyed Lloyds and Sainsbury's with Lloyds drawing most of its customers from the area around the pharmacy and around this GP practice. This area was surveyed and the diversion ratio was found to be as shown in the table below.

Table 20: Warlingham customer diversion ratios

	%	
	<i>Including own party</i>	<i>Excluding own party</i>
Lloyds to Sainsbury's	40	67
Sainsbury's to Lloyds	66	67

Source: CMA consumer survey.

7.336 Although the two Lloyds branches in this area are located 0.8 miles apart, the non-surveyed Lloyds store is relatively isolated with the nearest pharmacy being an independent 1.1 miles to the north (it is 1.4 miles from this pharmacy to Sainsbury's). As such, it is likely that the main competitive constraints on the second Lloyds store come from the independent and from Sainsbury's. Consequently the merger is likely to give some incentive to worsen the offering at the second Lloyds store and we consider that it is appropriate to consider the excluding own party diversion ratio in this area. However, we note that even if we were to include own party diversion, the diversion ratio would still be high.

7.337 Most Lloyds customers would divert either to the other Lloyds or to the Sainsbury's. Similarly, half of Sainsbury's customers would divert to the surveyed Lloyds, the rest spreading between the other local Lloyds and pharmacies in nearby towns.

7.338 Given our assessment we conclude that the merger may be expected to result in an SLC in the area shown on the map of Warlingham set out in Appendix K.

Other competitive constraints which might offset the effect of the merger in community pharmacies

Market entry/expansion

7.339 In line with our guidelines²⁰² we assessed whether entry by new companies or expansion by existing ones might mitigate the effect of the merger on competition.

7.340 We note the following for our local effects assessment:

- (a) Regulation controlling entry to pharmaceutical lists acts as a high barrier to entry in Community pharmacy. The actual extent of the barrier, however, depends on local conditions – in some areas entry may be likely and may mitigate the effects of the merger.
- (b) Regulations regarding practising as a pharmacist are a barrier but in the context of entry we consider that they are not significant.
- (c) While entry and exit costs are a consideration for any entrant, they are not a significant barrier to entry and we do not therefore consider that in general entry costs act as a barrier to entry.

7.341 We have not been provided with any evidence that entry may mitigate the effects of the merger in any of the local areas highlighted by our filtering process and conclude that entry is unlikely to mitigate the SLC in any of the local areas identified in paragraph 7.236.

Other competitive constraints

7.342 We have not found any other competitive constraints that might offset the effects of the merger.

Adverse effects on customers

7.343 In light of our findings on the nature of competition in the pharmacy market (paragraph 7.160) and the incentives for Lloyds to deteriorate the offer discussed in paragraphs 7.166 to 7.191), we have found that the merger may be expected to result in an SLC in the areas described in paragraphs 7.236 to 7.338. We consider that the merger may be expected to result in a reduction in QRS across a range of measures that customers view as being important in

²⁰² CC2, section 5.8.

choosing a pharmacy (see paragraph 7.42). As a result the merger may be expected to result in adverse effects for customers in those areas.

Effect of the merger on outpatient dispensary

7.344 We assessed whether the merger is likely to give rise to an SLC in the OPD market through horizontal unilateral effects. The OPD market is discussed in Section 2. The concern we examined was that if the two merging parties are both significant suppliers to NHS trusts, and if they are commonly among the top ranked bidding firms, the merger may create incentives to worsen their bids. This is because if one of the Parties did not win a contract there would be a high likelihood of it being awarded to the other party.

7.345 The large majority of OPD contracts are currently held by Boots and Lloyds.

Table 21: Numbers of OPD contracts with NHS trusts

<i>Provider</i>	<i>Number of contracts</i>
Lloyds	25*
Sainsbury's	3
Boots	20
Well	3
Rowlands (Phoenix)	3
Pharmaxo	1†
Healthcare at Home	1
Trust subsidiaries	6 (at least)

Source: Celesio, Boots, Pharmaxo.

* Lloyds has 25 contracts with 24 trusts (it has two separate contracts with one trust).

† Pharmaxo's OPD service is not contracted through an NHS hospital, but commissioned by Circle Partnership for the Nottingham NHS Treatment Centre.

7.346 We examined bidding data for OPD contracts. Boots and Lloyds won all the contracts for which Sainsbury's submitted a bid between 2013 and 2015. In only [X] did Sainsbury's finish second in a tender won by Lloyds between 2013 and 2015, suggesting that the competitive constraint imposed by Sainsbury's on Lloyds is limited. [X]. This suggests that Sainsbury's offering might be closer to that of Boots than to Lloyds's, as Boots is also in a position to offer a retail proposition to NHS trusts. In contrast, Lloyds does not have a convenience retail proposition and its bids have focused on providing an OPD pharmacy with additional GSL products.

7.347 Where we have been supplied with tender scoring data for each firm, [X].

7.348 The evidence, therefore, suggests that Sainsbury's and Lloyds are not close competitors: Boots is the main competitor to Lloyds, and Sainsbury's is a closer competitor to Boots than to Lloyds. Additionally, Rowlands appears to be a strong bidder among the second-tier bidders, although its retail offering is weaker than that of Sainsbury's. We note that Rowlands recently won two OPD contracts in April 2015 and January 2016. This firm will remain in the

market post-merger and will be able to exert a competitive constraint on Lloyds and Boots similar to that which Sainsbury's exerted pre-merger. We also received evidence to suggest that an in-sourced self-supply option can be attractive for trusts, and that these firms are also able to bid for the OPD contracts of other NHS trusts.

Conclusions on competitive effects of the merger on outpatient dispensary

7.349 In view of the limited competitive constraint exerted by Sainsbury's on Lloyds and the presence of alternative bidders, we conclude that the merger may not be expected to result in an SLC in the provision of outsourced OPD services to NHS trusts.

Vertical effects of the merger

7.350 Celesio is active as a pharmaceutical wholesaler through its subsidiary AAH. AAH is the second largest wholesaler operating in the UK, after Alliance Healthcare, which is part of the Walgreens Boots Alliance group. The third largest national wholesaler is Phoenix, which is vertically integrated with Rowlands pharmacies. These three national wholesalers account for the vast majority (75 to 80%) of the value of the wholesale market, based on the estimates shown in Table 22. A much smaller market share by value is held by regional wholesalers, by short-line wholesalers or directly by manufacturers, as shown in the following table. Table 22 shows market shares as estimated by the three largest wholesalers; estimates refer to the year up to November 2015 and include only medicines distributed to retail pharmacies, therefore excluding dispensing doctors and hospitals.

Table 22: Market shares by value for the wholesale distribution of medicines to retail pharmacies (December 2014 to November 2015)

Wholesaler	POMs			P-medicines	
	AAH (Celesio) estimates	Alliance (Boots) estimates	Phoenix (Rowlands) estimates	AAH (Celesio) estimates	Alliance (Boots) estimates
AAH (Celesio)	[X]	[X]	[X]	[X]	[X]
Alliance (Boots)	[X]	[X]	[X]	[X]	[X]
Phoenix (Rowlands)	[X]	[X]	[X]	[X]	[X]
Total national full line	78.2	79.0	79.3	57.9	75.2
Regional full line	[X]	[X]	[X]	[X]	[X]
Short line	[X]	[X]	[X]	[X]	[X]
Direct from manufacturer	[X]	[X]	[X]	[X]	[X]

Source: the Parties and third parties.

7.351 Vertical theories of harm are generally classified into the categories of input foreclosure and customer foreclosure. In the present case:

- (a) Input foreclosure refers to the possibility that the merged Parties may foreclose rival retailers by denying the wholesale supply of medicines or by offering worse contractual terms. There may be an incentive to foreclose if the market shares of the merged entity lead to a sufficiently high retail diversion from the foreclosed rival to the Parties' pharmacies.
- (b) Customer foreclosure refers to the possibility that the Parties may foreclose rival pharmaceutical wholesalers by denying them access to Sainsbury's as a customer.

7.352 Sainsbury's pharmacy business accounts for approximately [REDACTED] [0–5]% of the downstream retail pharmacy market.²⁰³ For this reason, the merger is unlikely to lead to the foreclosure of any wholesaler. [REDACTED].²⁰⁴ The merger would not therefore result in a reduction of volumes for any rival wholesaler and there would be no risk of customer foreclosure.

