Completed acquisition by Woolworths Group plc of AMP Enterprises Limited

The OFT's decision on reference under section 22(1) given on 15 December 2006. Full text of decision published 21 December 2006.

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

PARTIES

1. GM Group Limited ('GM'), a wholly owned subsidiary of Woolworths Group plc ('Woolworths') is the holding company for Woolworths' entertainment division, including Entertainment UK Ltd ('EUK'). EUK is a wholesale distributor of books and home entertainment products ('HEPs')[1] in the UK. Woolworths also operates 803 high-street retail stores and 17 out-of-town superstores – offering toys, children's clothing, confectionery, household and entertainment products. EUK's turnover for the financial year ending 28 January 2006 was £992 million[2].

2. AMP Enterprises Limited ('AMP') is the holding company for Total Home Entertainment Distribution Ltd ('THE') and DVD Plus (C.I.) Limited ('DVD Plus'). AMP's turnover was £302.5 million in the financial year ending 3 June 2006. THE is an independent wholesale distributor of books and HEPs in the UK. DVD Plus is an internet retailer of HEPs to UK customers.

[1] Music, video/DVD, computer games software and hardware.
[2] Including sales to other parts of the Woolworths Group.

TRANSACTION

3. On 5 September 2006, GM acquired 100 per cent of the share capital of AMP. The parties made a submission to the OFT on 20 October 2006. The OFT's administrative deadline is 15 December 2006.

JURISDICTION

4. As a result of this transaction Woolworths and AMP have ceased to be distinct. The UK turnover of AMP 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.

FRAME OF REFERENCE

5. EUK and THE are both active in the wholesale supply of books and home entertainment products (HEPs) from suppliers (or primary distributors[3]) to retailers, who sell both through shops and online.

Product market

Books and each type of HEP

6. The parties acknowledge that demand-side considerations suggest that the market could be segmented into individual products (books, music, video content[4], games software and games hardware), given the limited substitution between these products at the retail level. The evidence on demand side substitution put before the OFT supports this view.

7. The parties argue that supply-side substitution is facilitated by the similar IT inventory systems across product types, similar space requirements for all but computer games hardware, and the existence of large non-specialised retailers (for example supermarkets) who may want to stock across product categories in one operation (the wholesaler would not have to build a new customer relationship).

[3] Agents appointed by certain suppliers to market and distribute their products.
[4] Films, television programmes and other audiovisual programmes sold on various formats for home viewing.

8. Third party competitors have conflicting views on the ease of supply-side substitution. However, the OFT has found evidence that supply-side substitution has occurred in practice, for example in 2004, with ASDA's support, Handleman UK expanded into children's books from HEPs within two months[5].

9. On the balance of the evidence before it the OFT considers that it is appropriate to consider separate frames of reference for each of books, music, video, games software and games hardware.

Type of retail customer

10. Wholesale prices are agreed as part of individually negotiated contracts or *ad hoc* purchases. Suppliers publish list prices which are used as the basis for negotiated discounts for wholesalers. Wholesale prices to retailers are also expressed in terms of a discount off this list price. The OFT considered whether the market should be segmented by type of customer, and price discrimination. The evidence before the OFT in this case, however, suggests that markets are not segmented in this way and that most customers - of all types - have the option of by-passing wholesalers and setting up direct purchasing arrangements.

11. The parties claim that around two-thirds of all books and HEPs are distributed through direct purchasing arrangements. Consolidation amongst suppliers is reducing the number of direct purchasing arrangements a retailer would need to establish, making this distribution option more attractive. Amazon, Argos, Choices, Fopp, HMV and Music Zone are some of the examples cited of retailers with direct purchase arrangements already in place. The parties provided examples of switching between the wholesale and direct purchase distribution channels (in both directions), which they contend is driven by a constant assessment of distribution arrangements/costs in a highly competitive retail environment.

12. Most third parties said that both switching wholesalers and switching distribution channels is considered to be relatively easy and some recent examples of actual switching have been supplied to the OFT. However one small variety chain and one specialist music/video chain claimed that direct purchases were not an option for small customers, given the small volumes required. Two third party competitors also took this view with respect to the video and computer games sectors respectively. Nevertheless, the evidence before the OFT indicates that some small retailers do have direct

[5] Confirmed by ASDA.

purchasing arrangements in place. According to one book wholesaler, for example, most book retailers have existing accounts with major publishers that they use in parallel with wholesalers, so switching to direct purchases is easy (with only the largest of their thousands of retail customers constrained by contract).

