

# Anticipated acquisition by Poundland Group plc of 99p Stores Limited

Provisional findings report

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The Competition and Markets Authority has excluded from this published version of the provisional findings report information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✂]. Some numbers have been replaced by a range. These are shown in square brackets. Non-sensitive wording is also indicated in square brackets.

## Contents

	<i>Page</i>
Summary.....	3
Provisional findings .....	7
1. The reference .....	7
2. The companies and the industry in which they operate .....	7
Poundland.....	7
99p.....	9
Overview of the offerings of the Parties .....	11
The value retail sector.....	13
Other retailers and their 'value' propositions.....	16
3. The merger and relevant merger situation .....	17
The Transaction.....	17
Rationale for the merger .....	18
Jurisdiction.....	19
Enterprises ceasing to be distinct.....	19
Turnover test .....	19
Provisional conclusion on jurisdiction .....	20
4. Market definition.....	20
Product market.....	21
The CMA econometric analysis .....	22
The CMA survey.....	23
The CMA range review.....	26
Provisional conclusions on product market definition .....	27
Geographic market .....	28
Provisional conclusions on geographic market definition .....	31
5. Counterfactual.....	31
The financial and operational performance of 99p.....	32
Our assessment of the counterfactual .....	34
Scenario 1: continuation of the pre-merger situation .....	34
Scenario 2: sale of 99p to an alternative purchaser.....	37
Scenario 3: failure of 99p.....	38
Provisional conclusions on the counterfactual .....	39
6. Assessment of the competitive effects of the merger.....	40
Introduction.....	40
Customer behaviour.....	40
Introduction.....	40
Trends .....	41
Reasons given by customers for visiting Poundland or 99p .....	43
Destination shopping .....	44
Demographic characteristics of customers, basket size, shopping frequency.....	45
Provisional conclusions on customer behaviour .....	46
The nature of pre-merger competition.....	47
How the Parties set their offering.....	48
Competitor monitoring and benchmarking.....	50
Qualitative evidence on competitive interactions .....	53
Assessment of evidence on the closeness of competition between the Parties and other retailers.....	57
Provisional conclusions on the nature of pre-merger competition.....	60
Effects of the merger.....	61

Introduction.....	61
Local effects .....	63
National effects.....	70
7. Provisional conclusions.....	77

*Appendices*

- A: Terms of reference and conduct of the inquiry
- B: 99p financial information
- C: Counterfactual
- D: Customer survey
- E: Econometric analysis
- F: Incentive to vary local parameters of competition

Glossary

## Summary

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 at the request of Poundland and resumed on 8 May 2015. Throughout this report, we refer to Poundland and 99p collectively as the Parties.
2. Poundland is a retailer that sells grocery products, health and beauty products and general merchandise, almost all at a single price point (SPP) of £1. It has 547 stores in the UK, most of which are located on high streets and shopping centres. Poundland was listed on the London Stock Exchange in 2014. In the year to 29 March 2015 its revenues were £1.1 billion, with pre-tax profits of £36.2 million.
3. 99p operates 216 stores under the '99p store' brand, which sell similar products, primarily at a SPP of 99 pence. The majority of its stores are located in the south of England. 99p also operates 34 stores with different ranges and pricing models under the 'Family Bargains' and '99p Plus' brands. 99p is a private limited company. In the year to 1 February 2015, its revenues were £[~~3~~] million [~~3~~].
4. The value retail sector, of which SPP retail is a part, has experienced significant growth over the past decade, from £2.1 billion in estimated net sales in 2005 to £6 billion in estimated net sales in 2015. It is expected to continue to grow, as many value retailers have significant expansion plans. This sector includes the following categories, among others:
  - (a) SPP retailers, including Poundland, 99p and Poundworld Retail Limited (Poundworld), all of which operate across a large number of geographic areas (the large SPP retailers) and numerous smaller SPP retailers, many of which have only one store (the small SPP retailers).
  - (b) Limited assortment discounters (LADs), including ALDI Stores Limited (Aldi), Lidl UK GmbH (Lidl) and Iceland Foods Limited (Iceland), which sell primarily own-branded grocery products.
  - (c) Value general merchandise retailers (VGM retailers), including B&M European Retail Value S.A (B&M), Home Bargains (operated by TJ Morris Limited), Poundstretcher Limited (Poundstretcher) and Wilkinson

Hardware Stores Limited (Wilko) as well as Poundworld's Bargain Buys and 99p's Family Bargains branded stores.