7.353 We considered the risk of input foreclosure. While the Parties' small national retail market shares ([REDACTED] [0–5]% for Sainsbury's and [REDACTED] [10–20]% for Lloyds)²⁰⁵ make it unlikely that there would be the incentive after the merger at national level to foreclose rival retailers, we examined whether there might be an incentive in local areas where the Parties had high market shares.

7.354 The Parties argued that they did not have the ability to foreclose rival retailers. They said that:

- (a) branded manufacturers required wholesalers to offer uniform national service and an obligation to deliver, therefore preventing any discrimination risk against retail operations of rival wholesale groups;²⁰⁶
- (b) several large manufacturers had adopted a 'direct to pharmacy' model, in which wholesalers simply operated as agents of the manufacturer; and
- (c) with the exception of products distributed under exclusive wholesale arrangements, customers were able and willing to switch wholesale suppliers.

7.355 We recognise that for medicines distributed under a 'direct to pharmacy' scheme, discrimination against rival retailers may not be possible. However, in 2015 these medicines accounted for only approximately [REDACTED]% of the value of prescription medicines distributed by AAH to third party customers. For the

²⁰³ Parties' initial submission, Part D, Section 9.

²⁰⁴ [REDACTED].

²⁰⁵ Parties' initial submission, Part D, Section 9.

²⁰⁶ Parties' initial submission, Part J, Section 3.2.

remaining medicines, wholesalers have the ability to offer different terms to different customers, depending on the respective bargaining power.

7.356 While it is true that retailers can switch to alternative suppliers, market shares suggest that the market is dominated by three wholesalers, and some retailers told us that wholesale competition was limited.²⁰⁷ Representatives of independent community pharmacies²⁰⁸ told us that the level of service provided by the major wholesalers to independent pharmacies was poor and that independent pharmacies felt that these wholesalers did not ensure a fair and equitable supply.²⁰⁹ Switching may also be limited by the existence of contracts between retailers and AAH.

7.357 As we noted in paragraph 7.353, given the Parties' small national market shares, an input foreclosure strategy could potentially be profitable only if targeted at independent retailers operating in those local areas where diversion to the Parties can be expected to be particularly large. We consider that a substantial constraint on Celesio's ability to target competitors in specific local areas is provided by the existence of buying groups, many of them including thousands of independent pharmacies. Buying groups negotiate with suppliers on behalf of their members, allowing them to get better terms than if they dealt with the wholesalers independently.²¹⁰ All but a small number of independent pharmacies are members of a buying group and it appears easy for independent pharmacies to join them.²¹¹ A significant proportion are a member of more than one group.²¹² According to Cambrian Alliance, pharmacies could and did switch between different groups, as they offered differentiated services.²¹³

7.358 We consider that, since most independent pharmacies are members of such buying groups and can easily join one or switch between them, it would be difficult for Celesio to adopt a foreclosure strategy to target specific retail competitors in a limited local area. This was also supported by margin analysis, which showed that at least [REDACTED] of the lost wholesale sales to the foreclosed pharmacy would have to divert to one of the Parties' pharmacies for foreclosure to be profitable.²¹⁴ Even in a concentrated local area, unless

²⁰⁷ [REDACTED]

²⁰⁸ [REDACTED]

²⁰⁹ [REDACTED]

²¹⁰ Cambrian Alliance told us that some of its members saw an increase in profitability [REDACTED] as a result of collective negotiation.

²¹¹ Independent pharmacies are here defined as those having at most 15 retail stores. According to Cambrian Alliance, pharmacy chains with more than 15 retail stores tended to deal with wholesalers directly.

²¹² Between [REDACTED] of Cambrian Alliance members are also members of at least one other buying group.

²¹³ Some buying groups may be stronger than others in negotiating for particular types of products or in offering particular support services. Moreover, some buying groups source most of their medicines through a single wholesaler; for example, Cambrian Alliance sources through AAH, while Numark sources through Phoenix.

²¹⁴ [REDACTED].

the foreclosed pharmacy is forced to close, the loss of retail sales that would result from increased wholesale costs is likely to be limited.

Conclusion on the effect of the merger on foreclosure

- 7.359 We do not consider that the merger will substantially increase Celesio's ability and incentive to foreclose rival retailers or rival pharmaceutical wholesalers. Therefore we conclude that the merger may not be expected to result in an SLC as a result of foreclosure.

Conclusion on the effects of the merger

- 7.360 We have assessed the effects of the merger in community pharmacies against the situation in the counterfactual and have examined the effect of the merger in each of the 929 local overlap areas. We initially used a mechanistic filtering process to focus down on areas of potential concern and then performed an increasingly detailed assessment of the local areas more likely to be of concern. In developing filtering rules, we took account of all the evidence that informed our assessment of pre-merger competition, including the consumer survey, our demand estimation model and wider evidence on pre-merger competition.
- 7.361 We focussed on the possible deterioration of the competitive offer at Lloyds stores because the Cooperation Agreement means it will be more difficult for Lloyds to materially change its offer at Sainsbury's pharmacies than at its own pharmacy stores.
- 7.362 We have used substantially higher diversion thresholds in our initial filter than in more traditional retail mergers such as supermarkets. This is because the Parties do not have the ability to flex the price of many of their products and other products are priced at nationally set levels. Also the impact of regulation affects how the Parties can set some aspects of their service offering. The Parties can therefore compete over a narrower range of parameters than many other retail operations.
- 7.363 As a result of our assessment we conclude that the merger may be expected to result in an SLC in: Beaconsfield; Bracknell; Cardiff; Christchurch; Kempston; Kidlington; Leeds; Liverpool; Luton; Reading/Theale; Sandy and Warlingham.
- 7.364 In our view, in those local areas listed in paragraph 7.363 where as a result of the merger there will be materially reduced competition faced by Lloyds pharmacies, the merger may be expected to result in a material loss of competitive constraint. We consider that the adverse effects on consumers

that may be expected to result from this, on aspects of the competitive offer that consumers regard as important, are sufficiently material for us to find that the merger may be expected to result in an SLC. The adverse effects for customers in the SLC areas, in terms of a reduction in QRS, may include effects on the following: opening hours, store ambience, staffing and quality of advice, provision of additional services, waiting times, prescription collection and delivery, and relationships with GPs.

- 7.365 We examined the effect of the merger on OPD. In view of the limited competitive constraint exerted by Sainsbury's on Lloyds and the presence of alternative bidders, we conclude that the merger may not be expected to result in an SLC in the provision of outsourced OPD services to NHS trusts.
- 7.366 We also considered vertical effects of the merger. We do not consider that the merger has substantially increased Celesio's ability and incentive to foreclose rival retailers or rival pharmaceutical wholesalers. Therefore we conclude that the merger may not be expected to result in an SLC as a result of foreclosure.

8. Findings on the statutory questions

- 8.1 We have identified that although price is not varied locally the Parties have the ability and the incentive to vary aspects of their local QRS offer to compete with other pharmacies. Although regulation sets a minimum standard for some quality parameters pharmacies are generally free to compete by offering higher levels of service. Our review of Lloyds' internal documents showed that Lloyds responded to competition from other pharmacies in local areas and, in areas where supermarkets are present in the area, responded to competition from supermarkets.
- 8.2 We concluded that there was clear evidence that the Parties compete pre-merger and that the extent of the competitive constraint imposed by Sainsbury's on Lloyds would be material in local areas where there are few other competitors.
- 8.3 Given this conclusion we then assessed the effect of the merger, focusing on the effect on Lloyds' customers in each local overlap area. We recognised that the Parties had less ability to compete than in many other retail mergers by using substantially higher intervention thresholds than in many other retail mergers (both in the initial mechanistic filtering process that we applied and in our detailed assessment of the areas that failed the filters).
- 8.4 As a result of our assessment we have concluded that:
- (a) arrangements are in progress or contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and

- (b) as a result of the assessment described in Section 7 we conclude that the merger may be expected to result in an SLC in 12 local areas and that this may be expected to lead to adverse effects for customers in terms of a reduction in the quality of service provided in those areas. The areas are: Beaconsfield; Bracknell; Cardiff; Christchurch; Kempston; Kidlington; Leeds; Liverpool; Luton; Reading/Theale; Sandy; and Warlingham.

