

Anticipated acquisition by Tesco Stores Limited of two former Kwik Save stores (Audley and Dudley)

No. ME/3343/07

The OFT's decision on reference under section 33(1) given on 30 October 2007. Full text of decision published 7 November 2007.

Please note that square brackets indicate text or figures which have been deleted or replaced with a range at the request of the parties for reasons of commercial confidentiality.

PARTIES

1. **Tesco Stores Limited** (Tesco) is a large national grocery retailer operating grocery stores of various sizes throughout the UK.
2. **Kwik Save Stores Limited** (Kwik Save) entered administration on 6 July 2007. **FreshXpress Retail Limited** and **FreshXpress Property Limited** (together FreshXpress) are carrying on Kwik Save's business under licence in continuation of and in succession to Kwik Save and with the right to direct the sale of the Kwik Save stores.

TRANSACTION

3. Tesco proposes to acquire two former Kwik Save stores in Audley and Dudley (the Acquisition Stores) from FreshXpress. The turnover associated with the Acquisition Stores is estimated to be around £2.8 million.
4. The transaction was notified by merger notice and the Office of Fair Trading's (OFT) statutory deadline for deciding whether to refer the merger to the Competition Commission (CC) is 30 October 2007.

JURISDICTION

5. As a result of this transaction Tesco and the Acquisition Stores will cease to be distinct. The parties overlap in the supply of grocery retailing, and post-merger will account for over 25 per cent of all grocery retailing in the UK. As a consequence the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

RELEVANT MARKET

Product market

6. The OFT and the CC have drawn distinctions in previous cases between different types of grocery shopping trips and the abilities of different sized stores and fascias to cater for different grocery requirements.¹ The types of shopping trips identified include 'one-stop shopping', 'top-up shopping' and 'convenience shopping'.² The set of competitor stores relevant to the analysis in previous cases has been identified with respect to both store size and store fascia.
7. In past cases the OFT and the CC have broadly classified grocery stores into the following store size categories:

Type of store	Net retail area
One-stop	above 1,400 sq m
Mid-range	280 – 1,400 sq m
Convenience	below 280 sq m

¹ OFT's decision on the *Completed acquisition by Somerfield plc of 114 Safeway stores from Wm Morrison Supermarkets plc*, 23 March 2005; CC's report on the *Acquisition by Somerfield plc of 115 stores from Wm Morrison Supermarkets plc*, September 2005 (hereafter referred to as *Somerfield/Morrisons*); CC's report on *Safeway plc and Asda Group Limited (owned by Wal-Mart Stores Inc), Wm Morrison Supermarkets Plc, J Sainsbury plc and Tesco plc*, 18 August 2003 (hereafter referred to as *The Safeway Report*); CC's Groceries market investigation (ongoing, hereafter the Groceries Investigation).

² The CC used the term 'secondary shopping' to describe other shopping trips designed to top-up or to complement the main shopping trip (*The Safeway Report*, paragraph 5.4).

8. In the context of its ongoing Groceries Investigation, the CC has recently published an 'Emerging Thinking' document³ and a working paper⁴ setting out its initial thinking in relation to issues of market definition for the groceries sector. The OFT shares the CC's current view contained in these papers that competitive constraints in relation to the supply of groceries are asymmetric - as larger stores place a greater constraint on smaller stores than vice versa.
9. The OFT has considered the competitive constraint that each of the Acquisition Stores provides at both the national and local levels. The OFT has also identified those fascia that might significantly constrain the merging parties' stores in terms of both price and non-price parameters of competition, which the CC abbreviates to price, quality, range and service (PQRS) to capture the complex competitive proposition that rival grocery stores offer to local shoppers.
10. The set of stores which are considered as effective competitors for secondary shopping is more limited than for convenience stores. In respect of secondary shopping (served by both one-stop and mid-range stores) the CC in *Somerfield/Morrisons* identified the effective competitor set as incorporating Asda, Booths, Budgens, Co-op, Somerfield/Kwik Save⁵, Morrisons/Safeway, Sainsbury's, Tesco and Waitrose. The CC is continuing to assess this view in the context of the Groceries inquiry, and in the absence of more concrete conclusions from the CC's current investigation, the OFT has adopted a cautious approach and not widened the effective competitor set beyond the above (while accepting that there may be an argument that Kwik Save should no longer be in this group).
11. For convenience stores, all fascias listed above, as well as Iceland, Marks & Spencer, symbol stores and the limited assortment discounters Aldi, Lidl and Netto (LADs) are considered as being effective competitors.
12. The two Acquisition Stores have 285 square metres (Audley) and 316 square metres (Dudley) of net retail area, and are therefore classified as mid-range stores although they might be expected to operate as convenience stores rather than mid-range stores (because they are close to

³ *CC Groceries Market Investigation: Emerging Thinking*, 23 January 2007, paragraph 12.

⁴ *CC Working paper on market definition*, May 2007.

⁵ When that report was published Kwik Save was still owned by Somerfield.

the 280 square meters threshold). Tesco [] argues that it is appropriate to consider the Acquisition Stores as convenience stores.

