

Anticipated acquisition by Lincolnshire Co-operative Limited of a Budgens store in Holbeach, Lincolnshire, from Musgrave Retail Partners GB Limited

ME/6476/14

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

SUMMARY

1. Lincolnshire Co-operative Limited (**LCL**) is acquiring a mid-sized Budgens store located in Holbeach, Lincolnshire (**the Target**) from Musgrave Retail Partners GB Limited (**Musgrave Retail**). LCL and the Target together are hereinafter referred to as the '**Parties**' and the anticipated acquisition is referred to as the '**Merger**'.
2. The Competition and Markets Authority (**CMA**) considers that LCL and the Target will cease to be distinct and that the share of supply test is satisfied on the basis of certain grocery retailing in Lincolnshire. Accordingly, the CMA believes arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation. The CMA assessed the Merger against the prevailing conditions of competition.
3. The Parties overlap in the retail supply of groceries in Lincolnshire in the United Kingdom (**UK**).
4. The CMA found that the Merger will not result in a realistic prospect of a substantial lessening of competition (**SLC**) in the retail supply of groceries:
 - (a) on a national basis, due to LCL's minimal national market share and the Merger resulting in a minimal increase in this share; and
 - (b) on a local basis, due to the significant constraints imposed by a Tesco one-stop store (**OSS**), and survey evidence showing that the Parties are not close competitors.

5. The Merger will therefore **not be referred** for a Phase 2 investigation under section 33(1) of the Enterprise Act 2002 (**the Act**).

ASSESSMENT

Parties

6. LCL is an independent consumer co-operative in the UK. It is active in the retail supply of groceries in Lincolnshire and some surrounding counties and also operates pharmacies, travel agencies, funeral services, Post Offices and property letting services.
7. Musgrave Retail is the UK subsidiary of the Irish retailer Musgrave Group plc, which owns the Budgens brand name. There are over 180 Budgens stores across the UK, which are owned and operated by Musgrave Retail and other companies.¹
8. The Target comprises one mid-sized Budgens grocery store in Holbeach, Lincolnshire, which is owned and operated by Musgrave Retail. The turnover of the Target was approximately £[~~£~~] million in 2013.

Transaction

9. On 22 August 2014, LCL and Musgrave Retail entered into an agreement for LCL to acquire the Target, which includes the freehold in the land together with fixtures and fittings. It is considered that TUPE² will apply and that certain staff will transfer to LCL. The Merger is valued at approximately £[~~£~~] million (excluding VAT) and is conditional on Phase 1 clearance by 31 December 2014.

Jurisdiction

10. As a result of the Merger, LCL and the Target will cease to be distinct. The CMA considers that the Target constitutes an 'enterprise' for the purposes of section 23 of the Act.³

1 These other companies independently own the stores and trade under the name of Budgens.

2 Transfer of Undertakings (Protection of Employment) Regulations 2006.

3 See, for example, [ME/5176/11](#): anticipated acquisition by Asda Stores Limited of a grocery store in Tiptree, Essex, from East of England Co-operative Society Limited and Ardencrest Limited OFT decision dated 26 September 2011, where the OFT considered one grocery store to constitute an enterprise within the meaning of section 129 of the Act.

11. The Parties overlap in the supply of groceries in Lincolnshire in the UK, which the CMA considers is a reasonable description of a supply of goods.⁴ Based on the data⁵ submitted by LCL, the CMA considers that its share of supply following the Merger will be in excess of 25% in Lincolnshire for mid-sized grocery stores.⁶ The CMA considers that Lincolnshire constitutes a substantial part of the UK.
12. As such, the CMA considers that the share of supply test in section 23 of the Act is satisfied. 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.
13. The initial period for consideration of the Merger under section 34ZA of the Act commenced on 12 November 2014 and therefore the statutory deadline for the decision is 9 January 2015.

Product frame of reference

14. The Parties are both active in the retail supply of groceries. The Target is a mid-sized store (MSS) in Holbeach, Lincolnshire. LCL operates a MSS in Long Sutton, Lincolnshire, which is around five miles and a ten minute drive away from the Target.
15. The CMA, and its predecessor bodies the Office of Fair Trading (OFT) and the Competition Commission (CC) have in previous cases classified grocery stores according to their size and determined that the competitive constraints faced by such stores are asymmetric, as follows:⁷
 - (a) OSS:⁸ stores with a net sales area of more than 1,400 square metres (sqm). OSS are only constrained by other OSS.
 - (b) MSS: stores with a net sales area of less than 1,400 sqm but more than 280 sqm. MSS are constrained by other MSS and OSS.

