Anticipated acquisition by Post Office Limited of Payzone Bill Payments Limited

Decision on relevant merger situation and substantial lessening of competition

ME/6759/18

The CMA's decision on reference under section 33(1) of the Enterprise Act 2002 given on 19 October 2018. Full text of the decision published on 12 November 2018.

Please note that [✂] indicates figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

SUMMARY

1. Post Office Limited (**Post Office**) has agreed to acquire Payzone Bill Payments Limited (**Payzone**), a newly created company comprising the bill payment systems (**BPS**) businesses of Payzone UK Limited and Alphyra Payment Services Limited (**Alphyra**) from Payzone UK Limited (**Payzone UK**) (the **Merger**). Post Office and Payzone are together referred to as the **Parties**.

2. The Competition and Markets Authority (**CMA**) believes that it is or may be the case that each of Post Office and Payzone is an enterprise; that these enterprises will cease to be distinct as a result of the Merger; and that the share of supply test is met. Accordingly, arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

3. The Parties overlap in the supply of BPS services in the UK. A BPS terminal allows consumers to make payments (eg of utility bills) over the counter in retail stores. These payments are predominantly made in cash, without the consumer necessarily needing either a bank account or debit/credit card. The Parties also overlap in the supply of pick-up/drop-off (**PUDO**) services for parcel carriers in the UK. Royal Mail, which has an exclusive agreement with

Post Office, is active as a parcel carrier in the UK, and therefore is also a customer for PUDO services.

4. The CMA has assessed the impact of the Merger in the supply of BPS services in the UK. The CMA's investigation indicates that there is, in practice, very limited head-to-head competition between Post Office and Payzone at present, reflecting the highly differentiated nature of the Parties' offerings. In addition, the Parties' combined market position (as reflected in their combined share of supply) is relatively modest and the increment brought about by the Merger is limited (given Payzone's moderate market presence). The CMA therefore considers that the Merger will not result in the removal of a significant competitive constraint on the Parties. The merged entity will continue to be constrained by PayPoint plc (**PayPoint**), which is by far the largest player on the market at present, with the available evidence also indicating that the merged entity will likely be better placed to compete effectively against PayPoint than either of the Parties are at present.

5. The CMA also assessed whether the Merger could give rise to vertical effects as a result of input foreclosure by preventing rival parcel carriers from access to retail outlets that offer PUDO services. The CMA found that the merged entity would not have the ability to engage in such a strategy.

6. The CMA therefore believes that the Merger does not give rise to a realistic prospect of a substantial lessening of competition (**SLC**) as a result of horizontal unilateral effects or vertical effects.

7. The Merger will therefore **not be referred** under section 33(1) of the Enterprise Act 2002 (the **Act**).

ASSESSMENT

Parties

8. Post Office was a wholly-owned subsidiary of Postal Services Holding Company Limited (the **Holding Company**) until June 2017 when the Holding Company entered voluntary liquidation and the shares in Post Office were distributed to the Department for Business, Energy and Industrial Strategy. Post Office provides a wide range of products and services, including postage stamps, ID services and financial services to the public through its network of branches across the UK. The turnover of Post Office in the financial year ending 30 September 2017 was approximately £957m, all of which was achieved in the UK.

9. Payzone is a newly created company comprising the BPS business of Payzone UK and the BPS business of Alphyra (a wholly-owned subsidiary of Payzone Holdings Limited). The turnover of Payzone in the financial year ending 26 March 2017 was approximately £8 million, all of which was achieved in the UK.

Transaction

10. The Merger relates to the acquisition of the share capital of Payzone by Post Office.

Jurisdiction

11. As a result of the Merger, the enterprises of Post Office and Payzone will cease to be distinct.

12. The Parties overlap in the supply of BPS services in the UK, with a combined share of supply of [40-50]% (on the basis of the number of retailer locations in which BPS services are installed), with the Merger bringing about an increment of [20-30]%. On this basis, the CMA believes that the share of supply test in section 23 of the Act is met.

13. The CMA therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

14. The initial period for consideration of the Merger under section 34ZA(3) of the Act started on 24 August 2018 and the statutory 40 working day deadline for a decision is therefore 19 October 2018.

Counterfactual

15. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). For anticipated mergers, the CMA generally adopts the prevailing conditions of competition as the counterfactual against which to assess the impact of the merger. However, the CMA will assess the merger against an alternative counterfactual where, based on the evidence available to it, it believes that, in the absence of the merger, the prospect of these conditions continuing is not realistic, or there is

a realistic prospect of a counterfactual that is more competitive than prevailing conditions.[1]

16. The Parties submitted that the correct counterfactual against which the competitive effects of the proposed merger should be assessed is one where Payzone exits the market within the next [✄] years, with its market share being acquired mainly by PayPoint, [✄].

17. In forming a view on an exiting firm scenario, the CMA will consider:[2]

(a) whether the firm would have exited (through failure or otherwise) *(Limb 1)*; and, if so

(b) whether there would have been an alternative purchaser for the firm or its assets to the acquirer under consideration *(Limb 2)*; and

(c) what would have happened to the sales of the firm in the event of its exit. *(Limb 3)*

18. To accept an exiting firm scenario at phase 1, the CMA would need (on the basis of compelling evidence) to believe that it was inevitable that Payzone would exit the market and be confident that there was no substantially less anti-competitive purchaser for the firm or its assets.[3] The CMA would then need to conclude that the Merger does not represent a substantially less anti-competitive outcome than what would have happened to the sales of Payzone in the event of its exit.

19. Where, based on the evidence available, the CMA is unable to reach a sufficient level of confidence on each of the considerations set out above, it will use the pre-merger competitive conditions as the relevant counterfactual.[4]

20. The CMA has considered the Parties' submissions within this framework, as set out below.

Limb 1 – would Payzone inevitably have exited the market?

21. The Parties submitted that Payzone has continued to lose material numbers of clients and retailers over a prolonged period of time. Payzone has not won

[1] *Merger Assessment Guidelines* (OFT1254/CC2), September 2010, from paragraph 4.3.5. The *Merger Assessment Guidelines* have been adopted by the CMA (see *Mergers: Guidance on the CMA's jurisdiction and procedure* (CMA2), January 2014, Annex D).

