

# Anticipated acquisition by Poundland Group plc of 99p Stores Limited

**ME/6467-14**

The CMA’s decision on reference under section 33(1) of the Enterprise Act 2002 given on 9 April 2015. Full text of the decision published on 15 May 2015.

**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.**

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## SUMMARY

1. Poundland Group plc (**Poundland**) has agreed to acquire 99p Stores Limited (**99p**) (the **Merger**). Poundland and 99p are together referred to as the **Parties**.

2. The Competition and Markets Authority (**CMA**) considers that the Parties will cease to be distinct as a result of the Merger, that the turnover test is met and that 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 retail supply of value general merchandise at a single price point in the United Kingdom (**UK**).
4. The CMA considered that the appropriate frame of reference on which to assess the effects of the Merger is the retail supply of general merchandise by single price point retailers with national scale (**SPP retailers**) and value general merchandise retailers (**VGMs**) (as described in paragraph 32).
5. The CMA recognises that some competitive constraint is exerted on the Parties by retailers outside the frame of reference, and has therefore considered the competitive constraint imposed on the Parties by these retailers in its competitive assessment.
6. For the geographic frame of reference, the CMA assessed the effects of the Merger at a local level using a one mile catchment area as its starting point. The CMA also considered whether the Merger could result in the realistic prospect of a substantial lessening of competition (**SLC**) at a national level.
7. In its competitive assessment, the CMA considered whether there would be unilateral horizontal effects arising from the Merger that would allow the merged firm to profitably raise prices or, taking into account the Parties' single price point business model, lead to a reduction in promotional activity and/or allow the Parties to degrade the range, quality and/or service of their offer. The CMA also considered whether the Parties would be incentivised to close stores in a number of overlap areas post-Merger. The horizontal unilateral effects considered by the CMA were:
  - (a) loss of actual competition at a national level;
  - (b) loss of actual competition at a local level; and
  - (c) loss of potential competition.
8. It was unnecessary for the CMA to conclude as to whether the Merger would result in the realistic prospect of an SLC as a result of horizontal unilateral effects arising from a loss of actual competition at a national level. The CMA found that, in this case, any such anti-competitive effects would be generated as a result of the aggregate loss of competition at a local level and, therefore, this would be sufficiently captured by the CMA's local assessment.

9. The CMA found that there is a realistic prospect that the Merger will result in an SLC in 80 overlap areas as a result of a loss of actual competition at a local level.
10. In relation to a loss of potential competition, the CMA found that:
  - (a) there is a realistic prospect that the Merger will result in an SLC as a result of a loss of actual potential competition in 12 additional local areas where the Parties' pipeline stores will overlap with an existing store of the other party within a one mile radius, or slightly beyond this radius, and where there are currently fewer than four SPP retailers and VGM fascia in the local area; and
  - (b) the effect of the Merger on the Parties' expansion plans does not give rise to a realistic prospect of an SLC in any local areas not specified in the Parties' current pipeline of store openings.
11. The CMA assessed whether any countervailing factors exist which would prevent the realistic prospect of an SLC. It found that significant entry and expansion has taken place in the recent past by SPP retailers and VGMs in the UK, and continues to take place. However, the Parties did not provide compelling evidence that new competitors would enter into specific local areas where the CMA found an SLC. The CMA therefore found that entry and expansion would not be timely, likely and sufficient to prevent a realistic prospect of an SLC resulting from the Merger at a local level.
12. With regards to exceptions to the CMA's duty to refer, the Parties put forward arguments in relation to relevant customer benefits. However, the CMA did not consider that the evidentiary threshold for applying this exception to the duty to refer was satisfied.
13. The Parties have until 16 April 2015 to offer clear cut undertakings in lieu of a reference, in accordance with section 73 of the Enterprise Act 2002 (the **Act**), which comprehensively remove the competition concerns that the CMA has identified. If no such undertakings are offered, then the CMA will refer the Merger pursuant to sections 33(1) and 34ZA(2) of the Act.

## ASSESSMENT

### Parties

14. **Poundland** is a general merchandise retailer which adopts a single price point business model<sup>1</sup> in the 533 stores it operates in the UK under the 'Poundland' brand and in the 44 stores it operates across Ireland and Spain under the 'Dealz' brand.
15. Poundland is listed on the London Stock Exchange and generated sales of £997 million for the year ending March 2014, of which £828 million were generated in the UK.
16. Poundland's stores offer over 3,000 product lines, including both branded and own-label products, across 17 different categories, ranging from stationery, homewares, gardening and seasonal merchandise to fast moving consumer goods (**FMCGs**) such as food and drinks, health and beauty, household and baby products.
17. **99p** is a general merchandise retailer, which operates 246 stores in the UK under the following fascia: '99p Stores', '99p Plus Stores' and 'Family Bargains'. 99p also operates two stores in Ireland under the 'Euro 50' fascia. 99p Stores generated sales of £[£] million in the UK in the year ending February 2014.
18. 99p operates most of its stores (209 stores) under the '99p Stores' fascia. In these stores, 99p adopts a single price point business model.<sup>2</sup> The majority are located on the high street and, like Poundland stores, they offer a mix of branded and own-label products across the categories listed in paragraph 16, with FMCGs representing the largest proportion of their sales.
19. 99p also operates 30 stores in the UK under the 'Family Bargains' fascia. Family Bargains stores are not typically located on the high street. These stores are also typically larger in format and do not adopt a single price point business model.
20. The other fascia used by 99p is '99p Plus'. There are seven 99p Plus stores in the UK and they are also generally larger than 'standard' 99p stores (over 10,000 square feet). 99p's pricing strategy for its 99p Plus stores is a hybrid of

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<sup>1</sup> The single price point business model adopted by Poundland means that it sells most of its products at £1, although it may offer a bundle of products for more than £1 or conduct promotional events offering products for less than this £1 price point.

<sup>2</sup> As for Poundland, the single price point business model adopted by 99p means that it sells most of its products at 99p, although it may offer a bundle of products for more than 99p or conduct promotional events offering products for less than this 99p price point.

Family Bargains and 99p Stores, using both a single price and multi-price point business model.

## Transaction

21. Poundland proposes acquiring the entire share capital of 99p for a consideration of £55 million (the **Merger**), consisting of £47.5 million in cash and the issue of new Poundland shares with a value of £7.5 million at closing.
22. Poundland submitted that the Merger represents an opportunity to achieve material growth rapidly and compete across a wider range of locations with its retail competitors. Poundland also considers that the Merger will create significant, long term and sustainable benefits for 99p's customers through the application of its offering – across all the metrics of price, quality, range and service (**PQRS**).

## Jurisdiction

23. As a result of the Merger, the enterprises of Poundland and 99p will cease to be distinct.
24. The UK turnover of 99p exceeds £70 million. Therefore, the turnover test in section 23(1)(b) of the Act is satisfied.
25. 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.
26. The initial period for consideration of the Merger under section 34ZA(3) of the Act started on 11 February 2015 and the statutory 40 working day deadline for a decision is 9 April 2015.

## Counterfactual

27. 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 considers 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 these conditions.<sup>3</sup>

28. In this case, there is no evidence supporting a different counterfactual, and the Parties and third parties have not put forward arguments in this respect.
29. Therefore, the CMA considers the prevailing conditions of competition to be the relevant counterfactual.

## **Frame of reference**

### ***Product frame of reference***

30. The CMA considers that 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 effects of the merger in any mechanistic way, and in assessing whether a merger may give rise to an SLC the CMA may take into account constraints on merger parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others.
31. The CMA's approach to market definition is to begin with the overlapping products of the Parties in the narrowest plausible candidate product market and then to consider whether this can be widened primarily on the basis of demand-side considerations. However, there are circumstances where the CMA may aggregate several narrow relevant markets into one broader market based on supply-side considerations (ie on the basis of considerations about the response of suppliers to relative changes in prices).<sup>4</sup> In addition, at phase 1, the CMA will usually make an initial assessment of the boundaries of the relevant market but may not reach a conclusion.

### ***Parties' submission on the product frame of reference***

32. The Parties submitted that the frame of reference should not be limited to the supply of general merchandise by SPP retailers, the narrowest plausible candidate product market, but should include:
  - (a) VGMs (as defined in paragraph 4) operating a multi-price point business model (B&M, Home Bargains, Poundstretcher, Wilko);<sup>i</sup>

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<sup>3</sup> *Merger Assessment Guidelines*, from paragraph 4.3.5.

<sup>4</sup> *Merger Assessment Guidelines*, paragraph 5.2.17.

- (b) national multiples (Tesco, Sainsbury's, Morrisons, Asda);
- (c) limited assortment discount stores (**LADs**) (Aldi, Lidl, Iceland);
- (d) local or regional SPP retailers (**local SPP retailers**) (eg Max 99p and Sam 99p); and
- (e) specialist category retailers (Boots, WHSmith, Superdrug).
33. The Parties submitted the following main pieces of evidence to support their submission that the product frame of reference includes all of the different groups of retailers mentioned above:
- A consumer survey commissioned by Poundland, conducted by [X] throughout the entire Poundland estate and in all of 99p's stores within one mile of a Poundland store (**consumer survey**).
  - A performance concentration analysis (**PCA**) conducted by the Parties' external economic advisers.
  - Internal documents from Poundland and press releases showing that Poundland benchmarks national multiples and, in the Parties' view, which indicate that Poundland is subject to competitive pressure from different types of retailers.
34. Based on the results of the consumer survey, the Parties submitted that the diversion ratio from the Parties to retailers other than SPP retailers is on average [80–90]%<sup>5</sup> at a national level (including both overlap and non-overlap areas) and ranges from [60–100]% at a local level.
35. The Parties submitted a critical loss analysis which looked at the amount of diversion that would be needed outside of a hypothetical single price retail market in order for a 5% increase in price to be unprofitable.
36. In their analysis, the Parties assumed variable margins of around [X]% – consistent with those of Poundland – and estimated that the critical loss<sup>6</sup> needed to make a 5% price rise unprofitable would be [10–20]%. In other

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<sup>5</sup> The diversion from the Parties, based on the results of the validation telephone interviews is [80-90]% (see more details in paragraphs 85 to 107).

<sup>6</sup> The critical loss is the percentage decrease in sales that makes unprofitable a 5 to 10 per cent price increase, that is, a small but significant and non-transitory increase in price (**SSNIP**) by a hypothetical monopolist in a narrow candidate market. The actual loss is the predicted percentage decrease in sales in response to such a SSNIP by the hypothetical monopolist. If the actual loss exceeds the critical loss, the relevant market appears wider than the narrow candidate market considered.

words, if more than [10–20]% of sales would divert outside the market, the price increase would not be profitable.

37. As such, the hypothetical monopolist test,<sup>7</sup> in relation to an SPP frame of reference, would only be satisfied if diversion outside the candidate market was below 17%.
38. The Parties argued that the results of the consumer survey suggest that diversion from the Parties to non-SPP retailers is substantially higher than [10–20]%. The Parties therefore consider, based on the results of the consumer survey, that the hypothetical monopolist test indicates that the product frame of reference is wider than SPP retailers.

#### *CMA's assessment*

39. The CMA considers that the narrowest plausible candidate product market in which the Parties have overlapping activities is the supply of general merchandise by SPP retailers. However, on the basis of the evidence available at this stage, the CMA considers that the appropriate frame of reference on which to assess the effects of the Merger is the supply of general merchandise by SPP retailers (the Parties and Poundworld) and VGMs (B&M, Home Bargains, Poundstretcher, Wilko, and Bargain Buys<sup>1</sup>) for the following reasons:
  - (a) the range of products sold by VGMs overlaps to a significant extent with the range of products sold by SPP retailers and both are aimed at the discount market;
  - (b) a significant proportion of customers do not perceive VGMs as being different from SPP retailers;
  - (c) the Parties' consumer survey evidence indicates that VGMs place a material constraint on the Parties;
  - (d) the presence of VGMs in a local area affects the profitability of Poundland's stores to a material extent; and
  - (e) Poundland's internal documents indicate that it takes into consideration the presence of VGMs when it is considering entering into a local area.

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<sup>7</sup> A 'candidate market' will satisfy the hypothetical monopolist test if a hypothetical firm that was the only present and future seller of the products in the candidate market would find it profitable to raise prices. Under this framework, a candidate market will fail the hypothetical monopolist test, and will be too narrow to comprise the relevant market, if customers would respond to the price rise by switching to products outside the set to such an extent that the price increase by the hypothetical monopolist would not be profitable.

40. Despite the concerns about the reliability of the consumer survey results, the CMA agrees that a critical loss analysis based on these results indicates that the market is likely to be wider than SPP retailers.
41. Since defining the frame of reference as the supply of general merchandise by SPP retailers and VGMs does not preclude consideration of the importance of constraints from retailers outside the frame of reference, on a cautious basis the CMA has not widened the frame of reference. Instead, the CMA has considered the constraint imposed by other suppliers of general merchandise in the assessment of the competitive effects of the Merger.