13. The OFT considers that, on this occasion, the Acquisition Stores should be considered as mid-range stores for the purposes of competition assessment. First, it is the loss of competition in mid-range stores that is the relevant concern in this merger. Second, the OFT cannot be certain of when, whether and for how long the Acquisition Stores will be converted into convenience stores. However, the fact that this transaction deals with the acquisition of only two stores allowed the OFT to consider the stores under both frames of analysis for the sake of completeness.

GEOGRAPHIC MARKET

14. In previous investigations in the grocery retail sector the OFT and the CC have concluded that the scope of the geographic frame of reference is essentially local, as most consumers are prepared only to travel a limited distance for their grocery shopping, and that distance may vary according to the type of shopping trip required.
15. At the same time, on the supply-side, national dimensions of competition also exist.⁶ Key decisions affecting the operation of stores and other aspects of their business (such as supplier relationships and general promotional activity) are taken centrally on a national basis.
16. In providing its analysis of this case Tesco supplied information using each of the geographic frames of reference used by the CC in *Somerfield/Morrisons* for mid-range and convenience stores, that is:
 - Mid-range stores - five minute (for urban areas) to ten minute (for rural areas) drive-time isochrones drawn around individual stores
 - Convenience stores - one mile radius.
17. The OFT has considered the local circumstances for each of the Acquisition Stores and found no evidence to suggest that the application of this approach would be inappropriate in this instance.

⁶ Such as national advertising, promotional activity, purchasing arrangements, etc.

HORIZONTAL ISSUES

Market shares

National issues

18. Tesco state that, according to recent TNS data, its current national market share of grocery sales is 27.3 per cent. The increment caused by the merger will be minimal (significantly less than one per cent) based on Kwik Save's current sales. Even if both Acquisition Stores were thriving, the increment at a national level would still be negligible. Hence, the merger does not give rise to any substantive competition issues on a national basis.

Local issues

19. In *Somerfield/Morrisons* the CC concluded that the loss of competition between acquirer and target stores in each market would result in higher prices (including fewer local promotions), and/or a reduction in quality, and/or range and/or service compared with that available in other stores through unilateral effects. In addition, the CC noted that customers in the relevant areas would lose the benefit of being able to choose between the formerly competing stores, for example between different prices, qualities or ranges of goods on offer, or services provided. Should one of the stores be shut, at least some of its existing shoppers would lose the benefit of choice between more or less accessible locations.
20. In *Somerfield/Morrisons*, the CC applied a filtering methodology for mid-range and convenience stores which was used as an initial screening for potential competition concerns. Stores which did not pass this filter were assessed in more detail, by considering diversion ratios.
21. For mid-range stores, the first phase filter involves sequentially applying and examining relevant-sized isochrones centred on:
 - a) one of the parties' stores (the primary isochrone)
 - b) each relevant competitor's store located within the primary isochrone
 - c) population centres within the primary isochrone
 - d) census output areas within the primary isochrone.

22. At each sequential stage, the approach identifies isochrones (and relevant stores) subject to a local fascia reduction of four to three, or less, in stores above 280 square metres. For convenience stores, the four to three fascia reduction rule was applied to one-mile radii centred on the parties' stores and local competitor stores.
23. The two Acquisition Stores pass both the mid-range and the convenience store filters. In Audley, there is no overlap within the primary isochrone and, for all of the recentring analysis (see paragraph 21 (b-d) above), at least four competing fascia remain. In a convenience store isochrone, there is no overlap between Tesco and the Audley Kwik Save store.
24. In Dudley, there is no reduction in fascia under a mid-range store analysis since the only Tesco in the isochrone is a Tesco Express, which is classified as a convenience store rather than a mid-range store. In a convenience store analysis the merger reduces the number of fascia from six to five.
25. One competitor had concerns about the store in Dudley because Tesco operate the nearest one-stop shop and two Tesco Express stores within a ten-minute drive time from the Dudley store. However, the OFT believes it is more appropriate to classify the area in question as urban and therefore use a five-minute drive time isochrone. Even if a rural isochrone is used (of ten minute drive-time), the merger only represents a reduction in the number of fascia in that area from five to four.
26. Moreover, on the basis of all the evidence available to the OFT, in particular local information and maps of the local areas provided by Tesco and by third parties, the OFT does not believe that there is any reason in this case to deviate from previous OFT and CC methodology (see for example the *Safeway report* and *Somerfield/Morrisons*), and therefore it does not believe that the merger can be expected to give rise to any competition concerns.

THIRD PARTY VIEWS

27. Some third parties expressed general concerns about the increasing levels of concentration in the supermarket sector but these were not specific to

this particular acquisition. One competitor had concerns about acquisition of the Dudley stores, which were dealt with above.

ASSESSMENT

28. Tesco overlaps with the Acquisition Stores in grocery retailing. Due to the very small market share increment, the merger does not cause any concerns at a national level. In neither of the local areas will there be, as a result of the merger, less than four effective competitors. Although third parties have expressed concerns about increased concentration in the grocery sector as a whole, any change in this respect as a result of this acquisition is negligible.
29. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

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