

## Completed acquisition by Bestway (Holdings) Limited of Batleys Limited

The OFT's decision on reference under section 22 given on 19 May 2005. Full text of decision published on 2 June 2005.

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### PARTIES

1. **Bestway (Holdings) Limited** is primarily engaged in grocery wholesaling in the UK, with turnover [together with its sister company, Bestway Northern Limited]<sup>1</sup> of around £1,047 million from this activity in the year to June 2003. The majority of this turnover derived from sales on a cash & carry basis, with about £100 million from delivered wholesale grocery sales. In this decision, the Bestway grocery wholesaling business is referred to as **Bestway**.
2. **Batleys Limited** is active in grocery wholesaling in the UK, with a strong presence in the north of England. The turnover of the Batleys UK grocery wholesaling business was £571.4 million in its 2004 financial year. The majority of this turnover derived from sales on a cash & carry basis, with about £25 million from delivered wholesale grocery sales. In this decision, the Batleys UK grocery wholesaling business is referred to as **Batleys**.

### TRANSACTION

3. Bestway acquired the entire issued share capital of Batleys on 28 January 2005.

### JURISDICTION

4. As a result of this transaction Bestway and Batleys have ceased to be distinct. The UK turnover of Batleys exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. A relevant merger situation has been created.

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<sup>1</sup> Information inserted for clarification.

## RELEVANT FRAME OF REFERENCE

5. The parties overlap primarily in grocery wholesaling on a cash & carry basis. There is also an overlap in delivered wholesale grocery sales, however, no competition concerns appear to arise in this segment since the merged entity has only a small share of sales and faces competition from a range of rivals.

### Product scope

6. The parties note that their cash & carry businesses operate alongside their delivered wholesale businesses, and consider that they both face direct competition from a number of sources including supermarkets, direct supply from manufacturers and wholesalers supplying the food service industry. These are considered in turn below.
7. The parties, and a number of third parties, submit that cash & carry outlets compete with local supermarkets since 'special offers' often result in retail prices that are lower than cash & carry prices. However, the nature and scope of this competition is likely, by its very nature, to be narrow and sporadic. Cash & carry customers are typically independent retailers or caterers who purchase goods for on-sale to the general public. It would not be viable for such customers to use local supermarkets for the majority of their needs. In light of this, we consider that supermarkets do not constitute a sufficient competitive constraint to warrant inclusion in the relevant frame of reference.
8. Both the parties and third parties also submit that customers can, in certain circumstances, source goods (such as dairy and bakery products) directly from the manufacturer. The nature of the constraint offered by direct supply by manufacturers is partial, since no single manufacturer will offer the full range of goods in the same way as a cash & carry outlet. Arranging a large number of contracts of this type is likely to be inefficient due to the transaction costs involved.
9. Third parties consider that wholesalers supplying the food service industry would be a credible alternative for catering customers only, since they do not tend to supply the general grocery products that independent retailers require. It is not necessary to conclude on the extent of this option as a constraint since it does not materially affect the competition assessment.
10. Third parties were unanimously of the view that delivered wholesaling is a competitive constraint on cash & carry wholesaling, citing two main reasons. First, the customers of wholesalers are highly price sensitive since their purchases are directly linked to their profitability and goods are purchased solely with the

intention of on-sale for profit. Second, the price differential between cash & carry and delivered wholesale is generally five to ten per cent, so in the event of a price rise, a material number of customers would switch. For the purposes of analysing this case, cash & carry and delivered wholesale have been considered together.

### **Geographic scope**

11. The parties submit that the appropriate geographic frame of reference is national, since all of the major cash & carry wholesalers have national price lists and all delivered wholesalers have a national delivery network. However, third party responses indicate that prices do vary by region (through special offers) and depot managers often have discretion to alter prices in the face of local conditions, suggesting some regional aspects to competition. Consequently, the transaction has been assessed both at the national level and at the local level using isochrone analysis around local wholesale depots.
12. The parties' internal research and experience suggests that customers travel on average five to seven miles (translating roughly to a 15 minute drive time) but that they are prepared to drive up to 30 minutes to their depots. In light of this, the parties supplied isochrone maps based on both 15 minute and 30 minute drive times. The assumptions used by the parties in relation to average drive times were verified by other cash & carry suppliers.
13. It is important to note that drive times and isochrone analysis do not apply to the delivered wholesale segment since these operators tend to have national distribution networks and can deliver anywhere, as opposed to cash & carry outlets which rely on customers driving to their depots to collect goods. Any fascia test based on isochrone analysis will therefore omit the alternatives offered by delivered wholesalers and consequently, will understate the competitive constraints on a particular store or depot.
14. Since the transaction does not appear to raise competition concerns at either the local or the national level, there is no need to conclude definitively on the appropriate geographic frame of reference in this case.

### **HORIZONTAL ISSUES**

#### **National issues**

##### Shares of supply

15. Shares of supply in grocery wholesaling as a whole (i.e., including delivered wholesale) on a national basis are set out below.