9. Remedies

- 9.1 Having concluded that the merger may be expected to result in an SLC in 12 local areas we are required to decide whether action should be taken to remedy, mitigate or prevent the SLC or any adverse effects resulting from the SLC. This section discusses our assessment of possible remedies to the SLC and its resulting adverse effects.
- 9.2 Section 36(3) of the Act places a duty on the CMA to decide on three questions concerning remedial action:
- (a) Should the CMA itself take action to remedy, mitigate or prevent the SLC or any adverse effect which may be expected to result from the SLC?²¹⁵
 - (b) Should the CMA recommend the taking of action by others, eg government, regulators and/or public authorities, for the purpose of remedying, mitigating or preventing the SLC or any adverse effect which may be expected to result from the SLC?²¹⁶
 - (c) In either case, if action should be taken, what action should be taken and what is that action designed to address?²¹⁷
- 9.3 The Act requires that the CMA, when considering possible remedial actions, shall 'in particular, have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the substantial lessening of competition and any adverse effects resulting from it'.²¹⁸ To fulfil this requirement, the CMA will seek remedies that are effective in addressing the SLC and its resulting adverse effects and will then select the least costly remedy that it considers to be effective. The CMA will also seek to ensure that no remedy is disproportionate to the SLC and its adverse effects. In this

²¹⁵ Section 35(3)(a).

²¹⁶ Section 35(3)(b).

²¹⁷ Section 34(3)(c).

²¹⁸ Sections 35(4) and 36(3).

consideration the CMA may also have regard, in accordance with the Act,²¹⁹ to any RCBs arising from the merger.

Remedy options

9.4 It is possible to distinguish two broad categories of merger remedies:

- (a) Structural remedies, such as divestiture or prohibition are generally one-off measures that seek to restore or maintain the competitive structure of the market through a direct change in market structure.
- (b) Behavioural remedies are measures that are designed to regulate or constrain the behaviour of merger parties with the aim of restoring the level of competition that would have been present absent the transaction.

9.5 The CMA's merger remedies guidelines set out four aspects to be considered in assessing the effectiveness of a remedy:²²⁰

- (a) **Impact on the SLC and its resulting adverse effects** – where possible, the CMA will seek to restore competitive rivalry, through remedies that re-establish the structure of the market expected in the absence of the merger.
- (b) **Appropriate duration and timing** – the CMA prefers a remedy that quickly addresses competitive concerns, with the effect of the remedy sustained for the likely duration of the SLC.
- (c) **Practicality** – a practical remedy should be capable of effective implementation, monitoring and enforcement.
- (d) **Acceptable risk profile** – the CMA will seek remedies that have a high degree of certainty.

9.6 In merger inquiries, the CMA will generally prefer structural remedies rather than behavioural remedies because:

- (a) structural remedies are likely to deal with an SLC and its resulting adverse effects directly and comprehensively at source in restoring rivalry;
- (b) behavioural remedies may not be effective and may create significant costly distortions in market outcomes; and

²¹⁹ Sections 35(5) and 36(4).

²²⁰ *Merger Remedies: Competition Commission Guidelines (CC8)*, (adopted by the CMA board), paragraph 1.8.

- (c) structural remedies do not normally require monitoring and enforcement once implemented.
- 9.7 These factors mean that behavioural remedies are generally subject to higher risks than structural remedies and are therefore less likely to be effective and/or proportionate solutions to an SLC in a merger inquiry.²²¹
- 9.8 Having considered the effectiveness of remedy options, the CMA will then consider the costs (including costs to the Parties, third parties, the CMA and other monitoring agencies) of those remedies that it expects would be effective in addressing the SLC and resulting adverse effects.²²² In order to be reasonable and proportionate, the CMA will seek to select the least costly remedy or package of remedies that it considers will be effective.^{223,224}
- 9.9 In our Remedies Notice published on 29 April 2016 we invited views on potential structural remedies involving:
- (a) prohibition of the merger; or
 - (b) requiring the divestiture of one or more Lloyds pharmacies (licence with premises) in each local market where we have provisionally found that the merger may be expected to result in an SLC as a result of the transaction.
- 9.10 We also invited views on behavioural remedies although we stated in the Remedies Notice that we considered a behavioural remedy was unlikely to be effective in remedying the SLC.
- 9.11 We held hearings with the Parties and four third parties to discuss their views on the options in the Remedies Notice and views on whether there were other remedies which we should consider. No parties suggested that we should consider alternative remedies to those we consulted on in the Remedies Notice. Celesio proposed a behavioural remedy. This is discussed in paragraphs 9.13 to 9.20.

²²¹ The risks associated with behavioural remedies are identified in paragraph 4.2 of [CC8](#) as:

Specification risks. These risks arise if the form of conduct required to address the SLC or its adverse effects cannot be specified with sufficient clarity to provide an effective basis for monitoring and compliance.

Circumvention risks. As behavioural remedies generally do not deal with the source of an SLC, it is possible that other adverse forms of behaviour may arise if particular forms of behaviour are restricted. To avoid or reduce these risks, behavioural measures need to deal with all the likely substantial forms in which enhanced market power may be exercised. In practice this may not be feasible or may make the behavioural measures too complex to monitor.

Distortion risks. These are risks that behavioural remedies may create market distortions that reduce the effectiveness of these measures and/or increase their costs.

Monitoring and enforcement risks. Even clearly specified remedies may be subject to significant risks of ineffective monitoring and enforcement

²²² [CC8](#), paragraph 1.10:

²²³ [CC8](#), paragraph 1.9.

²²⁴ [CC8](#), paragraph 1.9.

Assessment of remedy options

9.12 In the remainder of this section we first assess the effectiveness of the various remedy options on which we have received evidence (paragraphs 9.13 to 9.91). We start by considering the behavioural remedy proposed by the Parties and then consider the two structural remedy options (prohibition and divestments). Second we look at the proportionality of those remedy options we consider are effective at addressing the SLC (paragraph 9.92), and third we look at any RCBs that we should take into account in our assessment (paragraph 9.95). Finally we conclude on what we consider is the least costly remedy or package of remedies that are effective in addressing the SLC (paragraph 9.96).

The Celesio behavioural remedy proposal

9.13 Celesio initially submitted a behavioural remedy. It said it would be prepared to offer an undertaking:

- (a) not to reduce the opening hours below those that were in place immediately prior to the date of the BSA (or such other date to be agreed with CMA);
- (b) at any Lloyds pharmacy identified on the maps contained in Appendix M to our provisional findings;
- (c) for a period of three years, which is equal to the typical duration of a PNA, or such other period as deemed by the CMA to be appropriate, proportionate and reasonable in the circumstances;
- (d) unless consent is sought and received from the CMA (for example, as a result of a material change in circumstances in a particular local area).

9.14 Celesio argued that the remedy would have immediate and certain effect, because it ensured that those customers faced no loss of convenience, and that each Lloyds pharmacy would stay open for its current hours. Celesio argued that the remedy would be straightforward to implement, monitor and enforce, given that any change in core pharmacy opening hours was already subject to regulatory approval (or three months' notice in the case of supplementary hours). Celesio also argued that pharmacy regulation meant that there was a reduced need for the usual monitoring and enforcement concerns. Celesio added that local regulatory bodies would also be aware of the remedy, and be able to detect any breaches, and regular reports could readily be provided to the CMA with details of any request for regulatory approval made in relation to opening hours for any of the relevant pharmacies.

- 9.15 In a further submission on remedies²²⁵ Celesio stated that the remedy could be expanded to cover the range of pharmacy services offered at Lloyds' stores in the SLC areas. Specifically Lloyds could undertake: not to voluntarily cease providing any additional pharmacy services (including any locally commissioned and private services); and to reapply for permission to keep providing any additional services it currently provides for a period the CMA deemed necessary and which would be effective and proportionate. It submitted that this would address the CMA's concern about the possible deterioration of the competitive offer at these Lloyds stores. Celesio also submitted that this would be proportionate as, being profitable activities for Lloyds, it had a commercial incentive to supply these services and therefore it would not be burdensome for Lloyds to continue to offer them. It also meant that the risk of Lloyds failing to comply with the undertaking was low, thus negating the need for it to be 'vigorously' monitored and enforced.
- 9.16 The third parties that we spoke to did not believe that behavioural remedies would be effective in addressing the SLC.

