

ANTICIPATED ACQUISITION BY POUNDLAND PLC OF 99P STORES LIMITED

Statement of issues

25 June 2015

The reference

1. On 17 April 2015, the Competition and Markets Authority (CMA), in exercise of its duty under section 33(1) of the Enterprise Act 2002 (the Act), referred the anticipated acquisition by Poundland Group plc (Poundland) of 99p Stores Limited (99p) for further investigation and report by a Group of CMA Panel Members (Inquiry Group). The investigation was suspended for a period of three weeks and resumed on 8 May 2015.
2. In exercise of its duty under section 36(1) of the Act, the CMA must decide:
 - (a) whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and
 - (b) if so, whether the creation of that situation may be expected to result in a substantial lessening of competition (SLC) within any market or markets in the UK for goods or services.
3. In this statement, we set out the main issues we are likely to consider in reaching our decisions, having had regard to the evidence currently available to us including evidence set out in the phase 1 decision to refer the acquisition of 99p by Poundland for further investigation (the reference decision) and the comments made by Poundland in its [initial submission for the phase 2 review](#) (Poundland's submission). This does not preclude the consideration of any other issues which may be identified during the course of our investigation.
4. Throughout this document, where appropriate, we refer to Poundland and 99p collectively as the Parties.

Background

5. Under a sale and purchase agreement signed on 5 February 2015, Poundland proposes acquiring 99p for an enterprise value of £55 million (the proposed transaction).
6. More information on the Parties can be found at paragraphs 14 to 20 of the reference decision.
7. Both companies are value general merchandise retailers (VGM retailers). Both have adopted a single price point (SPP) business model: Poundland sells most of its products for £1, while 99p's products are generally priced at 99p. In the UK, Poundland operates 533 stores and 99p operates 246 stores.

Market definition

8. Market definition is a useful analytical tool, but not an end in itself, and identifying the relevant market involves an element of judgement. The boundaries of the market do not determine the outcome of the CMA's analysis of the competitive effects of the merger in any mechanistic way. In assessing whether a merger may give rise to an SLC, the CMA may take into account constraints outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others.¹
9. Poundland acknowledges that it and 99p compete with each other. It argues, however, that the relevant market includes the following categories of retailers:
 - (a) Other VGM retailers with an SPP model (SPP retailers), such as Poundworld, which operates over 210 stores in the UK, but also local operators, such as Sam 99p, which operates 18 stores predominantly in Greater London.
 - (b) VGM retailers with multiple price points (eg Wilkinsons, B&M Bargains, Home Bargains, Poundstretcher).
 - (c) Limited assortment discount store operators (discounters) like Aldi, Lidl and Iceland.
 - (d) National multiples, and in particular Tesco and Asda.

¹ [Merger Assessment Guidelines](#), paragraph 5.2.2.

(e) Specialist category retailers (Boots, WH Smith, Superdrug).

10. It also argues that competition should be analysed at the national level (rather than by reference to local markets) because it sets every aspect of its offering, (price, store layout, service quality and product range), at the national level. This is because its business model places a very significant premium on simplicity and consistency, which is key to remaining competitive in such a low margin business.
11. More detail on Poundland's reasoning is set out in paragraphs 32 to 38 and 56 to 58 of the reference decision.
12. In deciding which types of retailers should be included in the relevant product market, we will first consider the extent to which customers treat other retail options as suitable alternative sources for some or all of the products that they buy from the shops of either of the Parties. Our assessment will take into account, amongst other evidence:
 - the evidence from our survey² on the shopping preferences of customers and on the extent to which they can and do substitute their purchases between different types of retailers;
 - an analysis of the Parties' and other relevant retailers' offerings and competitive positioning and the impact of the opening and closing of other retailers' shops on the performance of the Parties' stores; and
 - the views of the Parties and other retailers on the relevant market and the strategies they adopt to compete.

We will also consider other relevant matters including:

- whether other types of retailers have the ability and incentive quickly and easily to start operating SPP or VGM stores, either through the opening of new outlets or the repositioning of some or all of their stores;
- whether other SPP or VGM retailers have the ability and incentive quickly and easily to expand into new areas; and
- whether other types of retailers have the ability and incentive quickly and easily to reposition sections of their stores to compete more closely with SPP or VGM retailers.