13. On the basis of the evidence before it, the OFT therefore considers that the frame of reference for each product should include all distribution channels (wholesalers and direct purchases) and all types of customer (e.g. supermarkets, specialist chains and independent specialist retailers). However, taking a cautious approach, and given that two customers responding to our enquiries did not consider the direct purchase option a viable option, a narrower frame of reference - restricted to wholesale supply only - is also considered.

Geographic market

14. According to the parties, major wholesalers operate on a national basis (for discounting, promotions and strategy decisions), and serve retailers with UK-wide networks of outlets from a small number of warehouse facilities. Transport costs are low, with the parties claiming that prices are determined by the number of drop locations rather than distance travelled. Larger retailers operate under contracts with UK-wide coverage.

15. The majority of third parties said they prefer wholesalers with the ability to distribute across the UK, although they can be based regionally. UK coverage is not essential, however, as one supermarket (with stores all over the UK) said it uses a separate national logistics carrier in conjunction with wholesalers. For reasons such as language, content, packaging, transport costs, certification, intellectual property rights and standards, on the basis of the evidence before it, the OFT considers that the appropriate geographic frame of reference for this assessment is no wider than the UK.

HORIZONTAL ISSUES

Market shares

16. The highest combined share of supply for the merged entity in any segment is in the supply to retailers of video content via any distribution channel (i.e. with or without the use of wholesale intermediaries): at around [10 to 20 per cent] (with an associated increment of [less than 10 per cent]).

17. If, however, direct purchases are excluded from the frame of reference (and only the wholesale distribution channel included) post-merger shares of supply are significant in two segments: the wholesale supply of books to retailers and the wholesale supply of video content to retailers. The parties' combined share of wholesale supply of books would be approximately [30 to 40] per cent by value ([30 to 40 per cent] by volume), with an increment of around [10 to 20 per cent] on a value basis. In the wholesale supply of video content the parties combined share would be around [20 to 30 per cent] by value, with an increment of approximately [10 to 20 per cent] (on a value and volume basis).

18. In the wholesale supply of books, there are two significant competitors (Bertrams and Gardners), a smaller third competitor (Handleman UK) and also a tail of smaller wholesale competitors. In the wholesale supply of video content, there are three strong competitors (Handleman UK, Kuehne & Nagel and Amethyst) as well as a variety of smaller competitors (such as Golds and Music Box Leisure).

Barriers to entry and expansion

19. The parties' argue that new entry - by an existing wholesaler or distributor of books, video, music, games software or games hardware - to wholesale supply of another of these products would be rapid, as 'limited additional investment' is required. In order to set up a wholesaling business from scratch (investing in warehousing, stock, IT, personnel and support services), on a viable scale, the parties estimated a cost of around £20-30 million for a sophisticated service capable of servicing a large supermarket (and providing a full range of 'add-on' services). For a significant dispatch-only service, a wholesaler would need to invest around £15-17 million - or £6-7 million for a service where the retailer rather than wholesaler handles the stock.

20. Third parties submitted that scale is the main impediment to new entry. However, on the basis of the evidence before it, the OFT considers that as the sunk component of the investments required (warehousing, stock and IT) is limited, this barrier to entry is not significant. Most third parties argued that establishing relationships with suppliers is a barrier to entry. However the OFT considers on the basis of the evidence before it that this is not a significant impediment to entry as it should be in the interests of most suppliers to maximise their sales through the use of all available

wholesale channels. One third party competitor, for example, said that book publishers would sponsor new wholesale entry[6].

21. EUK entered the books segment from HEPs in 2004. With the support of Asda, Handleman UK entered the wholesale supply of HEPs in 1999 in less than twelve months, and has recently expanded into children's books. It now supplies HEPs to Tesco and Waitrose (having displaced EUK). Kuehne & Nagel confirmed they entered the HEP sector as a distributor for Virgin in 2003. The parties are not aware of any recent exits by wholesalers from the sectors concerned, except Andromeda – which was the subject of a management buy-out and subsequently became the logistics and distribution company, Trilogy Logistics UK[7].