Our assessment of the effectiveness of the behavioural remedy proposal

- 9.17 When assessing the merits of behavioural remedies the CMA generally prefers measures that remove obstacles to competition rather than those that control market outcomes.²²⁶ Remedies must be practical and capable of effective implementation, monitoring and enforcement.²²⁷ In addition, remedies that act quickly in addressing competitive concerns are preferable to those which take longer to implement or where the timing of the effect is uncertain. Remedies must be in place for the likely duration of any SLC.²²⁸ In evaluating effectiveness we also seek remedies with a high degree of certainty that they will achieve the intended effect.²²⁹ As noted in our guidance,²³⁰ the CMA will generally only use behavioural remedies as the primary source of remedial action in a merger inquiry where structural remedies are not feasible, or where the SLC is expected to have a short

²²⁵ Further submission of the Parties in relation to possible remedies and in response to the provisional findings, 17 June.

²²⁶ In general, in the above circumstances, the CMA will prefer to use enabling measures that 'work with the grain of competition' such as access remedies (see Section 4) and measures that remove obstacles to competition rather than behavioural remedies that control market outcomes such as price caps. The latter measures tend to be onerous to operate and monitor, may create significant market distortions and do not address the causes of an SLC. These are therefore unlikely to be appropriate other than for a limited duration unless there is no practical alternative to a continuing regulatory solution. CC8, paragraph 2.17.

²²⁷ CC8 paragraph 1.8 (c).

²²⁸ CC8 paragraph 1.8 (b).

²²⁹ CC8 paragraph 1.8 (d).

²³⁰ CC8, paragraph 4.1.

duration, or where behavioural measures will preserve substantial RCBs that would be largely removed by structural measures.

9.18 We assessed the behavioural remedy put forward by Celesio against these criteria.

- (a) The proposed remedy looks to control the outcomes of the merger (its adverse effects) rather than addressing the source of the SLC or removing obstacles to competition.
- (b) This is a multi-dimensional SLC in terms of QRS and Celesio's remedy only addresses some of the elements of QRS that we have found may be deteriorated post-merger. It does not address all areas with which we have concerns.
- (c) The remedy looks to freeze opening hours and services maintaining the status quo taking no account of, in particular, innovation or improvement in service provision that could occur under competitive conditions. This raises the risk of significant market distortions over time.
- (d) In relation to the time period for the remedy there is no obvious end date for the remedy, where we could be reasonably certain that competitive conditions would exist so as to render the behavioural remedy redundant. Consequently the length of the remedy would be of indefinite duration thereby increasing the requirement for monitoring and the risk that it would result in market distortion.

9.19 Furthermore, the Parties and third parties told us that there were no RCBs that should be taken into account in our assessment of the most appropriate remedy (see paragraph 9.95).

9.20 We therefore consider that for the reasons set out in paragraph 9.18 the behavioural remedy put forward by Celesio is not effective in addressing the SLC we have found.

Effectiveness of the structural remedy options

9.21 We first look at the effectiveness of these remedy options: prohibition of the merger (paragraphs 9.22 to 9.24); and divestitures in local markets (paragraphs 9.25 to 9.90).

Prohibition of the merger

9.22 Under this option Lloyds would be prevented from buying any of the Sainsbury's pharmacies (whether in an area where we found an SLC or not).

We set out in the Remedies Notice that we considered that prohibition represented a comprehensive solution to the SLC and had few risks in terms of effectiveness. No party disagreed with this.

- 9.23 The Parties submitted that the number of markets in which the CMA had provisionally found that the merger may be expected to result in an SLC was small in relation to the total number of stores to be acquired, and that prohibition of the merger would not therefore be a proportionate solution. Third parties also agreed with this view.

Conclusion on the prohibition option

- 9.24 We considered that prohibition would be an effective remedy. We assess its proportionality in paragraph 9.92.

Divestitures in each of the local markets where we had found an SLC

- 9.25 Under this option pharmacies would be divested in the local markets where we had found an SLC. In looking at whether divestitures in local markets would be effective we assessed both the divestiture of Lloyds pharmacies (as set out in the Remedies Notice) and Sainsbury's pharmacies in each of the local areas where we have identified an SLC. In assessing whether such a divestiture would be effective we considered, in line with our guidance:²³¹

- (a) composition risk: the risk that the scope of the divestiture package is not appropriately configured to attract a suitable purchaser or may not allow a purchaser to operate as an effective competitor in the market (paragraphs 9.26 to 9.56);
- (b) purchaser risk: the risk that a suitable purchaser is not available or that the Parties will dispose to a weak or otherwise inappropriate purchaser (Purchaser suitability) (paragraphs 9.58 to 9.65); and
- (c) asset risk: the risk that the competitive capability of a divestiture package will deteriorate before completion of divestiture (paragraphs 9.67 to 9.83).

Composition risk

- 9.26 The key elements in relation to assessing composition risk are:

- (a) the composition of the divestiture package (paragraphs 9.27 to 9.35); and

²³¹ CC8, paragraph 3.3.

(b) the identity of the pharmacy (which will include the licence and may also include the store) to be included in each local market (paragraphs 9.36 to 9.56).

- *Composition of the divestiture package*

9.27 The composition of any divestiture package needs to be appropriately configured to address the SLC; be attractive to potential purchasers; and enable the purchaser to operate effectively as an independent competitor.

- *The Parties' and third parties' views*

9.28 All parties told us that the divestiture package must include the NHS pharmacy licence. A purchaser must also be able to meet the regulatory criteria to obtain the GPhC registration for that pharmacy.

9.29 Third parties told us that the property associated with the licence should also be part of the divestiture package. No third party raised a concern with either Celesio or Sainsbury's, if they wished, retaining the freehold to a property and leasing the premises to the purchaser. One third party said that there should be no restrictive covenants within the lease that would affect the ability of the purchaser to compete effectively in the local pharmacy market.

9.30 The Parties submitted that it was not necessary to include the property in the divestiture package. They submitted that they could divest a pharmacy as a 'going concern' subject to a relocation of the pharmacy licence from the existing site to an alternative site nearby, if this was the preference of the purchaser. They argued that this would enable the purchaser to operate what was, in effect, a new pharmacy with the same services while creating a new fascia independent of the Parties in the local market. The Parties submitted that this approach may be particularly appropriate in a location where Lloyds leased its pharmacy premises from Sainsbury's, as it would allow the purchaser to operate completely independent of the Parties.

9.31 The Parties submitted that pharmacy licence relocations were relatively common in the industry. They stated that while there was no specific limitation on the distance of the relocation, since the new premises must be accessible to the relevant customer group, all relocations tended to be within a 0.5 to 1-mile radius. In this case, they submitted that the purchaser would be required to ensure that the relocation was accessible for existing customers and to offer at least the same pharmacy services. Consequently, the sale of a pharmacy subject to a minor relocation should be equally effective in addressing a SLC in a local area.

- 9.32 In addition to the NHS pharmacy contract and property, we were told that a divestiture package should include:
- (a) Stock – this would include all pharmaceutical stock (POMs and P-medicines), GSL medicines and non-Lloyds branded general stock.
 - (b) Patient data – transfer of the data from Patient Medical Records (PMR) held by the pharmacy to the purchaser. This would include prescription history and service history, for example MUR or other services the patient obtained from the pharmacist. EPS nominations would also need to be part of the sale contract and the ODS code²³² would need to be transferred.²³³
 - (c) Technology (possibly through transitional arrangements) to ensure the seamless continuity of patient care.
 - (d) Staff – to be transferred under Transfer of Undertakings (Protection of Employment) Regulations (TUPE).
- 9.33 Celesio submitted that it should be permitted to transfer the ‘non-retail’ Business to Business (B2B) business out of any divestment store prior to sale given that this part of the business would not form part of any SLC which required remedying. It argued that with respect to the supply of care homes (and mental health trusts and prisons), the overlap between the Parties was minimal and that the merger was not expected to have a significant impact on the supply to care homes. Celesio also told us that most B2B contracts were non-local, [REDACTED].

- *Our assessment on the composition of the divestiture package*

- 9.34 We considered that the key elements essential in any divestiture package were:
- (a) The licence. The licence forms a fundamental part of the divestiture package. However, its transfer is dependent on the approval of NHS England or NHS Wales (in the case of Cardiff) and to be effective the purchaser must also register the pharmacy address with the GPhC.