*Possible segmentation of the candidate frame of reference by product type*

42. Both Parties offer products across a number of different product categories, from grocery, health and beauty, and household items through to entertainment, celebrations and stationery.<sup>8</sup> As mentioned above, the majority of products that both Parties sell are FMCGs.
43. The CMA considered whether the product frame of reference should be segmented by product category, assessing the extent to which:
  - (a) customers purchased a bundle of products;
  - (b) other retailers sell a range of similar products; and whether
  - (c) the conditions of competition are similar across different product categories.
44. The evidence currently available to the CMA does not support the segmentation of the market by product category for the following reasons.
45. First, the CMA notes that the results of the consumer survey conducted by the Parties show that one of the main reasons that consumers shop at Poundland's and 99p's stores is because they offer a 'good range of products to choose from'. This evidence suggests that many customers value the convenience of top-up shopping for multiple categories at a single store.
46. Secondly, the diversion between Poundland and 99p based on the results of the consumer survey conducted by the Parties does not vary significantly by product category (see Figure 1 below).

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<sup>8</sup> The product categories offered by both Parties are: (a) grocery; (b) health and beauty; (c) household (eg cleaners); (d) homewares; (e) do it yourself; (f) gardening; (g) toys; (h) clothing; (i) pet; (j) entertainment; (k) stationery; (l) baby; (m) batteries; (n) celebrations; and (o) seasonal (including Christmas).

**Figure 1 – Diversion from Poundland to 99p by product category (aggregated across all overlap areas)**

[✂]

Source: CMA, based on the results of the consumer survey.

47. Thirdly, internal documents from Poundland indicate that it developed its store layout to maximise basket size, which suggests that it is targeting customers that buy a wide basket of products.<sup>9</sup>
48. Finally, third party submissions suggest that SPP retailers compete to supply customers across the full range of products that they offer and that the range of products they offer is broadly similar. In this regard, Poundworld estimates that [✂] of Poundworld's current stock keeping units (**SKUs**) is similar to Poundland's and 99p's product offering.

### *Conclusion*

49. The CMA therefore considers that the product frame of reference should not be segmented by product category.

### *Conclusion on product frame of reference*

50. CMA considers that the appropriate frame of reference on which to assess the effects of the Merger is the supply of general merchandise by SPP retailers and VGMs. The CMA has considered the constraint imposed by other suppliers of general merchandise in its assessment of the competitive effects of the Merger.

### **Geographic scope**

#### *National versus local frame of reference*

51. As set out in its retail market guidance, the CMA's starting point has been to recognise that consumers shop in local retail outlets within a given travel time from their home or work.<sup>10</sup>
52. The definition of the geographic frame of reference in retail markets involves assessing customers' willingness to switch to stores in other areas following a

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<sup>9</sup> See [✂].

<sup>10</sup> Joint CC and OFT (since adopted by the CMA) Commentary on retail mergers, March 2011 (Commentary on retail mergers), paragraph 3.7.

price rise or other worsening of the retail offer at stores in the candidate geographic frame of reference.<sup>11</sup>

53. Even if, pre-merger, the Parties have a national policy for all aspects of their retail offer, if a merger increases market power in some local areas, the CMA would consider whether the merged firm would have an incentive to change its policy in order to be able to flex some local variables in areas where they gain market power.<sup>12</sup>
54. Therefore, when considering a retail merger and the geographic frame of reference, the CMA considers:
- whether the Parties compete locally;
  - whether the Parties compete nationally on some or all aspects of their retail offer; and
  - whether the way in which the merged firm competes would be changed as a result of the merger.
55. In previous decisions, the CMA's predecessor entities in retail mergers considered that competition between retailers is local rather than national, as demand is locally driven. In addition, the UK Competition Authorities assessed the extent to which the competition that national chains face from each other in local areas can influence competition nationally.<sup>13</sup>

#### *Parties' submission*

56. The Parties submitted that the geographic scope of competition should be assessed nationally because the parameters of each Party's PQRS offering is set on a national basis.
57. The Parties submitted that there are several reasons why their PQRS offering is set at a national level but that the simplicity and consistency that this creates is key in running a low margin business.
58. Specifically, the Parties argue that they set each aspect of their PQRS at a national level:

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<sup>11</sup> See decision of the Competition Commission regarding the acquisition by Sports Direct International plc of 31 stores from JJB Sports plc, March 2010, paragraph 6.49

<sup>12</sup> See 'Commentary on retail mergers', paragraphs 3.1–3.9.

<sup>13</sup> See, for instance, the Competition Commission decision regarding the *Acquisition by Optimax of Ultralase*, November 2013, and the OFT decisions on the *Acquisition by the Home Retail Group of Focus*, April 2008, and on the *Acquisition by NBTY Europe Limited of Julian Graves Limited*, March 2009.

- **Price** – The Parties submitted that both Poundland and 99p operate single price points that are set nationally and that there are only very limited exceptions to this fundamental part of the Parties’ commercial proposition. Further, the Parties argue that there will not be an incentive to alter this policy post-Merger, highlighting that Poundland has operated at the £1 price point for 24 years.
- **Quality** – The Parties submitted that they both operate a highly standardised plan for the opening and closing of stores, and operate a set layout for stores which is set nationally.
- **Range** – The Parties argued that the layout and range of SKUs across their stores are planned and implemented in a highly uniform manner with the majority of products allocated to stores via automated tools.
- **Service** – The Parties submitted that they run marketing campaigns nationally, with staff receiving the same basic training across stores and local opening hours not varying according to local competition.

#### *CMA’s assessment*

59. The CMA notes the Parties’ submission that its PQRS parameters of competition are set at a national level and that, therefore, it is not appropriate or necessary to assess the competitive effects of the Merger at a local level.
60. However, in line with its previous retail merger decisions, the CMA considers that competition between retailers takes place locally rather than nationally, primarily because consumer demand is locally driven. The CMA also notes that even if, pre-merger, the Parties do not often depart from the parameters set nationally for the majority of the PQRS elements of their offer, the loss of competition in some local areas may give Poundland an incentive to change its policy in order to be able to flex some local variables in areas where they gain market power.
61. Accordingly, the CMA has taken a cautious approach in this case and has considered the competitive effects of the Merger at both a national and local level.
62. At a national level, the CMA has considered whether the loss of competition between the Parties post-Merger may have an effect on the parameters of

their offering set at a national level and whether it may result in the Parties having less incentive to innovate (see paragraphs 227 to 235).<sup>14</sup>

63. The CMA has also gathered evidence to assess whether local parameters of competition may be altered post-Merger (including store closures) leading to a deterioration of the Parties' offering at a local level. This assessment has been conducted taking into account the specific nature of the Parties' single price point business model, and is set out below in the CMA's assessment of the loss of actual competition at a local level (see paragraphs 236 to 288). For the purposes of conducting its local assessment, the CMA considered the appropriate local catchment area and this analysis is set out below.

*Catchment area for assessing local competition*

64. Notwithstanding their submission that the Merger should be assessed at only the national level, the Parties submitted that the appropriate catchment area to analyse local overlaps should be one mile.
65. The CMA considers below whether a one mile catchment area is appropriate for assessing the local effects of the Merger in this case.
66. The Parties did not submit an isochrone analysis centred on each of the Parties' stores or provide information to allow the CMA to re-centre these isochrones based on population centres.
67. Due to the number of overlaps, the CMA has not conducted this additional analysis but has considered whether the one mile catchment area should be flexed where necessary on the basis of the diversion ratios estimated in the consumer survey.

- *Third party submissions*

68. Most third parties (including grocery stores) said that the catchment area of their stores (depending on the location of the store) is around a 15 to 20 minute walk.
69. For example, market research conducted by Poundworld indicates that [X]. In support of this, and as set out above, Poundworld notes that a visit to a single price store is often seen as complementary or a 'top-up' shop that is combined with a larger shopping trip. This can be contrasted with visits to a

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<sup>14</sup> See 'Commentary on retail mergers', March 2011, paragraph 3.1.

large national multiple where customers are much more likely to travel longer distances to make a specific visit to one grocery store.

70. Furthermore, a report based on a consumer survey from [REDACTED] submitted by a third party states [REDACTED].<sup>15</sup>
71. A number of third parties submitted that the catchment area is broader than one mile, although referring in many cases to national multiples' stores which might be expected to draw customers from further afield due to their wider product range and likely 'destination shop' mission focus.
- *Internal documents and consumer survey evidence*
72. A number of the Parties' internal documents consider competition at a local level. For example, the [REDACTED] shows that Poundland's 'competitor' analysis was based on [REDACTED].
73. Similarly, [REDACTED].
74. The evidence from the consumer survey on diversion ratios and the Parties' entry analysis suggests that customers switching to competitors within one mile is significantly higher than to competitors located further away:
- (a) The diversion ratios between stores that are within one mile are generally substantially higher than beyond that radius, [REDACTED]. However, the CMA has been unable to perform a full analysis on the extent to which these stores are located just outside one mile or significantly further away.
- (b) [REDACTED].
75. The CMA also reviewed evidence from the Parties indicating that the Parties' stores are used mainly for convenience or top-up purposes and, as such, are unlikely to be destination outlets in their own right. For example, the Parties' average transaction value is around £[REDACTED], which suggests that the majority of consumers are not using the stores as destination shops. This might suggest that consumers would only be willing to travel a short distance to an alternative store should the offering at their current preferred store worsen due to the low value of their purchases. This evidence indicates that a local catchment area of one mile (or 15 to 20 minutes' walking time) may be sufficient.

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<sup>15</sup> [REDACTED]

76. However, the consumer survey results suggest that the catchment area may be broader for some areas because the responses to the question about how the customer got to the store that day indicate that more than [X]% of the Parties' customers do not walk to the Parties' stores (ie they use a bus, car or other method of transport), and that the journey time for more than [X]% of the Parties' customers is more than 15 minutes. These results suggest that a catchment area based on the origin of 80% of the Parties stores' sales would have a radius greater than one mile.<sup>16</sup>
77. Another factor suggesting a wider local catchment area is that [X]. However, the CMA does not consider that these particular cases in isolation provide strong evidence that the local catchment area should be wider than one mile.

### *Conclusion*

78. On the basis of the evidence available, the CMA believes that a one mile catchment area centred on each of Poundland's stores is a reasonable starting point. The CMA has not found it necessary to conclude on the precise scope of the local catchment area because the CMA has taken into account the extent of competition beyond a one mile radius in its competitive assessment where the Parties overlap in a local area on this basis.

### *Conclusion on geographic scope*

79. On a cautious basis, the CMA has assessed the effects of the Merger at a national and local level taking a one mile catchment area centred on each of Poundland's stores as a starting point.

### *Conclusion on frame of reference*

80. For the reasons set out above, on a cautious basis the CMA has assessed the impact of the Merger on the retail supply of general merchandise by SPP retailers and VGMs both at a national and local level.
81. As part of its competitive assessment, the CMA has considered the competitive constraint posed on the Parties by other retailers from outside the frame of reference.

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<sup>16</sup> See paragraph 2.14 of the Commentary on retail mergers, about using a catchment area measure that captures about [X]% of the Parties' store sales. The CMA, however, notes that it was not tested in previous cases whether this catchment area measure is appropriate for the assessment of mergers between SPP retailers.

## Competitive assessment

### *Horizontal unilateral effects*

82. 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 degrade quality on its own and without needing to coordinate with its rivals.<sup>17</sup>
83. Horizontal unilateral effects are more likely when the merger 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 as a result of unilateral horizontal effects in the retail supply of general merchandise by SPP retailers.
84. The CMA undertook its assessment in the context of the following theories of harm:
- (a) loss of actual competition at a national level;
  - (b) loss of actual competition at a local level; and
  - (c) loss of potential competition.

### *The Parties' consumer survey*

85. As mentioned above, the Parties conducted an online consumer survey of their customers in every Poundland store and in 99p stores where they overlapped within a one mile radius of a Poundland store. The consumer survey received over 60,000 responses, 5% of which were removed through data cleaning processes.<sup>18</sup>
86. The CMA has significant concerns with the robustness of the consumer survey and, therefore, concerns with the evidential weight it can place on this evidence. The CMA sets out these concerns below.

### *Methodological issues*

87. The CMA generally welcomes survey evidence and considers that it can provide informative insights about how the market in question works and the

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<sup>17</sup> [Merger Assessment Guidelines](#), from paragraph 5.4.1.

<sup>18</sup> Data cleaning removed 5% of the respondents who completed the consumer survey. These comprised: second and subsequent responses from the same individual or someone else living in the same home (3.9%); those who completed the survey extremely quickly (under five minutes) (0.6%); and those who claimed to spend an abnormally large amount (over £25) in any department (0.5%).

closeness of competition between the merging parties. However, as with all forms of evidence, there are a number of reasons to be cautious when interpreting the results of consumer surveys. For example, the questions posed in consumer surveys are hypothetical and provide customers with an opportunity to state their preferences, rather than for them to be revealed. This may lead to certain biases in the results of the survey if there are differences between a respondent's true reaction to a change in circumstances and their stated action.

88. The CMA also has a number of more specific concerns about the consumer survey in this case, which are set out below.

- *Response rate*

89. The average estimated response rate to the survey was very low at approximately [0–10]%. The Parties argue that this might underestimate the actual response rate because around [0–10]% of customers (which the Parties considered to be a conservative estimate) did not in fact receive a receipt after shopping at the store. However, the CMA notes that even if the proportion of customers that did not receive receipts was higher at, say, [20–30]% the response rate still remains very low. This very low response rate is a cause for concern in the interpretation of the results of the survey. Response bias, which is always a risk when conducting consumer surveys, could be particularly relevant if there are underlying differences between the people who chose to respond to the survey and the underlying population.

