
Completed acquisition by Woolworths Group plc of Bertram Group Limited

The OFT's decision on reference under section 22(1) given on 3 April 2007. Full text of decision published 16 April 2007.

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

PARTIES

1. **Woolworths Group plc (Woolworths)** is principally a retailer of a wide range of 'home' products, with 803 stores throughout the UK. However, it also operates as a distributor of books and home entertainment products (HEPs) through its subsidiaries **Entertainment UK Limited (EUK)** and **Total Home Entertainment Distribution Limited (THE)**.
2. **Bertram Group Limited (Bertram)** is a wholesale supplier of books to retailers, a wholesale supplier of books to libraries and the primary distributor of books for some small publishers. Wholesale book distribution to retailers currently accounts for about 75 per cent of the group's sales. Bertram's turnover in the financial year ended 31 July 2006 was approximately £106.3 million, of which over £70 million was achieved in the UK.

TRANSACTION

3. On 1 February 2007 EUK acquired sole control over Bertram when it acquired all of Bertram's preference shares and, separately, by way of offers for all the classes of ordinary shares in the capital of Bertram, the majority of Bertram's ordinary shares. EUK declared the offers for the ordinary shares unconditional on 1 February. EUK has acquired a sufficient

number of ordinary shares to acquire compulsorily those ordinary shares which were not assented to the relevant offer, thereby enabling EUK to acquire 100 per cent of Bertram. The compulsory acquisition process will be completed on 6 April 2007.

4. The parties notified the transaction to the OFT on 8 February 2007. The administrative deadline is therefore 5 April 2007, and the statutory deadline is 31 May 2007.

JURISDICTION

5. As a result of this transaction Woolworths and Bertram have ceased to be distinct. The UK turnover of Bertram exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

BACKGROUND

6. The parties overlap in 'trade' (retail) wholesale supply of books and library wholesale supply. There is also a minor vertical overlap as THE obtains a small number of books from Bertram (£370 worth in 2005/2006). As mentioned above, Woolworths is also a retailer, and stocks a relatively limited range of books at their retail stores.

The book supply chain

7. In 2005, the UK book market was worth around £4.1 billion (by retail value), with retail sales accounting for around £2.8 billion, sales to businesses and academics approximately £1.1 billion and sales to libraries and schools around £0.3 billion.¹ Recent growth in the book market has been robust at around 2.8 per cent per annum (by volume) in recent years but revenue growth slowed in 2006 as a result of a decline in prices.
8. Although there are thought to be up to 10,000 publishers in the UK, the parties told the OFT that over 50 per cent of the book publishing market is accounted for by the top four publishers - Hachette/Time Warner (Warner, Hodder Headline, Orion), Bertelsmann (Random House, Transworld, Ebury,

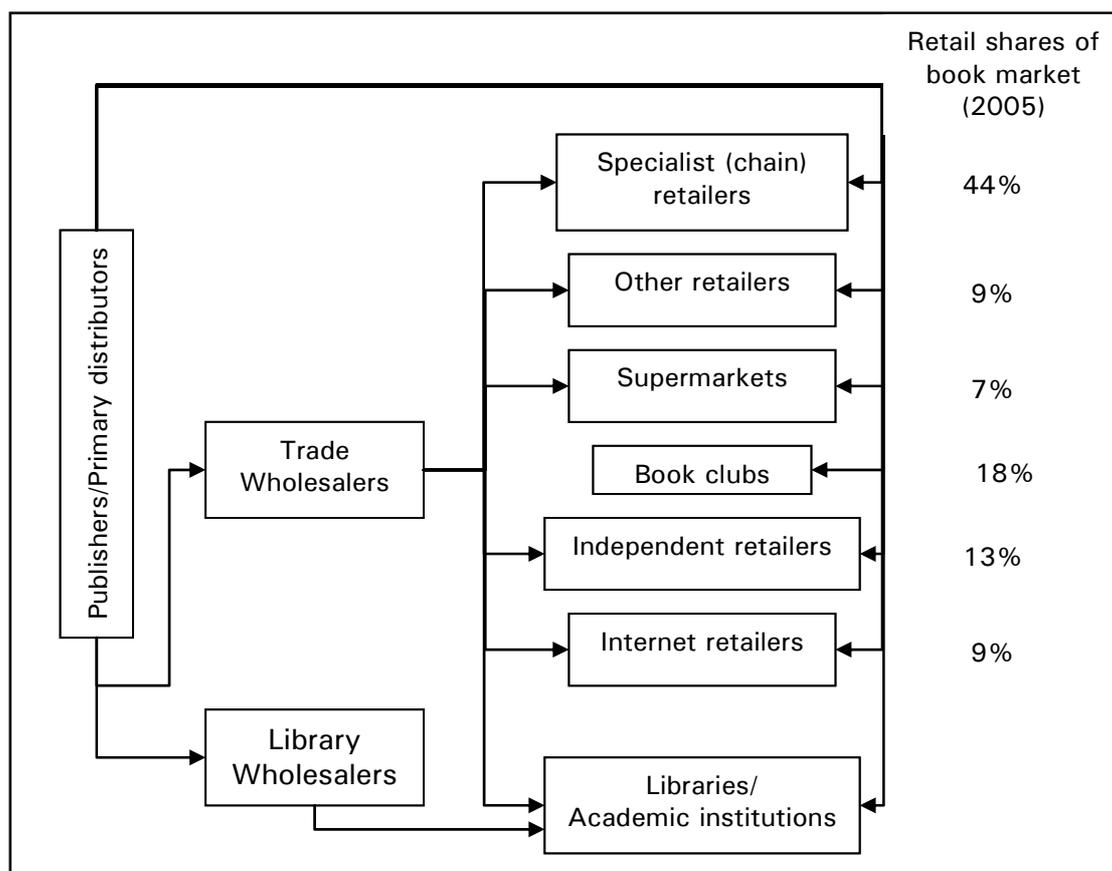
¹ Exports represent around £1.3bn of this total across all three types of customer.