²³² The ODS or F-Code is the unique code issued to a pharmacy that identifies it to NHS prescription services. It is used to support a number of NHS IT systems and disruption to service can be caused if it is not transferred on sale of the pharmacy. See [Pharmaceutical Services Negotiating Committee: Allocation of ODS codes](#).

²³³ The nature of the personal data that is allowed to be transferred and the procedures enabling such a transfer (including obtaining consent where necessary from the person to whom that data relates) is subject to various legislation and regulations including the Data Protection Act 1998 and the Data Sharing Code of Practice, May 2011.

(b) Property: we considered that it would be more straightforward to sell the licence with the property (freehold or leasehold) where the licence was currently registered with the GPhC. However, in certain circumstances, the property might not need to be part of the divestiture package for the divestiture to be effective. For this to be considered an effective divestiture we would need to have evidence that the purchaser had another property in place, or was contractually committed to obtaining a nearby property in the near future and able to operate from the property by the time completion of the sale of the licence had occurred. This would enable the purchaser to operate the licence from and transfer the customers to those premises, so that the pharmacy remained operational following completion. While we note that regulations covering relocation of pharmacies require that the pharmacy should be relocated within the local area we will need to be provided with evidence from the purchaser that the location of the new property would provide as effective a remedy to the SLC as if it had been operated from the location of the Lloyds site subject to the divestiture. We therefore consider that if the licence was to be transferred without the property the relocation will need to be approved by the CMA as part of the purchaser suitability test. Any relocation of a licence would have to be completed within the divestiture period (see paragraph 9.83).

(c) PMR and EPS data including the ODS code.

(d) Stock, staff and any transitional arrangements required to ensure that the purchaser is an effective operator on day one. We considered that the identity of the purchaser would determine to a large extent what elements within these categories it required. As such, we do not intend to prescribe what should be included but will require Celesio to offer the elements required by the purchaser and will assess these as part of the purchaser suitability assessment.

9.35 We consider that if the purchaser wished to include B2B customers within a divestiture package this should be part of the negotiation between Celesio and the purchaser. We note that, if the B2B customers were not part of the package, we would need to be satisfied that the pharmacy would still be viable. This would be part of our assessment of whether the divestiture package would result in an effective competitor in that local market, thereby addressing the SLC.

- *Identity of the pharmacies to be divested*

9.36 In this section we address whether, in each local market, the pharmacy to be divested should be a Lloyds pharmacy or a Sainsbury's pharmacy, how many

pharmacies should be divested in each of the local markets and whether Celesio should be able to choose which pharmacy it should divest within each local market? We then look at which pharmacy (or pharmacies) in each individual local market should be divested to address the SLC.

- *Should a Lloyds or a Sainsbury's pharmacy be divested in each local market?*

9.37 In our Remedies Notice we set out our view that the appropriate pharmacy in each area would be one or more of the Lloyds pharmacies (and that this should include both the licence and the store).

9.38 In response, third parties told us that it was highly unlikely that anyone would be interested in acquiring a pharmacy licence within a Sainsbury's. Day Lewis viewed it as impractical to divest a Sainsbury's pharmacy as Sainsbury's would not want to damage its brand by including a single brand in one store while the remainder were branded Lloyds. Third parties ([REDACTED] and Rowlands) told us that the likely requirements of Sainsbury's in regards to, for example, what the pharmacy could or could not sell and where it was located, may be too restrictive for a one-off purchase. A third party (Rowlands) also told us that it would be difficult to relocate the licence at a later date from the Sainsbury's pharmacy as it would be difficult to find a suitable location nearby and there would be objections from other local pharmacies.

9.39 [REDACTED].

- *How many pharmacies should be divested in each local market?*

9.40 The Parties said that it would be disproportionate to require more than one pharmacy to be sold in any area. They added that divesting a single pharmacy would introduce an additional pharmacy operator into the area in question that was able to compete with Lloyds on an ongoing basis, and would (in terms of fascia) restore competition to its pre-merger levels.

- *Should Celesio be able to choose which pharmacy it should divest within each local market?*

9.41 The Parties submitted that Celesio should be able to choose which pharmacy was to be divested in each relevant local area (within reason and subject to considerations such as location, size of pharmacy relative to the Sainsbury's pharmacy, proximity to GP surgeries and sufficient interest from suitable purchasers), as the divestment of a single Lloyds pharmacy should at least restore competition to its pre-merger level.

- 9.42 [REDACTED] believed that the decision as to which Lloyds pharmacy to sell should be made by Celesio. However, one third party (Day Lewis) noted that if Celesio could choose which Lloyds pharmacy to sell, it would have the incentive to divest the worse performing/located store of the choice it had.
- *Our assessment of the identity of the pharmacies to be divested*
- 9.43 In principle the divestiture of a Sainsbury's pharmacy licence may address the SLC in a particular local area. We note that our analysis in paragraphs 7.232 to 7.338 showed that our concerns in each of the local markets were generally centred around Lloyds and not Sainsbury's pharmacies. Responses from third parties also suggested that the sale of a Sainsbury's licence is likely to be less attractive to potential purchasers and so would be significantly more risky in terms of purchaser risk²³⁴ than the sale of a Lloyds pharmacy. No third party suggested that it would be preferable to sell a Sainsbury's rather than a Lloyds pharmacy in any local area.
- 9.44 In paragraphs 7.232 to 7.338 we identified in all but two areas that our concern in the local market could be satisfied with the divestment of a specific Lloyds pharmacy. This included areas where multiple Lloyds pharmacies were present. Celesio submitted that in three of these local areas, Beaconsfield, Kempston and Warlingham, a different Lloyds pharmacy to the one we identified should be divested.
- 9.45 Celesio told us that in Beaconsfield [REDACTED]²³⁵ [REDACTED]²³⁶. Therefore Celesio considered that the Lloyds pharmacy in Beaconsfield new town centre would be a more appropriate divestiture given that its future location was known and it would ensure that there was a 'plurality of pharmacy competitors in central Beaconsfield', namely, Boots, Lloyds (through its ownership of the current Sainsbury's pharmacy) and the purchaser of Lloyds' new town pharmacy.
- 9.46 We considered Celesio's evidence, and agreed with Celesio that the Lloyds pharmacy in Beaconsfield new town would be a more appropriate pharmacy to be divested than the one in the old town.
- 9.47 Celesio stated that in Kempston the Lloyds pharmacy (242 Bedford Road) was located in a parade of shops next to a Sainsbury's supermarket and that Sainsbury's owned the freehold for the parade of shops. Lloyds was therefore a tenant of Sainsbury's. Celesio submitted that there was a risk that a purchaser of the store lease may not have security of tenure as Sainsbury's

²³⁴ The risk that a suitable purchaser is not available or that the merger parties will divest to a weak or otherwise inappropriate purchaser.

²³⁵ [REDACTED]

²³⁶ [REDACTED]

could decide to expand its supermarket into the parade of shops. Celesio also said that having a non-Lloyds pharmacy in such close proximity to a Sainsbury's with a Lloyds pharmacy in-store would be confusing for customers. It added that the parade of shops shared the same car park as Sainsbury's.

- 9.48 Celesio proposed that the pharmacy licence for this store should be sold and the purchaser should then relocate the licence. To ensure the divestiture was not delayed by the relocation application Celesio stated that the purchaser would be allowed to trade from the current pharmacy location while the application process and physical relocation occurred. Celesio submitted that there were currently sites available in the immediate vicinity of the current pharmacy but that any decision on the eventual site of the pharmacy would be the purchaser's.
- 9.49 Our view is that the 242 Bedford Road, Kempston pharmacy should be sold and that sale should be of the licence and the property. We did not consider that the close proximity of the pharmacy to the Sainsbury's would cause confusion for customers given that there was currently a different fascia (Lloyds) to the Sainsbury's pharmacy and this would not change post-merger. In addition, we considered that Celesio's argument on tenure was insufficient to require a relocation immediately post sale of the licence as there was no evidence of any plans by Sainsbury's to do so.
- 9.50 Celesio submitted that in Warlingham its preference was to divest 337 Limpsfield Road. This was a different pharmacy to the one we had identified (46-48 The Green) – Celesio said that this pharmacy had limited parking in a local area with high car usage. Celesio also argued that 337 Limpsfield Road was close to the larger of the two GP surgeries, and the diversion ratios were the same for both of Lloyds' pharmacies.
- 9.51 Our view is that 337 Limpsfield Road is further away from the GP surgeries than 46-48 The Green and for the majority of customers the closest alternatives would still be the Sainsbury's and the Lloyds pharmacies. Therefore our view is that 46-48 The Green should be the pharmacy to be divested.
- 9.52 In relation to two areas: Christchurch and in Sandy (Sandy/Potton/Biggleswade area), there were in each of them two Lloyds pharmacies located close together, both of which are of concern.
- 9.53 In Christchurch there are two Lloyds pharmacies in close proximity at 344-346 and 248 Lymington Road. We consider that divestiture of either would be effective in remedying the SLC in Christchurch. We also consider as a result

that Celesio should be able, in the first instance,²³⁷ to choose which pharmacy it would look to divest.