[2] *Merger Assessment Guidelines* (OFT1254/CC2), September 2010, paragraph 4.3.8.

[3] *Merger Assessment Guidelines* (OFT1254/CC2), September 2010, paragraph 4.3.10.

[4] *Merger Assessment Guidelines* (OFT1254/CC2), September 2010, paragraph 4.3.10.

a client tender for BPS services, on a stand-alone basis,[5] since November 2016 and has only won a single utility client in the last decade. Payzone told the CMA that it had developed secondary sources of income (eg late payment fees and revenues from parcel services), which had allowed it to offset the loss of BPS revenues to some extent. Payzone also told the CMA that these secondary revenue streams depended on the size of its BPS network and therefore that a further loss of clients and retailers would also threaten these sources of income. As a result, the Parties submitted that Payzone's business was no longer commercially viable in the medium- to long-term.

22. The CMA notes that the available evidence supports the position that Payzone is encountering material commercial difficulties. The CMA does not, however, consider that this evidence shows, to the required legal standard, that the exit of Payzone is inevitable for reasons of financial failure. In particular:

(a) As set out the Merger Assessment Guidelines, the CMA's analysis of the counterfactual is affected by the extent to which events or circumstances and their consequences are foreseeable, enabling the CMA to predict the counterfactual with some confidence.[6] Many of the claims made by the Parties appear to be highly speculative in the absence of accompanying compelling evidence.

(b) Payzone is ultimately owned by GrovePoint Capital, which acquired Payzone in December 2015. The CMA has not been provided with compelling evidence indicating that, absent the Merger, GrovePoint Capital would have ceased Payzone's operations in the UK. In particular, the Parties have not provided any contemporaneous written evidence of exit being recommended or even considered at any point prior to the Merger by Payzone (or GrovePoint Capital).

(c) The CMA notes that [✂]. The impact of this change in focus on Payzone UK's BPS business is not clear (and therefore the CMA cannot exclude that Payzone's commercial difficulties could have been addressed [✂]).

(d) The evidence on Payzone's performance is not sufficiently compelling for the CMA to be able to reliably conclude that Payzone would have continued to decline to the point of exiting the market absent the Merger.

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[5] In 2016, Payzone and Post Office were invited to respond for a pre-qualification questionnaire issued by [✂]. Post Office inadvertently missed the deadline for submitting a bid and Payzone approached Post Office to seek agreement to be put forward to [✂] as part of an extended BPS network on a sub-contracting basis. Payzone was awarded the contract ahead of PayPoint, the incumbent.

[6] *Merger Assessment Guidelines* (OFT1254/CC2), September 2010, paragraph 4.3.2.

In particular, the CMA notes that none of Payzone's current clients had indicated an intention to terminate their contracts.

23. Accordingly, for the reasons described above, the CMA does not believe that the available evidence is sufficiently compelling for the CMA to conclude, to the required standard, that the exit of Payzone from the market was inevitable.

Conclusion on Counterfactual

24. For the reasons set out above, the CMA believes that the requirements of Limb 1 of the exiting firm test have not been met. It has therefore not found it necessary to consider Limb 2 or Limb 3 of the exiting firm scenario.

25. The CMA therefore believes that the appropriate counterfactual against which to assess the Merger is the prevailing conditions of competition. The CMA has considered submissions that the competitive constraint imposed by Payzone will become weaker in the competitive assessment.

Market Context

26. As noted above, the Parties are both active in BPS services and PUDO services. By way of background, and to inform the analysis of the relevant frames of reference and competitive assessment that follows in this decision, the CMA first provides an overview of the market context within which these services are provided.

BPS services

27. BPS services are over-the-counter payments, made predominantly in cash, which are offered by retailers, without the consumer necessarily needing either a bank account or debit/credit card.

28. The BPS market can be described as two-sided because suppliers compete for:

    (a) clients, ie companies who issue bills to consumers, for example utility companies and local authorities;[7] and

    (b) retailers, ie outlets that host the BPS terminals, for example small convenience stores, retailer chains or retail multiples.

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[7] Smaller clients often contract with the BPS suppliers through resellers, such as Allpay, Santander and Capita.

29. The two-sided nature of the market arises from the existence of indirect network effects between clients and retailers.

30. Clients are attracted by BPS networks that are able to provide a large volume of transactions. A BPS supplier's network is attractive if it offers:

(a) a large number of retailers;

(b) 'high quality' retailers (ie where a higher volume of transactions performed at each retailer);

(c) retailers with long opening hours; and

(d) large population coverage through the network.

31. Retailers prefer BPS suppliers with more clients. This increases the number of transactions (for which a retailer is paid) and the footfall at the store. Retailers prefer BPS suppliers with:

(a) a greater number of clients, both overall and across as many sectors as possible, in order to increase the chances of a retailer being seen as a 'one-stop shop' (ie with consumers able to pay multiple bills at a single outlet); and

(b) large clients (ie clients that have significant numbers of consumers likely to pay their bills through BPS).

32. This indicates that a positive network externality exists between the two sides of the market. In order to win over clients, the BPS supplier needs to demonstrate to the client that it has a wide enough network of retailers. Similarly, to win over the retailers in signing up their stores to the BPS network, the BPS supplier needs to demonstrate to the retailer that it has a sufficient number of clients signed up. The more types of bills a consumer can pay over the BPS network, the more likely they are to come to the store to pay bills and purchase other retail goods during the same visit.

33. The available evidence indicates that the BPS market is generally in decline, having recorded at least a 7% year-on-year decline since 2014/15. According to Payments UK,[8] the total number of cash payments in the UK, as well as the cash share of total consumer payment values, has been declining. More specifically, the Payments UK 2017 report showed that the share of cash

[8] Payments UK was a trade association for financial institutions, technology firms and payment processing companies in the UK. It merged with a number of other British financial organisations in July 2017 to form UK Finance.

payments overall in the UK declined by approximately 35% during the 10-year period 2006-2016.[9] Meanwhile, contactless payments, online banking and mobile banking increased their shares of payments in the UK during the same period.