² Involving face-to-face interviews with customers of the Parties in several local areas.

13. In establishing the geographic boundaries of the market, we will consider two separate sets of issues. First, we will assess the Parties' ability and incentive to modify any aspect of their offerings (for example, price, quality, range and customer service or PQRS) in specific local areas following the proposed transaction, and in particular the costs and benefits of adopting more local policies. This will enable us to establish whether the effects of the merger should be analysed at the national level and/or in specific local areas. Second, in line with the approach taken by the CMA in its assessment of retail mergers,³ we will seek to estimate the sizes of local catchment areas around the Parties' stores in order to identify which of the Parties' stores overlap and to rule out unproblematic local areas from any detailed assessment of local competitive conditions (as described in paragraphs 22 to 23 below).

Assessment of the competitive effects of the merger

Counterfactual

14. We will assess the potential effects of the merger on competition compared with the competitive conditions in the counterfactual situation (ie the competitive situation that would likely prevail absent the merger).
15. As part of that assessment, we will consider what would have been likely to happen if the Parties had not agreed to the proposed transaction and what would be likely to happen in the foreseeable future, in particular whether:
 - (a) 99p would have been likely to be sold, in whole or in part, to another purchaser; and/or
 - (b) its stores would have been likely to continue to operate as before.
16. In making our assessment, we will consider possible alternative scenarios and decide upon the appropriate counterfactual situation based on the facts available to us and the extent to which events or circumstances and their consequences are foreseeable.

Pre-merger competition

17. Poundland's submission refers to changes in the shopping patterns of consumers (paragraph 6) and the significant growth of SPP retailers, other

³ See Commentary on Retail Mergers, March 2011, paragraphs 2.1 to 2.21 for a description of the methodological considerations relevant to the calculation and use of catchment areas by the CMA.

VGM retailers and discounters, particularly since 2007 (paragraph 50). We will seek to understand the shopping patterns of customers, including:

- (a) the socio-demographic profile of the customers of SPP retailers, VGM retailers, and discounters;
 - (b) their reasons for shopping at these types of retailers and how this relates to the customers' other shopping decisions on a given shopping trip;
 - (c) the frequency of visits to these types of retailers;
 - (d) the number and types of products that customers typically purchase and amount they typically spend per visit at these types of retailers; and
 - (e) the extent to which customers perceive those various types of retailers and other types of retailers (in particular national multiples) as substitutes to each other.
18. We will also seek evidence from the Parties and other retailers to understand the nature of pre-merger competition between Poundland, 99p and other retailers both at the local and national levels.

Theories of harm

19. Theories of harm describe the possible ways in which an SLC could arise as a result of the merger, and provide the framework for our analysis of the competitive effects of the merger. We have set out below the theories of harm that we are currently minded to investigate. However, we may revise our theories of harm as our inquiry progresses. Also, the identification of a theory of harm does not preclude an SLC being identified on another basis following further work by us, or the receipt of additional evidence. We welcome views on all the theories of harm set out below.

Theory of harm 1: loss of a current competitor at the local level

20. The concern under this theory of harm is that, as a result of the merger, in some (or all) of the areas where the Parties both have stores, Poundland would have the ability to increase the prices of its products (including by changing the sizes of product packaging or modifying the bundles offered for £1), lower the quality of products and/or service, reduce or modify in other ways the range of products offered in those areas, or close stores, because it would face competition from one fewer competitor.

21. In general, for this theory of harm to hold, two conditions need to be met, which are:
 - (a) the merging firms are close competitors; and
 - (b) other retailers cannot replicate the competitive constraint that the merging firms exert on one another.
22. To the extent that Poundland and 99p compete at the local level (see paragraph 13), the effect of the proposed transaction may differ between local areas. We will therefore consider whether the two above conditions are met in local areas where both Parties have stores in close proximity, using the filtering methodology set out in the Commentary on retail mergers.⁴ This will enable us to focus our detailed competitive assessment on the areas where the merger could give rise to an SLC (the shortlisted areas), having eliminated those that are unlikely to be problematic based on the number of credible competitors (ie retailers identified through the analysis described in paragraph 12) present in the defined catchment areas.
23. Our detailed competitive assessment of each shortlisted area is likely to include an analysis of the cumulative competitive constraints exerted by other retailers on the Parties, including the number and sizes of relevant retailers operating both within and outside the relevant market.