- *Validation exercise*

90. The CMA acknowledges that online methods have been used with increasing regularity in recent years, particularly in cases where these fit well with the purchasing channels or use of the products or services of the parties. However, as highlighted in the CMA's guidance on survey design, face-to-face and telephone interviews are usually considered to be more reliable than paper or online self-completion questionnaires due to the involvement of a trained intermediary who can engage the attention of the survey respondent and clarify or probe responses in a controlled way.<sup>19</sup>

91. The Parties conducted a validation exercise using a telephone survey in two overlap areas, [redacted]. The objective was to validate the results of the online

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<sup>19</sup> Joint CC and OFT, Good practice in the design and presentation of consumer survey evidence in merger inquiries, March 2011, OFT1230 and CC2com1 3.43–3.44 (as adopted by the CMA).

consumer survey by comparison with those of the telephone validation interviews.

92. However, the CMA considers that the results of the telephone survey are not consistent with the results of the online consumer survey. When comparing the estimated diversion ratios between the Parties derived from the telephone validation interviews with those derived from the online consumer survey, the results of the telephone validation interviews show a higher diversion between the Parties in both directions. The CMA calculates that the diversion ratios are on average around [40–60]% higher in the telephone validation survey than in the online consumer survey conducted in [redacted].
93. The differences between the results of the online consumer survey and the validation telephone interview creates significant uncertainty about the validity of the consumer survey results and provides some evidence that active self-selection of respondents and/or measurement error may have given rise to bias.

**Table 1: Results of online consumer survey and validation phone interview**

	%			
	[redacted]		[redacted]	
	Poundland	99p	Poundland	99p
<i>Diverting from:</i>				
Online	[0–10]	[10–20]	[20–30]	[10–20]
Telephone survey	[10–20]	[20–30]	[30–40]	[30–40]

Source: CMA, based on the results of the consumer survey and validation telephone interviews.

94. The Parties submitted that the telephone interviews had erroneously omitted the VGM retailer B&M from the survey script, despite there being a B&M in the [redacted] area, leaving customers who may have diverted to B&M with only the option of saying ‘other’. The Parties argue that this omission might cause slightly inflated diversion ratios in that area, including between the Parties. However, the CMA notes that this only affects one of the two areas and that, in any event, the increase in the number of customers diverting to ‘other’ stores, which would be expected if B&M were a genuine diversion destination, is not large.
95. In order to understand what might be driving the differences between the surveys, the CMA analysed the characteristics of the respondents to the two types of survey. In the telephone validation interviews, a significantly higher proportion of respondents are in lower socio-economic groups compared to the average respondents across the whole consumer survey, and the

respondents to the online survey in the two areas concerned.<sup>20</sup> In addition, the CMA notes that compared to the average online consumer survey results, respondents to the telephone validation interviews tended, on average, to visit the Parties stores more regularly and do their shopping in the same stores more often. Furthermore, fewer respondents to the telephone validation interviews stated having an excellent knowledge of prices and fewer travelled by car.

96. The Parties noted the proportion of C2DE respondents (of lower socio-economic status) in the telephone sample exceeds the proportion of C2DE respondents across all the available comparator surveys<sup>21</sup> and that considering only those surveys commissioned by Poundland with respect to its own customer base, the proportion of ABC1 respondents (of higher socio-economic status) to the online sample is far more in line with these comparator surveys than with the telephone validation interviews. However, the CMA notes that the majority of these surveys were also conducted online which may mean that they suffer from the same response bias.
97. In this regard, the CMA found that some of the other survey evidence to which it had access through the Parties ([redacted]) and through third parties suggested that lower socio-economic groups may be underrepresented in the online consumer survey sample. The CMA notes that the respondents to a consumer exit survey provided by a third party had a nearly identical socio-economic split to the respondents to the telephone validation survey in this case. Further, the [redacted] had a higher representation of the lower socio-economic groups than suggested by the consumer survey.
98. Furthermore, and as stated on a report from YouGov on ‘Online research’, people without internet access have a ‘zero probability of taking part’ in online research and, therefore, ‘there could be a bias against those groups who do not have internet access’. The same report refers to research showing that:
- (a) 46% of DE social grades are online compared with 88% of AB social grades; and

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<sup>20</sup> The respondents to both the online consumer survey and validation telephone survey were asked questions in order to evaluate their socio-economic status based on NRS social grades:

- A – upper middle class (Higher managerial, administrative or professional)
- B – middle class (Intermediate managerial, administrative or professional)
- C1 – lower middle class (Supervisory or clerical and junior managerial, administrative or professional)
- C2 – skilled working class (Skilled manual workers)
- D – working class (Semi-skilled and unskilled manual workers)
- E – non-working (Casual or lowest grade workers, pensioners, and others who depend on the welfare state for their income).

<sup>21</sup> These consumer surveys included: [redacted].

(b) 48% of unemployed people are online compared with 81% of employed people.<sup>22</sup>

99. The CMA, therefore, is concerned that the online survey results are based on a sample of respondents that does not accurately represent the Parties' customer base and it does not consider that the inconsistent results between the online consumer survey and the validation telephone interviews are explained by the alleged overrepresentation of lower socio-economic groups in the validation telephone interviews.

- *The CMA's use of the survey evidence*

100. As a result of the methodological concerns outlined above, the CMA considers that it must treat the survey evidence with caution and limit the evidential weight placed on it. In particular, where other evidence from the Parties' internal documents and third party evidence indicates that the relevant competitor set should be narrower than suggested by the results of the consumer survey, the CMA considers that there is sufficient uncertainty regarding the robustness of the consumer survey results for this other evidence to outweigh these results.

101. However, the CMA does acknowledge that a substantial number of people have responded to the survey and notes that some findings are consistent across both the online consumer surveys and the validation telephone interviews (eg that the Parties are each other's closest competitor and that the diversion to retailers other than SPP retailers is significant).

102. As such, the CMA considers that the survey evidence can provide some indication of how consumers may act in this market, albeit without the necessary accuracy to allow the CMA to place much weight on the consumer survey when balanced with the other evidence available to the CMA, including the Parties' internal documents and third party evidence.

103. The CMA has calculated the average diversion ratios from Poundland to a number of different fascia across the areas where those retailers were located within one mile of the Poundland store and for areas where the retailers were located within three miles but not within one mile.<sup>23</sup>

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<sup>22</sup> See paragraphs 3.1.3 and 3.1.4 of the YouGov Report '*Online research – A discussion*' by Dr Michael Wagstaff.

<sup>23</sup> The results of this analysis are mentioned throughout. The averages were calculated using the underlying dataset from the Parties' PCA to indicate the location of retailers. As such, the CMA notes that only Poundland stores covered in that analysis have been used for the calculation of these diversion ratios. The CMA has also calculated similar results using diversion to these retailers from 99p Stores, but considers that these results may be less reliable since the location data is based around the Poundland store in each area.

104. For this exercise, the CMA has used the Parties' diverted spend by store as the basis for calculating these diversion ratios. These diversion ratios, and all others discussed below, have been calculated by adjusting for known diverted spend to an unknown location. Therefore, where spend has been attributed as diverted but to an unknown location, the CMA has reallocated that spend to all other diverted options as a proportion of the overall diverted spend, dividing this new reallocated spend by the total known destination spend (ie total diverted and total not purchased).
105. The CMA notes that all of the average diversion ratios from Poundland to VGMs were lower than the diversion ratio to 99p ([10–15]%)<sup>24</sup> and, with the exception of Home Bargains ([10–15]%), lower than the diversion ratio to Poundworld ([10–15]). In addition, the average diversion ratio from Poundland to Asda and Tesco is not much lower than the diversion ratio to SPP retailers and VGMs.
106. The average diversion ratios from Poundland to other retailers are set out in the table below.

**Table 2: Average diversion ratios from Poundland**

<i>Store</i>	<i>Average diversion ratio</i>
	%
99p	[10–15]
Home Bargains	[10–15]
Poundworld	[10–15]
B&M	[10–15]
Asda	[10–15]
Tesco	[10–15]
Wilko	[5–10]
Sainsbury's	[5–10]
Morrisons	[5–10]
Poundstretcher	[5–10]
Aldi	[5–10]
Lidl	[0–5]
Boots	[0–5]
Superdrug	[0–5]
Iceland	[0–5]
WHSmith	[0–5]

Source: CMA, based on the results of the consumer survey.

107. The CMA considers that these average diversion ratios can provide some indication of the credibility of these fascia as competitive constraints on the Parties and has taken this into account below in the section on closeness of competition. However, in relying on this evidence, the CMA recognises the scope for these results to overstate the strength of particular alternatives (as may be suggested by the telephone validation interviews). It has therefore only sought to rely on evidence on diversion ratios from the online survey to

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<sup>24</sup> Note that the average diversion ratio from Poundland to 99p may be underestimated because it includes overlap areas where 99p operates under the Family Bargain fascia, which follows a multi-price business model.

the extent that they are also supported by the telephone validation survey and considered this evidence alongside other evidence on the credibility and extent of the constraint imposed by each type of retailer.

*Performance concentration analysis*

108. As mentioned above, the Parties submitted a PCA which sought to identify whether Poundland's margins varied in local areas according to different levels of concentration.
109. The Parties submitted that the results show that they do not impose a constraint on each other in the local areas where they overlap and that the competitor set is much wider than merely SPP retailers, as evidenced by the lack of significance in the coefficients from other competitors.
110. The Parties have used an econometric model to test the extent to which 99p stores impose a competitive constraint on Poundland stores at the local level. The PCA uses regression analysis to test whether margins of Poundland stores are affected by the presence of competing stores within their catchment area.
111. The Parties considered alternative definitions of the local market by catchment area, ranging from a narrow to a wider radius, including a wide range of competitors.
112. The Parties used information on store level annual average gross and variable margins for 508 Poundland stores across the UK. The level of concentration was measured using alternatively the number of fascia and the number of stores in each catchment area. Three alternative definitions of catchment area were used corresponding to the geographic areas within the one, three and five mile radius from each Poundland store, respectively.
113. The analysis submitted by the Parties does not find any statistically significant effect of concentration on Poundland stores' margins. The Parties submit that the inability to find a statistically significant effect is the result of 99p not imposing a competitive constraint on Poundland stores. Moreover, they argue that the inability to find a statistically significant effect for other VGMs is indicative of the fact that Poundland is constrained by a wider set of competitors.
  - *The CMA's interpretation of the results*
114. The CMA considers that the non-significance of the estimated coefficients does not itself constitute proof that local competitive constraints do not vary.

115. In particular, the CMA considers that it is not appropriate to use margins as the dependent variable to evaluate the effects of local competition. The CMA notes that the Parties have submitted that they do not alter prices or their product range in response to local competitive conditions as their business model relies on rolling out a simple and consistent offering across different areas. The CMA notes further that this is supported by a very low level of variation in the Parties' margins across local areas. The CMA considers that the evidence submitted by the Parties supports the view that this policy is driven primarily by the benefit of a consistent business model rather than a lack of variation in local competition. In this respect, the CMA notes that on the occasions when Poundland has deviated from single pricing in the past, this has been in response to local competition and that these promotional trials were ended as management decided that [✂].
116. The CMA found that there is insufficient variation in the margin, as a result of the Parties' business model, to allow for the identification of a relationship between performance and concentration across local areas. Accordingly, it is not possible to draw any conclusions on local competition and market definition from the PCA. The CMA has set out a number of further concerns with the PCA in Annex I.

#### *Closeness of competition*

117. The CMA considers that the Parties compete to some extent with a wide spectrum of competitors, but, as explained in the section below, the strength of the constraint that each competitor imposes on the Parties varies significantly.

#### *SPP retailers*

118. The CMA considered the extent to which the Parties compete closely with other SPP retailers, including each other.

- *Consumer survey*

119. Despite the limited weight that can be placed on the consumer survey evidence, the CMA used its results to estimate average diversion ratios. These average diversion ratios directionally indicate that Poundland's closest competitor is 99p and that the diversion ratio from 99p to Poundland is slightly higher than the other way around. Furthermore, they show that the diversion ratio from Poundland to Poundworld is third highest after Home Bargains.
120. However, the CMA recognises that, if the consumer survey results were taken at face value, competitors other than SPP retailers could be considered

relatively close competitors to the Parties based on the calculated average diversion ratios.

- *Internal documents*

121. The evidence from Parties' internal documents indicates that SPP retailers are close competitors:

- [redacted]<sup>25</sup>
- The graph on page 84 of the same [redacted].<sup>26</sup>
- A report prepared by [redacted] estimated that [redacted].<sup>27</sup>
- A document provided by Poundland regarding the [redacted].
- A Poundland board minute suggests that the [redacted].<sup>28</sup> [redacted].

- *Third party submissions*

122. Poundworld told the CMA that it carefully evaluates the presence and location of any Poundland or 99p when deciding whether or not to open a new store. This is in contrast with Poundworld's approach when opening stores in local areas where multi-price point retailers are present. [redacted].

123. [redacted]

124. The CMA notes that there are a number of other factors that could account for the changes in revenues other than entry; however, as the effect appears to be consistent across the five areas, the CMA considers that it is likely to be indicative of a significant effect of the entry of an SPP retailer on Poundworld's revenue.

125. Finally, submissions received from individual customers of the Parties in response to the invitation to comment issued by the CMA indicate that they rely on SPP retailers to acquire essential products at lower prices and that the Parties are particularly close competitors.

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<sup>25</sup> See [redacted].

<sup>26</sup> See [redacted].

<sup>27</sup> See [redacted]. All the multi-price retailers considered for the purpose of this analysis were VGMs.