34. The CMA notes that BPS services are likely to be particularly important for vulnerable consumers.[10] Around 1.5 million households in the UK have no bank accounts and a further 1 million have basic bank accounts but prefer to use cash.[11] Digitally-excluded consumers are also more likely to use BPS services to pay bills, compared to those with access to the internet.

PUDO services

35. A PUDO service allows for parcels to be picked up and/or dropped off at specified locations.

36. In a pick-up service, the originating sender of the parcel is typically a business (usually an online retailer) and the recipient of the parcel is typically a consumer (or individual who placed the order), who chooses the location and time to collect the parcel.

37. In a drop-off service, the originating sender specifies the location at which the consumer can return an item they have purchased (and how this should be done), with the consumer selecting the drop-off location from the options provided by the originating sender.[12]

38. The PUDO location is often a local shop or retail outlet that typically forms part of a wider network of PUDO locations. PUDO locations and networks include:

(a) Retail/grocery chains (such as Morrisons and Co-op), which offer PUDO services via their networks of local shops;

(b) the Post Office network, which offers PUDO services at local Post Office branches;

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[9] Payments UK, *UK Payments Market Summary*, 2017

[10] See Competition and Markets Authority, *Competition and Markets Authority Annual Plan 2018/19*, March 2018, paragraph 1.9-1.12.

[11] Citizens Advice, *Banking with benefits: exploring the need for basic banking in a world of Universal Credit,* September 2016.

[12] PUDO services can also include providing a drop-off and collection point for customers sending single piece parcels.

(c) outlets with the ability to store parcels (such as petrol station forecourts, pubs, Amazon Lockers); and

(d) independent retailers, newsagents and convenience stores that may belong to a BPS network (eg Payzone or PayPoint).

39. As with the market for BPS services, the market for hosting PUDO services can be described as two-sided. Parcel carriers (eg Royal Mail, Hermes, Yodel) have contracts with online retailers/businesses to pick-up/drop-off their items at PUDO locations. The host of the PUDO location/retail outlet, which also has a contract with the parcel carrier, receives a transaction fee from the parcel carrier for each PUDO transaction it carries out. In addition to the transaction fee, retail outlets also benefit from the additional footfall that PUDO services bring to their stores. There is typically no direct financial transaction between the consumer and the PUDO location/retail outlet.

40. The total number of PUDO locations in the UK is currently estimated to be more than 40,000.[13] The available evidence indicates that parcel carriers currently have agreements in place with certain networks of PUDO locations:

(a) Royal Mail has an agreement with the Post Office, which accounts for around 11,500 PUDO locations;

(b) Drop & Collect Limited (trading as **Collect+**) has an agreement with PayPoint, which accounts for around 7,000 PUDO locations through PayPoint's retailer network;

(c) Hermes has an agreement with Payzone, which accounts for around 200 PUDO locations through Payzone's retailer network (although Hermes has approximately 4,500 PUDO locations in total); and

(d) Other parcel carriers, such as United Parcel Service (UPS), DHL International (UK) Limited (DHL) and Doddle Parcel Services Limited (Doddle) contract with retail multiples or other PUDO locations (such as individual convenience stores).[14]

Frame of reference

41. Market definition provides a framework for assessing the competitive effects of a merger and involves an element of judgement. The boundaries of the market do not determine the outcome of the analysis of the competitive

[13] Citizens Advice, *Mapping Parcel Shops*, May 2018.
[14] Responses from third parties to the CMA's investigation.

effects of the merger, as it is recognised that there can be constraints on merging parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others. The CMA will take these factors into account in its competitive assessment.[15]

42. The Parties overlap in the supply of BPS services in the UK and the supply of PUDO services in the UK.

Product scope

43. As explained in paragraphs 28 to 32 above, the Parties provide their products and services to two distinct and unrelated groups of customers: clients and retailers, where the willingness of clients to use the Parties' networks depends on the participation of retailers on the networks, and vice versa.

44. As explained in the Guidelines,[16] the implementation of the hypothetical monopolist test may be more complicated when products are two-sided. The number of customers in each group affects the profitability of the product, because the value that one group of customers realises from using the intermediary depends on the participation of customers from the other group (indirect network effects). Prices charged to each set of customers take account of the need to get both sets 'on board'.

45. As set out in the Guidelines, a hypothetical monopolist test may be more difficult to conduct in a two-sided market because:

(a) there is no single price to both sets of customers to which to apply a SSNIP;

(b) the effect of a SSNIP on the demand of one set of customers may be exacerbated by indirect network effects; and

(c) the constraints on the merger firms' products may come not only from other two-sided intermediaries but also from 'one-sided' firms serving one set of customers.[17]

46. The CMA considered whether separate markets should be defined on each side of the BPS or PUDO platform. As noted in *Just Eat/Hungryhouse*, a distinction can be made between two-sided markets which facilitate

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[15] *Merger Assessment Guidelines*, paragraph 5.2.2.
[16] *Merger Assessment Guidelines*, paragraph 5.2.20.
[17] *Merger Assessment Guidelines*, paragraph 5.2.20.

transactions between customers on each side of the platform (such as auction houses or credit card services) and those two-sided platforms which do not facilitate transactions (eg 'media-type' platforms like radio stations and newspapers).[18] In some two-sided markets, which do not facilitate transactions between each side of the platform, the platform suppliers may face materially different competitive constraints on each side of the market.[19] In those cases, it may be necessary to define two separate markets: one on each side of the platform, with distinct product and geographic scopes and separate sets of competitors and competitive constraints.[20]

47. In this case, where the platform is 'matching' or facilitating transactions (in relation to both BPS and PUDO services), the CMA considers that analysing the Merger by reference to a single frame of reference is appropriate. As set out below, this assessment takes account of the competitive constraints on both sides of the market and assesses the hypothetical monopolist's ability to increase the price of executing a transaction, taking account of the number of substitutes on each side of the market and the impact of any indirect network effects.

Supply of BPS services

48. The Parties submitted that the appropriate product frame of reference was for all BPS services because the same BPS infrastructure is used for all types of bill payments and all BPS providers approach retailers with the fullest possible range of bill-issuing clients (with the possible exception of mobile top-ups).