4 See for example, most recently, ME/6466/14: anticipated acquisition by Asda Stores Limited of five grocery stores and three petrol filling stations from Co-operative Group Limited CMA decision dated 28 November 2014 ([Asda/Co-op five stores](#)).

5 LCL submitted gross internal area data, as net sales area data was not available.

6 Only taking into account the fascia as set out in Annex A of ME/4551/10: anticipated acquisition by Asda Stores Limited of Netto Foodstores Limited, OFT decision dated 23 September 2010 ([Asda/Netto](#)).

7 See for example, most recently, the CMA decision in [Asda/Co-op five stores](#) (see footnote 4).

8 The Merger does not include the sale of any OSS.

(c) Convenience stores:⁹ stores with net sales area of less than 280 sqm. Convenience stores are constrained by other convenience stores, MSS and OSS.

16. The CMA has not received any information in the present case to suggest that it should depart from the CMA, OFT and CC's previous decisional practice by considering a different segmentation by stores to that set out in paragraph 15.

Geographic frame of reference

17. The CMA notes that previous CMA and OFT decisions¹⁰ and the CC's Groceries Report¹¹ identified that the relevant geographic scope of the retail supply of groceries is essentially local, but that a national dimension of competition exists. At a national level, the OFT and CC have found that the largest national retailers (Tesco, Asda, Sainsbury's, Morrisons and Co-operative Group) constrain each other in an all grocery stores market. The CMA has followed the same approach in this case.

18. At a local level, the definition of the relevant geographic market has previously been determined on the basis of a variety of drive-time isochrones.¹² Specifically, in relation to the three store types identified in paragraph 15, the geographic scope has generally been defined as follows:

(a) for OSS: a ten minute drive-time isochrone in urban areas or a 15 minute drive-time isochrone in rural areas;

(b) for MSS: a five minute drive-time isochrone in urban areas or a ten minute drive-time isochrone in rural areas. MSS are also constrained by OSS within a ten minute drive-time isochrone in urban areas or a 15 minute drive-time isochrone in rural areas; and

(c) for convenience stores: in all areas a five minute drive-time isochrone. Convenience stores are also constrained by OSS within a ten minute drive-time isochrone in urban areas or 15 minute drive-time isochrone in rural areas and by MSS within a five minute drive-time isochrone in urban areas or a ten minute drive-time isochrone in rural areas.

19. The CMA has not received any information in the present case to suggest that it should depart from the geographic scope set out in previous CMA, OFT and

⁹ The Merger does not include the sale of any convenience stores.

¹⁰ See, for example, [Asda/Co-op five stores](#).

¹¹ Competition Commission: The supply of groceries in the UK market investigation (2008) ([CC's Groceries Report](#)).

¹² An isochrone is a line joining points of equal travel time (usually drive-time) from a given point.

CC decisions. For the purposes of the assessment of the local competitive effects arising from the Merger, the CMA has therefore used the geographic scope set out in paragraph 18. The CMA notes, however, that these geographic boundaries are merely a starting point for analysis and other evidence, such as customer surveys, may carry significant weight in its assessment.¹³

Conclusion on frame of reference

20. In line with previous decisional practice, the CMA considers that the relevant frame of reference for assessing the Merger is the retail supply of groceries at a national level and on the basis of the local geographic scope as set out in paragraphs 15 and 18 above.

Counterfactual

21. The CMA considers the effect of a merger compared to the most competitive counterfactual providing always that it considers that situation to be a realistic prospect. In practice, the CMA generally adopts the pre-merger conditions of competition as the counterfactual against which to assess the impact of the merger.¹⁴
22. The CMA considers that no evidence has been provided in the present case to suggest that a counterfactual other than the prevailing conditions of competition is appropriate and has therefore assessed the Merger against this counterfactual.

Competitive assessment

23. The CMA considers below whether the Merger results in a realistic prospect of an SLC through horizontal unilateral effects with respect to the retail supply of groceries at a national or local level. Unilateral effects can arise in a horizontal merger when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm profitably to raise prices on its own, or to reduce quality/innovation, without needing to coordinate with its rivals.¹⁵

13 See [Merger Assessment Guidelines](#) (joint publication of the Competition Commission and OFT, September 2010), paragraph 5.2.2. These have been adopted by the CMA, see Annex D to CMA2 Mergers: [Guidance on the CMA's Jurisdiction and Procedure](#), January 2014.