BBC), Pearson (Dorling Kindersley, Penguin) and News Corporation (HarperCollins).

9. Publishers distribute almost all of their products (to both retailers and wholesalers) using primary distributors who may act for more than one publisher. From these primary distributors (and in the minority of cases, from the publishers themselves), books are supplied downstream in one of the following ways:
 - **Direct supply to retailers** – this accounts for around 80 per cent of the books sold in the UK, with retailers of all sizes negotiating orders directly with publishers (and relevant primary distributors);
 - **Via a trade wholesaler** – approximately 20 per cent of books sold by retailers in the UK are supplied through a trade wholesaler; and
 - **Via a library wholesaler** – almost all sales of books to public libraries and the majority of sales of books to academic libraries occur through library wholesalers.

10. The book supply chain can be represented graphically by the chart below.

Chart 1: The book supply chain



Source: Figures from PricewaterhouseCoopers Report commissioned by Bertram

- While there are a large range of titles distributed through these supply chains, information obtained by the OFT suggested that volume is concentrated in the leading titles, with a long tail of titles sold at a smaller volume. The parties' internal documents suggested that, although there were 625,000 titles sold across the whole UK books market in 2005, the top 500 titles accounted for 24 per cent of sales.

Previous OFT / CC decisions

- There are two recent merger investigations relating to the book supply chain. On 6 December 2005 the OFT referred the proposed acquisition of Ottakar's plc by HMV Group to the Competition Commission (CC).² The parties overlapped on the basis of the retail supply of books. The OFT believed that there was a loss of close competition between the parties, primarily on non-price factors at the local level. Upon further investigation

by the CC,³ it found that the merged entity would not willingly reduce range and service quality, nor would the merger result in a reduction of books promoted. The CC concluded that the proposed acquisition would not result in a substantial lessening of competition in the market for the retail sale of new books.

13. The OFT has also recently considered a merger in relation to Woolworths' wholesale distribution. In Woolworths/AMP⁴ the OFT considered the acquisition by Woolworths of AMP Enterprises Limited, at that time the parent company of THE. The merger has a direct relationship with the current investigation, given that it involved the same acquirer and also examined the wholesale supply of books.
14. Prior to the Woolworths/AMP transaction, EUK was an in-house distributor of books and HEPs for Woolworths and also provided book distribution services for a national supermarket customer. The transaction resulted in Woolworths acquiring the business of THE, a wholesale distributor of HEPs and books to a range of retailers.
15. The OFT considered the appropriate frame of reference for that merger to be the supply of each of HEPs and books through all distribution channels (i.e. through wholesalers and direct supply). On the basis of both the evidence received in and of the nature of that case, even on a narrower frame of reference (the wholesale supply of books) the OFT did not believe that the merger would give rise to a substantial lessening of competition. The OFT considered that, in addition to the remaining wholesalers in the market, some constraint from the threat of new entry and expansion and strong countervailing buyer power from large chains and retailers would provide effective competitive constraints on the conduct of the merged entity.
16. The OFT's approach in Woolworths/AMP was the obvious starting point for the OFT's current investigation. However, there is a significant difference in those customers affected by the present case. As stated above, prior to the acquisition of THE, Woolworths, through EUK, was involved only in the

² OFT decision: Anticipated acquisition by HMV Group plc through Waterstone's plc of Ottakar's plc (6 December 2005).

³ CC decision: HMV Group plc and Ottakar's plc: Proposed acquisition of Ottakar's plc by HMV Group plc through Waterstone's Booksellers Ltd (12 May 2006).

distribution of books in-house and to a single supermarket customer, but not to independent retailers, internet retailers or chain stores. Therefore, that merger only resulted in a reduction in the number of wholesalers supplying supermarkets, and did not therefore result in a reduction of the number of suppliers to other retailers. In the case of this current merger, both Bertram and EUK/THE are involved in book distribution to all types of retailers, such that the merger gives rise to a reduction in the number of wholesale suppliers for all retail customers.

17. Indicative of this difference between the two merger situations, the OFT received comments and complaints from an extremely large number of customers during this investigation, compared to both the Woolworths/AMP investigation and the typical OFT merger investigation. A significant proportion of these responses were from independent retailers, who suggested that while they were unaffected by the Woolworths/AMP merger, the merger of Woolworths (that is, EUK/THE) and Bertram would have a significant effect on competition for the wholesale supply of books to this retail group, and that this reduction in competition would not be offset by any of the factors discussed in Woolworths/AMP. Responses at other levels of the supply chain supported the views of independent retailers.
18. Given the difference in the factual circumstances surrounding this case, and the coherent and widespread opposition to the transaction by a large number of third parties, both of which were raised with the parties early in the investigation, the OFT considered it appropriate to revisit many of the issues that were relevant to the analysis of the Woolworths/AMP merger.

MARKET DEFINITION

Product market

19. As set out above, the parties overlap in the wholesale supply of books to retailers (including independent retailers, which accounted for 27 per cent of Bertram's revenue in 2006) and libraries. The parties do not overlap in the supply of HEPs (Bertram currently only supplies books) and the information obtained by the OFT during the investigation confirmed that we

⁴ OFT decision: *Completed acquisition by Woolworths Group of AMP Enterprises Limited* (15 December 2006).

should not depart from our view in Woolworths/AMP that books and other HEPs should be considered under different frames of reference.