Mobile top-up

49. The CMA first considered whether the frame of reference for BPS should include mobile top-up payments.

50. The Parties submitted that mobile top-ups could potentially be split out as a separate segment of the BPS market on the basis that it is an adjacent niche area in being purely pre-pay and it is possible to purchase mobile top-ups at a larger number of locations and facilities.

51. The CMA's investigation found that:

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18 See *Just Eat and Hungryhouse*, 16 November 2017, paragraph 4.11.

19 For example, a local radio station may face very different constraints in the market for selling advertising from those it faces in the market for attracting listeners.

20 *Merger Assessment Guidelines*, footnote 60.

(a) Pay-as-you-go sim cards can be topped up through the BPS networks of Post Office (through Epay), Payzone or PayPoint. In addition, Epay offers this service through its own network.

(b) Epay has the highest share of supply within a separate segment for mobile top-up payments. In addition, while Post Office offers mobile top-up services to consumers, it does so as a reseller of Epay's services (and therefore does not offer this service to mobile phone operators on a stand-alone basis). There would therefore be no overlap between Post Office and Payzone within a separate segment for the supply of mobile top-up services (and the inclusion of mobile top-up services within a broader segment for BPS could understate the Parties' competitive significance given the presence of Epay).

(c) There are material commercial and technical differences between the supply of mobile top-up services and BPS. In particular, the technology used by Epay for mobile top-ups is different from that used by the Parties for clients in other sectors, as mobile top-ups can be made using the electronic point of sale (**EPOS**) terminal of the retailer rather than a separate BPS terminal. Moreover, the transaction fee is computed as a percentage of the amount being topped up, rather than a fixed amount per transaction.

52. On the basis of the evidence described above, the CMA considers that mobile top-ups should not be included within the supply of BPS for the purposes of the frame of reference. The CMA notes, however, that market definition can be left open because competition concerns would not arise under an alternative market definition that included mobile top-ups as part of BPS (or within a separate segment for mobile top-up services). Mobile top-up services are therefore not considered further in this decision.[21]

Pre- and post-pay

53. Post-pay transactions are made for services are the subject of regular payments by consumers, for example utility bills, housing rent and council tax, which are paid once every month or once every quarter. They are generally of higher bill value but less frequent than pre-pay transactions.

54. Pre-pay transactions are made for services which require payments before the product or service is supplied, for example, top-up of electricity keys, gas card recharging and energy tokens. These are more frequent transactions

[21] No third parties raised any competition concerns in relation to the supply of mobile top-ups in the UK.

and, on average, consumers visit retailers to make pre-pay transactions up to three times per week.

55. The Parties submitted that clients procure BPS as a whole and that clients and retailers always appoint the same BPS provider for both pre- and post-pay transactions.

56. A third party however told the CMA that, in the energy sector, there was limited substitutability between pre- and post- payment services for legacy meters, noting that banks provided post- payment services, but did not provide pre-payment services. Energy suppliers were therefore unable to easily shift consumers between post- and pre-payments, as this would involve a change of meter and depend on the end consumer's choice of payment method.

57. In light of the differences between the services described above, the CMA considered whether the frame of reference should be segmented into pre- and post- pay transactions.

58. The CMA's investigation found that the same terminals are used for pre- and post-pay transactions and that all retailers offer both pre- and post-payments. The Parties, clients and resellers told the CMA that pre- and post-pay transactions are usually procured together, and retailers always appoint the same BPS supplier for both pre- and post-pay transactions. PayPoint told the CMA that its pricing, client and marketing strategies did not vary between pre- and post-pay services.

59. The CMA also found that, in post-pay transactions, Payzone was particularly weak with a [0-5]% share of supply by number of transactions and Post Office had a [30-40]% share of share. In pre-pay transactions, the Parties combined share of supply was around [10-20]%. These shares of supply would indicate limited head-to-head competition between the Parties if the frame of reference was segmented further.

60. The CMA has considered BPS services for pre- and post-pay transactions within the same frame of reference. The CMA has not found it necessary to conclude on the appropriate frame of reference as no competition concerns arise on any reasonable frame of reference.

Sectors

61. Clients for BPS are active across a range of sectors (eg energy, water or transport). Data provided by the Parties' data suggested that the market position of the Parties varied between different sectors (eg Post Office has a share of [70-80]% in telecoms but [10-20]% in energy). The CMA therefore

considered whether the frame of reference should be segmented to appropriately reflect any differences in the conditions of competition between different industry sectors.

62. The CMA found that:

(a) On the retailer side, BPS suppliers use the same networks of retailers for all clients, irrespective of the sector.

(b) There are positive externalities between the sectors, as winning clients in one sector helps BPS networks attract clients in other sectors because of the positive impact on attracting retailers. This means that any potential price increase to clients in a sector would have an (indirect) impact on clients in other sectors.

(c) Post Office, Payzone and PayPoint all compete for all clients, irrespective of the sector. While each supplier's existing position varies, at least to some extent, between different sectors, suppliers appear to be bid in a consistent manner across all sectors. The CMA noted, in this regard, that all three firms had participated in almost all of the tenders within the tender data submitted by the Parties, irrespective of the sector or the client. Indeed, PayPoint stated that its business strategy (eg clients, marketing) did not vary across sectors.

63. The CMA has therefore considered BPS services for all sectors as part of the same frame of reference.

Supply of PUDO services

64. The Parties both supply PUDO services to parcel carriers. Post Office provides PUDO services through its Post Office branches,[22] with Payzone providing PUDO services through its network of Payzone retail outlets, using the retail outlets that have extended their contract with Payzone to enable them to act as PUDO locations.

65. The Parties argued that the appropriate frame of reference for the supply of PUDO services should include not only those retailers that are linked to a BPS network, but also all other retailers and outlets that host PUDO services. According to the Parties, this would include supermarkets, DIY stores, petrol station forecourts and pharmacy chains, among others (which, for the most part, provide pick-up and/or drop-off facilities for their own retail operations).

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[22] Post Office branches include two agency models of postmasters, Main and Local, and managed Post Office branches (formerly called Crown Post Office branches) which are run by Post Office Limited employees.