5. In recent years, the Big Four supermarkets (Asda Stores Limited (Asda), Tesco Stores Limited (Tesco), Wm Morrison Supermarkets plc (Morrisons) and J Sainsbury's plc (Sainsbury's)) have engaged in intense price competition. Some of this has involved the promotion of products at a fixed £1 price point, and in the case of Asda and Tesco, this has been done in dedicated areas within their stores, the latter under its Brand Outlet initiative.
6. On 14 May 2014, KPMG, acting on behalf of 99p, approached Poundland. Following a lengthy due diligence and negotiation process, a sale and purchase agreement (SPA) between the shareholders of 99p and Poundland came into effect on 5 February 2015. As a result of this SPA, it is proposed that Poundland will acquire 100% of the share capital of 99p for a gross consideration of £55 million (the Transaction). We are satisfied that this Transaction will create a relevant merger situation.
7. We first sought to identify the most significant alternatives available to the customers of the Parties, using three sources of evidence: a survey of Poundland's and 99p's customers which we carried out in June 2015, an analysis of the opening or closing of stores on the revenue of the Parties' stores located in their vicinity and an analysis of the product ranges of the Parties and a selection of other retailers. We provisionally concluded that the closest competitors to the Parties were other large SPP retailers, and that VGM retailers were also good alternatives to the Parties, albeit less close competitors than the large SPP retailers. The data from these three sources of evidence provided a mixed picture on the strength of the competitive constraint posed by supermarkets on the Parties' stores.
8. Before turning to our analysis of the competitive effects of the Transaction, we considered what would have happened to 99p in the absence of the Transaction (the counterfactual). To reach a view, we examined three possible scenarios: the continuation of the pre-merger situation; the sale of 99p to an alternative purchaser; or the failure of 99p. In making our assessment, we considered the actions that had been taken by 99p's management, including the recruitment of a new Chief Operating Officer (COO) and implementation of a three-year plan, and evaluated the extent to which the negotiations between 99p and Poundland that took place over a period of over eight months had an impact on the performance of 99p. We provisionally concluded that the most likely scenario, and therefore the counterfactual we chose, was that 99p would have continued to implement its three-year plan. [X]. We recognised that in the short term, the competitiveness of 99p may have declined, but given the underlying trend of

the industry overall and recent injection of professional management, we considered that it would have been likely to survive, largely operating the same business. We considered, however, that it would have been likely to slow down its expansion plans.

9. We then turned to the assessment of the effects of the Transaction on competition. This took account of the shopping behaviour of customers, the closeness of competition between the Parties and the totality of competitive constraints exerted by other retailers on Poundland and 99p.
10. We provisionally found that:
  - (a) there is an increased propensity for UK customers from all socio-demographic groups to visit value retailers, including SPP retailers;
  - (b) as reported by a significant proportion of the retailers that submitted evidence to us, the single weekly shop has been replaced to some extent by more frequent so-called 'top-up' shopping or multi-outlet shopping involving a variety of stores including value retailers;
  - (c) the value of the average SPP shopping basket is small, and compared with the population of the UK as a whole, SPP retail customers, among other things, are more likely to have a lower average household income; and
  - (d) customers are primarily attracted to Poundland and 99p because of the affordability of their offer.
11. Bringing together the quantitative evidence we had used in our consideration of the economic market in which the Parties operate with qualitative evidence gathered from the Parties and other retailers, we provisionally concluded the following:
  - (a) The closest competitors to Poundland are the other large SPP retailers.
  - (b) Of the VGM retailers, Home Bargains, B&M, Wilko and Bargain Buys are competitive constraints on the Parties, but not as close as the large SPP retailers. We infer from the evidence that Poundstretcher is a weaker competitive constraint than the other VGM retailers.
  - (c) With respect to the supermarkets, Tesco and Asda exert a similar or somewhat closer competitive constraint on the Parties to that exerted by the VGM retailers.
  - (d) The competitive constraint from other retailers, including the LADs, is weak.