Wholesale supply of books to libraries

20. The OFT considered whether library wholesalers constitute a separate sales channel from trade wholesaling.
21. The parties estimate that almost all sales of books to public libraries occur through library wholesalers, as do the majority of books to academic libraries. There are also several suppliers that have a significant share in library wholesale that do not serve such a significant proportion of retail wholesaling (e.g. Coutts, Dawsons, Blackwells, Holt Jackson, Askews).
22. However, it was suggested to the OFT - by both the merging parties and some third parties - that the particular add-on services provided by library wholesalers could easily be replicated by other (retail) wholesalers. Furthermore, the distinction made by publishers in terms of the different discounts offered to 'library' and 'trade' wholesalers was gradually being eroded – for example, Bertram Library Services (BLS) has recently obtained a far greater proportion of its books via Bertram's retail wholesaling business rather than purchasing direct from publishers and is successfully leveraging that lower discount to undercut existing library wholesalers. Evidence from internal documents and third parties suggests that such an approach is not looked upon favourably by publishers, as this destroys the publishers' differential (by category) pricing model.
23. This is likely to be evidence of an asymmetric constraint operating on library wholesalers due to the structure of discounts offered to library and trade wholesalers by publishers. It is therefore difficult for library wholesalers to supply retailers, as they are at a disadvantage in terms of publisher discounts and hence the prices they are able to offer. Indeed, some library wholesalers purchase their stock from trade wholesalers as BLS has begun to do so.
24. The absence of library wholesalers moving in to trade wholesaling (but not necessarily vice versa), coupled with the entry of Bertram into library wholesaling largely through its merger with Cypher Group in 1999 (now BLS, but at the time the largest specialist library wholesaler) indicates that

supply-side substitution between trade and library wholesaling is likely to be limited at best.

25. On the basis of the evidence before it the OFT will take a cautious approach and consider wholesale supply to libraries separately from wholesale supply to retailers.

Wholesale supply of books to independent retailers

26. As discussed above, in Woolworths/AMP the OFT considered the appropriate frame of reference to be the supply of books through both wholesalers and direct supply. However, a large number of third parties commenting on this merger suggested that it was more relevant for the OFT to consider the extent to which direct supply constrains wholesale supply for different types of book retailers. Third parties noted that there were key differences between the different types of book retailer such that the potential effect of the current merger would be different to that of Woolworths/AMP. Third parties suggested that these differences particularly affected the ability of independent retailers to use direct supply as a constraint on wholesalers. These issues are examined in detail below.
27. Despite the growth in internet and supermarket sales, the independent retail book sector is still a significant part of the retail book industry. According to a Report commissioned from [-] by Bertram (the Bertram Report), independent retailers account for approximately 13 per cent of total retail book sales, or approximately £360 million. While the number of independent retailers appears to be declining, the Bertram Report suggests that the value of sales by independent retailers has grown in recent years.
28. The OFT found that different independent retailers can have significantly different characteristics, making an assessment of the effect of the merger on the typical 'independent retailer' difficult. In HMV/Ottakar's the CC included in its description of independent retailers both 'small chains of independents with five outlets or fewer....., as well as individual bookshops (of which a few.....are very large, but the majority are relatively small)'.⁵ The CC also noted that independents 'were often situated in tertiary sites away from town centres, or in smaller towns without one of

⁵ HMV/Ottakar's at paragraph 5.8.

the large chains'.⁶ The parties' internal documents tend to categorise independent retailers as any bookseller that is not a supermarket, book club, internet retailer or high street chain.

29. In order to obtain information on the characteristics of independent retailers, and in response to the large number of third party responses to the OFT's 'Invitation to Comment' (ITC) notice, the OFT distributed a small questionnaire to independent retailers through the Booksellers Association. The OFT obtained over 60 responses to this survey, which sought information on where independent retailers obtained their book supplies, how easy it was to switch between different sources of supply and what would cause a change in the source of supply. While accepting that there is a risk that these responses may be biased towards those retailers supplied by the parties, the OFT believes that the responses to this survey taken together with the other responses to the ITC, broadly support other representations made to the OFT and other evidence discussed below.
30. Notwithstanding the differing characteristics of independent retailers, the OFT's analysis suggested that there are some characteristics common to a sufficient number of them that are relevant to the OFT's frame of reference. Supermarket expansion into 'popular' titles, favourable discount rates granted to supermarkets by publishers and concentration among retail chains means that independent retailers have had to find a point of difference between themselves and other retailers. The Bertram Report states that '[s]pecialisation, and expert local knowledge, are thought to be key for the survival of independent bookshops', quoting one independent retailer as describing itself as 'more of a back list shop and that's where we compete well'.
31. The relative size of independent retailers and the focus on differentiating their offering from supermarkets and retail chains are consistent with the evidence the OFT received that independent retailers buy on an ad hoc basis, and in smaller volumes, than other book retailers. Independents said that they rely on wholesalers for day-to-day replenishment of stock, allowing for a varied stock holding and quick (usually next day) responses to customer orders.

⁶ Ibid.