The Parties also submitted that the market could include both pick-up and drop-off volumes (which would, in practice combine home shopping returns and 'click & collect' volumes). Payzone submitted that there is no difference for Payzone or its retail outlets between pick-up and drop-off as regards the terms of transaction fee paid to the retailer, or other commercial arrangements.

66. The CMA considers, however, that retailers that perform only 'self-supply' PUDO services (ie where a consumer can order from an online retailer and collect at the same retailer's physical store, for example Argos) should be excluded from the product scope because their sales are captive and not part of the merchant market. The CMA notes, in this regard, that these retailers are not an alternative source of supply for parcel carriers (as they service only their own demand for PUDO services).

67. Therefore, the CMA has considered that the supply of PUDO services (excluding 'self-supply') as an appropriate frame of reference.

Conclusion on product scope

68. For the reasons set out above, the CMA has considered the impact of the Merger in the following product frames of reference:

- the supply of BPS services; and
- the supply of PUDO services.

69. The CMA notes, however, that the appropriate product frame of reference can be left open because competition concerns would not arise under any plausible market definition.

Geographic scope

Supply of BPS services

70. The Parties submitted that the market for the supply of BPS services is UK-wide on the basis that:

(a) BPS suppliers typically offer their clients access to their entire retail terminal network and the prices offered by the BPS suppliers to clients are typically set on a customer basis;

(b) contracts with clients are generally negotiated at the national level or through resellers in the case of regional clients (eg local authorities), with one price set for the entire network;

(c) retailers are paid the same fee for each contract irrespective of their location and most contracts with the retailer merchants tend to be negotiated nationally; and

(d) marketing activities of Post Office and Payzone are also largely carried out at a national level on both the client and retailer sides.

71. Third parties told the CMA that competition mainly occurs at national level. For example, PayPoint explained that its pricing, clients and marketing strategies (or any other strategy) do not vary across geographic areas of the UK.

72. The CMA has therefore assessed the impact of the Merger on the supply of BPS on the basis of a UK-wide frame of reference.

Supply of PUDO services

73. The Parties submitted that the market for the supply of PUDO services is UK-wide.

74. The CMA notes that Post Office hosts PUDO services for Royal Mail and Payzone hosts PUDO services for Hermes, with both agreements having been entered into on a national basis, with the pricing set at the national level and access granted to the entire network of retailers.

75. The CMA has therefore assessed the impact of the Merger on the supply of PUDO services on the basis of a UK-wide frame of reference.

Conclusion on geographic scope

76. For the reasons set out above, the CMA has considered the impact of the Merger on the basis of a UK-wide frame of reference.

Conclusion on frame of reference

77. For the reasons set out above, the CMA has considered the impact of the Merger within the following frames of reference:

- the supply of BPS services in the UK; and
- The supply of PUDO services in the UK.

Competitive assessment

Horizontal unilateral effects

78. Horizontal unilateral effects may arise when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm profitably to raise prices or to degrade quality on its own and without needing to coordinate with its rivals.[23] Horizontal unilateral effects are more likely when the merging parties are close competitors. The CMA assessed whether it is or may be the case that the Merger has resulted, or may be expected to result, in an SLC in relation to horizontal unilateral effects in the supply of BPS services.

79. The Parties submitted that the Merger would not give rise to competition concerns because the Parties are not close competitors and that, by combining two largely complementary businesses, the merged entity expects to be in a position to compete more effectively with PayPoint.

80. In order to assess the likelihood of the Merger resulting in unilateral effects, the CMA has considered in particular:

(a) the Parties' shares of supply;

(b) the closeness of competition between the Parties;

(c) the competitive constraint imposed by PayPoint; and

(d) third party views.

Shares of supply

81. The Parties provided estimates of shares of supply for the BPS services market. In this case, shares of supply can be compiled based on the number of transactions performed through a network, on the value of all transactions, or on the number of retailers belonging to each network. The CMA refined the market share estimates through its market testing.

Table 1: Shares of supply in the supply of BPS services for 2017

	2017		
	Transactions	**Revenue**	**Locations**
Post Office	[10-20]%	[20-30]%	[20-30]%

[23] *Merger Assessment Guidelines*, from paragraph 5.4.1.

Payzone[24]	[0-5]%	[0-5]%	[20-30]%
Combined	*[20-30]%*	*[20-30]%*	*[40-50]%*
PayPoint	[70-80]%	[70-80]%	[50-60]%
Epay	[0-5]%	[0-5]%	[0-5]%
TOTAL	100%	100%	100%

Source: CMA analysis of data from the Parties and third parties

82. The Parties' combined share of supply by transaction volume in 2017 was [20-30]%, with an increment of [0-5]% resulting from the Merger. The Parties' combined share of supply by revenue in 2017 was [✂], at [20-30]%, with an increment of [0-5]% resulting from the Merger. The Parties' combined share of supply (at [40-50]%) and the increment brought about by the Merger (at [20-30]%) are more significant when compiled on the basis of the number of locations within each supplier's network. The CMA notes that the Parties have a higher share of supply by number of locations, but considers that this measure is likely to provide a less accurate representation of competitive significance (eg because it will not reflect differences in the quality – in terms of footfall and geographic coverage – of suppliers' networks).

Closeness of competition

Closeness of competition on the retailer side between the Parties

83. On the retailer side, the Parties submitted that there are significant commercial differences between the offerings of Post Office and Payzone which means that there is limited head-to-head competition between the Parties in practice.

84. The CMA's investigation confirmed that the Parties' respective offerings to retailers are different and that there is very limited head-to-head competition between Post Office and Payzone on the retailer side in practice. In particular:

    (a) If a retailer decides to become a Post Office branch, the retailer must take and offer the full suite of Post Office products. Post Office does not charge its retailers (ie Post Office branches) separately for the BPS service and stated that [✂].[25] By contrast, Payzone contracts separately for BPS services (typically as a stand-alone offering) and charges a fee of [✂] for the BPS service.

24 2017 data is not yet available for Payzone, so the Parties provided absolute values for 2016 instead.

25 As the provision of BPS services forms part of the broader suite of services offered under the contract between Post Office and Post Office branches.