Theory of harm 2: loss of a current competitor at the national level

24. In general, as stated in the CMA's Commentary on retail mergers,⁵ the CMA's starting point is to recognise that consumers shop in local retail outlets, within a given travel time from their home or work, and that competition between retailers takes place at the local level. Therefore any loss of competition between retailers at the national level is likely to arise as a result of the aggregated loss of competition in the various areas in which the two retailers operate. In other words, if the proposed transaction may be expected to result in competition concerns in local areas representing a significant proportion of the Parties' overall business, the proposed transaction may create an incentive to worsen any of the aspects of the Parties' offerings that are set on a national basis.

⁴ Commentary on retail mergers, March 2011, paragraphs 2.7 to 2.9.

⁵ Commentary on retail mergers, March 2011, paragraph 3.7.

25. Our assessment of this theory of harm may therefore largely derive from our assessment of the local effects of the proposed transaction. In addition, we will consider:
- (a) the extent of overlap between the Parties' stores in aggregate and as a proportion of their overall business; and
 - (b) the approach taken by the Parties and factors taken into account to set and modify the aspects of their offerings that are common across all of their stores.

Theory of harm 3: loss of a potential competitor at the local level

26. A loss of competition similar to that described in paragraph 20 may arise in areas where, as a result of their expansion plans, the two Parties would have been likely to operate stores in the future absent the proposed transaction, even though they do not overlap in those areas at present.
27. To test this theory of harm, we will examine the Parties' expansion plans, with a focus on their planned store openings in specific areas, as well as other retailers' expansion plans. We will consider the likelihood and timing of such openings on the basis of the Parties' and others retailers' internal documents and views. We will also assess the likely effect of these openings on competition in the relevant local areas, based on direct evidence relating to these areas and inferences from our assessment of the likely effects of the proposed transaction in the areas in which the Parties currently overlap.

Countervailing factors

28. We will consider whether there are countervailing factors which are likely to prevent or mitigate any SLC that we may find. In particular, we intend to consider the following:
- **Entry and expansion** – we will consider whether entry or expansion by effective competitors could be expected to be timely, likely and sufficient to prevent any SLC that might otherwise arise. To do this, we will in particular:
 - look at the history of actual entry, expansion and exit by the Parties and by their competitors (including any repositioning of their offering) and review any future plans;
 - assess the availability of suitable retail premises in the local area;
 - consider whether economies of scale and scope are important; and

- examine other factors which might inhibit entry or the expansion of existing competitors into the relevant local areas.
- **Efficiencies** – we will examine any evidence available to us in relation to efficiencies arising from the merger. In particular, we will examine whether any potential efficiencies are rivalry-enhancing and could be expected to offset the effects of any loss of competition. Poundland has put forward two potential efficiency benefits resulting from the merger that we will consider, which are:
 - a significant enhancement of the customer proposition, resulting from the application of Poundland’s offering across the 99p store estate; and
 - the creation of a stronger competitor to the UK’s largest retailers such as Asda and Tesco.

29. We are not currently aware of any other countervailing factors.

Possible remedies and relevant customer benefits

30. Should we provisionally conclude that the merger may be expected to result in an SLC in one or more markets, we will consider whether, and if so what, remedies might be appropriate, and will issue a further statement.
31. In any consideration of possible remedies, we will take into account whether any relevant customer benefits might be expected to arise as a result of the merger and, if so, what these benefits are likely to be and which customers would benefit.

Responses to the issues statement

32. Any party wishing to respond to this issues statement should do so in writing, by no later than 5pm on 9 July 2015. Please email Poundland.99p@cma.gsi.gov.uk or write to:

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