32. Evidence obtained by the OFT, which was confirmed by the parties, suggested that most independent retailers have relationships with usually a 'primary' and 'secondary' wholesaler – with lower discounts offered by the 'secondary' wholesaler due to the lower total volumes involved - as well as publishers – mainly for advance orders for new books (where prompt supply was less of an issue). The parties report that the proprietary ordering/stock management software supplied by a particular wholesaler to independents also facilitated switching, by allowing retailers to place orders with other wholesalers and publishers.
33. However, despite the availability of direct purchase, the split between wholesale supply and direct supply from publishers is very different for independent retailers compared to other book retailers. From the responses received by the OFT, including the survey facilitated by the Booksellers Association, it appears that a significant proportion of independent retailers purchase less than 20 per cent of their books direct from publishers and very few books from wholesalers other than Bertram, THE and Gardners. This despite the fact that the discounts offered to independent retailers by publishers would usually be some 5 per cent higher than those offered by trade wholesalers (such as the parties). Moreover, this split can be compared to total book sales through all retail channels, which suggests that over 83 per cent of all books sold in the UK are distributed to retailers by direct supply.⁷ Third party retailers said that independent retailers might typically obtain initial orders (and so better discounts) on new and/or promotional titles using direct supply, but were reliant on wholesalers for all other stock requirements.
34. The reasons for the difference in wholesale/direct purchase split between independent retailers and other retailers appear to relate to the non-price factors discussed above. Indeed, the parties told the OFT that they could not generally compete with direct supply on price. This was confirmed by the Bertram Report, which claimed that 'while direct purchasing from publishers is often cheaper [for retailers], there appears to be limited threat from this due to the convenience and service offered by a wholesaler'.

⁷There was a small number of independents that buy all but a small fraction of the books from publishers – the reason given for this is the terms offered by publishers compared to wholesalers, though these retailers tended to focus on specialist types of books (e.g. academic, religious).

35. Difficulties cited by independents with obtaining a significant volume of their stock through direct purchase included:
- lack of sufficient volume to qualify for competitive discount terms, supply or free delivery. Independent retailers told us that publishers often required a minimum volume spend to qualify for free delivery, or to open a credit account. Even if free delivery was possible, this often took at least 3 - 5 days compared with overnight wholesaler delivery
 - additional administration costs arising from dealing with a greater number of suppliers. While the parties told us that the top 50 per cent of books are accounted for by the top four publishers (the top 60 per cent being accounted for by the top ten publishers), the Bertram Report suggests that '[w]holesalers benefit from the fragmentation of the small publishers because retailers cannot deal with the long tail directly, and there has not been significant consolidation amongst these'. In order for independent retailers to switch to direct supply they would have to deal with a number of publishers, particularly those who wish to differentiate themselves from other retail channels and stock a more diverse range of titles. Although the parties provided us with one example of a retailer who dealt with about 200 suppliers, independent retailers told us that dealing with a number of publishers required significant time and resources, particularly with smaller publishers who were not equipped to deal with small accounts
 - lack of online ordering/stock management software and merchandising/promotional support from publishers.
36. The parties argued that there was little difference between the service offering provided by wholesalers and publishers. They suggested that minimum order requirements were not significant, and that delivery times, returns policies and other service aspects were similar between direct and wholesale supply. However, evidence from third parties appears to contradict this by showing the difficulties independent retailers face in switching to direct supply and the lack of a constraint on wholesalers, which was further supported by the internal documents of the parties. For example, in relation to the type of services provided, Bertram provided the OFT with the results of its yearly survey of independent retailers (the Bertram survey). The results showed that publishers did not compare

favourably with wholesalers in terms of speed of delivery, though did compare quite well in offering competitive terms.

37. The Bertram survey also showed the importance of non-price competition for independent retailers, with price ranked as the third most important aspect of book supply, below both service and range. Although publishers were generally included amongst the top three suppliers for a large proportion of independent retailers, no information was provided on the volume of books obtained from each source of supply. This is not, however, inconsistent with the OFT's findings that independent retailers generally have a primary and secondary trade wholesaler and some direct supply from publishers. Of the examples given by Bertram to the OFT of changes to their product offering in response to the Bertram survey results, all were to Bertram's service quality - to allow it to become more competitive vis-à-vis other wholesalers, rather than direct supply.
38. Independent retailers' reliance on wholesalers was further described in the Bertram Report:

'Wholesalers are strong in the independent sector due to independents' inability to source directly from publishers given their size (and, in some cases, inability to obtain trade insurance).'

39. While the Bertram Report suggests that publishers are a threat to retailers if they could improve their delivery processes, it concludes:

'The distribution arms of publishers have been developed for the delivery of large pallets of books, unlike wholesalers which are mostly geared to deliver efficiently in smaller packs. This may prevent publishers from effectively moving in to the role currently performed by wholesalers'

40. A report for EUK by [-] on the possible acquisition of Bertram (the EUK Report) also suggests smaller retailers are relatively more dependent on wholesalers:

'Smaller retailers are far more dependent [than other retail channels] on wholesalers

- Lack stock management capabilities

- Too small to negotiate with multiple publishers
 - Too small to obtain significant discounts from publishers'.
41. The EUK Report further suggests that independents are 'actually increasing their use of wholesalers as publishers rationalise sales staff'. It suggests that the acquisition of Bertram by another wholesaler (Gardner) would be 'very unlikely to be allowed past the OFT in current form' and that, if permitted, such a merger 'would create a very powerful player'. This appears to be inconsistent with the parties' submission that direct supply would be a significant and adequate constraint on trade wholesalers post merger.
 42. The parties did provide examples of publishers actively engaging with independent retailers to support them. The parties provided us with public statements by publishers concerning initiatives aimed at independent retailers, and some publishers contacted by the OFT told us that they had staff tasked with encouraging sales growth specifically to independent retailers. It is not clear to the OFT whether this means that publishers would be promoting specific titles rather than direct supply. However, publishers that did respond to the OFT told us that sales to independent retailers made up only a very small proportion of their total sales, and this proportion had generally remained static or declined in recent years.
 43. In conclusion, while acknowledging the different characteristics of independent retailers, in particular the fact some independents do obtain a significant proportion of books through direct supply, the evidence collected by the OFT suggests that a sufficient number of independent retailers cannot use direct supply to constrain trade wholesalers for a large proportion of their book requirements, and that supply to independent retailers should be considered as a separate frame of reference for the purposes of this investigation.
 44. With the exception of independent retailers, the OFT did not obtain evidence to suggest that direct supply was not a constraint for other retail channels. Larger retailers such as retail chains, book clubs, supermarkets, and internet retailers obtained a large volume of their stock using direct supply, and were not concerned by the merger. Given the lack of concerns from these customers and responses that direct supply could be (if it was

not already) a constraint on wholesalers, the consequences of the transaction on these groups of retailers are not considered further.