<sup>28</sup> See [redacted].

- *Conclusion*

126. The evidence set out above indicates that the Parties are close competitors and that they compete closely with, Poundworld, the only other SPP retailer operating in the UK.

*VGMs*

127. The CMA considered the extent to which the Parties compete closely with VGMs.

- *Consumer survey evidence*

128. The CMA considers that the aggregated diversion ratios to some VGMs (in particular, to Home Bargains and B&M) resulting from the Parties' online consumer survey, suggests that these retailers may compete closely with the Parties. In particular, the diversion ratio from Poundland to Home Bargains at [10–15]% is higher than the diversion ratio to Poundworld at [10–15]%. The CMA also notes that there is still significant diversion to VGMs (particularly to Home Bargains and Wilko) in the results of the telephone validation interviews.

129. The CMA considers that the survey evidence provides some support that VGMs closely compete with the Parties. However, given the limited weight that the CMA can place on the survey it has considered whether other evidence supports this finding.

- *Internal documents*

130. Internal documents provided by Poundland provide mixed evidence on the extent to which VGMs constrain SPP retailers.

131. On the one hand, some documents provided by the Parties suggest that VGMs compete closely with SPP retailers.

132. First, [REDACTED].

133. Secondly, evidence from the [REDACTED] indicates that SPP retailers compete closely with VGMs:

(a) It estimates that the [REDACTED].

(b) It concludes that [REDACTED], which suggests that consumers value low prices, independently of whether they find a good value offer in an SPP retailer or VGM.

(c) It states that SPP retailers and VGMs are in '[redacted]'. The offering of both SPP retailers and VGMs is jointly described as:

- [redacted]
- [redacted]
- [redacted]

(d) Based on an online consumer survey conducted in 2013, the [redacted] mentions that [redacted].

134. Thirdly, the [redacted].

135. Finally, the [redacted].

136. On the other hand, some internal documents suggest that VGMs constrain the Parties to a much lesser extent than SPP retailers, due to substantial differences between the business model and product range of SPP retailers and VGMs.

137. [redacted].

138. Despite the conclusion of the [redacted] (see paragraph 121), the same report notes: [redacted].

139. [redacted] conducted by [redacted] and summarised in the document entitled [redacted] states: [redacted].

140. The CMA notes that, [redacted].

141. The evidence from the Parties' internal documents is mixed. However, the CMA considers that, on balance, the internal documents support the contention that VGMs competitively constrain the Parties. In particular, [redacted]. The CMA has considered further entry impact events below.

- *Entry impact events*

142. The Parties submitted an analysis on the effect of entry by a number of SPP retailers and VGMs in the last six months, on Poundland's revenues. The Parties calculated the change in revenues at the relevant store for the 12 weeks after the store opened compared to the 12 weeks before the store opened, and compared this to the change in revenues over the same periods in the previous year. This approach therefore controls for some of the differences in sales due to seasonality and for underlying trends in the data.

However, the CMA notes that this approach does not account for any other factors that may be driving differences in growth rates across areas.

143. In this regard, the Parties submitted that a number of recent entry events should be excluded from the analysis, on the following basis:

- [REDACTED];
- [REDACTED]; and
- [REDACTED].

144. The CMA notes that even when the above areas are included in the analysis, the results do not vary significantly and therefore the CMA considered the Parties' analysis excluding the entry events above. However, the CMA notes that these events illustrate how other factors may drive differences in growth rates across areas and the CMA considers that the exclusion of certain specific areas where the Parties have flagged known issues is unlikely to adequately control for these factors, some of which may not be observable. The CMA therefore puts limited weight on the results of this analysis.

145. The results are shown in Table 3 below.

**Table 3: Entry impact events submitted by Poundland regarding local SPP retailers and VGMS**

<i>Competing retailer</i>	<i>Openings last six months</i>	<i>Impact on revenue adjusting for growth</i>
99p Stores	[REDACTED]	[REDACTED]
Poundworld	[REDACTED]	[REDACTED]
Poundstretcher	[REDACTED]	[REDACTED]
Home Bargains	[REDACTED]	[REDACTED]
B&M	[REDACTED]	[REDACTED]
Bargain Buys	[REDACTED]	[REDACTED]
Sam 99p	[REDACTED]	[REDACTED]

Source: Poundland submission.

146. The results suggest [REDACTED].

147. The CMA does not put weight on the results of the analysis regarding entry by Sam 99p, because the Parties have only submitted one isolated example (see paragraphs 211 to 213).

148. The CMA considers that the entry impact events submitted by Poundland support that the entry of VGMs may have a significant impact on Poundland's sales. However, as mentioned above, it does not account for other factors that may be driving changes in Poundland's growth rate.

149. Contrasting with Poundland's entry impact analysis, [REDACTED]. [REDACTED].

- *Third party submissions*

150. The submissions received from VGMs were mixed. Some VGMs that responded to the CMA's market testing stated that they do not monitor SPP retailers and do not consider SPP retailers to be close competitors. Those VGMs that do monitor SPP retailers also monitor a broad set of retailers.
151. One VGM stated that it does not consider itself to be in the same market as SPP retailers, and another VGM submitted that it only competes with the Parties in relation to its own products sold at a single price point.
152. In this regard, the information submitted by third parties shows that the range of products offered by VGMs differs to some extent from the range of products offered by Poundland and 99p. This is particularly true in terms of the relative importance of each product category to total sales.
153. However, the CMA notes that some VGMs offer more SKUs than SPP retailers. Therefore, even if for instance FMCGs account for a lower proportion of sales in some VGMs, that does not necessarily imply that the range of FMCGs they offer is significantly different from the FMCGs offered by SPP retailers. The CMA gathered evidence from VGMs on the product categories that they sell and the proportion of their sales that these account for. While there are some differences across different stores, the information submitted by VGMs regarding their range of products shows that VGMs overlap with the Parties in relation to almost all product categories.
154. The evidence gathered by the CMA indicates that the percentage of products that VGMs sell at a 99p or £1 price point varies from 10 to 50%. One VGM specifically told the CMA that due to the small number of the products that it sells at a single price point, customers would use SPP retailers and its stores differently. As such, in its view, it was not in the same market as the single-price retailers.
155. [✂]
156. [✂]
157. [✂] told the CMA that multi-price stores are typically larger and compete more directly with each other than with SPP retailers. In its view, consumers use multi-price and SPP retailers for different purposes; consumers visit SPP retailers for top-up shopping, which is intended to supplement a main shop carried out at a multi-price point retailer or national multiple.
158. However, this third party notes that all SPP retailers strive to offer a competitive product range (in terms of the depth and breadth of products

offered) and that there is some overlap between the range of products sold by SPP retailers and other multi-price retailers, despite the differences between the mix and range of products sold by different types of retailers and the complementary shopping missions of SPP retailers (top-up shopping) and national multiples (weekly shopping).

159. In its consideration of new store openings, Poundworld told the CMA that the presence of one or more VGMs is generally regarded as a benign factor, and more positively, is likely to guarantee a level of footfall into a new Poundworld store that might otherwise be absent. [✂].

160. [✂]

161. The CMA considers that the evidence from third parties is mixed, but, on balance, it suggests that some VGMs monitor SPP retailers and that the offer of both VGMs and SPP retailers are aimed at customers seeking a consistent low price offer and overlap in the supply of a significant number of products.

- *Conclusion*

162. On the basis of the evidence set out above, the CMA considers that VGMs impose a significant constraint on the Parties:

- The presence of VGMs in an area is an element that is weighted by Poundland when it considers opening a new store.
- The evidence suggests that the impact of the presence of VGMs on the profitability of Poundland stores is not much lower than the impact of SPP retailers. However, the CMA notes that the entry impact of VGMs on Poundworld's revenues was much weaker.
- VGMs appear to sell a similar range of products to SPP retailers, and both are aimed at the discount market.
- A significant proportion of customers do not perceive VGMs as different from SPP retailers.
- The survey evidence suggests that VGMs place a significant constraint on the Parties, with both the online and telephone survey suggesting significant diversion between the Parties.

163. Therefore, the CMA considers that the evidence clearly indicates that VGMs impose a significant constraint on the Parties, albeit weaker than the constraint imposed by the Parties on each other.

*National multiples and LADs*

164. The CMA considered the extent to which the Parties compete closely with national multiples and LADs.
- *Consumer survey evidence*
165. The consumer survey results indicate that:
- the average diversion ratio from Poundland to some national multiples and LADs is not much lower than the diversion ratio to SPP retailers and VGMs (see Table 1 above);
  - the diversion ratio to Tesco and Asda is similar to the diversion ratio to VGMs and that there is still significant diversion to the national multiples (albeit at a lower level) in the results of the telephone survey; and
  - the aggregate diversion ratios to the LADs is substantially lower than to other SPP or VGMs.
166. For the reasons described above in paragraphs 85 to 107, the CMA can only place limited weight on the consumer survey evidence but acknowledges that the consumer survey evidence would otherwise support the view that national multiples constrain the Parties to some extent. As a result, the CMA has considered other evidence available to assess the closeness of competition between the Parties and national multiples.
- *Benchmarking evidence*
167. Poundland submitted evidence showing [REDACTED].
168. The CMA considers that these documents indicate that Poundland monitors the activities and prices of the main national multiples closely, and that the Parties overlap across a wide range of products. However, the CMA considers that the results of the benchmarking exercises also demonstrate that the Parties are consistently and significantly cheaper than the national multiples.
169. The benchmarking report undertaken by [REDACTED].
170. Furthermore, the evidence indicates that [REDACTED].

171. For example:
- [REDACTED]
  - [REDACTED]
172. This evidence is consistent with the other benchmarking exercises undertaken, which show that the vast majority of products sold at Poundland are cheaper in Poundland than in the national multiples.
173. The [REDACTED] shows that the main reason given by [REDACTED]% of customers for shopping in Poundland is that it is 'cheaper than the supermarkets' and, based on the Parties' consumer survey, the main three reasons given for why the vast majority of consumers choose to shop in the Parties' stores is because they offer good value for money, are cheaper than other stores and offer low prices.
174. The CMA therefore considers that, while the benchmarking of the national multiples suggests they place some constraint on the Parties, the size of the price differential between SPP retailers and national multiples does not suggest particularly close competition between them.
- *Case studies*
175. The Parties submitted evidence suggesting that for four products ([REDACTED]) there was switching to national multiples following a reduction in the relative offering of Poundland:
- (a) [REDACTED]
  - (b) [REDACTED]
  - (c) [REDACTED]
  - (d) [REDACTED]
176. This evidence suggests that there is a degree competition between SPP retailers and the national multiples, at least for these particular products.
177. However, the CMA notes that only a small number of products were considered in these case studies. Moreover, these products are likely to be important items to consumers and, as such, consumers may be particularly responsive to a change in the price of these products. On this basis, the CMA does not consider that these four examples necessarily reflect the constraints relevant to the wider range of products offered by the Parties.

178. In addition, the decrease in the relative price of these products for each case study was very significant and, therefore, the substantial number of consumers switching in reaction to these price changes is probably higher than it would be in response to a smaller change in relative price or pack size.
179. Finally, as submitted by the Parties, competition between the Parties and other retailers should be assessed not at a product or category level, but in relation to the overall offer of each retailer.
180. Therefore, the CMA considers that the above evidence relates to a small number of specific products and is insufficient to support the contention that national multiples should be included in the product frame of reference.

- *Entry impact events*

181. Poundland provided examples of how the entry of two national multiples ([REDACTED]) affected Poundland's sales in particular locations.
182. The like-for-like effect of these two national multiples on Poundland's revenue was negative in the four examples provided by Poundland. [REDACTED].
183. Although the examples submitted by Poundland suggest that the opening of a [REDACTED] on Poundland's revenue is not insignificant when compared to the relative effect of the opening of a 99p store within the relevant local area, the CMA considers that it cannot infer from the limited number of examples selected by Poundland that national multiples closely compete with the Parties. There are a number of other factors (eg change in the management of the store, parking restrictions), that could have led to the decreased revenue growth in those areas, and that, compared to a significant effect across a number of areas, make it harder to infer as much from a few examples given.
184. Furthermore, in one of the areas where Poundland assessed the impact of entry by [REDACTED], two [REDACTED] stores (a [REDACTED]) opened within a short period of time. The CMA considers that the impact of the opening of these two stores may be overstated, as the effect of the opening of one of the stores may also be captured in the assessment of the impact of the opening of the other store.
185. Finally, these entry impact events involving national multiples were selected by Poundland and, as far as the CMA is aware, were not based on any objective criteria. Therefore, these examples may be affected by selection bias, whereas the entry impact events provided by Poundland regarding VGMs included all the examples collected by Poundland of VGM entry in the

last six months in areas where Poundland is present (see paragraphs 142 to 148).

186. Therefore, the CMA can only place limited weight on the results of the Parties' analysis regarding the impact of entry of national multiples, as they may be affected by selection bias.

- *Internal documents*

187. Internal documents submitted by the Parties suggest that [REDACTED].

188. [REDACTED]

189. The [REDACTED] states that there was no '[REDACTED]'. [REDACTED].

190. The CMA considers the fact that [REDACTED] indicates that Poundland does not perceive these retailers as particularly close competitors.

191. Furthermore, the reports and studies that Poundland commissioned from external consultants focus on [REDACTED]. For instance:

(a) [REDACTED].

(b) [REDACTED].