(b) While Post Office's network has more rural coverage (53% of Post Office's locations are in rural areas), Payzone's network is more urban than Post Office's (85% of Payzone's locations are in urban areas).

(c) Post Office branches (which are mostly open between 9am to 5:30pm) typically also have significantly more limited opening hours than Payzone retailers (which are generally retail multiples and convenience stores). This indicates that the Parties tend to focus on different types of retailer in practice.

85. Post Office's internal documents consistently show that it views Payzone as having a complementary network of convenience stores (rather than as a focus for head-to-head competition for retailers). Payzone's internal documents showed that it was concerned about the reducing quality of its retailers in terms of consumer footfall and geographic coverage and viewed Post Office's network as being a premium network (compared to its own).

86. The CMA's investigation confirmed that there is a lack of competitive interaction between the Parties and limited switching between the Parties on the retailer side. PayPoint, retailers and the retailers' associations (the Association of Convenience Stores and National Federation of Retail Newsagents) told the CMA that the Parties' had different offerings. Some retailers stated that Post Office and Payzone were not close alternatives. One retailer told the CMA that while it does not see Post Office and Payzone individually as credible alternatives at present, if the Parties combined and were able to offer a comparable range of services and the technological capability of PayPoint, the merged entity would be a very credible alternative to PayPoint.

87. In the round, the CMA considers that the evidence described above indicates that the Parties' offerings are considerably differentiated and that the Parties provide a limited constraint on each other, on the retailer side, at present.

Closeness of competition on the client side between the Parties

88. On the client side, the Parties submitted that Payzone's network is too small and lacks the rural coverage to be the sole BPS provider for clients, whereas Post Office's offering is different in terms of the geographic coverage and brand that it offers to clients.

89. The CMA's investigation confirmed that the Parties' respective offerings to clients are different and that there is very limited head-to-head competition between Post Office and Payzone on the client side in practice. In particular:

(a) The differences in the Parties' retailer networks (eg in terms of geographic scope and opening hours), as described above, mean that the offering they provide to clients is very different;

(b) Consistent with this differentiation, there are significant differences in the Parties' pricing to clients. Post Office typically charges [✂]. The CMA believes that the fact [✂] suggests that Post Office has a materially different client offering.

90. This is consistent with evidence submitted by the Parties showing that clients that Payzone failed to win cited its less attractive network of retailer merchants as a key reason for their departure. For example, in two tender results (for [✂] and [✂]), clients explicitly stated that Payzone scored low, among other things, in relation to network coverage. The evidence submitted by the Parties showing that Payzone's retailer network has continued to decline over the last few years suggests that Payzone's ability to attract clients is likely to further decrease in future absent the Merger.

91. The evidence from the Parties' internal documents was mixed but generally showed that Payzone has rarely been considered by Post Office as its closest competitor. A small number of Post Office documents identified Payzone as a competitor. A more significant proportion of Post Office's internal documents tended to show, however, that Post Office considered Payzone as a complementary network to its own, and that its main competitor was PayPoint.

92. Some clients who responded to the CMA's merger investigation told the CMA that Post Office had a different offering to Payzone and PayPoint. Clients cited Post Office's rural coverage and restricted opening hours, as opposed to the urban focus and longer opening hours of Payzone and PayPoint. Clients also told the CMA that Post Office was a strong and trusted brand and that they were likely to choose a combination of Post Office and one of Payzone or PayPoint.

93. The Parties further submitted that the existing constraint exercised by Payzone on Post Office is likely to further reduce in future. In this regard, the Parties submitted that Payzone was increasingly falling behind in the market for BPS services: its limited network did not allow Payzone to win clients, which, in turn, limited its attractiveness to retailers. The Parties told the CMA that Payzone had ceased to provide any strong competitive pressure on PayPoint or Post Office and its competitive strength was certain to decrease further over time, due to the presence of indirect network effects in the BPS market.

94. To support this position, the Parties submitted that Payzone's transactions had declined by an average of [✂] per year over the past three years. The Parties suggested that if this trend continued, Payzone's transaction volume – of [✂] in FY2017 – would fall to [✂] by FY2021. The Parties also noted that Payzone's market share had shrunk by over [70-80]% in the last seven years, from [10-20]% in 2010 to its current share of approximately [0-5]%.

95. As noted in paragraph 33 above, the use of BPS services is generally in decline, as non-cash payment options become more widespread. The CMA notes, however, that Payzone's decline is more marked than that of the other two firms in the BPS market. For example, while Payzone's BPS revenues decreased by [✂] from 2012/13 to 2016/17, the revenues of Post Office fell by [✂] over the same period with those of PayPoint falling by [✂]. Payzone also had the largest annual percentage decrease in BPS revenues of all suppliers for nearly every single year within this period, with the exception of 2015/16.

96. The increasing weakness of Payzone's competitive offering is also consistently evidenced in its internal documents, with documents indicating, for example, [✂].

97. In the round, the CMA considers that the evidence described above indicates that, while there has been some competitive interaction between the Parties in the past, Payzone does not currently exercise a strong constraint on Post Office. Moreover, the CMA considers that the available evidence also indicates that any constraint exercised by Payzone on Post Office (and PayPoint) would be likely to reduce further in future absent the Merger.

The competitive constraint imposed by PayPoint

98. The only competitor in the BPS services market is PayPoint. The Parties submitted that PayPoint is the strongest player within the BPS segment and the biggest constraint on each of them.

99. In assessing the constraint imposed by PayPoint, the CMA has considered, in particular, tender data submitted by the Parties, the internal documents of the Parties and views of third parties.

100. The CMA found that the available evidence supports the Parties' position that PayPoint has the strongest position of any supplier of BPS and has typically been the most significant constraint on both Parties.

101. For example, the available bidding data (which constituted 14 instances between 2013 to 2018 where either or both Parties had bid for a client) indicates that:

(a) All three competitors (ie Post Office, Payzone and PayPoint) were almost always invited to bid by the clients;

(b) PayPoint was selected by the client as BPS provider in all 14 tenders in the available bidding data, including the two tenders where the client was seeking an exclusive BPS supplier (ie BBC and Severn Trent Water).