9.54 In the Sandy/Potton/Biggleswade area Celesio submitted that in this area if it had to divest any store it should be one of its two Lloyds stores in Biggleswade. It argued that:

- (a) in all three locations there was a high proportion (between 8 and 17% of the population) that used dispensing doctors for their prescriptions;
- (b) in Sandy the merger did not change the current competitive dynamic – there were currently two Lloyds pharmacies in Sandy and there would be two after the merger;
- (c) the Potton Lloyds pharmacy was constrained by the Gamlingay pharmacy; and
- (d) in Biggleswade there was a strong Boots pharmacy which customers coming from Potton would get to before the Lloyds pharmacies. Jardines (which was relatively new – open since 2005) was growing and was closer to a new estate development in the east of Biggleswade.

9.55 We considered that the divestment of either of the two Lloyds pharmacies in Sandy (either 5 Market Square, Sandy, Bedfordshire SG19 1HU or 4 Market Square, Sandy, Bedfordshire SG19 1HU) would be effective in addressing the SLC. We did not consider that the divestment of the Lloyds pharmacy in Potton or one of the Lloyds pharmacies in Biggleswade would be effective. The Sandy stores lie within the catchment area of the Sainsbury's Biggleswade pharmacy but not the catchment of the Lloyds pharmacies in Biggleswade or Potton. The divestment of either of these pharmacies would not address the problem in Sandy. We also consider as a result that Celesio should be able, in the first instance, to choose which pharmacy in Sandy it would look to divest.

○ *Conclusion on the identity of the pharmacies to be divested*

9.56 We have therefore concluded that the following divestitures would be required in each local market – see Table 23.

²³⁷ The circumstances under which an alternative pharmacy may be required to be divested are discussed in paragraph 9.90.

Table 23: Required divestitures

Area	Lloyds pharmacy		
Beaconsfield	5 The Highway, Beaconsfield, Buckinghamshire HP9 1QD (Lloyds' New Town pharmacy)		
Bracknell	97 Liscombe, Birch Hill Rd, Bracknell, Berkshire RG12 7DE		
Cardiff	44 Station Road, Cardiff CF14 5LT		
Christchurch	344-346 Lymington Road, Christchurch, Dorset BH23 5EY	OR	248 Lymington Road, Christchurch, Dorset BH23 5ET
Kempston	242 Bedford Road, Kempston, Bedfordshire MK42 8PP		
Kidlington	18 The Parade, Kidlington, Oxfordshire OX5 1DB		
Leeds	2 The Avenue, Leeds, West Yorkshire LS17 7BE		
Liverpool	1-3 Rice Lane, Liverpool L9 1AD		
Luton	2 Whitehorse Vale, Luton, Bedfordshire LU3 4AD		
Reading/Theale	27 High Street, Theale, Berkshire RG7 5AH		
Sandy	5 Market Square, Sandy, Bedfordshire SG19 1HU	OR	4 Market Square, Sandy, Bedfordshire SG19 1HU
Warlingham	46-48 The Green, Warlingham, Surrey CR6 9NA		

Purchaser risk

9.57 As noted in our guidance the identity and capability of a purchaser is fundamental in ensuring the effectiveness of a divestiture remedy. The Parties will therefore need to obtain the CMA's approval of any purchaser. The CMA needs to be satisfied that the prospective purchaser is independent of the Parties, has the necessary capability to compete, is committed to competing in the relevant market(s) and that divestiture to the purchaser will not create further competition concerns. These criteria are discussed in more detail below:²³⁸

- (a) **Independence** – The purchaser should have no significant connection to Celesio that may compromise the purchaser's incentives to compete with the merged entity. We note that there may be a requirement for transitional services to be provided by Celesio or Celesio to act as landlord. These will be assessed on a case-by-case basis. We also note that the purchaser may wish to use Celesio's wholesale business, AAH. We did not consider commercial arrangements of this nature on an arm's length basis to create independence issues.

²³⁸ CC8, paragraph 3.15.

- (b) **Capability** – The purchaser must have access to appropriate financial resources, expertise and assets to enable the divested business to be an effective competitor in the market. This access should be sufficient to enable the divestiture package to continue to develop as an effective competitor. In our assessment of the operational capability we will take into account the Parties’ submission on the relevant core skills, attributes and facilities/assets that are required for the provision of pharmacy services. In addition we would need to be satisfied that the prospective purchaser satisfies the necessary regulatory requirements to operate the licence at the stated premises in the local market. The purchaser must meet all the necessary criteria to have an NHS pharmacy contract set out by either NHS England or NHS Wales (in respect of Cardiff) at the time of the transaction completing.
- (c) **Commitment to relevant market** – The CMA will wish to satisfy itself that the purchaser has an appropriate business plan and objectives for competing in the pharmacy market.
- (d) **Absence of competitive or regulatory concerns** – Divestiture to the purchaser should not create a realistic prospect of further competition or regulatory concerns.²³⁹ In the case of a ‘swap’ transaction (see paragraph 9.62 this would apply to both areas where the licences were situated.

- *Potential purchasers*

- 9.58 We were told by the Parties and third parties that the current market for the sale of pharmacies was buoyant, and that currently pharmacies were changing hands frequently and without difficulty. One third party (Well) stated that there was currently an over-supply of pharmacists in the market and therefore there were a number of pharmacists who were looking to buy a pharmacy to secure a job. Prices for pharmacies were not coming down even with the proposed changes in funding in England. Well stated that the purchase price for pharmacies was usually based on a turnover ratio, currently around £1 to £1.10 for every £1 of annual turnover.
- 9.59 We were told by third parties that there was nothing that made the sites unattractive from a buyer’s perspective. We received evidence from third parties who told us that they were interested in acquiring pharmacies in the local markets where we provisionally found an SLC. Most third parties were either not interested in all the pharmacies or believed they would not be

²³⁹ In considering whether a divestiture is likely to give rise to competition concerns, we will apply the same framework to competition assessment as we have used in our analysis of competitive effects in the investigation.

suitable purchasers for all of the pharmacies. Third parties also believed that other pharmacy chains would be interested in acquiring licences as well as independent pharmacies and individual pharmacists.

- 9.60 Celesio told us that it had [§]. It therefore did not anticipate any difficulty in identifying suitable purchasers in any of the SLC areas.
- 9.61 Celesio told us that its expectation was that its pharmacies would be sold to one or more existing pharmacy operators, which by definition would already meet the regulatory requirements to operate in the market. Celesio told us that it would consider selling a package of pharmacies to a single purchaser but that it was more likely there would be a number of purchasers as a result of possible competition concerns in individual areas. Celesio also considered that any SLC could equally be addressed by way of individual disposals (given the local nature of the market, and the ability of smaller chains and independent pharmacies to compete strongly).
- 9.62 Celesio said that it might wish to ‘swap’ a licence in lieu of a sale, and that this was dependent on the nature of the bidders for the stores and their offers. It argued that a swap could fulfil all relevant CMA criteria provided that it did not raise any competition issues.