Geographic market

45. On the basis of the evidence before it, the OFT considers that in general, the supply of books occurs on a national, rather than regional or international basis and a UK-wide market was used in the Woolworths/AMP case. The European Commission stated in Bertlesmann/Havas/Bol⁸ that the book market may be wider than national as a result of sales made over the internet, but the OFT has not received persuasive evidence to support this. The OFT therefore considers that the appropriate frame of reference for this merger is the UK.

Conclusion

46. The relevant frame of reference for the purpose of this analysis is therefore the wholesale supply of books to independent retailers in the UK.

HORIZONTAL ISSUES

Non-coordinated effects

Wholesale supply of books to libraries

47. THE supplies audio books to public libraries, amounting to £[] in sales last year, and also sells to buyers who purchase on behalf of schools (school buyers), which accounted for around £[] last year. THE also supplies books to some library wholesalers (Askews, Dawsons and Coutts), amounting to about £[] in sales last year.
48. There is a negligible overlap in wholesale book supply to libraries, indicated by a post-merger share of supply of [10 to 20] per cent by volume ([10 to 20] per cent by value) with an increment of [0 to 10] per cent by volume ([0 to 10] per cent by value). There are several other significant suppliers in this segment, including Coutts ([10 to 20] per cent share by volume), Dawsons ([10 to 20] per cent), Blackwells ([10 to 20] per cent) and Askews ([10 to 20] per cent).

⁸ COMP/M.1459 - Bertlesmann/Havas/Bol (6 May 1999).

49. The market is still relatively fragmented and therefore the OFT considers that the parties (even post-merger) could not profitably sustain a price increase or significant worsening in their terms of service to customers. Given this the OFT does not believe that the merger will raise competition concerns in respect of library wholesalers, and therefore library wholesaling is not discussed further in this decision.

Wholesale supply of books to independent retailers

50. As set out above, independent retailers value the non-price factors provided by wholesalers. The OFT therefore considered whether, in addition to any price effect from the merger (i.e. lowering the margin on RRP provided to independent retailers), the merger would affect non-price aspects of competition, such as lowering the service levels provided by wholesalers to independent retailers.
51. When considering the supply of books to retailers both through wholesalers and direct supply, the increment resulting from the merger is quite low – only [0 to 10] per cent by volume ([0 to 10] per cent by value) – due to the high proportion of books supplied directly from publishers. As discussed above, (and consistent with the decision in Woolworth/AMP) there are many larger retailers (such as supermarkets, chain book retailers and major internet retailers) for whom the competitive dynamics reflect this relatively fragmented supply structure, with wholesalers effectively constrained by publishers through direct supply.
52. However, further to our conclusion in relation to the appropriate frame of reference, on the basis of the evidence before it, the OFT considers that direct supply does not provide an effective competitive constraint on wholesalers in relation to their supply of independent retailers. For this customer group, therefore, it is more meaningful to exclude direct supply from any share of supply analysis. On this basis, the supply structure becomes much more concentrated, with only three major wholesalers prior to the merger, which decreases to two as a result of the merger. Market shares are set out in Table 1 below.

Table 1: Shares of supply for books to retailers, 2006 (wholesalers only) ⁹

Supplier	Share of supply (per cent, by volume)	Share of supply (per cent, by value)
EUK/THE	[20 to 30]	[10 to 20]
Bertram	[20 to 30]	[20 to 30]
Post-merger	[40 to 50]	[40 to 50]
Gardners	[40 to 50]	[40 to 50]
Handleman	[0 to 10]	[0 to 10]
Other wholesalers	[0 to 10]	[0 to 10]

Source: Parties' estimates

53. The above figures do include some wholesale supply to supermarkets and large retail chains. While it has not been possible to break down these shares of supply based on type of retailer, from data supplied by the parties OFT estimates their combined post-merger share of supply to independents at about [50 to 60] per cent. If it is assumed that Gardners would have at least an equal share to each of the other two major wholesalers, the three-firm concentration ratio for wholesale supply to independent retailers (or two firm concentration post merger) would be over 80 per cent. The Information Memorandum prepared by Bertram in relation to the potential sale (Bertram Information Memorandum) confirms that '[t]here is limited competition within the UK books wholesale market' and the Bertram Report notes that 'the UK retail book wholesale market is dominated by three players, although Lomond Books and Advanced Marketing (Europe) Ltd are also believed to be active'. Such a high combined share of supply arising from the merger might be expected to raise concerns on a horizontal basis.
54. There is substantial evidence from the parties internal documents that THE, Bertram and Gardners are each others closest competitors. Almost all competitive analysis in the parties' internal documents refers to these three wholesalers as the only choices for independent retailers (with the exception of the possible 'threat' from direct supply described above in the

⁹ []. The figures above exclude the in-house supply of books by EUK to Woolworths' retail outlets, which many third parties have argued should not be excluded, so EUK/THE's share of supply is likely to be slightly underestimated on this basis.

Bertram Report). Bertram's 2006/2007 Business Plan suggests that Bertram's product offering is positioned between that of Gardners and THE, offering 400,000 titles (compared to 500,000 for Gardners and 130,000 for THE) at superior terms to Gardners but inferior to those offered by THE.

