

## Completed acquisition by Punch Taverns plc of InnSpired Group Ltd

The OFT's decision on reference under section 22 given on 13 December 2004

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**Please note square brackets indicate exact figure excised or replaced by a range at the request of the parties for reasons of commercial confidentiality.**

### **PARTIES**

1. **Punch Taverns plc (Punch)** is a publicly listed company which owned 7,340 tenanted pubs in the UK prior to the merger. **InnSpired Group Ltd (InnSpired)** is a pub company which owned 1,064 pubs in the UK prior to the merger. InnSpired's UK turnover was [more than £70 million] in the year ended 31 October 2003.

### **TRANSACTION**

2. On 10 September 2004 Punch completed its acquisition of the entire share capital of InnSpired.
3. Punch subsequently sold 87 pubs to Admiral Taverns (Portfolio No 2) Ltd and one pub to the tenant of the Lamb and Flag pub in Nuneaton (the on-sale pubs). 37 of the on-sale pubs were originally from the Punch estate; 51 were originally from the InnSpired estate.
4. The OFT received a satisfactory informal submission on 15 October 2004 and the administrative deadline was therefore 10 December 2004.

### **JURISDICTION**

5. As a result of this transaction Punch and InnSpired have ceased to be distinct. The UK turnover of InnSpired 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 UK competition authorities have considered a number of merger cases involving the acquisition of pubs. Following the MMC's approach in its report into the Elders IXL and Scottish and Newcastle Brewers PLC merger,<sup>1</sup> the OFT has in a number of pub cases required the acquirer to divest (or, in some earlier cases, free from tie) a number of pubs so that its share of pubs in any Petty Sessional Division (PSD) would not, as a result of the merger, exceed 25 per cent or, if higher, the pre-merger level (the PSD rule).

## **RELEVANT MARKET**

### **Product market**

7. The parties overlap in the operation of pubs. In previous cases examined by the OFT,<sup>2</sup> the appropriate frame of reference adopted when assessing the competitive effects of mergers in this sector has been considered to be the ownership of pubs.<sup>3</sup>
8. The distinction between pubs and other on-licensed outlets, particularly restaurants, has blurred over recent years as pubs have sought to widen their offering to include food, a broader range of drinks, entertainment, accommodation, dancing and other amenities. As a result, pubs increasingly compete on a number of different levels in addition to pricing amongst themselves, and potentially also with other on-licensed premises.
9. An important characteristic of pubs, as opposed to other on-licensed premises, however, is that they allow for the purchase of alcohol without restriction, e.g. without the need for membership, being a resident or the purchase of a meal. Demand side switching to other on-licensed premises by consumers only wanting a drink is therefore limited. On the supply side, different characteristics of different types of licences may make switching difficult in some circumstances. It may also be considered that pubs can be segmented further. Location, customer profile, range of products sold and pub experience are among the features that pub companies use to characterise different segments of the market. Past cases have highlighted the potential distinction between 'local' pubs, which attract residents from a small catchment area, and 'destination' pubs, that offer other features such as entertainment or food that customers are willing to travel further

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<sup>1</sup> Cm 1227, October 1990.

<sup>2</sup> For further discussion, see the OFT's advice on the acquisition by Enterprise Inns plc of assets of Morgan Grenfell Private Equity Ltd, namely the Laurel Pub Group Ltd.

<sup>3</sup> A pub is defined as premises operated under a full publican on-licence.

for, particularly at certain times of the week. Furthermore, some pubs could be categorised as 'gastropubs' or pubs with substantial food offerings. These pubs could interact more closely with restaurants than other pubs with lesser food offerings. To an extent, it is possible that pubs may be able to switch between these various categories within the terms of their licences.

10. In previous cases, the competitive constraint from sales from some unlicensed retail premises (e.g, coffee-bars) and off-licensed premises<sup>4</sup> on sales from on-licensed premises has been argued by parties as being sufficient for sales from such venues to be included in the product market. Although on-licensed and off-licensed premises both sell alcohol, it is generally accepted that sales from on-licensed and off-licensed premises constitute separate product markets owing to the additional service feature of on-licensed premises and the persistent price differences and pricing trends between the two channels.
11. In previous pub cases the OFT has considered it appropriate to analyse competition on the basis of pubs as a frame of reference. The appropriate focus may, however, be wider and include other on-licensed premises. Conversely, pubs may be segmented further, for example, as between local and destination pubs or as between gastropubs and other pubs. However, on the information currently available, there is insufficient evidence to justify deviating from the approach taken in previous cases. The OFT has therefore taken pubs as the appropriate frame of reference against which to assess the competitive effects of this merger.

#### **Geographic market**

12. On the demand side, many pubs exhibit strong local characteristics since customers are generally only willing to travel short distances (possibly within walking distance of their home) to pubs. On the supply side, where national chains exist, certain parameters of competition increasingly takes place at the national level, for example, beer supply arrangements are negotiated nationally and many aspects including features of service (such as opening hours and pub themes), advertising, promotions and campaign pricing (for managed pub groups) are determined nationally or at least regionally. Some parameters of competition are still determined locally to an extent however.
13. In previous cases involving pubs, the geographic analysis of overlaps for assessing the extent of local competition among pubs has focused on PSDs, as a proxy for the alternatives for local consumers. Where a merger creates or increases a share of 25 per cent or above in any PSD, parties have been required to divest a number of pubs to reduce their share of pubs in any PSD to no more than 25 per cent or, if higher, the pre-merger level.