192. The CMA also notes that, based on the documents submitted by the Parties, [REDACTED].

193. The Parties submitted [REDACTED]. The CMA, therefore, can only place limited weight on the evidence resulting from this document.

194. Furthermore, these documents still suggest that the level of constraint imposed by national multiples and LADs on Poundland is [REDACTED] less significant than the constraint imposed by VGMs. The products offered at 99p or £1 by national multiples account for 10% or less of the SKUs offered.

195. The CMA considers that, on balance, the internal documents submitted by Poundland and, in particular, the proposals submitted to Poundland's board regarding the opening of new stores which do not identify national multiples and LADs as direct competitors, indicate that national multiples and LADs constrain the Parties to a lesser degree than VGMs.

- *Third party submissions*

196. One SPP retailer provided evidence indicating that single price and multi-price stores are fundamentally different and that this limits the extent to which they

compete with one another. In its view, as mentioned above in paragraph 157, multi-price stores are typically larger and compete more directly with each other than with SPP retailers. Further, this third party told the CMA that there was an element of complementarity between the two types of stores and that the presence of a multi-price store can increase footfall for a single price store.

197. Most national multiples and LADs that responded to the CMA's market testing do not monitor SPP retailers or only monitor them on an *ad hoc* basis. One LAD submitted that it competes with SPP retailers, although, this was only over a relatively limited range of products.
198. The information submitted third parties indicates that the single price point offer of national multiples and LADs is limited to a few product categories and a small proportion of their total number of SKUs ([X]).
199. Submissions received from third parties also indicate that the smaller formats of national multiples offer a narrower range of products. Prices in national multiples' convenience stores tend to be higher than in other larger store formats. This suggests that the convenience stores of national multiples constrain SPP retailers to an even lesser extent than their larger formats.
200. Finally, all the national multiples and LADs that responded to the CMAs market testing submitted that they do not intend to alter their business model to more directly target SPP retailers.

- *Conclusion*

201. Based on the evidence available, the CMA considers that national multiples and LADs do not compete as closely with the Parties as the other SPP retailer, Poundworld, and the VGMs. However, the CMA recognises that the national multiples and the LADs may provide some competitive constraint on the Parties. The CMA considers that this is taken into account in its methodology for assessing the effects of the Merger on competition at a local level (see section on loss of actual competition at a local level).

*Local SPP retailers*

202. The Parties submitted that they compete with single price point retailers that operate at a local level and do not have a national network of stores. They further submit that these local SPP retailers, such as Sam 99p and Max 99p, are rapidly expanding.

203. The CMA considered the extent to which the Parties compete closely with local SPP retailers.
- *Consumer survey evidence*
204. The consumer survey evidence submitted by the Parties [REDACTED]. The CMA has therefore been unable to estimate the diversion ratios from the Parties to specific local SPP retailers.
205. The CMA was unable to verify, within the scope of its phase 1 investigation, the exact location of local SPP retailers in each overlap area and, therefore, the CMA has calculated the average diversion to local SPP retailers only across areas where there was non-zero diversion to them and other local multi-price retailers in aggregate (together local independent discounters). Even on this basis, the average diversion ratio to local independent discounters from both Poundland and 99p stores was low, at around [0–5]%.
206. There are some local areas where the diversion ratios to local independent discounters are higher than [0–5]%. However, it was not possible to attribute the diversion to any one store in particular. At an aggregated level, the diversion to local independent discounters is not higher than [10–15]% to any of the Poundland stores or 99p stores included in the consumer survey, and in only six stores is the diversion to local independent retailers more than [5–10]%.
207. Where there is a particular local SPP retailer present in an overlap area, the CMA would expect any constraint imposed by these local SPP retailers to be reflected by a higher level of diversion from the Parties to local independent discounters in that area (on a proportionate basis). For instance, Sam 99p, one of the largest independent SPP retailers with around 19 stores, has a store in the overlap area of [REDACTED] according to entry analysis presented by the Parties. However, in this area, there is very low diversion from both the Poundland and 99p to local independent discounters.
208. Accordingly, the CMA considers that the consumer survey provides limited evidence of a significant constraint from local independent discounters, and, more specifically, local SPP retailers, on the Parties.
- *Internal documents and entry impact events*
209. Local SPP retailers [REDACTED].
210. [REDACTED]
211. Poundland submitted evidence regarding [REDACTED].

212. In addition to this example, Poundland provided [redacted].
213. As noted above in paragraph 147, the CMA considers that it cannot place significant weight on a limited number of entry impact events. In the particular case of the impact of Sam 99p's entry in two local areas, the examples provided by Poundland are [redacted].

- *Third party submissions*

214. Several third parties submitted that local SPP retailers have difficulty in offering an equivalent product range to SPP retailers, as local SPP retailers lack the necessary scale to source goods from manufacturers and wholesalers of branded goods at a price that allows them to sell them at £1 and to offer attractive own-label products.
215. Furthermore, the CMA was told that the margins of local SPP retailers are likely to be much lower due to an inability to get the same value from suppliers. This limits the extent to which local SPP retailers may have a product offer that closely competes with SPP retailers with a national scale.
216. Evidence submitted by third parties also suggests that the presence of a local SPP retailer in a local area makes no difference to the decision of an SPP retailer with national scale to open a store in that local area.
217. A local SPP retailer that responded to the CMA's market testing stated that they avoid opening stores in close proximity to Poundland, as it fears that Poundland would drive them out of the market. Submissions received from third parties also suggested that local SPP retailers currently face significant barriers to expansion, preventing them from closely competing with the Parties in the near future. These are assessed in the section on barriers to entry and expansion.

- *Conclusion*

218. Based on the evidence set out above, the CMA does not consider that local SPP retailers are particularly close competitors to the Parties relative to the closeness of competition faced from SPP retailers, and from VGMs. However, the CMA recognises that these retailers may provide some competitive constraint on the Parties. The CMA considers that this is taken into account in its methodology for assessing the effects of the Merger on competition at a local level (see section on loss of current competition at a local level).

### *Specialist category retailers*

219. The Parties submit that they compete with a number of category specialists including WHSmith (mainly books, newspapers and stationery), Card Factory (greeting cards and gifts), Ryman (mainly stationery), Claire's Accessories (jewellery, accessories and beauty products) and Holland & Barrett (mainly vitamins, minerals and herbal supplements).
220. The average diversion ratios from Poundland to specialist category retailers is lower than 2% (see Table 1 above).
221. Other evidence such as internal documents and third party submissions also indicates that category specialist retailers do not closely compete with SPP retailers.
- *Internal documents*
222. [✂].
- *Third party submissions*
223. A specialist category retailer submitted that it only competes with the Parties on a limited number of product categories and that it does not monitor the Parties' commercial activities.
- *Conclusion*
224. Based on the evidence mentioned above, the CMA does not consider that specialist category retailers impose a significant competitive constraint on the Parties. The constraint specialist category retailers may impose on the Parties is taken into account (together with the constraint imposed by other retailers) in the CMA's methodology for assessing the effects of the Merger on competition at a local level.

### *Conclusion on closeness of competition*

225. The CMA concluded, based on the evidence assessed above, that SPP retailers are very close competitors and compete strongly at a national and local level. The evidence also indicates that, where present in a given local area, the Parties will take account of the competitive offer and presence of VGMs. This tends to indicate that VGMs are sufficiently close competitors to the Parties to exercise a constraint post-merger on the Parties' portfolio of products offering a discounted, value proposition. Competition between SPP retailers and VGMs is borne out by the Parties' internal documents, impact of

entry events and, in part, by the consumer survey (recognising the limited weight the CMA has placed on the latter).

226. The CMA considers that the evidence indicates that other retailers, including national multiples, LADs, local SPP retailers and specialist category retailers, constrain the Parties to a much lesser extent than Poundworld and the VGMs. In reaching this decision the CMA placed weight on the following evidence (in summary):

- (a) [REDACTED]
- (b) Poundland only conducted local promotions [REDACTED].
- (c) While internal documents indicate that [REDACTED].
- (d) Poundland internal documents and entry impact events submitted by the Parties indicate that [REDACTED].
- (e) Internal documents and third party submissions indicate that the offer of SPP retailers and VGMs have many aspects in common, including its everyday low price proposition. In contrast, other retailers' offering differs substantially in terms of pricing, range and shopping mission.

### ***Loss of actual competition at a national level***

#### *Parties' submission*

227. The Parties submitted that, although the parameters of the Parties' PQRS offer are set nationally, any concerns with the competitive effects of the Merger at a national level are fanciful, mainly because:

- (a) Although the Parties are close competitors, they compete with a number of other retailers with a national presence. The Parties estimate that they account for less than [0–10]% of the addressable market (including retailers that are outside the current product frame of reference).<sup>29</sup>
- (b) Even within a narrower competitor set, Poundland will remain constrained at a national level by four VGMs and an SPP retailer. The Parties estimated that their combined share stands at around [20–30]% even when restricted to a competitor set that only includes SPP retailers and VGMs.

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<sup>29</sup> Market shares intended to adjust for revenues attributable to products that only the Parties sell.

- (c) Based on the results of the consumer survey, the diversion ratio from Poundland to 99p at a national level is [0–10]% (ie the aggregation of diversion ratios from all Poundland stores, not only in overlap areas).<sup>30</sup>

### *Third party submissions*

228. A third party submitted that the Merger will reduce the number of competitors from three to two and that the Merger may lead to an SLC at a national level as a result of a reduction of competition between the Parties' network of stores.
229. This third party considers that the Merger should be assessed considering a frame of reference that only includes SPP retailers and notes that the incentive of a retailer to compete across their store network depends on the sum total of local competition which it faces, since this determines the aggregate volume of sales they would lose by worsening any aspect of their national competitive offering. In this context, it estimates that, after the Merger, Poundland would 'enjoy a 'local monopoly' regarding [70–80]% of its stores and the only other SPP retailer operating in the UK, after the Merger, would be [X] the size of Poundland by value of sales. It also estimated that the combined share of supply of the Parties is around [70–80]%, by number of stores, and around [X], by turnover.
230. Based on the above reasons, this third party submits that the Merger may result in an SLC at the national level, as the aggregated loss of local competition resulting from the Merger is greater than in other mergers recently reviewed by the CMA,<sup>31</sup> in which the CMA found that it may be the case that the merger would result in an SLC at a national (network) level.

### *CMA's assessment*

231. The CMA notes that, as mentioned above, the Parties' share of supply under a national frame of reference including SPP retailers and VGMs is less than 25% (using the Parties' estimate). The CMA also notes that, notwithstanding its concerns with the robustness of the consumer survey results, the diversion ratio between the Parties is very low at a national level (less than 10%).
232. However, while the Parties are only two of seven national discount general merchandisers (including SPP retailers and VGMs), they are two of only three SPP retailers operating in the UK. As set out in its assessment on closeness

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<sup>30</sup> The diversion ratio from Poundland to 99p is [0–10]%, if the respondents that answered 'Don't know' are not included.

<sup>31</sup> This third party refers to the CMA's reference decision in relation to the anticipated merger of Pure Gym Limited and The Gym Limited.

of competition, the CMA found that SPP retailers are very close competitors and, therefore, considers that shares of supply may understate competition between them.

233. Furthermore, around [60–70]% of 99p’s estate overlaps with a Poundland store (based on a catchment area of one mile) and, as mentioned below in the section on Loss of actual competition at a local level, the Merger may result in an SLC in a significant number of local areas where the Parties overlap. These areas represent less than [10–20]% of the total number of stores that Poundland will operate after the Merger, although, they represent a higher percentage in relation to the 99p stores being acquired (approximately [40–50]%).
234. A loss of competition at the national level may result in a deterioration of those aspects of the Parties’ PQRS offering which are set centrally and on a national basis. However, given the CMA’s findings in respect of horizontal unilateral effects arising as a result of a loss of actual and potential competition at a local level (see sections on loss of actual competition at a local level and loss of potential competition in specified local areas), it was unnecessary for the CMA to determine conclusively the extent to which the Merger may also raise competition concerns arising from the loss of current competition at a national level.
235. In this Merger, the CMA considers that the aggregate effect of the loss of competition at a local level, assessed below in paragraphs 236 to 288, sufficiently captures the anti-competitive effects that the CMA found may arise from the Merger at a national level.

### ***Loss of actual competition at a local level***

236. As set out above in the section on geographic frame of reference, in previous retail mergers the UK competition authorities considered that competition between retailers takes place at the local rather than national level, primarily because consumer demand is locally driven.
237. In assessing whether the Merger may result in a loss of actual competition at a local level, the CMA has considered the extent to which local parameters of competition may be altered post-Merger and whether as a result of a loss of competition between the Parties the Merger will lead to the realistic prospect of an SLC at a local level.