(c) Post Office participated in all 14 tenders and was successful in 10 of them. Post Office was never the sole winner of any tender and was always appointed together with PayPoint (in six tenders) or with both PayPoint and Payzone (in four tenders).

(d) Payzone also participated in all 14 tenders and was successful in four of them. All of them were awarded on a non-exclusive basis, along with both PayPoint and Post Office.

102. The strong position of PayPoint is supported by Post Office's internal documents, which consistently show that it saw PayPoint as its primary competitor for BPS services. Post Office's internal documents also stated that [✄].

103. Third parties (clients and resellers) responding to the CMA's investigation were asked to indicate their preferences in terms of use of multiple BPS providers. These responses showed that:

(a) The vast majority of clients (all clients except one) stated that they had a preference for using multiple BPS providers so that they could achieve the maximum geographic coverage and fulfil their regulatory obligations;

(b) PayPoint was ranked as the first choice BPS supplier by [✄] clients that responded to the CMA's investigation; and

(c) Utility companies had mixed views in terms on whether any BPS supplier is a 'must-have'. [✄] stated that PayPoint was a must-have, [✄] and [✄] stated that Post Office was a must-have, while [✄] stated that it did not consider any BPS supplier to be a must-have.

104. PayPoint told the CMA that it competes with Payzone to be [✄]. PayPoint told the CMA that the Merger will enhance the market power already held by the Post Office and this will be [✄]. In particular, PayPoint told the CMA that the merged entity will be in a stronger position to [✄]. Therefore, in PayPoint's view, the Merger gives rise to [✄].

105. The CMA notes, however, that PayPoint's position is not consistent with the available evidence (as set out above). Indeed, the CMA believes that

PayPoint currently provides, and will continue to provide, the most significant competitive constraint on the Parties in particular because:

(a) PayPoint has a very strong and well-established position within the BPS market, as evidenced by its high market shares (with Payzone's market share being significantly higher than that of the merged entity on any basis);[i]

(b) under several metrics (including number of retailers and number of clients), PayPoint's network is stronger than both Post Office's and Payzone's;

(c) there is a low likelihood of PayPoint losing major contracts in the short-term, because of the length of contracts, the practical difficulties in switching highlighted by third parties, and the desirability of the bundle of products supplied by PayPoint for some customers;[26] and

(d) the evidence described above indicates relatively limited competitive interaction between Post Office and Payzone to be the number 1 BPS supplier, rather such competition appears to exist between Post Office and PayPoint.

The ability of the merged entity to compete more effectively with PayPoint

106. The Parties submitted that the Merger will create a credible alternative that will be able to more effectively compete with PayPoint.

107. As described above, the available evidence indicates that PayPoint is the clear market leader in terms of transactions and revenue, and currently has contracts with all major clients. PayPoint has a significantly larger retailer network than either of the Parties – [✂] retailers, compared to Post Office's 11,500 retailers and Payzone's [✂] retailers.

108. The available evidence also indicated that PayPoint's strong advantage over other BPS suppliers has allowed it to be successful in tenders despite offering prices significantly higher than Payzone. The CMA's investigation found that some clients considered that they had to offer BPS services through the PayPoint network, even though they were more expensive.

109. The CMA notes that a Post Office internal document stated that the merged entity's combined network would be much closer in size to that of PayPoint, with [✂] branches within half a mile of [80-90]% the population, which

[26] PayPoint offers a consolidated "3-in-1" terminal which covers not just the BPS service but also ancillary credit/debit card payments, which previously were done through separate terminals.

compares [✂] to PayPoint's [✂] branches within half a mile of [80-90]% the population (and Post Office at [60-70]% coverage on its own).

110. A number of third parties told the CMA that the merged entity would have a more competitive offering and would be able to provide a better counterbalance to PayPoint (although some noted that the effects of the Merger would be difficult to predict).

111. In the round, the CMA considers that the evidence described above supports the Parties' position that the merged entity will be able to compete more effectively with PayPoint than either of the Parties are able to at present. The CMA therefore considers, in assessing the effect of the merger on rivalry over time,[27] that the Merger is more likely to have pro-competitive effects within the market for BPS services.

Third party views

112. The majority of customers who responded to the CMA's questionnaire did not raise concerns about the Merger in relation to BPS services. In addition, various third parties stated that the merged entity would have a more competitive offering and provide a better counterbalance to PayPoint.

113. One competitor raised concerns that the "three-to-two" merger will enhance the market power already held by Post Office and this greater market power will give rise to higher prices and lower services to clients. However, for the reasons explained above, the CMA is of the view the Merger will not give rise to horizontal unilateral effects.

Conclusion on horizontal unilateral effects

114. For the reasons set out above, the CMA considers that Payzone does not currently exercise a strong constraint on Post Office and there is limited direct competition between the Parties. Post-merger, the Parties will continue to be constrained by PayPoint, which is by far the most significant competitor to each of the Parties at present.

115. The CMA notes, in this regard, that the Merger is more likely to have pro-competitive effects within the market for BPS services because the merged entity will be able to compete more effectively with PayPoint than either of the Parties are able to at present.

[27] *Merger Assessment Guidelines*, paragraph 4.1.3

116. For the reasons set out above, the CMA therefore believes that the Merger does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in relation to the supply of BPS services in the UK.

Vertical effects

117. Vertical effects may arise when a merger involves firms at different levels of the supply chain, for example a merger between an upstream supplier and a downstream customer or a downstream competitor of the supplier's customers. Vertical mergers may be competitively benign or even efficiency-enhancing, but in certain circumstances can weaken rivalry, for example when they result in foreclosure of the merged firm's competitors. The CMA only regards such foreclosure to be anticompetitive where it results in an SLC in the foreclosed market(s), not merely where it disadvantages one or more competitors.[28]

118. Royal Mail is the major parcel carrier in the UK. Post Office has a long-term exclusive agreement with Royal Mail (due to end in 2022). Under this agreement, Post Office is required to procure that the retail outlets in the Post Office network provide PUDO services to Royal Mail on an exclusive basis.[29]

119. Third parties raised concerns that, post-Merger, Royal Mail and/or the merged entity might be able to automatically extend the exclusivity for the provision of PUDO services that currently attaches to the retail outlets in the Post Office network to the retail outlets in the Payzone network (or, alternatively, seek to encourage Payzone retailers to open Post Office branches in their stores). These third parties suggested that the exclusivity arrangements in Royal Mail's contracts with Post Office outlets could, if extended to the Payzone retail outlets, prevent those outlets from providing PUDO services to parcel carriers competing with Royal Mail (such as Hermes, Doodle and Collect+), resulting in the foreclosure of rival parcel carriers.