14. There are, however, some inherent weaknesses in this approach. The extent to which PSDs represent the true distance that customers are prepared to travel to a pub is unclear. PSDs are administrative boundaries which vary significantly in size as well as in the number of pubs they contain. They are therefore unlikely to reflect fully consumer behaviour. It is also possible that consumers with the ability to switch between premises in different PSDs may create a chain of substitution that links such areas (whether on a sub-regional, regional or national basis). Nor does this approach take any account of the size of the premises involved. However, to the extent that the concern is one of consumer choice, this may not be a significant factor.
15. Under the Licensing Act 2003, responsibility for premises licensing is expected to transfer from local magistrates to local authorities towards the end of 2004. As a consequence of the new licensing regime, the PSD will no longer be the relevant licensing area. In Enterprise/Unique,<sup>5</sup> the parties and third parties were questioned on the most appropriate method for examining local competition following the removal of PSDs. In general, it was considered that the most appropriate replacement would be the local authority areas. Although it was acknowledged that this would have similar flaws to the PSD methodology, information on the numbers of pubs would, at least, be relatively reliable. Respondents were divided on whether an isochrone approach would be an accurate method of analysing local competition. Flaws identified included difficulties in assessing exactly how far people are prepared to travel to pubs, particularly when pubs have such variable offerings and identifying the appropriate minimum number of outlets within an isochrone. It must also be said that the number of pubs in Great Britain (in the region of 60,000) may create practical difficulties for any isochrone analysis.
16. Despite concerns over the ability for PSDs to capture accurately the geographic scope of competitive constraints on individual pubs,<sup>6</sup> based on the information available and in the absence of a detailed study into local market conditions, PSDs are presently considered to be the most appropriate proxy for assessing local competition.

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<sup>4</sup> Premises licensed for the sale of alcohol for consumption off the premises.

<sup>5</sup> The OFT's decision on the completed acquisition by Enterprise Inns plc of the outstanding equity in the Unique Pub Company Ltd.

## **HORIZONTAL ISSUES**

### **National Issues**

17. Post merger, the Punch estate consists of 8404 fully tenanted pubs, an increase of 1064 pubs. In the most recent case a base line figure of 55,720<sup>7</sup> pubs in Great Britain was used. In this case the parties propose two different methodologies for estimating the number of pubs. These suggest that there are between 60,000<sup>8</sup> and 66,000<sup>9</sup> pubs in the UK. Proceeding on a cautious basis, a base line figure of 55,720 pubs will be used in this case. On this basis, Punch owns 15.1 per cent of pubs in Great Britain post-merger, representing an increment 1.9 per cent.
18. The merger enhances Punch's position as the second largest pub company, behind Enterprise Inns plc, which owns approximately 9,000 pubs in Great Britain. Supply remains fragmented with the top five players accounting for 43.3 per cent of all pubs in Great Britain and the top 20 companies accounting for 63.2 per cent of pubs. No national concerns therefore arise as a result of this transaction.

### **Local Issues**

19. On the basis of the application of the PSD approach described above, it would appear that there are 39 PSDs in which the parties' combined shares of pubs creates or increases a share of 25 per cent or more. Applying the PSD rule in this case, 88 pubs require divestment. Accordingly, Punch has disposed of 88 on-sale pubs in order to ensure that its share of pubs in any PSD does not exceed 25 per cent or, if higher, the pre-merger level.

### **Barriers to Entry**

20. The main barrier to entry in pub retailing is obtaining a licence to supply alcohol. The disintegration of breweries and pubs have allowed the entry of retail pubs.
21. Entry on a small scale may be difficult to sustain. To secure discounts from brewers and wholesalers the new entrant needs to be a significant player or a brewer. Without discounts the new entrant may find it difficult to compete effectively against the larger pubs chains.

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<sup>6</sup> For further discussion, see the OFT's advice on the acquisition by Enterprise Inns plc of assets of Morgan Grenfell Private Equity Ltd, namely the Laurel Pub Group Ltd.

<sup>7</sup> Source: The Publican Industry Report 2004.

<sup>8</sup> Based on a methodology developed by Experian using data from Nielson, Thomson directories, retailers and suppliers.

<sup>9</sup> Based on AC Nielson data.

22. Barriers to entry in pub retailing therefore appear to be falling due to vertical disintegration. Sustainable entry for small players is still likely to be difficult.

#### **Buyer Power**

23. In previous cases, concerns have been raised with regard to the enhanced buyer power of pub companies vis-à-vis the breweries. Most brewers offer volume related discounts to pub companies, thus greater concentration will improve the parties' bargaining power and may lead to a reduction in the price paid to the brewer.
24. Although Punch may benefit from a slight improvement in buyer power, its post merger purchase of beer sales is relatively small, accounting for [0 – 10 per cent] of total UK beer sales to the on-trade and off-trade and around [0 – 10 per cent] of on-licensed beer sales in the UK. Additionally Punch has a policy of multi-sourcing and periodic tendering and sources beer from [40 – 50] national and regional brewers as well as [30 – 40] small brewers. Further, in contrast to beer retailing, the brewing industry is concentrated with the top five largest brewers accounting for approximately 80 per cent of supply to the on-trade market.
25. Despite some improvement in upstream buyer power, it is not considered that this is a cause for concern in this merger.

#### **VERTICAL ISSUES**

26. The merger does not give rise to any vertical issues.

#### **THIRD PARTY VIEWS**

27. No third parties who expressed a view were concerned about the merger.

#### **ASSESSMENT**

28. Any concerns which would have arisen from the merger have already been addressed by Punch's disposal of pubs in PSDs where the merger would have led to the parties' combined share exceeding either: 25 per cent; or the pre-merger level, in the event that one of the parties already had a 25 per cent share prior to the merger in any individual PSD.
29. Third parties did not have any concerns.

30. 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**

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