- *Conclusion on purchaser risk*

- 9.63 In our assessment of competitive effects, we did not find a difference between the local effects exercised between pharmacy chains, independents and single retailers. As a result we do not rank potential purchasers simply by the number of pharmacies they currently own or the financial performance of those pharmacies. Our purchaser suitability criteria would also not rule out a new entrant from being a suitable purchaser, ie a person or a company that is not on a pharmaceutical list or at the start of the process does not have a fitness to practise certificate. However, we considered that it would be more difficult for new entrants to satisfy our divestiture time frame (see paragraph 9.83).
- 9.64 We also consider that as a purchaser(s) must meet the above suitability criteria it did not make a difference whether Celesio decided to sell a package of pharmacies or pharmacies individually.
- 9.65 We considered that a swap transaction might be as effective in addressing the SLC in a local market as a simple sale and purchase. However, there must be no potential competition concerns in both the area where the pharmacy is divested and where it is acquired. Second the divestiture of the Lloyds

pharmacy needs to be achieved within the divestiture time frame, even if the other part of the 'swap' (Lloyds purchase) does not occur at the same time.

Asset risk

9.66 As the final part of our assessment of the effectiveness of divestitures in each of the local markets where we had found an SLC (paragraph 9.25) we assessed asset risk. We assessed the divestiture process and whether there is a need to protect the assets to be divested with a monitoring trustee or the divestiture process with a divestiture trustee.

- *Divestiture process*

9.67 An effective divestiture process requires an appropriate timescale for achieving a divestiture and procedural safeguards to minimise the risk that the assets to be divested will deteriorate before completion of the divestiture, for example through the loss of customers or key members of staff. This requires an assessment of:

- (a) the stages involved in a sale process to determine an appropriate time frame and to determine when completion takes place and therefore the SLC is addressed;
- (b) whether an upfront purchaser is required; and
- (c) whether there is a need to appoint a divestiture trustee and/or a monitoring trustee to oversee the divestitures to ensure that the pharmacies to be divested are maintained and preserved during the course of the process.

9.68 In relation to the sale of a pharmacy licence there are two processes involved: the commercial sale and purchase; and the regulatory approval. The interaction of these two processes shapes the overall structure of the sale process and the timeframe for divestiture.

9.69 The processes in divesting a pharmacy are:

- (a) Commercial:
 - (i) marketing of the pharmacy;
 - (ii) agreement of heads of terms and negotiation of a sale and purchase agreement;

- (iii) exchange of contracts (the point at which the transaction becomes legally binding); and
- (iv) property contracts negotiation (freehold sale or assignment of the lease).

(b) Regulatory:

- (i) application by the purchaser to NHS England/Wales to transfer the NHS contract – minimum 60 days plus 30 days appeal process; and
- (ii) following receipt of notice of transfer from the NHS the transferee has to put in its notice to change GPhC contract. It is at the point when the transfer notice is received from the NHS that a date is set for completion (the commencement date, ie the date on which the purchaser would commence operation of the pharmacy).

9.70 The Parties submitted that it would take six months to identify suitable purchasers for the affected sites, conclude signed agreements and meet the regulatory requirements (broadly three months to agree the sale with a suitable purchaser and a further three months to obtain regulatory approvals).

9.71 Third parties provided a range of time frames from two to three months up to a maximum of 15 months.²⁴⁰ Most third parties, however, considered that six months would be sufficient to divest the pharmacies given the current demand for licences. A third party told us that within this time frame the regulatory aspects of transferring the licence would require not less than three months from application and that this time frame could not be shortened.

9.72 Third parties highlighted two potential issues that could delay the time frame for completion, being:

- (a) **Property:** the assignment of a lease was dependent on how willing the landlord was to consent to the assignment of the lease and the speed with which it wished to proceed.

²⁴⁰ Boots (3 to 6 months); [8] (the quickest transactions have been completed within six months whilst the longest period has been 15 months); Day Lewis (not less than three months, excluding the marketing process); Rowlands (it would take six months to sell).

(b) Regulation:

- (i) Transfer of the NHS contract: we were told that currently NHS England was taking longer than the prescribed 60 days to process the transfer of the NHS contract.
- (ii) Fitness to practise: if a business has a 'Fitness to Practise'²⁴¹ certificate then it does not require a further assessment. For a new entrant with no 'Fitness to practise' certificate it would need to apply to the NHS to obtain one. Third parties told us that the application usually took two to three months to be approved. A third party told us that if an existing pharmacy contractor already had a Fitness to Practise certificate, it believed it normally took less than two to three months for approval depending on which NHS Area team was dealing with the application.²⁴²
- (iii) Relocation: relocation of a licence requires separate application to NHS to be made.

9.73 Parties also told us that completion would need to happen at a month end to enable the accounting for NHS prescription income to occur.

9.74 One third party ([REDACTED]) said that a possible option to expedite the process would be for a buyer to hold the licence in name; everything would be transferred except the licence and property. It added that prescriptions would be dispensed in the seller's name and the seller would then pay the buyer for these prescriptions. It told us that this would mean that the purchaser would take on the risk of the transfer notice not being granted (low if it has a 'Fitness to practise' certificate), and more importantly the transfer of the property if leasehold requiring landlord consent. In this context the purchaser would need to be financially strong enough (ie a reasonably sized pharmacy operator) to be able to accept this risk – ie so that the landlord would not be able to 'reasonably withhold consent for the transfer of the lease'.

9.75 The Parties similarly submitted that the CMA should allow the completion of the sale of a divestment pharmacy to occur prior to the pharmacy licence

²⁴¹ Under the NHS (Pharmaceutical and Local Pharmaceutical Services) Regulations 2013, pharmacies are required to provide a Fitness to Practise declaration to NHS England (through their local NHS Team) when they join the pharmaceutical list, and to keep the local NHS Team updated if they are subject to any incident which may affect their Fitness to Practise.

²⁴² The [Certificate of Current Professional Status and fitness to practise history \(CCPS\) application form](#) states that a CCPS will usually take about two to three weeks to be prepared, which is then sent directly to the authority indicated on the application for approval.

being formally transferred (at least where there is an external cause for delay which may make the six-month timetable untenable).

- 9.76 The Parties and third parties believed that there was no reason to prevent the merger being completed prior to the divestiture of the licences in the local SLC areas.

- *Conclusion on divestiture process*

- 9.77 We considered that the appropriate time frame for completion of the divestitures was [REDACTED] (the Divestiture Period). We considered that the divestiture period should end on the **commencement date**, ie the date on which the purchaser would commence operation of the pharmacy under the divested licence. If the commencement date is significantly different to completion date as a result of the intentions of the purchaser we reserve the right to use completion date or a date thereafter (but prior to commencement date) as the effective end of the divestiture period. This will be assessed on a case-by-case basis as required. During this period, however, we will also be looking to assess the progress being made towards divestiture by Celesio and/or the purchaser. We considered that the key milestones to assess this process were as follows:

- (a) Agreement of heads of terms and negotiation of a sale and purchase agreement.
- (b) Exchange of contracts.
- (c) Application to NHS England/Wales for change of ownership by the purchaser.
- (d) Receipt of agreement from NHS England/Wales on change of ownership.
- (e) Submission of application to GPhC by the purchaser.
- (f) Completion.
- (g) Commencement date.

- *Monitoring trustee/divestiture trustee*

- 9.78 Celesio said that there was no need to appoint a monitoring trustee or put in measures to maintain the divestiture assets during the divestiture period. [REDACTED]. It stated that its reputation and the regulatory environment prevented it from degrading the service and that this meant that the assets would not be at risk of deterioration during the sale process. Celesio also told us that it was in its

interests to maintain the stores as any deterioration would be reflected in a reduced sales price.

- 9.79 Celesio said it would be disproportionate to require the appointment of an external trustee (at what it said would likely be a considerable cost) to oversee Celesio's compliance with a limited number of relatively straightforward and targeted interim measures. It said its compliance could be assured without the need for oversight from an external trustee, due to the consequences (legal, financial and reputational) that could flow from non-compliance. It said that Lloyds could provide monthly statements of compliance in relation to any interim measures.
- 9.80 Third parties told us that there was a risk that the competitiveness of the divestiture stores could be diminished by Celesio in the period between the final report and the completion/commencement date. This could arise from:
- (a) Transfer of repeat prescription customers to the Sainsbury's store.
Although this would not be possible without the customers' consent, it would be possible for Lloyds to engage with customers during this period to solicit those customers moving their repeat prescriptions to the Sainsbury's pharmacy.
 - (b) Reduction in stock levels leading to more stock 'outages'.
 - (c) Reduction in staffing or changes in opening hours, although opening hours might require regulatory approval.
 - (d) Moving staff.
 - (e) Customers being encouraged in the Lloyds pharmacy to be divested to move from that pharmacy to either another Lloyds pharmacy in the local area or the Sainsbury's pharmacy.
- 9.81 The Parties also submitted that there was no need to appoint a divestiture trustee. Celesio stated that it did not anticipate any difficulty in attracting interest from a number of suitable potential purchasers given the buoyant nature of the pharmacy market, and the appointment of a third party specialist ([§]) to run the sales process would ensure a fair and transparent process. The Parties said that a divestiture trustee was therefore unnecessary. The Parties further submitted that even if they did not appoint a third party to divest the pharmacies, given the interest already received there was no reason to believe that a divestiture would not be achieved within the divestiture period.