12. We provisionally concluded that the constraint of stores located at a distance of over 1 mile from a Poundland or 99p store was likely to be negligible, and that catchment areas of up to 1 mile were appropriate for the analysis of the competitive effects of the merger. We also provisionally concluded that this analysis should take account of the diminishing constraint of competitors at a distance between 0.5 miles and 1 mile.
13. Having identified the relevant competitor set, as defined in paragraph 11 above, we sought to quantify the effects of the merger, using weights to reflect the varying strength of the constraints posed by different competitors and diminishing constraint of stores located further away from the Parties' stores.
14. Our assessment took account of the fact that the retail model of Poundland relies on a simple, low-cost business model, which, with few exceptions, has not in the past involved the variation of its offering locally in response to local changes in competition or to derive higher profits in areas where it did not face competitive constraints. We therefore sought to assess how the merger would change Poundland's incentives to flex its offering at the local level, by considering the extent to which the proportion of areas in which it faces no or a limited number of competing retailers increased significantly as a result of the merger. We provisionally found that the Transaction would not be likely to have such an effect on Poundland's incentives as the change in this proportion was not material.
15. We also considered whether the Transaction would create an incentive for Poundland to worsen any of the aspects of its offering on a national basis. This could be the case if, following the Transaction, Poundland faced limited competition in a significantly larger proportion of the areas in which it operates than before the Transaction. Through our quantitative analysis, we provisionally found that the Transaction would not be likely to have such effects.
16. In view of the above, we provisionally conclude that the proposed acquisition of 99p by Poundland may not be expected to result in an SLC within any market or markets in the UK for goods or services.

## Provisional findings

### 1. The reference

- 1.1 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 at the request of Poundland for a period of three weeks<sup>1</sup> and resumed on 8 May 2015.
- 1.2 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.
- 1.3 Our terms of reference are in Appendix A. We are required to publish our final report by 23 October 2015.
- 1.4 This document, together with its appendices, constitutes our provisional findings, published and notified to Poundland and 99p in line with the CMA's rules of procedure.<sup>2</sup> Further information relevant to this inquiry, including a non-confidential version of the submission received from Poundland, as well as summaries of evidence received in oral hearings, can be found on our [webpages](#).
- 1.5 Throughout this document, where relevant, we refer to Poundland and 99p collectively as the Parties.

### 2. The companies and the industry in which they operate

#### ***Poundland***

- 2.1 Poundland is a retailer that sells non-edible and edible grocery products, health and beauty products and general merchandise at a single price point of

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<sup>1</sup> The investigation was suspended by the CMA pursuant to section 39(8A) of the Act.

<sup>2</sup> *CMA rules of procedure for merger, market and special reference groups (CMA17)*, Rule 11.

£1. It has 547 stores<sup>3</sup> located throughout the UK. Around 85% of Poundland stores are located on high streets or in shopping centres and around 15% are located on retail parks.<sup>4</sup>

**Figure 1: Poundland's store locations**



Source: Poundland website.