120. The CMA's approach to assessing vertical theories of harm is to analyse (a) the ability of the merged entity to foreclose competitors, (b) the incentive of it to do so, and (c) the overall effect of the strategy on competition.[30]

121. In the present case, the CMA has assessed whether the Merger could restrict an important input – retail outlets providing PUDO services– to parcel carriers

[28] In relation to this theory of harm 'foreclosure' means either foreclosure of a rival or to substantially competitively weaken a rival.
[29] Post Office must obtain the written consent of Royal Mail to provide PUDO services to competitors of Royal Mail.
[30] *Merger Assessment Guidelines*, paragraph 5.6.6.

competing with Royal Mail, harming those carriers' ability to compete with Royal Mail post-Merger.

Ability

122. The CMA assessed whether the Merger would bring about any change in Post Office's ability to engage in input foreclosure. In particular, the CMA considered whether the agreement between Post Office and Royal Mail would allow Royal Mail and/or the merged entity to extend the exclusivity obligations to retail outlets in the Payzone network post-Merger.

123. The Parties told the CMA that the exclusivity obligation described above only applies to retail outlets in the Post Office network (ie Post Office Branches) and will not automatically extend to the Payzone retail outlets post-Merger.[31] The Parties also told the CMA that the vast majority of retail outlets in the Payzone network are independently-owned and will not be owned by Post Office as a result of the Merger.[32]

124. The Parties also submitted that the retail outlets in the Payzone network will not become Post Office retail outlets post-Merger. The Parties noted that any decision by a retail outlet in the Payzone network to become a Post Office Branch would require it to transact a broader range of Post Office products and services on behalf of the Post Office. The Parties therefore consider that Payzone network outlets will only become direct agents of the Post Office (for the purposes of supplying PUDO services) where they opt to become Post Office branches (as they can already pre-Merger).

125. The Parties also submitted that Payzone's business and network will continue to be distinct from Post Office's branch network (including in terms of branding) and run as a separate subsidiary which retains its own contracts with clients and will therefore not be subject to the contractual arrangements between Post Office and Royal Mail.

126. Royal Mail submitted that the exclusivity clause in the agreement between itself and the Post Office only applies to the Post Office retail outlets and, post-Merger, would only apply to Payzone outlets (or retailers) carrying Post Office signage/branding.

127. Based on the available evidence, the CMA considers that the Merger does not bring about any material change in Post Office's ability to foreclose Royal

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[31] This does not apply to a very limited number of Payzone retail outlets that are also postmasters.
[32] A small number of Payzone retailers are also Post Office branches.

Mail's rival parcel carriers from access to retail outlets providing PUDO services.

128. In particular, the Merger will not bring about any change in Royal Mail's control over Payzone's retail network (the retail outlets will remain independently-owned and will not be subject to the exclusivity obligations that Post Office branches are subject to). While Payzone retailers could apply to become Post Office branches, if they are willing and able to meet the applicable requirements, this is already the case pre-Merger.

129. For completeness, the CMA also considered the range of alternative options for PUDO services available to parcel carriers competing with Royal Mail. As set out in paragraph 40, Payzone currently accounts for a minority of potential retail outlets for PUDO locations. More specifically, the CMA estimated that, realistically, Payzone's retailer network may account for approximately [5-10]% of potential PUDO locations.[33] There are therefore alternative options for PUDO locations outside of the Payzone network which would be available to parcel carriers.

130. Accordingly, for the reasons set out above, the CMA believes that the merged entity will not have the ability to foreclose parcel carriers competing with Royal Mail from access to retail outlets in the Payzone network. Accordingly, it is not necessary to assess whether Post Office/Royal Mail would have the incentive to pursue a foreclosure strategy and what effect this could have on competition in the supply of PUDO services.

Conclusion on vertical effects

131. For the reasons set out above, the CMA believes that the Merger does not give rise to a realistic prospect of an SLC as a result of vertical effects via input foreclosure of parcel carriers.

Barriers to entry and expansion

132. Entry, or expansion of existing firms, can mitigate the initial effect of a merger on competition, and in some cases may mean that there is no SLC. In assessing whether entry or expansion might prevent an SLC, the CMA

[33] The CMA looked at the proportion of PayPoint's network that is used as PUDO locations by Collect+ and applied the same ratio to Payzone's network. This is based on the assumption that PayPoint and Collect+ maximised the number of PUDO locations available, and that Payzone's retailers are equally able to offer PUDO services as retailers in PayPoint's network. The Parties also estimated that PayPoint may account for [5-10]% of UK PUDO locations, but that was based on a total market size including all locations that could potentially offer PUDO locations.

considers whether such entry or expansion would be timely, likely and sufficient.[34]

133. However, the CMA has not had to conclude on barriers to entry or expansion as the Merger does not give rise to competition concerns on any basis.

Third party views

134. The CMA contacted clients, retailers and competitors of the Parties, PUDO suppliers and other government departments. Third party comments have been taken into account where appropriate in the competitive assessment above.[35]

Decision

135. Consequently, the CMA does not believe that it is or may be the case that the Merger may be expected to result in an SLC within a market or markets in the United Kingdom.

136. The Merger will therefore **not be referred** under section 33(1) of the Act.

Colin Raftery
Senior Director, Mergers
Competition and Markets Authority
19 October 2018

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[i] Paragraph 105: The CMA notes that it incorrectly stated that Payzone's market share is significantly higher than that of the merged entity on any basis. It is PayPoint's market share that is significantly higher than the merged entity on any basis.

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[34] *Merger Assessment Guidelines*, from paragraph 5.8.1.

[35] Third parties did not raise any concerns regarding coordinated effects in relation to the Merger and the CMA has therefore not considered a coordinated effects theory of harm.