55. The OFT received substantial evidence of competitive interaction between the three wholesalers. A number of third parties suggested that, given THE's product offering, retailers often played off THE against Gardners and Bertram to obtain better terms from these wholesalers. The Bertram Information Memorandum suggests that Bertram's business strategy is to 'differentiate itself from Gardners and THE by combining a broad title range with excellent and flexible service'.
56. The OFT considered whether it would be possible for the merged entity to discriminate between independent retailers and other retail customers, and to a lesser extent between different independent retailers depending on their reliance on wholesale supply. The OFT also considered whether it would be possible for the merged entity to discriminate between those titles for which direct supply was an option for independent retailers and those for which it was not. The parties submitted that it was not possible for them to determine which type of retailer was not able to switch to direct supply, nor was it possible for the parties to discriminate between those titles/services for which independent retailers may have an option of direct supply and those for which they did not.
57. The OFT found that, in addition to the Bertram survey, wholesalers have access to a large amount of market information regarding independent retailers. The Bertram Report states that 'most independents appear to be very loyal to their principal wholesaler', such that any diversion of sales is likely to be noted. In addition, regular contact with retailers is a key part of a wholesaler's service offering, and wholesalers provide independent retailers with computer systems on which they can place stock orders. These factors suggest that there is regular interaction between a wholesaler and its customers and that wholesalers will have a sufficient degree of information to determine both the extent to which a retailer is able to use direct supply, and the nature of any purchases that are made using direct supply.
58. Further evidence of this ability to discriminate is evident from margin data in Bertram's financial accounts, which show that gross margins for large

independent booksellers (identified individually) are significantly lower than those for 'other independents' – that is, excluding those larger independents – for whom the OFT considers, on the basis of the evidence before it, that direct supply was less of a constraint on wholesale supply.

59. The parties submitted that, given the limited book range offered by THE compared to Bertram and Gardners, the merger would effectively result in little or no change in the competition dynamics for those retailers who require a deeper titles range. However, while THE offers a substantially smaller range of titles than Bertram and/or Gardners, it still offers over 100,000 titles to retailers. Information provided to the OFT by the parties suggests that 100,000 titles is sufficient to cover 94 per cent of the total book market. This suggests that there is sufficient scope for exercising the theory of harm.
60. Moreover, as mentioned above, independent retailers tend to have a primary trade wholesaler and a secondary wholesaler. Currently, the three trade wholesalers compete to be the primary wholesaler but also, the two that are not the primary wholesaler, compete to be the secondary wholesaler. Some third parties made the point that, in addition to reducing their choice of primary wholesaler, the merger would also remove their choice of secondary wholesaler. Post merger, on the basis of the evidence before it, the OFT considers that, as well as a reduction in competition to be primary wholesaler, the parties and Gardner would have a reduced incentive to offer the current level of discounts (if any at all) as secondary wholesaler and a reduced incentive to provide an effective back up service.
61. Overall, based on the evidence set out above and the concerns raised by a large number of customers, the OFT considers that the merger may lead to the loss of an important competitive constraint in relation to the wholesale supply of books to independent retailers. This may be expected to give rise to an increase in price (through lower discounts) and less favourable non-price (eg service quality) terms to customers.

Barriers to entry and expansion

62. In Woolworths/AMP the OFT considered that entry and expansion would provide an effective competitive constraint on the merged entity, and that even considering the wholesale market separately from direct supply, new entry exerted some competitive discipline on existing firms. However, given the factual differences between the two cases, the OFT considered in this case whether entry was possible not just for the wholesale supply of books but for the wholesale supply of books to independent retailers.
63. The parties provided three cost scenarios which reflected the approximate costs of entry for a wholly new entrant into book wholesaling (approximately £[-]), an existing HEP wholesaler expanding into the books segment (approximately £[-]) and a library wholesaler expanding into trade wholesaling (approximately £[-]). This was based on costs required for a new entrant to serve approximately [0 – 10] per cent of the book retailer base, which is considerably less than that served by Bertram pre-merger.
64. Many third parties submitted that barriers to entry were high and it was generally considered unlikely that a major book wholesaler would emerge, either from the expansion or entry of a new wholesaler. In addition to the costs estimated by the parties, a new entrant would also need to establish relationships with all major publishers, as well as retailers, which would be time-consuming and administratively costly. The OFT found that wholesalers had close relationships with independent retailers. In addition, the Bertram Information Memorandum stated that '[b]arriers to entry are high and include customer relationships, dedicated warehouse facilities and in-house expertise in book-buying'.
65. In terms of expansion by existing wholesalers, the parties provided the example of EUK, which significantly expanded its book wholesaling operations to meet a single supermarket's supply requirements following the award of a contract in 2004. The costs of expansion were £[-] to serve a business that represents approximately [0 to 10] per cent of the total UK book retail market. However, in June 2005 and May 2006 EUK looked at the possibility of expanding its book offering to independent retailers. Despite the relatively low cost of such expansion (approximately £[-]), these plans were halted by the acquisition of THE.

66. The parties also provided the example of Handleman UK Limited (Handleman), which entered the UK wholesale market in 1999 as the wholesaler for Asda. The parties submitted that Handleman's book distribution capabilities were about to increase significantly, with minimal additional investment required to start servicing other supermarkets and smaller book retailers. However, the OFT received no third party evidence to support this view, and note that despite its sponsored entry Handleman has not significantly increased its market share since its entry in 1999, nor has it extended its services beyond supermarket customers.
67. The difficulty in expanding into the independent sector is further illustrated by the EUK Report, which suggests that rather than purchase Bertram, EUK could allow another party to purchase Bertram and instead attempt to buy market share. However, it is acknowledged in the report that 'this could take a long time and the cost is uncertain'. If EUK/THE, as an established competitor, has doubts about its own ability to expand, this calls into question the ability of new or expanding wholesalers to obtain market share.
68. The parties contend that library book wholesalers, as well as trade wholesalers currently specialising in the distribution of HEPs, have the ability to expand rapidly into the trade wholesale book segment with limited additional investment. However, as explored in the section on market definition, there is currently little supply-side substitution between library wholesalers and trade wholesalers, though there is limited evidence to suggest that this may be changing.
69. The parties' internal documents, the EUK and Handleman examples and the limited supply-side substitution between library wholesaling and trade wholesaling all support the view that customer relationships are a key barrier to supplying independent retailers. Given this evidence, the OFT does not consider that entry into the wholesale supply of books to independent retailers will be sufficient in time, scope and likelihood to prevent the effects of any lessening of competition arising from this merger.