**Table 1: Shares of supply in UK grocery wholesaling 2003**

| <b>Wholesaler</b> | <b>Turnover<br/>wholesale (£m)</b> | <b>Share<br/>wholesale (%)</b> |
|-------------------|------------------------------------|--------------------------------|
| Bestway           | 1,047                              | 6.4%                           |
| Batleys           | 571                                | 3.5%                           |
| <b>Combined</b>   | <b>1,618</b>                       | <b>9.9%</b>                    |
| Booker            | 3,602                              | 22.0%                          |
| Palmer & Harvey   | 3,600                              | 22.0%                          |
| SPAR              | 2,300                              | 14.0%                          |
| Makro             | 1,250                              | 7.6%                           |
| Costco            | 1,024                              | 6.2%                           |
| Londis            | 510                                | 3.1%                           |
| Key Lekkerland    | 400                                | 2.4%                           |
| Dhamecha          | 225                                | 1.4%                           |
| AG Parfett        | 211                                | 1.3%                           |
| Blakemore         | 130                                | 0.6%                           |

Source: The parties from IGD data

16. The post-acquisition Herfindahl-Hirschman Index (HHI) is 1378, which suggests that grocery wholesaling as a whole is 'concentrated'. However, the increase in the HHI resulting from the acquisition is 45, which is significantly below the level at which the OFT generally considers that potential competition concerns may arise.<sup>2</sup>
17. The merged entity will be the fourth largest grocery wholesaler in the UK with a share of supply of 9.9 per cent. A number of large competitors will remain in both the cash & carry and delivered wholesale segments.
18. For completeness, shares of supply in the cash & carry segment alone are set out below.

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<sup>2</sup> OFT 516, *Mergers – Substantive assessment guidance*, May 2003, para.4.3.

**Table 2: Shares of supply in UK grocery wholesaling (cash & carry only) 2003**

| <b>Wholesaler</b>      | <b>Turnover<br/>cash &amp; carry (£m)</b> | <b>Share<br/>cash &amp; carry (%)</b> |
|------------------------|---|---------------------------------------|
| Bestway                | 947                                       | 10.1%                                 |
| Batleys                | 546                                       | 5.8%                                  |
| <b><i>Combined</i></b> | <b><i>1,493</i></b>                       | <b><i>15.9%</i></b>                   |
| Booker                 | 3,602                                     | 38.3%                                 |
| Makro                  | 1,250                                     | 13.3%                                 |
| Costco                 | 1,024                                     | 10.9%                                 |
| Dhamecha               | 225                                       | 2.4%                                  |
| AG Parfett             | 211                                       | 2.2%                                  |
| Blakemore              | 130                                       | 1.4%                                  |

Source: The parties from IGD data

19. In this segment, the merged entity will have a share of supply of 15.9 per cent and a number of sizeable competitors (including Booker, Costco and Makro) will remain.
20. In light of the merged entity's modest share of supply in both grocery wholesaling as a whole and cash & carry alone, we consider that the transaction does not raise competition concerns at the national level.

#### **Local issues**

21. As noted earlier, third party responses indicated that there are local aspects to competition in grocery wholesaling and therefore, the transaction has also been examined at this level.
22. In general, the parties have a different geographic focus. Bestway has a stronger presence in the south of England while Batleys has greater coverage in the north of England and southern Scotland. The extent of local overlaps is therefore rather limited with only 13<sup>3</sup> of 32 Bestway stores falling within a 30 minute drive time of a Batleys store.
23. Our isochrone analysis indicates that in all but one of the overlap areas, there will remain at least four major cash & carry competitors (and potentially a number of delivered wholesalers whose presence is not captured by the isochrone analysis). In one overlap area, the acquisition reduces the number of major competitors from four to three on a 15 minute drive time. However there are also three independent cash & carry outlets in the overlap area and the analysis does not take into

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<sup>3</sup> There is a further 'overlap' depot in Coventry, however this is Bestway's central distribution depot and as such is not open to customers or the general public.

account the constraint posed by delivered wholesalers in that area. Expanding the isochrone to a 30 minute drive time in this area also introduces an additional major cash & carry competitor.

24. None of the third parties contacted by the OFT identified any local area where the merged entity would have a share of supply sufficient to raise local competition concerns. One third party went further than this and stated that on their own analysis, there was no local area where the merged entity's share of supply would exceed 18 per cent.
25. We consider that the transaction does not give rise to any competition concerns at the local level.

### **Barriers to entry**

26. The parties submit that barriers to entry are low, mainly because cash & carry warehouses are not subject to the same restrictive approach from planning authorities as supermarkets. The only infrastructure needed is warehouse space, which is easily obtainable. Fixed costs are low and there are almost no sunk costs since the majority of the capital outlay will be for stock. The parties submit that entry and exit is common in the cash & carry segment.
27. Third parties, however, cite the importance of economies of scale, and the buyer power that this confers, in determining the ability of wholesalers to compete effectively with established incumbent suppliers. It is therefore less clear that new entry would be likely to pose a sufficient constraint on the merged entity.
28. However, since this transaction does not raise substantive competition concerns and we consider that existing competition constitutes a sufficient constraint, it is not necessary to conclude definitively on barriers to entry in this case.

### **Buyer power**

29. Customers of cash & carry wholesalers tend to be small businesses or sole traders, and as such, there is little prospect of their exercising any buyer power.

### **VERTICAL ISSUES**

30. There are no vertical issues arising from this transaction.

## THIRD PARTY VIEWS

31. The vast majority of third parties contacted by the OFT were unconcerned about the transaction. Only one third party (a competitor) was concerned that the merged entity would be able to predate or cross-subsidise in the London area. However, they were unable to provide any supporting evidence and the OFT has not seen any other evidence to substantiate the claim.

## ASSESSMENT

32. The merged entity is the fourth largest national grocery wholesaler in the UK, with a modest 9.9 per cent share of supply in grocery wholesaling as a whole and 15.9 per cent share of supply in cash & carry alone. The merged entity will continue to face competition from a number of other sizeable wholesalers.
33. At a local level, the parties have had a different geographic focus, giving rise to a limited number of local overlaps. Isochrone analysis of these overlaps shows that the parties will face competition from rival cash & carry outlets in all areas. Additionally, the ability of delivered wholesalers to supply customers on a national basis will provide a strong competitive constraint on the merged entity.
34. The overwhelming majority of third parties contacted by the OFT considered that the transaction did not raise competition concerns.
35. 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

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