## *Extent to which local parameters may be altered post-Merger*

### *Local pricing response*

238. The CMA started by assessing the extent to which competition between the Parties influenced their pricing at a local level.
239. Poundland told the CMA that it had trialed a small number of short-term promotional events ([REDACTED]) in the past that led to changes in prices at a local level. [REDACTED].
240. Poundland told the CMA that [REDACTED]:
- (a) [REDACTED];
  - (b) [REDACTED];
  - (c) [REDACTED];
  - (d) [REDACTED]; and
  - (e) [REDACTED].
241. Poundland submitted that [REDACTED].
242. It further submitted that the trials [REDACTED].
243. Similarly, the CMA was told that 99p has also changed prices in the past, for example, in relation to store openings, although the Parties submitted that these were time limited and rare with only [REDACTED] such examples in the past ten years.
244. In addition, the Parties told the CMA that [REDACTED].
245. The CMA notes that a number of [REDACTED]. Third parties submitted that 99p responded to local promotions conducted by Poundland and referred to press releases where these promotions are evidenced.<sup>32</sup>
246. Finally, in relation to local pricing responses, one third party explained that while a number of parameters would be determined centrally, ultimately competition occurred on a very localised basis between the Parties, and was able to point to a number of examples of local 'price wars' between the

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<sup>32</sup> See for instance '[Cheap shot? Poundland cuts prices in 99p stores war](#)', The Week, where Poundland's Chief Executive Officer stated: 'It is part of our competitive response ... Sometimes we do vouchers, sometime we do special offers. We have got four stores that for a couple of weeks started off at 95p and then moved to 97p ... Like all retailers we test competitor response options all the time and this is just one of a number of tactical options.'

Parties. Another third party similarly pointed out examples of local reactions in price between the Parties in the past.

247. The CMA considers that these pricing examples highlight how the Parties have reacted to local competitive conditions in the past. The CMA recognises that the Parties have only altered pricing at a local level in a limited number of instances, with the overall sales attributable to the discounts being a very small proportion of overall sales, however, these examples demonstrate Poundland's ability to flex the price variable of its offer if it has an incentive to do so.

- Other factors of competition

248. The CMA has also considered whether the Parties may have the ability and incentive to flex other factors of competition, including quality range and service, at a local level post-Merger.

249. The Parties told the CMA that [REDACTED].

250. The CMA notes that, in the six months prior to December 2014, [REDACTED]. In addition, the fixed level of staffing and regimented layout plans suggest that it is unlikely that these mechanisms have been altered to reflect local competition in the past.

251. The CMA, therefore, considers that there is little evidence of Poundland altering these other parameters of competition in response to local competition in the past.

252. The more limited evidence it received regarding the commercial operations of 99p Stores resulted in the CMA being unable to assess whether its offering might vary locally, beyond the local promotions examples highlighted above.

253. The Parties argued that their national approach to levels of service are vital to maintaining their low cost model. However, the CMA notes that there have been examples of the Parties varying some elements of their range locally in the past, albeit not according to local competition, but to account for specific features of the demand in particular locations. The Parties have not provided evidence on how that local variation affected its costs.

254. As a result, the CMA has not ruled out that Poundland may have the ability to flex the range, quality and service parameters of its offer and that, after the Merger, it may have the incentive to change these parameters of competition as a result of changes in the competitive dynamic at a local level.

### *Store openings and closures*

255. The Parties submit that, when opening a new store, they pursue a consistent national strategy.
256. For Poundland, this includes considering the [REDACTED].
257. For 99p, [REDACTED].
258. Internal documents [REDACTED].<sup>33</sup> [REDACTED].<sup>34</sup>
259. Importantly, [REDACTED].<sup>35</sup> [REDACTED].<sup>36</sup>
260. Although the CMA has not found any evidence of [REDACTED].
261. The CMA therefore considers that the Merger could result in the closure of stores in particular local areas and therefore give rise to consumer harm. Closures affect consumer welfare by reducing convenience because customers of the closed store will have to travel further to an alternative store or reduce the quality of the offering at a local level in other ways, perhaps through an increase in queue times and increased congestion in the store due to increased footfall.
262. Third parties told the CMA that location was of the utmost importance in the discount general merchandise market, and especially so for SPP retailers. This suggests that consumer preferences are driven at least partly by location, and, as such, some may therefore be put in a worse position post-Merger if the Parties close some stores.

### *Conclusion*

263. The CMA considers that a loss of actual competition at a local level may give Poundland the incentive to close competing stores. In addition, the CMA has not ruled out that any loss of competition may give Poundland the incentive to worsen its PQRS offering in some local areas.

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<sup>33</sup> For example, Poundland's proposals for the opening of new stores mention the potential competition threat of [REDACTED].

<sup>34</sup> See [REDACTED].

<sup>35</sup> See [REDACTED] and the [REDACTED].

<sup>36</sup> See [REDACTED] and the [REDACTED].

## *CMA methodology for identifying problematic local overlap areas*

264. To assess the competitive effects of the Merger at a local level, the CMA has considered the design of an appropriate methodology based on the following inputs:
- (a) **Diversion ratios:** the CMA considers below, taking into account the limited weight it can place on the consumer survey, what upper and lower bound diversion ratios can be applied in order to account for the relative strength of competition in each local area, including retailers inside and outside of the relevant competitor set for fascia counting purposes.
  - (b) **Competing fascia within the competitor set:** the CMA considers below which competing fascia should be included within the relevant competitor fascia count, based on the degree of competitive constraint that each type of retailer imposes on the Parties as assessed in the section on closeness of competition (ie SPP retailers, VGMs, national multiples, LADs, specialist category retailers and local single price retailers).

### *Parties' proposed approach*

265. The Parties consider the Merger should be assessed at a national level. The CMA explained to the Parties in its issues statement that it would consider local effects. The Parties therefore proposed a 'cautious' methodology for the assessment of local competitive effects.
266. The Parties identified overlaps between them based on a one mile radius centred on the relevant Poundland store. This resulted in 153 overlap areas (including five areas which opened after the beginning of the consumer survey). The methodology suggested by the Parties for each local area is based on a five to four fascia filtering, which will count:
- SPP retailers, VGMs and the medium and larger outlets<sup>37</sup> of Tesco, Sainsbury, Asda and Morrisons as one fascia; and
  - the Tesco, Sainsbury, Asda and Morrisons supermarket convenience outlets,<sup>38</sup> Aldi and Lidl as half a fascia.

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<sup>37</sup> The CMA's predecessor entities defined 'one stop stores' as stores with a net sales area of more than 1,400 square metres (**sqm**), and medium size stores as stores with a net sales area of less than 1,400 sqm but more than 280 sqm.

<sup>38</sup> Convenience stores were defined in previous decisions of the CMA's predecessor entities as stores with a net sales area of less than 280 sqm.

267. The Parties submitted that this filter would identify [10–20] overlap areas where there would be three or less fascia after the Merger, which could give rise to potential competition concerns.

*CMA approach*

268. The methodology used in phase 1 to identify the areas where the Merger gives rise to a realistic prospect of an SLC should be cautious and reflect the fact that some types of retailers only constrained the Parties to a very limited extent.
269. The CMA has adopted a cautious methodology based both on fascia counting and diversion ratios, which counts the fascia that more closely constrain the Parties (SPP retailers and VGMs) and uses the diversion ratios resulting from the survey on a cautious basis, both:
- (a) to rule out the realistic prospect of an SLC in local areas where the diversion ratio is sufficiently low, indicating that the aggregated diversion to other retailers is sufficient to constrain the Parties or that the Parties are not competing particularly closely in a particular area; and
  - (b) to identify the areas where the Parties are particularly close competitors (high diversion ratios between the Parties).
270. The CMA has sought to rely to some extent on fascia counting in its methodology due to its concerns on the reliability of the results on the consumer survey. However, the CMA has also sought to rely to some extent on diversion ratios in its methodology notwithstanding these concerns. This is because diversion ratios directly measure the closeness of competition between the Parties relative to other retailers and therefore take into account both the competitive constraint of retailers within the frame of reference, such as SPP retailers and VGMs, and the competitive constraint that other retailers outside of the frame of reference, such as national multiples, may impose on the Parties in aggregate.

- *Diversion ratios*

271. The CMA considers that competition concerns would be unlikely to arise where there would be at least four competing fascia after the merger. Therefore, as a starting point, it notes that a diversion ratio of 25% would arise in a five to four merger between equal competitors.<sup>39</sup>
272. In considering the level of diversion that may give rise to competition concerns in this case, the CMA notes the Parties' submission that customers of Poundland and 99p stores are price aware and highly price sensitive, and shop around for their purchases to secure best value for money. The CMA considers that these points are supported by the results of the consumer survey. In particular, almost [90–100]% of respondents cited value for money as being an important or essential reason in deciding to visit one of the Parties' shops, and approximately [80–90]% of the Parties' customers search across multiple shops for all or some of their purchases. The CMA considers that this evidence may support to some extent the use of a less conservative diversion ratio threshold for identifying areas of concern.
273. However, the CMA considers that, taking into account its concerns with the results of the consumer survey described above in paragraphs 84 to 105, the diversion ratios resulting from the consumer survey may substantially understate the diversion between the Parties (downward bias) and overstate diversion to other retailers.
274. Therefore, the thresholds adopted in the CMA's approach were cautiously set to take account of the above factors. The Merger was considered to give rise to a realistic prospect of an SLC in the overlap areas where the diversion ratio between the Parties is higher than 25% in either direction. Competition concerns in the overlap areas were only ruled out where the diversion ratio between the Parties in both directions is lower than 15%. This is because even if 15% were to be an underestimate of the true diversion between the Parties, it would be unlikely to indicate a competition problem unless the estimates were underestimated by a substantially larger degree than is suggested by the validation survey.

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<sup>39</sup> In the review of previous mergers involving grocery retailers, the CMA's predecessor entities have used fascia counting filters to identify the local areas deemed to be unlikely to present competition. For instance, the Competition Commission in its decision on the *Acquisition by Somerfield plc of 115 stores from Wm Morrison Supermarkets plc* (Somerfield/Morrison decision) and the OFT, in its decision on the *Acquisition by Asda Stores Limited of Netto Foodstores Limited* used a filter considering that competition concerns were unlikely to arise where there would be at least four competing fascia after the merger.

- *The CMA's fascia count methodology*

275. For areas where diversion is below 25% in both directions and above 15% in at least one direction, the CMA has considered whether the loss of competition in a particular area is substantial through an analysis of the competing fascia that will remain post-Merger. Given the CMA's findings on closeness of competition, the fascia counted are all SPP retailers and VGMs within a one mile radius.<sup>40</sup>
276. The Parties have supplied information to the CMA regarding the number of potential competitors within a one mile, three mile and five mile radius around each overlap Poundland store.<sup>41</sup>
277. The CMA considers that there may be a realistic prospect of an SLC in areas where the Merger will reduce the number of SPP retailers and/or VGMs fascia to less than four (ie a two to one, three to two or four to three).
278. For the purposes of fascia counting, the CMA gathered detailed information regarding the pipeline stores of [X]. The CMA assessed whether including the pipeline stores in the fascia counting would rule out competition concerns in any of the overlap areas. The CMA concluded that it could not dismiss competition concerns in any overlap area by counting the pipeline stores of [X].<sup>42</sup>
279. Therefore, the CMA has identified competition concerns in a number of local areas where one or more of the Parties' stores overlap within a one mile radius and where there will be no more than two other fascia of SPP retailers and/or VGMs post-merger in that overlap area.

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<sup>40</sup> For the reasons set out in paragraphs 65 to 78, the CMA used a one mile radius from Poundland as its catchment area.

<sup>41</sup> This evidence is also included within the raw data for the Parties' PCA analysis, and the CMA has used this as the basis for most of the local analysis. The CMA based its fascia counting exercise on this data set, adding Bargain Buys as a VGM fascia where it is present. The CMA confirmed the data used in the PCA analysis with the information provided by the Parties regarding each local area.

<sup>42</sup> The CMA only considered the pipeline stores of [X] that were not yet opened, but that were being fitted out or in relation to which: (a) contracts or heads of terms had been exchanged; or (b) the retailer was in correspondence with lawyers regarding the lease of the store space.

### *Conclusion on methodology for local actual competition analysis*

280. The CMA considers that there is a realistic prospect that the Merger will result in an SLC in the overlap areas where:
- the Merger will reduce the number of SPP retailers and/or VGMS fascia to less than four, except if in these local areas the diversion ratio between the Parties is less than 15%; or
  - the diversion ratio between the Parties in both directions is higher than 25%.
281. In these local overlap areas, the CMA considers it realistic that, as result of a loss of competition at a local level, Poundland will have an incentive to close a number of 99p stores that currently compete. The closure of some of the Parties' stores immediately impacts on consumer welfare as a direct consequence of the Merger. The CMA cannot also rule out that the loss of competition in local areas may give Poundland an incentive to deteriorate its PQRS offering in some local areas.
282. Applying the methodology described above, the CMA concluded that the Merger raises competition concerns in 80 overlap areas, corresponding to 98 of the 99p stores Poundland is acquiring.<sup>43</sup>
283. The areas where concerns arise are detailed in Table A of Annex II.

### *Loss of actual competition beyond one mile*

284. On a cautious basis, the CMA considered whether the Merger would give rise to a realistic prospect of an SLC, in areas where the Parties are more than one mile away and when the estimated diversion ratio from Poundland to 99p is above 25%.<sup>44</sup>
285. Based on the results of the survey, the CMA found that the diversion ratios from Poundland stores to 99p stores beyond one mile is always lower than 25%.<sup>45</sup>

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<sup>43</sup> In 18 of these areas there is more than one 99p store and in 15 of these areas there is more than one Poundland store.

<sup>44</sup> As the 99p stores located beyond a mile from a Poundland store were not part of the consumer survey, the CMA does not have data regarding diversion ratios from these 99p stores to Poundland. The diversion ratios between the Parties are typically higher from 99p to Poundland, suggesting that the Poundland diversion ratio may be an understatement of the constraint being lost on the 99p Store.

<sup>45</sup> The CMA adopted this threshold taking into account the CMA's concerns with the results of the consumer survey, which may understate the diversion between the Parties.