Buyer power

70. The parties submitted that, in general, buyer power was likely to be a strong competitive constraint on the parties post-merger. Most retailers do

not usually commit to entering into long term contracts with wholesalers for book supply, thereby enabling them to switch channels on an ad hoc basis. Those retailers most likely to agree to a supply contract are supermarkets, though these are usually no longer than 2 or 3 years in duration. Such retailers may be better able to negotiate large discounts from wholesalers given the large volumes of books purchased and the threat of switching to direct supply from publishers. They also have the ability to sponsor entry of new players or expansion of existing suppliers (examples include the entry of Handleman and the expansion of EUK). This is consistent with the OFT's decision in Woolworths/AMP, where the OFT considered that buyer power of supermarkets (the customer group most affected by that merger) was likely to exert considerable competitive discipline on the merged entity.

71. According to both third parties and the merging parties, independent book retailers typically list both 'primary' and 'secondary' wholesalers and may also have additional accounts with other wholesalers and some publishers, which facilitates the comparison of prices and availability on an order-by-order basis. This can also lead to retailers playing one wholesaler off against the other – for example, Bertram claims that it is regularly confronted with retailers quoting Gardners' prices to try and reduce Bertram's price further. Such pressure appears to have led to an improvement in their terms, although this appears to be more a reflection of choice of supplier rather than buyer power. Since the effect of the merger will be to reduce the choice independent retailers have of trade wholesalers, such 'negotiating' power may be lost post merger.
72. In September 2006, a number of independents joined together to form a buying group, the Independent Booksellers' Group (IBG), with logistical support provided by THE. Through negotiating directly with publishers, this group has successfully managed to increase the discounts offered to members beyond that which wholesalers could offer them. However, these discounts are only offered over a very narrow range of titles and the IBG still only has a membership of 160 retailers. A leading member of the IBG suggested that these titles are typically new titles or promotional titles, rather than the back list and specialist titles for which independent retailers would typically rely on wholesalers. The IBG also indicated that, following the initial purchase of titles through IBG, replenishment would occur through THE rather than direct supply. Although the parties claim that the IBG could be run as a standalone entity and hence evolve into a potential

alternative supply route for independents, third party comment suggests that it could not be run in the short or medium-term without the support of a major wholesaler.

73. The parties also noted that a third party has firm plans to enter the UK books market in May 2007 as a specialist in providing buying group services for smaller retailers, with the express purpose of assisting the UK independent bookselling sector. Similarly to the IBG, it will seek to negotiate large discounts directly with publishers on behalf of a group of independent retailers and purchasing either directly from publishers or through wholesalers with the same discount given.
74. Both buying groups discussed above appear to focus on a relatively limited collection of titles, and both have actively sought the involvement of wholesalers. The involvement of wholesalers in relation to both of these groups seems inconsistent with the parties' written submission that these groups are a competitive constraint on them. In oral evidence to the OFT, the parties suggested that they do not view these groups as a significant competitive constraint, which is consistent with the internal documents provided by the parties, none of which mention buyer groups in their competitive analysis.
75. On the basis of the evidence before it, the OFT considers that larger chain retailers and supermarkets have reasonably effective ways of exerting buyer power on book wholesalers, derived from their ability to threaten switching to direct supply. However, for some retailers (particularly independent retailers) this does not seem to be an option.

Susceptibility of the market to coordination

76. During the investigation, the OFT considered whether the transaction would raise the possibility of coordinated effects within the wholesale supply of books to independent retailers. Generally, a reduction in the number of suppliers makes it easier to establish co-ordination, as the merger may create a degree of concentration at which such mechanisms become effective; it may also make co-ordination easier, more stable or more effective for firms that were already co-ordinating before the merger, either by making co-ordination more robust or by permitting firms to co-ordinate on even higher prices.

77. There are some features of the wholesale supply of books that suggest coordination could be a factor post-merger.

Ability to align

78. As already discussed, there is repeated interaction between wholesale suppliers through contact with book retailers and there is likely to be some transparency of competitor's prices and service levels through knowledge acquired via this contact. Sales of books through independent retailers would also appear to be reasonably stable. Importantly, the merger would increase symmetry between the market participants (in terms of size, market share and catalogue) resulting in a duopoly structure.
79. A potentially significant barrier to alignment is the fact that books are a relatively heterogeneous product. However, there is considerable overlap in the titles supplied by book wholesalers, and the basic service provided to independent retailers, although slightly differentiated, is in many respects very similar. This is particularly so between Bertram and Gardners. In the circumstances, the OFT was not able to confidently dismiss any risk of coordination on the basis of barriers to alignment.

Incentives

80. Price competition would not appear to be the most important factor in competition in the wholesaling of books to independent retailers and individual retailers appear to exhibit loyalty to their existing wholesalers, with whom they have a close relationship. In the circumstances, it is not obvious what, if any, punishment mechanism there might be.
81. However, given the apparently muted nature of price competition, there could in principle be an incentive for a gradual coordinated reduction in service quality and/or increase in price in any event. In the circumstances, the OFT was not able to confidently dismiss any risk of coordination on the basis of a lack of incentives to coordinate.