9.82 Third parties told us that they believed Celesio should be allowed to sell the sites itself and that there was no need for a divestiture trustee.

- *Conclusion on asset risk*

9.83 As explained in paragraph 9.77 we considered that the appropriate time frame for completion of the divestitures should be [X] and the timings and milestones should be as set out in paragraph 9.77.

9.84 We recognise that Celesio has an incentive to maintain the assets to protect its reputation. We also note that regulation means that some aspects of the service cannot be changed without NHS approval. However, in our view this does not mean that there are no risks of deterioration associated with the sale process. We recognised that the sale value of an asset would reduce if an asset was degraded. However, we did not consider that this provided sufficient protection against such a degradation occurring because Celesio would benefit from the buyer being a less effective competitor in the local market. This would mean the SLC would not be addressed effectively.

9.85 Our view is that undertakings are required to preserve the viability of the pharmacies to be divested pending the completion of the relevant divestiture.

9.86 We considered that the following measures should be put in place to reduce the risk of this happening (see below). These measures will be applicable individually to each local area and be in place until commencement date in each individual area – ie in Beaconsfield the interim undertakings will remain in place until the commencement date of the divested Beaconsfield pharmacy:

(a) Lloyds not to initiate the transfer of its staff from the local divestiture pharmacy, and to encourage the relevant Lloyds staff to stay at the local divestiture pharmacy.

(b) Lloyds not to solicit the transfer of customers from the divestiture store to either other Lloyds pharmacies or the Sainsbury's pharmacy in the local area. The measure includes:

(i) for stores within the SLC areas, limiting the physical changes Lloyds can make to its pharmacies inside the Sainsbury's store so that the changes can only be made to the pharmacy itself (ie no changes within other parts of the Sainsbury's store or outside the Sainsbury's store); and

(ii) the publicity for the change of ownership from Sainsbury's to Lloyds of these pharmacies should only be available at the pharmacy premises (as defined by the register on the GPhC premises list),

except for the letters and emails to customers concerning the change that have already been sent. This means, for example: no change in external signage at the Sainsbury's store or within the Sainsbury's store outside the pharmacy premises and no advertising through, for example, local press of the Lloyds pharmacy within Sainsbury's or leaflets within the Sainsbury's store.

(c) Maintenance of POMs and P-medicines stock, staffing levels and opening hours.

- 9.87 In addition, we will need to approve the script that the Lloyds pharmacy staff in each of the areas are going to be given to inform customers of any change to ensure it does not undermine the competitiveness of the pharmacy during the divestiture period.
- 9.88 We considered that these undertakings will need to be monitored. The CMA's usual practice is to appoint a monitoring trustee to carry out this activity. We noted Celesio's comments about proportionality, but also noted third party comments which suggested that there was a risk that the competitiveness of the divestiture stores could be diminished by Celesio in the period between the final report and the completion/commencement date. We consider that a monitoring trustee will be required in this case. To seek to minimise the burden on Celesio the monitoring trustee would have a suitably focused brief that concentrated on the key areas of potential harm.
- 9.89 Our usual practice is not to require the appointment of a divestiture trustee at the outset of the divestiture process.²⁴³ We note that the appointment of [X] to effect the sale of the pharmacies provides further assurance that we will not need to appoint a divestiture trustee at the start of the divestiture process.²⁴⁴ In line with our normal procedures, we will reserve the right to appoint a divestiture trustee at the end of the divestiture period, or during this period if we have reason to expect that Celesio will not procure divestiture to a suitable purchaser within [X].
- 9.90 Finally, if for whatever reason the pharmacy chosen to be divested in a local area is not capable of being divested to a suitable purchaser within the

²⁴³ CC8, paragraph 3.26 states: 'If the merger parties cannot procure divestiture to a suitable purchaser within the initial divestiture period, then, unless this period is extended by the [CMA], an independent divestiture trustee may be mandated to dispose of the package within a specified period (the trustee's divestiture period) at the best available price in the circumstances, subject to prior approval by the [CMA] of the purchaser and the divestiture arrangements. If the [CMA] has reason to expect that the merger parties will not procure divestiture to a suitable purchaser within the initial divestiture period, the [CMA] may require that a divestiture trustee is appointed before the end of the initial divestiture period, or in unusual cases, at the outset of the divestiture process.'

²⁴⁴ We have also reviewed Christie & Co's sale mandate to ensure it can result in an effective divestiture, ie it is capable of achieving the criteria discussed in paragraphs 9.21–9.91.

divestiture time frame we reserve the right to require either Celesio or a divestiture trustee (if appointed) to sell a different pharmacy or pharmacies to remedy the SLC in that local area.

Conclusion on effective remedies

9.91 We therefore conclude that:

- (a) the behavioural remedy proposed by the Parties would not be effective in addressing the SLC and we consider that a behavioural remedy that addresses all potential impacts on quality would be difficult to specify and would give rise to difficulties in monitoring compliance;
- (b) prohibition of the merger would be effective in addressing the SLC; and
- (c) a local divestiture in each of the 12 local markets where we have found an SLC to a suitable purchaser would be effective in addressing the SLC. The pharmacies to be divested are set out in Table 2 and each divestiture would need to include the elements described in paragraph 9.34.

Proportionality

- 9.92 Having concluded that either prohibition or divestiture of the pharmacies specified in Table 23 represented effective remedies, we now consider proportionality. We consider two remedy options to be effective: prohibition and divestment of the pharmacies specified in Table 23 (one in each of the 12 local markets where we have found an SLC). Given that our SLC findings only affect a small number of pharmacies relative to the overall transaction we consider that a divestment of pharmacies in each of the areas where we have identified an SLC would represent a more proportionate remedy to the SLCs identified.
- 9.93 Our guidance states that for a completed merger we would not usually take account of costs or losses that will be incurred by the merger parties as a result of a divestiture remedy.²⁴⁵ Whilst we have treated the merger as anticipated, we note that it has many of the features of a completed merger. In particular, there is no ability for either party to withdraw from the Transaction and the Transaction was not made conditional on competition authorities'

²⁴⁵ CC8, paragraph 1.10, states: 'For completed mergers, the [CMA] will not normally take account of costs or losses that will be incurred by the merger parties as a result of a divestiture remedy as it is open to the parties to make merger proposals conditional on competition authorities' approval. It is for the parties concerned to assess whether there is a risk that a completed merger would be subject to an SLC finding and the [CMA] would expect this risk to be reflected in the agreed acquisition price. Since the cost of divestiture is, in essence, avoidable, the [CMA] will not, in the absence of exceptional circumstances, accept that the cost of divestiture should be considered in selecting remedies.'

approval – Celesio has assumed the competition risk arising from the Transaction. As a result, it is doubtful whether the costs associated with divestiture should be taken into account in this case. However, we also note that the Parties and third parties told us that there was a buoyant market for pharmacy sales (paragraph 9.58), so we would expect Celesio to obtain full value for the required divestitures. In light of these factors, we consider that the required divestitures in specified local areas are a proportionate remedy to the harm to competition, and resulting customer detriment, that may otherwise be expected to result from the merger (see paragraph 7.364).

- 9.94 As discussed in paragraph 9.88 we consider that it is necessary to appoint an external monitoring trustee but will structure the brief for the monitoring trustee to minimise the burden while still making the monitoring trustee effective.

Relevant customer benefits

- 9.95 The Parties and third parties told us that there were no RCBs that should be taken into account in our assessment of the most appropriate remedy. We do not consider that there are any RCBs which are relevant to our assessment.

Conclusion on remedy options

- 9.96 We conclude that one local divestiture in each of the 12 local markets where we have found an SLC would be an effective and proportionate remedy to address the SLC we have found.