14 See [Merger Assessment Guidelines](#), paragraph 4.3.5.

15 See [Merger Assessment Guidelines](#), paragraph 5.4.1.

National grocery retailing

24. LCL and Musgrave Retail overlap in grocery retail on a national basis. The CMA does not have any national competition concerns on the basis that LCL's national market share is minimal¹⁶ and the Merger, since it involves only one grocery store, results in a negligible increase in this share.

Local grocery retailing

25. For the purposes of assessing the local effects of the proposed transaction, the CMA usually¹⁷ employs a filtering methodology which excludes areas that are very unlikely to be problematic. Where the merger would lead to a reduction in competing fascia to three or fewer, and consequently competition concerns cannot be ruled out,¹⁸ a more detailed assessment is then carried out.¹⁹
26. In previous decisions,²⁰ and consistent with the CC's Groceries Report, the OFT concluded that the effective competitor set of grocery retailers consists of large national grocery retailers and regional grocers, and symbol groups.²¹ Specialist retailers (for example, bakers or butchers),²² Limited Assortment Discounters (LADs)²³ and frozen food specialists have previously been excluded from this set.²⁴
27. The CMA notes that Holbeach – a small town in the South Holland district of Lincolnshire – is a rural area in accordance with the definitions followed in the OFT case of CGL/Somerfield.²⁵
28. LCL has undertaken a stage 1 filter in this local area to determine whether a more detailed assessment is warranted. As the area failed a primary filter,

16 LCL submitted that its annual sales in stores larger than convenience stores is approximately £[redacted] million and therefore its share of the grocery market in Great Britain is approximately [<1]% based on the total market for MSS and OSS being valued at around £109 billion.

17 Where there is only a limited number of stores being acquired, the CMA does not always consider it necessary in the analysis of a merger to follow a strict filtering approach (see [Asda/Co-op five stores](#)). However, the CMA takes into account many of the factors considered in the filtering methodology in its analysis of each local area.

18 [Merger Assessment Guidelines](#), paragraph 5.3.5.

19 See, for example, the OFT decision in [Midcounties/Tuffin](#), dated 18 October 2012.

20 ME/3777/08: anticipated acquisition by Co-operative Group Limited of Somerfield Limited, OFT decision dated 20 October 2008 ([CGL/Somerfield](#)).

21 Symbol group retailers operate stores under a common fascia (or symbol). Stores within a symbol group may be independently owned and use the common fascia under a franchise or membership agreement, or alternatively, may be directly owned by the symbol group or affiliated wholesalers.

22 Specialist stores will typically offer a limited range of products and operate during restricted hours.

23 LADs carry a limited range of grocery products and base their retail offer on selling these products at low prices. The major LADs in the UK are Aldi and Lidl.

24 [CGL/Somerfield](#), paragraph 18.

25 Urban areas are population areas of at least 10,000 people and all other areas are rural: [CGL/Somerfield](#).

indicating that the Merger resulted in a 3 to 2 reduction in fascia, LCL has then conducted a detailed assessment.

29. LCL commissioned a survey at the Target and LCL store in the overlap area in order to obtain an empirical estimate of the closeness of competition between the Parties.²⁶

Estimation of diversion

30. A diversion ratio is an empirical estimate of the closeness of competition between two parties. Diversion ratios are commonly estimated based on survey data, which seeks to ascertain where consumers would go if their first provider were not available. The raw consumer responses are combined with information on the consumers' spend in order to calculate a revenue weighted diversion ratio, which gives more weight to the responses of consumers who spend more. The revenue weighted diversion ratios between the Target and the LCL MSS offers a measure of the degree to which they are local competitors. The revenue weighted diversion ratios in this area are shown in the table below:

TABLE 1: Revenue weighted diversion ratios from the Target and from the LCL MSS store in the overlap area

Diversion to Fascia	From LCL MSS ²⁷ (%)	From Target ²⁸ (%)
LCL MSS	n/a	7.2
Target	0	n/a
Tesco	39.9	85.9
Spar	30.2	0.3
Asda	19.1	
Morrison's	4.7	
Sainsbury's	3.7	0.4
Aldi	1.2	1.8
Other Store	1.2	
One Stop		4.5

Source: Consumer survey commissioned by LCL

31. The survey found that the revenue weighted diversion ratio from the LCL MSS to the Target is nil and from the Target to the LCL MSS is 7.2%. In previous

26 The CMA notes that, although the Target store was divested in [CGL/Somerfield](#), no survey was undertaken in this area during that investigation.