Sustainability

82. There appears to be relatively high barriers to entry or expansion into the wholesaling of books to independent retailers, suggesting that, if Bertram and Gardners had the ability and incentive to coordinate post-merger, such coordination could potentially be sustainable.

Conclusions

83. There does appear to be some potential for a co-ordinated effects theory of harm to be developed in this case. However, given its findings in relation to non-coordinated effects, the OFT was not ultimately required to reach a conclusion on this issue and did not do so.

VERTICAL ISSUES

84. The OFT received a number of complaints from third parties concerning the presence of Woolworths in both the market for the wholesale supply of books and the downstream market for the retail supply of books. Third parties told the OFT that Woolworths intends to expand its retail activities in relation to books through an expanded product range and a continued increase in the number of retail spaces, pointing to the introduction of the Woolworths 'Big Red Book' campaign and its public statements on its store-opening programme to support these claims.
85. The OFT considered whether, given Woolworths' vertical integration, it would have both the incentive and ability to foreclose independent retailers from the market for the retail supply of books. Foreclosure could arise from a refusal to supply, supplying on terms that leave retailers at a substantial disadvantage to Woolworths' retail outlets, or allowing Woolworths access to other retailer's supply information.
86. Woolworths' ability to foreclose will depend on the amount of market power it possesses at both upstream and downstream levels in the book supply market. Although Woolworths would be one of only two major UK book wholesale suppliers, the ability of retailers to use direct supply as a constraint on book wholesale suppliers is mixed (as discussed above). Therefore, Woolworths may have the ability to foreclose in relation to some customers. However, on the basis of the evidence before it, the OFT considers that any loss in revenue resulting from foreclosing supply to these customers would not be outweighed by an increase in retail sales: Woolworths has an extremely small share of the retail book market (estimated at around [0 to 10] per cent), such that any customers switching away from retail outlets foreclosed would still have a large number of alternative retailers to Woolworths from which to buy books.

87. The OFT therefore does not consider that the transaction raises competition concerns of a vertical nature.

THIRD PARTY VIEWS

88. There were a large number of complaints, from independent bookstores and customers of the parties as well as suppliers and competitors. Most complaints concerned the potential impact on independents, who were the source of the majority of the complaints – these concerns have been discussed above.
89. A few library wholesale suppliers and library customers raised concerns regarding the practice of trade wholesalers entering into the wholesale supply of books to libraries by using their superior discounts from publishers to undercut existing library wholesalers. This issue does not relate specifically to the merger and would appear to result from the publishers' structural pricing model of offering differential discounts by customer.
90. A specific concern was raised by one retailer in relation to a particular model of supply used. They informed us that the merging parties were the only wholesalers to offer this service and as such the transaction would be a merger to monopoly. The OFT have not reverted to the relevant party on this issue, but it on the basis of the evidence before it, the OFT considers that this particular supply channel may not constitute a major part of the retailer's business and may not be a service that can be performed solely by the merging parties (e.g. other types of wholesaler or in-house supply). Given the OFT's conclusion in this decision, it is not necessary for the OFT to conclude on this issue.

ASSESSMENT

91. The merger combines two of the major wholesaler suppliers of books to retailers. The parties also overlap in the supply of books to libraries and academic institutions.
92. In relation to the wholesale supply of books to retailers, the OFT's starting point was its recent Woolworths/AMP decision in relation to a similar market to the present transaction. However, the OFT found that the particular circumstances of the current transaction meant that a broader range of retailers are affected by the merger than in the case of

Woolworths/AMP. In particular, both Bertram and EUK/THE are involved in book distribution to independent retailers, such that there is a reduction in the number of wholesale suppliers for this retail group that did not arise in the Woolworths/AMP merger.

93. Consistent with Woolworths/AMP, the OFT considers that it is appropriate to consider books as a separate frame of reference to HEPs. A large number of third parties suggested that the OFT consider the extent to which different supply channels are substitutable for different book retailers. The OFT considers that there are key differences between the different types of retailer which affects, in particular, the ability of independent retailers to use direct supply as a constraint on wholesalers. These differences include the need for overnight replenishment of stock, flexible ordering and return systems, and the ability to order in small volumes. The OFT considers that the primary source of competition on these non-price factors is between different wholesalers, and that direct supply does not provide a competitive constraint on wholesalers in relation to a significant proportion of the stock purchase requirements of independent retailers.
94. The OFT considers that the merger leads to a reduction in the number of such trade wholesalers from three to two, and that pre-merger the three wholesalers regarded each other as their primary competitors. The merger would, therefore, lead to a reduction in competition to be the primary wholesaler to such independent retailers and remove all competition to be the secondary (or back up) wholesaler. The OFT therefore believes that the merger has resulted or may be expected to result in non-coordinated effects, either through a reduction in the discount margin obtained by independent retailers or a reduction in service levels. The OFT does not consider that the potential for entry and expansion or buyer power is sufficient to offset any potential unilateral effects arising from the merger.
95. The OFT also considered the potential for coordinated effects to arise as a result of the transaction. While a number of features of the wholesale supply of books that suggest co-ordination could be a factor post-merger (a symmetric duopoly structure post-merger, repeated interaction between wholesalers and retailers, price transparency, high barriers to entry, relatively homogenous services) ultimately it was not necessary for the OFT to conclude on this issue.

96. The OFT has also considered whether the merger presented any vertical competition concerns, given Woolworths presence in book retail. However, the OFT believes that given Woolworths very small retail market share, any loss in revenue resulting from foreclosing supply to retail customers would not be outweighed by an increase in retail sales.
97. Consequently, the OFT believes that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.
98. There was no offer of undertakings in lieu of reference.

DECISION

99. This merger will therefore be referred to the Competition Commission under section 22(1) of the Act.