286. The CMA therefore does not believe that there is a realistic prospect that the Merger will result in an SLC in relation to areas where the Parties' stores are located more than one mile from each other.

*Conclusion on loss of actual competition at a local level*

287. The CMA concluded that the loss of competition between the Parties at a local level may result in a worsening of Poundland's PQRS offering and lead to store closures. On this basis the CMA found that there is a realistic prospect that the Merger will give rise to an SLC in 80 overlap areas, corresponding to 98 of the 99p stores Poundland is acquiring.

288. These areas are identified in Table A of Annex II.

***Loss of potential competition***

289. In assessing whether a merger may result in a loss of potential competition, the CMA considers:

- whether one of the merging parties would be likely to enter a market absent the merger; and
- whether such entry would lead to greater competition.<sup>46</sup>

290. The CMA has considered whether the Merger will give rise to a realistic prospect of an SLC as a result of a loss of potential competition in areas where the Parties currently have specific plans to open stores in competition with one another.

291. In addition to the Parties' current pipeline of stores, the CMA notes that Poundland, in particular, has substantial expansion plans for the next few years, as described below. The CMA has therefore also considered in aggregate whether the effect of the Merger on these plans may give rise to a realistic prospect of a substantial lessening of competition in unspecified local areas where one of the Parties is currently present and the other may enter in the near future.

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<sup>46</sup> [Merger Assessment Guidelines](#), paragraph 5.4.15.

## *Parties' current pipeline*

### *Likelihood of entry*

292. The CMA was told by the Parties that:

- Poundland is planning [REDACTED];
- [REDACTED],<sup>47</sup> [REDACTED]; and
- [REDACTED].

293. 99p is planning [REDACTED]:

- [REDACTED];<sup>48</sup> and
- [REDACTED].

294. The CMA therefore considers that, absent the Merger, the Parties would have been likely to enter into the areas identified above.

- *Whether the entry would have led to greater competition*

295. As explained above in paragraphs 275 to 279, the CMA considers that there is a realistic prospect of an SLC in the areas where the Merger will reduce the number of SPP retailers and/or VGMs fascia to less than four.

296. Applying this fascia counting methodology, the CMA found that the Merger will result in a loss of actual potential competition in eleven areas where the Parties' pipeline stores would overlap with an existing store of the other party and where there are currently less than four fascia from SPP retailers and/or VGMs. These areas are identified in Table B in Annex II.

297. There are five areas where the Parties already operate a store less than one mile from the new pipeline store they plan to open. In each of these areas, the CMA found that the Merger either:

- already gives rise to a realistic prospect of an SLC based on the loss of actual competition, independently of the opening of the Parties' pipeline stores; or

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<sup>47</sup> [REDACTED].

<sup>48</sup> [REDACTED].

- would not give rise to an SLC even with additional entry since a sufficient number of competing fascia are present.
298. The CMA notes that some of the Parties' pipeline stores will only be marginally more than one mile from an existing store of the other party (less than 1.1 mile). This occurs in relation to two of Poundland's pipeline stores ([redacted]) and one 99p store ([redacted]). Absent diversion ratio information and using the one mile radius flexibly, the CMA considers that it cannot rule out anti-competitive effects in these areas, without further analysis.
299. Applying the fascia counting methodology described above to these areas, the CMA found that in one area, where Poundland proposes to open a store 1.04 miles from an existing 99p store ([redacted]), there are currently less than three competing SPP retailers and/or VGMs and that, therefore, there is a realistic prospect that the Merger will give rise to an SLC in this area.
300. To mitigate the effects of a loss of actual potential competition, the CMA considered whether any other SPP retailers and VGMs had plans to enter these prospective overlap areas. The CMA only received detailed information regarding the pipeline stores of [redacted]. The CMA found that including the pipeline stores of [redacted] in the fascia counting would not rule out competition concerns in any of the areas where the parties will overlap in the near future.

### *Conclusion*

301. Applying the fascia counting methodology described above in paragraphs 275 to 279 to all the specific areas where the Parties will overlap in the near future, the CMA found that the Merger gives rise to a realistic prospect of an SLC, as a result of the loss of actual potential competition, in the areas identified in Table B in Annex II.

### ***Additional areas***

302. The CMA has considered whether the effect of the merger on the Parties' expansion plans (over and above its pipeline of entry into specific areas) will give rise to a realistic prospect of a substantial lessening of competition, for instance if it reduced their incentive to expand into overlap areas. The CMA considers that the following conditions would need to be cumulatively met for this to occur:
- Absent the merger, the Parties would expand significantly into local areas in which they are not currently present, thereby creating additional local overlaps (over and above their pipeline of entry into specific areas).

- Entry into new overlap areas absent the merger would have led to substantially greater competition.
- The expansion plans of the Parties are such that they would be substantially more likely than other competitors to enter into new overlap areas.

#### *Parties' submission*

303. The Parties submitted that the Merger did not raise any problems due to a loss of potential competition as a result of the potential expansion of their network of stores because the Parties compete with a wide set of competitors that are also expanding into new areas.
304. Furthermore, Poundland notes that [REDACTED].

#### *Third party submissions*

305. A third party submitted that, based on the current significant degree of overlap between the Parties, absent the Merger, the future expansion of the Parties' network of stores would likely result in additional overlaps between them.
306. It therefore stated that the Merger will change Poundland's incentive to expand its network of stores, potentially leading to a reduction in the number of planned store openings, or a decrease in the level of competition in the markets in which new stores would enter. In both instances, this third party considers that the Merger will reduce future rivalry at the national and local level, impacting negatively on Poundland's PQRS offering.

#### *CMA's analysis*

307. The CMA considers that evidence from Poundland's internal documents indicates that it has plans to expand its local presence substantially, opening a number of additional stores beyond the current pipeline that has been identified. In particular it notes that Poundland has publicly stated its intention to open 500 additional stores at a rate of 60 new stores (net) a year in its 2014 annual report.<sup>49</sup>
308. However, the CMA [REDACTED].<sup>50</sup>

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<sup>49</sup> See paragraph 9 of Poundland Annual Report, 2014.

<sup>50</sup> See [REDACTED].

309. To assess the extent to which the Parties' stores are likely to overlap in the future, the CMA has first considered the overlap in the existing network of stores. The CMA notes that the Parties overlap in 153 areas within a one mile radius out of a total of 533 Poundland stores and 246 99p stores, which shows that most of 99p's stores ([60–70]%) overlap with a Poundland store. The CMA considers that for potential future overlaps to result in a realistic prospect of an SLC they would need to arise in areas where the Parties do not currently overlap. In this respect it notes that the majority of 99p stores already overlap with a Poundland store. Consequently, further expansion by Poundland in particular is less likely to result in additional overlaps. In this regard, the CMA notes that the [redacted] Poundland pipelines stores only create [redacted] new overlaps with existing 99p stores, considering a one mile radius. Therefore, the CMA considers that only a small number of additional overlaps would be likely to arise as a result of Poundland's expansion plans.
310. In addition, the CMA notes that its assessment of local competition indicates that there is a constraint from VGMs and out-of-market constraints in many areas, such that entry into this small number of additional overlaps would not necessarily result in greater competition.
311. Further, the information available to the CMA does not suggest that either of the Parties has an inherent advantage over the other national SPP retailer in opening stores or accessing sites such that they are better able to expand. [redacted].<sup>51</sup> In relation to other types of retailers, such as VGMs, which do place a constraint on the Parties when they compete locally, the CMA notes the evidence provided by the Parties on their expansion plans. In particular, it notes that [redacted] has plans on a similar scale to Poundland. For example, a [redacted] forecasts that [redacted].<sup>52</sup> [redacted]. The CMA notes that there are substantial existing overlaps between the existing VGMs portfolios of stores and those of the Parties. It considers that this indicates that the VGMs would be likely to enter into similar areas to the Parties in the future.

### *Conclusion*

312. On the basis of the evidence above, the CMA considers that the effect of the Merger on the Parties' expansion plans does not give rise to a realistic prospect of a substantial lessening of competition.

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<sup>51</sup> [redacted]

<sup>52</sup> [redacted]

### ***Conclusion on horizontal unilateral effects***

313. For the reasons set out above, the CMA considers that there is a realistic prospect that the Merger will result in an SLC in 80 overlap areas as a result of a loss of actual potential competition, with those 80 local areas corresponding to 98 of the 99p stores Poundland is acquiring. These areas are identified in Table A of Annex II.
314. There is a realistic prospect that the Merger will result in an SLC based on a loss of potential competition in 12 additional local areas where the Parties' pipeline stores will overlap with an existing store of the other party within a one mile radius, or slightly beyond this radius, and where there are currently less than four competing fascia from other SPP retailers and/or VGMs. These areas are identified in Table B in Annex II.
315. The CMA considers that the effect of the Merger on the Parties' expansion plans does not give rise to a realistic prospect of an SLC in any local areas not specified in the Parties' current pipeline of store openings.
316. Finally, given the CMA's findings in respect of horizontal unilateral effects arising as a result of loss of actual and potential competition at a local level, it was unnecessary for the CMA to determine conclusively the extent to which the Merger may also give rise to concerns arising from the loss of actual competition at a national level.

### **Barriers to entry and expansion**

317. 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 considers whether such entry or expansion would be timely, likely and sufficient.<sup>53</sup>

### ***Parties' submissions***

318. The Parties submitted that the barriers to entry in the market are very low, and that this can be evidenced by a number of recent entries into the market, including two case studies of smaller outlets that have expanded quickly.

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<sup>53</sup> [Merger Assessment Guidelines](#), paragraphs 5.8.1 to 5.8.4

319. The Parties submitted evidence that the value merchandise sector is growing around 9% each year and is predicted to increase in value from around £5.7 million in 2013 to £8.1 million by 2017.<sup>54</sup>
320. To support their submissions, the Parties stated that there are substantial amounts of empty retail space across the country and that there are a number of ways that new entrants can be supplied in the market.
321. In relation to the areas where the Parties' stores overlap, they submitted detailed information on vacant sites that would be suitable, in terms of location and size, for a new store for a retailer with the same characteristics of Poundland.
322. Furthermore, the Parties gave the examples of Sam 99p and Max 99p, two local SPP retailers, rapidly expanding their networks:
- Sam 99p, founded in 2005, expanded to over 19 locations.
  - Max 99p, which opened its first store in 2013, currently has five stores.
323. The Parties submitted evidence that B&M and Home Bargains have substantial expansion plans, though did not relate these plans to specific areas.

### ***Evidence from third parties and internal documents***

#### *Access to suitable sites*

324. Several retailers (including VGMs and local SPP retailers) told the CMA that there is not an abundance of appealing empty retail spaces across the country, with several retailers stating the importance of finding the right site in the right location.
325. For instance, one recently expanding local SPP retailer told the CMA that it is looking for some additional sites for expansion, but that this is not a straightforward proposition.
326. A VGM submitted that in some regions 'there is practically nil' vacant spaces with a size suitable for its business. Another VGM noted that, although there may be available sites, its decision to open a store in that space depends on the lease terms and commercial viability of the new store.

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<sup>54</sup> See [redacted].

327. The Parties' internal documents also suggest that SPP retailers compete aggressively for suitable new sites. For example, internal documents suggests that the [REDACTED]. The CMA considers that while this shows how wide-scale entry can impact upon the Parties, the fact that it took the collapse of a major retailer to induce significant entry suggests that space to expand is not generally widely available. However, the CMA acknowledges that it might be the case that there was a generally lower level of vacancy at that point in time.
328. In addition, the CMA notes that [REDACTED]. The fact that particular sites are contested so vigorously is not consistent with a widespread availability of entrance opportunities across all local areas.

### *Importance of scale*

329. Third parties told the CMA about the importance of scale in operating a profitable business and that this would be necessary to compete against national operators. For example, third parties pointed out the following scale advantages:
- (c) Increased buyer power.
  - (d) Ability to develop stronger long-term relationships with wholesale suppliers.
  - (e) Ability to direct sourcing relationships with manufacturers that offer more favourable terms and greater margins.
  - (f) Access to additional expertise and resources to develop own-brand products.
  - (g) Better position in covenants in lease negotiations for stores, warehouses and distribution.
  - (h) Logistical advantages in the form of a more advanced, reliable and efficient distribution and transport network that allows more products to be delivered to more stores in less time and at a lower cost.
330. A third party submitted that scale is particularly important in the value merchandise sector, with it being a low margin business model.

### *Competitors' entry plans*

331. The submissions received by SPP retailers and VGMs suggests that they plan to significantly increase their number of stores, in line with the rate at which they have roll-out new stores in the past years.

### ***CMA's assessment***

332. The CMA notes that there have been a number of examples of widespread expansion and some examples of entry by new players in the discount general merchandise sector over the past decade or so, with the Parties and VGMs showing a significant expansion path.
333. The CMA also acknowledges that the discount general merchandise sector is expected to continue growing in the near future.
334. Nevertheless, in phase 1, the CMA needs compelling evidence to conclude that entry and expansion will be timely, likely and sufficient to mitigate the SLC resulting from the Merger at a local level.<sup>55</sup>

#### *Timely and likely entry*

335. The CMA considers that entry and expansion may not be sufficiently timely or likely to prevent an SLC arising from the Merger.
336. With the exception of the list of pipeline stores of [X] for 2015, which were already taken into account in the methodology used by the CMA in assessment of the competitive effect of the Merger at a local level (see paragraph 278), the CMA has not received evidence on entry plans by third parties into specific areas.
337. Furthermore, the evidence mentioned above in paragraphs 324 to 328 suggests that finding a suitable vacant site for the opening of a new store by a SPP retailer or VGM may be difficult in some locations. Even the existence of a potentially suitable store for a competitor is not enough to ensure that entry will occur, since there are numerous uses for the site by non-competitors of the Party.
338. Without specific evidence of entry by competitors into specific local areas, the CMA considers that entry will not be timely or likely in order to prevent the realistic prospect of an SLC.