22. On the basis of the evidence before it the OFT therefore considers that the threat of new entry exerts a strong competitive discipline on the merged entity, where all distribution channels are considered together. Even considering wholesale supply of books and HEPs separately, the OFT considers on the basis of the evidence before it that new entry exerts some competitive discipline on existing firms – particularly given the presence of large retailers who could provide (and have done so in the past) support for entry or expansion.

Countervailing buyer power

23. Most supermarkets, large retail chains and large internet retailers submitted that they consider they have a degree of buyer power for the purchase of books and each type of HEP – manifested in the ability to negotiate volume discounts. There is also evidence to support this perception, in terms of examples of credible threats by retailers to switch wholesalers and Asda's sponsorship of Handleman UK's successful new entry to the supply of HEPs and now books.

24. On the basis of the evidence before it, the OFT also considers that there are strong incentives for retailers to negotiate hard for discounts with wholesalers given strong competition at the retail level. Wholesalers submitted to the OFT that they face strong suppliers (for example, five music suppliers account for around 80 per cent of the music market) and

[6] This was also the view taken by the OFT in its decision on the anticipated acquisition by HMV Group plc through Waterstones Ltd of Ottakar's plc, December 2005, paragraph 82.

therefore have limited ability to recoup the discounts demanded by retailers. Overall, therefore, on the basis of the evidence before it, the OFT considers that buyer power is likely to exert considerable competitive discipline on the merged entity.

VERTICAL ISSUES

25. EUK, is part of the vertically integrated Woolworths Group, with EUK supplying wholesale services to Woolworths' retail outlets (as well as other retailers) across the UK. There are also two vertical linkages between Woolworths' business and that of AMP (THE):

    - THE has an upstream presence: as the exclusive primary distributor of music produced by around 93 record labels (all of whom contract a firm called 'Vital' to do their sales and marketing). EUK is a customer of THE for music sold under Vital labels which represent [less than 10 per cent] of the primary distribution of all music labels in the UK on a volume basis.

    - Woolworths is part of a joint venture (having a 40 per cent share) with BBC Worldwide's video publishing arm, '2 entertain'. THE is a customer of 2 entertain for video and music products.

26. Although the merged entity may have an incentive to foreclose retail markets for Woolworths' rivals, the OFT considers on the basis of the evidence before it that they would not have the ability to do so since the shares of supply held by the parties at all levels in the supply chain, post-merger, are not consistent with the possession of significant market power. Rival retailers, faced with market foreclosure tactics, have both alternative wholesalers and an alternative distribution channel (direct purchases from suppliers). Consequently, the OFT considers that these vertical links do not give rise to concerns.

THIRD PARTY VIEWS

27. Most third parties were not concerned about this merger. Of those that had concerns, most were worried about the loss of choice of wholesalers. In all

[7] Trilogy UK Logistics' website confirms.

of these cases, however, the respondents still have alternative wholesalers, and/or the option to switch to direct purchase.

ASSESSMENT

28. The parties overlap in the wholesale supply of books and HEPs to retailers. The OFT considered the appropriate product frame of reference to be the supply of books and each type of HEP through all distribution channels. However, taking a cautious approach, the OFT also considered separately the wholesale supply of these products. The geographic frame of reference was considered to be no wider than the UK.

29. The highest combined share of supply for the merged entity in any segment via any distribution channel (in other words with or without the use of wholesale intermediaries) is in the supply to retailers of video content: at around [10 to 20 per cent] (with an associated increment of [less than 10 per cent]). On the basis of wholesale supply considered separately the merged entity has highest combined shares of supply of books of [30 to 40 per cent] (increment [10 to 20 per cent]) and of video content of approximately [20 to 30 per cent] ([10 to 20 per cent] increment).

30. However, the OFT considers that existing competition from significant other wholesalers as well as threat of new entry and expansion and strong countervailing buyer power provide effective competitive constraints on the conduct of the merged entity. Most third parties were not concerned by this merger. Of those who were concerned the concern related to reduced choice of wholesalers. However alternative wholesalers and direct purchasing are both options still available. The OFT does not consider that this transaction gives rise to any vertical concerns.

31. Consequently, the OFT does not believe 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.

DECISION

32. This merger will therefore not be referred to the Competition Commission under section 22(1) of the Act.