2.2 It was founded in 1990 and opened its first store in December 1990 in Burton-upon-Trent. By 2002, it operated 58 stores. In that same year, it was acquired by Advent International. With this backing, Poundland expanded its estate portfolio to 283 stores by June 2010.<sup>5</sup> At this point, it was acquired by Warburg Pincus, following which the company underwent an accelerated programme of store roll-outs to over 500 stores. In March 2014, Poundland was listed on the London Stock Exchange. At the end of FY15, Poundland operated 547 stores in the UK and an additional 48 stores in the Republic of Ireland (41) and Spain (7) under the Dealz brand.<sup>6</sup> Poundland is expecting to meet its stated objectives of adding at least 60 net new stores to its estate across the UK and Ireland by year end 2015.

2.3 Revenues to 29 March 2015 (FY15) were £1,117 million, with pre-tax profits of £36.2 million. Underlying revenues generated in the UK and Ireland were £1,111.5 million and grew by 11.4% on the previous year, and were driven by

<sup>3</sup> [X]

<sup>4</sup> Based on the numbers of stores trading as at 12 April 2015 (464 high street, 83 retail park). [X]

<sup>5</sup> [X]

<sup>6</sup> Poundland published accounts FY15.

the opening of new stores and like-for-like sales growth of 2.4%. Poundland also generated sales of £5.4 million from the seven stores it opened in Spain in FY15.

- 2.4 Underlying gross profits grew from £368.5 million to £412.7 million in FY15, representing an increase of 12%, and gross profit margins increased to 37.1%.

### **99p**

- 2.5 99p is a retailer that sells non-edible and edible grocery products, health and beauty products and general merchandise. It operates 250 stores<sup>7</sup> under three different brands with different product ranges:
- (a) 216 '99p stores', which sell products at a price of 99p or less, with [X] % of sales being accounted for by products selling at less than 99p.
  - (b) 27 'Family Bargains stores', which sell best-selling 99p products and other higher retail price items.
  - (c) Seven '99p Plus stores', which sell a mix of products from both the Family Bargains and 99p stores' ranges.
- 2.6 99p also operates two stores in Ireland under the 'Euro 50' brand.
- 2.7 The majority of 99p's stores are located in the south of England, where the business was originally established, although more openings in the north and midlands have occurred in recent years.<sup>8</sup> The locations of 99p's stores are shown at Figure 2 below. Around half of its stores are located in high streets, with the remainder split between retail parks, shopping centres and standalone retail warehouse stores.

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<sup>7</sup> [X] As at May 2015.

<sup>8</sup> [X]

Figure 2: 99p's store locations



Source: KPMG.

- 2.8 99p was formed as a private limited company and opened its first store in Holloway, London, in 2001. In the period to 2006, 99p opened 47 stores. In the period from 2007 to 2012, its expansion accelerated significantly with the opening of an additional 158 stores, including in a number of the former Woolworths outlets following the retailer's receivership in 2008. It continued to grow in 2013 and 2014, albeit at a much reduced rate. More detail on 99p's expansion is set out in paragraph 5.6.
- 2.9 The Lalani family members are the largest shareholder group, with [%] of the shareholding. Three members of the family hold senior management positions.<sup>9</sup> The remaining shares are split between private investors and financial institutions.
- 2.10 In the year to 1 February 2015 (FY15), its revenues were £[%] million and its pre-tax [%] were £[%] million (see Appendix B, Table 2). Up until 2014, sales

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<sup>9</sup> Mr Nadir Lalani – CEO, Mr Faisal Lalani – MD, and Mr Hussein Lalani – Commercial Director.

had grown year-on-year for the past decade, [REDACTED]. More detail on the evolution of 99p's financial performance is set out in paragraph 5.7.

## Overview of the offerings of the Parties

2.11 Poundland describes itself as a single price general merchandise retailer and 99p as a value general merchandise retailer.<sup>10</sup> Poundland and 99p offer products in similar product categories, and both make over [REDACTED] of their revenue from grocery/impulse, health and beauty and household products. This is shown in Table 1 below.