#### *Sufficient competition*

339. Without evidence of timely and likely entry, the CMA does not need to go on to consider sufficiency. However, The CMA notes that that the available

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<sup>55</sup> [Merger Assessment Guidelines](#), paragraph 5.1.3.

evidence indicates that entry and expansion will be insufficient to prevent an SLC in any local areas because:

- (a) many SPP or VGMs are already active in a number of the Parties' overlap areas where the CMA has found that the Merger may result in an SLC; and
- (b) entry by a single entrant may not be sufficient to mitigate concerns in most of the areas where the CMA identified competition concerns, where the diversion between the Parties is very high.

### **Conclusion**

340. The CMA, therefore, is of the view that new entry or expansion will not be timely, likely and sufficient to mitigate any SLC resulting from the Merger in the retail supply of general merchandise by SPP retailers and VGMs at a local level.

### **Third party views**

- 341. The CMA has sought views on the Merger from suppliers, different types of retailers (SPP retailers, VGMs, national multiples and category specialists) and business associations.
- 342. One supplier of the Parties expressed concerns with the Merger, submitting that the relevant frame of reference should be limited to SPP retailers and that the Merger would increase Poundland's buyer power. However, it results from the submission of other third parties that 99p and Poundland in some cases have different suppliers and that they source their products from the 'grey market' (ie parallel imports or other more indirect distribution channels than the authorised distributors). Furthermore, the Parties do not account for more than 5% of the sales of the main suppliers in the UK.
- 343. All the SPP retailers (including a local SPP retailer) that the CMA spoke to expressed concerns with the Merger, submitting that the Merger would significantly reduce the level of competition in the numerous local areas where the Parties' stores are in close proximity, increasing Poundland's ability and incentive to worsen its offer in these local areas.
- 344. None of the VGMs, national multiples and category specialists that responded to the CMA's market testing expressed concerns with the effect of the Merger on competition.

345. Only one LAD was concerned that the Merger might increase Poundland's buyer power and that Poundland might leverage that advantage to increase pressure on other retailers, threatening the viability and survival of other established retail businesses.
346. The CMA also received unsolicited submissions from four consumers expressing concerns with the Merger. Although some of these concerns were not related to the effect of the Merger on competition, some of these consumers emphasised that the Parties are very close competitors and the importance of maintaining competition between the existing SPP retailers to ensure that consumers continue to benefit from a good value for money in the diverse range offered by these retailers.
347. Third party comments have been taken into account where appropriate in the competitive assessment above.

### **Conclusion on substantial lessening of competition**

348. Based on the evidence set out above, the CMA believes that it is or may be the case that the Merger may be expected to result in an SLC as a result of horizontal unilateral effects in relation to the retail supply of general merchandise by SPP retailers and VGMs in the local areas identified in Annex II.

### **Exceptions to the duty to refer**

349. Where the CMA's duty to refer is engaged, the CMA may, pursuant to section 33(2)(c) of the Act, decide not to refer the merger under investigation for a Phase 2 investigation on the basis that relevant customer benefits in relation to the creation of merger situation concerned outweigh the SLC concerned and any adverse effects of the SLC concerned.<sup>56</sup>
350. The CMA has considered below whether it is appropriate to apply the relevant customer benefits (**RCBs**) exception to the present case.

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<sup>56</sup> *Exceptions to the duty to refer and undertakings in lieu of reference guidance*, OFT1122, December 2010.

## ***Relevant customer benefits exception***

### *Parties' submission*

351. The Parties submitted that the Merger will result in significant benefit to customers for two principal reasons:
- the application of the Poundland offering across the 99p Stores estate will lead to a significant enhancement of the customer proposition; and
  - the Merger will enhance the proposition and footprint of the merged entity which will create stronger competition to the UK's largest retailers which will increase value for customers.
352. More generally, the Parties submitted that the Merger will increase dynamic competition in the discount general merchandise sector.

### *CMA's assessment*

353. For the CMA to consider applying the discretionary exception to the duty to refer in relation to RCBs, the RCBs must be clear and the evidence in support of them must be compelling. The merging parties must be able to produce detailed and verifiable evidence of the RCBs that allows the CMA to assess both the magnitude of the RCBs and the probability of them occurring. The CMA sets the magnitude and probability of the RCBs against the scale and probability of the identified anti-competitive effects.<sup>57</sup>
354. In this case, the CMA considers that the Parties have not provided compelling evidence that the RCBs claimed by the Parties will accrue to customers and that they are merger specific (ie that absent the Merger customers would not benefit from the claimed efficiencies).
355. Furthermore, the RCBs claimed by the Parties are very unlikely to constitute an RCB for the purposes of the Act.

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<sup>57</sup> *Exceptions to the duty to refer and undertakings in lieu of reference guidance*, OFT1122, December 2010, paragraphs 4.9-10.

356. First, where the Parties overlap, the CMA notes that a finding of an SLC would be expected to impact upon the offering made by the Parties at their stores, and the CMA therefore considers that there are significant reasons to doubt that the Merger will result in an improved offering to customers. In addition, even where there is no SLC in a local area where the Parties overlap, the CMA notes that customers in those areas would already have access to a Poundland.
357. In local areas where there is currently no overlap, customers will now have a Poundland store rather than a 99p Store. However, the CMA notes that 99p has a number of stores within a short distance of Poundland that still make significant sales, which suggests that for a significant number of customers they have an offering that they value. The CMA is therefore sceptical that converting 99p stores into Poundland stores can result in an RCB. In either case, the CMA considers that such a benefit would not outweigh the customer harm that may result from the SLCs found in a large number of local areas.
358. Finally, the CMA considers that, while the Merger may enhance the scale of Poundland, it will result in the reduction of competition at a local level and this is likely to lead to a deterioration of the Parties' PQRS offering which may be expected to harm, rather than benefit, customers.

### *Conclusion*

359. For the reasons described above, the CMA does not consider that the evidentiary threshold for applying the RCB exception to its duty to refer is satisfied.

### **Decision**

360. Consequently, the CMA believes 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.
361. The CMA therefore considers that it is under a duty to refer under section 33(1) of the Act. However, the duty to refer is not exercised pursuant to section 33(3)(b) while the CMA is considering whether to accept undertakings in lieu of a reference under section 73 of the Act. Pursuant to section 73A(1) of the Act, the Parties have until 16 April 2015 to offer an undertaking to the CMA that might be accepted by the CMA under section 73(2) of the Act. If the Parties do not offer an undertaking by this date, if the Parties indicate before this date that they do not wish to offer an undertaking, or if pursuant to section 73A(2) of the Act the CMA decides by 23 April 2015 that there are no reasonable grounds for believing that it might accept the undertaking offered

by the Parties, or a modified version of it, then the CMA will refer the Merger for a phase 2 investigation pursuant to sections 33(1) and 34ZA(2) of the Act.

**Sheldon Mills**  
**Senior Director, Mergers Group**  
**Competition and Markets Authority**  
**9 April 2015**

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<sup>i</sup> Bargain Buys was not included in the definition of VGMs in paragraph 32, because it is operated by Poundworld Retail Holdings Limited, which also operates the single price fascia Poundworld.

## ANNEX I: The CMA's assessment of the Parties' PCA submission

### *Model specification*

1. The estimated equations present a series of limitations that may be affecting the ability of the econometric analysis to calculate an effect with sufficient precision for it to be relied upon by the CMA in its consideration of the competitive effects of the Merger. For example:
  - **Measures of concentration in local markets.** The measures of concentration used in the analysis include the fascia or store count separately by each type of store which is different to the traditional approach in PCAs to include the overall number of competitor fascia or stores given the market definition, for example, the number of VGMs stores in the region, and testing for sensitivities using interactions or a dummy variable for the presence of the merging party.
  - **Bad controls.** A bad control is a variable that captures partially or totally the effect that the model is trying to estimate, and therefore could be considered as an alternative dependent variable. In the case of PCAs, the regression should not include variables that are affected by local competition capturing part of this effect. A clear example is the inclusion of sales per square foot in the regression. This variable is a key component of the dependent variable (margins) and is therefore endogenous. Moreover, it would be expected that if local competition is affecting the performance of Poundland stores, it should do so by affecting its sales. Therefore, the inclusion of sales as a control is likely to be capturing the effect that the model is trying to estimate. A similar reasoning can be applied to the inclusion of store size as a control – which is associated with product range – and store refurbishment, which may be a response to more intense competition in the area.
  - **Local area controls.** The regression includes a number of controls that aim to control for the different level of demand in each area. The CMA acknowledges that controlling for demand-side characteristics is appropriate as areas of high demand may present larger margins for the same level of concentration. At the same time, high demand is likely to attract more entry into the local area, resulting in a larger number of stores. At the same time, adding too many local area controls, particularly if they are highly correlated between them and with the level of concentration, can affect the overall efficiency of the estimations and the ability of the econometric model to estimate the effect with enough precision leading to insignificance of the estimated coefficients. Inspection

of the data reveals that this may be an issue in this particular application. In fact, in most specifications, the coefficients of local area controls are insignificantly different from zero, with the exception of the unemployment rate. As an illustration, population density presents a correlation coefficient of 76 to 84% with the percentage of ethnic minority and 54 to 60% with average annual income in the region. However, they do not present high levels of correlation with the concentration indicators used by the Parties in the analysis.

### ***Endogeneity***

2. PCA applications are usually subject to endogeneity problems which may result in an underestimation of the impact of competition on margins. This is due to the fact that the local areas where margins are higher tend to attract more competitors. The Parties submitted in their report (page 17) that ‘...barriers to entry are extremely low in this sector, and the speed with which entry could take place if a margin opportunity arose is high’. They argue that this is as an indication that any potential endogeneity biases are likely to be small. As set out in the main text of the decision (see section on Barriers to entry), the CMA is not convinced that barriers to entry are as low as the Parties argue in this market. In any case, the CMA is not convinced that endogeneity would not be a problem even if barriers to entry were low. This is because the mechanism causing the endogeneity, that areas with characteristics that lead to higher margins can easily be entered by other competitors, would be functioning well in this market. The CMA considers that endogeneity is still likely to be an issue in this case if barriers to entry are not very low. This is because the Parties have entered a number of areas over a relatively recent time period and therefore their entry decisions into areas are likely to be affected by the current characteristics of the market.
3. In order to account for endogeneity, the Parties submitted an analysis using an instrumental variables (IV) approach. Four instruments are constructed on the basis of the total population in the area around each store’s catchment as follows: the five mile radius minus the total population in the three mile radius, total population in the three mile radius minus total population in the one mile radius, and the squares of each of these.
4. This instrumental variable specification is shown to suffer from ‘weak instruments’ problems. This means that the correlation between instruments and endogenous regressors is not sufficient for the instruments to successfully control for endogeneity, potentially resulting in biased estimations. In particular, weak instruments are known to lead to insignificant

results even when effects exist. This is clearly problematic in this case where conclusions are being drawn from the insignificance of coefficients.

### *CMA analysis*

5. The CMA performed a series of sensitivity tests to the analysis submitted by the Parties addressing some of the issues discussed above. In particular, the CMA tested how results changed by modifying the model's specification. In the absence of additional data, the CMA was not able to perform any sensitivity analysis regarding the weak instrument problem since no alternative instruments were available.
6. The specification used by the CMA for its sensitivity tests resulted in the following changes to the model:
  - (a) **Measures of local concentration.** The CMA constructed local concentration measures for the market of national SPP retailers – Poundland, 99p and Poundworld. The CMA considered alternative approaches to calculating concentration, as follows: (i) separate variables for the number of fascia/stores of each competitor in the catchment area, (ii) a unique variable counting the total number of competing fascia/stores in the catchment area, (iii) same as (b) plus its square to account for non-linear effects, and (iv) same as (b) but including a dummy for the presence of 99p.
  - (b) **Controls.** To check whether non-significance of the results are affected by the inclusion of different controls, the CMA first estimated the model including only regional controls and progressively added regional and store controls.
  - (c) **Dependent variable.** Estimating alternative specifications with the dependent variables, gross and variable margins, expressed either in logarithms or levels. The standard approach used in the literature is generally to express the dependent variable in logarithms.
7. The sensitivity test performed failed to find any significant effects of concentration measures on Poundland stores' margins.

## **ANNEX II: List of local areas where the CMA found a realistic prospect of an SLC**

**Table A: Areas where the CMA found an SLC based on loss of actual competition**

*1: Areas with more than one 99p store*

[REDACTED]

*2: Areas with more than one Poundland store*

[REDACTED]

*3: Areas where each of the Parties only have one store*

[REDACTED]

Source: CMA analysis.

**Table B: Areas where the CMA found an SLC based on loss of potential competition in specified areas**

*1: Poundland pipeline stores that overlap with existing 99p stores*

[REDACTED]

*2: 99p pipeline stores that overlap with existing Poundland stores*

[REDACTED]

Source: CMA analysis.