27 Customer base was 62.

28 Customer base was 84.

decisional practice, the OFT has had prima facie concerns with diversion ratios of 14.3% or more.²⁹

32. The survey found that a Tesco OSS in Holbeach, which is much larger than both the Target and the LCL MSS, is the primary alternative grocery store for customers of both the Target and the LCL MSS, with diversion ratio estimates of 85.9% and 39.9% respectively. The CMA considers that this Tesco OSS is likely to act as a significant constraint on both the Target and the LCL MSS. The CMA notes that this Tesco OSS is close in proximity to the Target (approximately 0.5 miles and a two minute drive-time), and within the geographic scope (approximately 5.5 miles and a ten minute drive-time) of the LCL MSS.
33. The CMA has analysed the survey results by calculating confidence intervals around the mean estimates of diversion to ensure that the sample size is sufficient to give robust results. The CMA found that the confidence intervals were relatively narrow and that the upper bound of the 95% confidence interval for diversion from either the LCL MSS or the Target was under 14.3%. As such the CMA concludes that the survey results are robust.³⁰

Illustrative price rises (IPRs)

34. Diversion ratio estimates and gross margin data can be combined to estimate IPRs anticipated as a consequence of the internalisation of pre-merger competitive constraints. It is important to note that these are not 'predicted' price increases, but simply a relative measure of potential consumer harm arising from the reduction in competitive pressure. There are alternative IPR formulae depending on (a) whether demand is assumed to be linear or isoelastic, and (b) whether the diversion ratios, prices and marginal costs of the parties are assumed to be symmetric.
35. The CMA and OFT have used both symmetric and asymmetric IPRs in previous decisional practice. The CMA considers that symmetric IPRs are particularly relevant where there are no significant asymmetries between the merging parties (in terms of diversion ratios, variable margins and prices). Given that the Parties have not submitted any evidence to show that prices or margins are significantly asymmetrical between them, and consistent with

29 See, for example, [CGL/Somerfield](#) and [Midcounties/Tuffin](#). The CMA notes that, in the present case, it has not used this measure as a threshold for concerns but merely as one piece of evidence pointing to whether the Merger is likely to raise concerns. This is due to the present case relating to only one overlapping area.

30 The CMA notes that the sample sizes in this survey are relatively small but, given the robustness of the results, it believes weight can be ascribed to it.

previous decisional practice, in the present case the CMA has estimated symmetric IPRs assuming isoelastic demand.³¹

36. In previous cases,³² the OFT has considered that IPRs above 5% are more likely to give rise to competition concerns. However, this measure is only a guide as to whether a merger may give rise to a realistic prospect of an SLC and cannot be viewed as a definite threshold below which no concerns would arise.³³
37. The CMA has calculated a symmetric isoelastic IPR for the Target³⁴ of 1.7%. The CMA notes that this is substantially below the 5% which has previously been used as an indicator of prima facie concerns.
38. The CMA considers that both the diversion ratios and IPRs do not suggest any significant competition concerns resulting from the Merger.

Third party views

39. The CMA contacted and received representations from several third parties. None of these third parties raised concerns in relation to the Merger, or indicated that they planned to close their stores in the area.
40. Given the outcome of its competitive assessment, the CMA has not found it necessary to consider barriers to entry and/or expansion or countervailing buyer power.

Conclusion

41. The CMA considers that, based on the significant constraints imposed by the Tesco OSS, the low diversion ratios between the Parties' stores, the low IPRs and the lack of third party concerns, there is no realistic prospect of an SLC arising from the Merger.

31 In *Somerfield/Morrisons* (2005), the CC noted that if demand is isoelastic, the price elasticity of demand is constant at different price levels, whereas linear demand implies that the price elasticity rises as prices rise. The CC considered the latter to be an unreasonable assumption for groceries (and suggested that it was more plausible that demand would become less elastic at higher prices, when demand had already fallen). The CC concluded that the use of an isoelastic demand function was preferable.

32 For example, [Asda/Netto](#) and [Midcounties/Tuffin](#).

33 For example, [Asda/Netto](#) and [Midcounties/Tuffin](#).

34 The CMA notes that diversion from the LCL MSS to the Target is null so the IPR is zero.

Decision

42. 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 UK.
43. The Merger will therefore **not be referred** for a Phase 2 investigation under section 33(1) of the Act.

Andrew Wright
Director of Mergers
Competition and Markets Authority
18 December 2014