**Table 1: Summary of main product categories offered by Poundland and 99p**

	% of sales	
	Poundland*	99p
Grocery/impulse†	[REDACTED]	[REDACTED]
Health and beauty	[REDACTED]	[REDACTED]
Household	[REDACTED]	[REDACTED]
Homewares	[REDACTED]	[REDACTED]
DIY	[REDACTED]	[REDACTED]
Gardening	[REDACTED]	[REDACTED]
Toys	[REDACTED]	[REDACTED]
Clothing	[REDACTED]	[REDACTED]
Pet	[REDACTED]	[REDACTED]
Entertainment	[REDACTED]	[REDACTED]
Stationery	[REDACTED]	[REDACTED]
Baby	[REDACTED]	[REDACTED]
Batteries	[REDACTED]	[REDACTED]
Celebrations	[REDACTED]	[REDACTED]
Seasonal/Christmas‡	[REDACTED]	[REDACTED]

Source: Poundland, 99p

\*Jefferies, Poundland company note (23 July 2014), reports that Poundland's sales broke down as follows in FY13: 32% General Merchandise; 24% Impulse; 16% Grocery; 14% Health & Beauty; 9% Household; 5% Seasonal.

†Unlike Poundland, 99p does not have a separate 'impulse' category. The Parties state that the 'impulse' category includes FMCG items that are convenience orientated, including confectionery, sweets and snacks, soft drinks, chilled drinks, pick and mix, indulgent snacking and other novelties.

‡Unlike Poundland, 99p does not have a separate category for 'Christmas'. It includes all Christmas sales in the Seasonal category.

2.12 In FY15, 63% of Poundland's products were branded and 37% were own-label.<sup>11</sup> The proportion of branded goods has risen in recent years from 59% in 2011.<sup>12</sup>

2.13 Poundland told us that it is a price led, volume driven discounter with a simple business model built on three interrelated principles:

- (a) A simple, low-cost business model, using volume to leverage the fixed cost base.

<sup>10</sup> See Poundland press release (6 February 2015): [Proposed acquisition of 99p Stores Ltd for an enterprise value of £55 million](#).

<sup>11</sup> [REDACTED]

<sup>12</sup> Nomura research report: Poundland group (10 March 2015), p6.

(b) Efficient purchasing and the offer of ‘amazing value’ to customers.

(c) The maximisation of sales volumes in stores.<sup>13</sup>

- 2.14 Poundland’s high street stores average in size from around 4,000 to 5,000 square feet (sq ft<sup>14</sup>). Its retail park stores are larger and range from around 6,000 to 8,000 sq ft.<sup>15</sup> The average store size is around 5,250 sq ft.<sup>16</sup> Across its stores, it stocks around 3,000 SKUs<sup>17</sup>. Poundland told us that it has a consistent in-store offer which enables efficient stock and working capital management through a tightly defined product range.<sup>18</sup>
- 2.15 Analysis by Exane BNP Paribas states that Poundland is able to offer its ‘compelling prices by targeting a narrow range of low-ticket items where supernormal margins are being earned across multiple [general merchandise categories], then cross-subsidising footfall-driving FMCG categories’.<sup>19</sup> Further, this analyst states that Poundland is able to manage its gross margin by ‘constantly re-engineering the product and range and extract[ing] cost’. For example, working with confectioner Guylian to offer an exclusive eight-chocolate box.<sup>20</sup>
- 2.16 Although overall Poundland tends to offer a stable range of products, there can be significant variation in the selection of products sold year-on-year, as about [X] % of its products are supplied by the grey market<sup>21</sup> or constitute end-of-line or end-of-life products.
- 2.17 The size of 99p stores varies, with trading floor space ranging from 3,000 to 14,950 sq ft with an average of around [X] sq ft. The average sizes of 99p Plus stores ([X] sq ft) and Family Bargains stores ([X] sq ft) are substantially larger.<sup>22</sup>
- 2.18 99p told us that the Family Bargains stores offered a wider range of products than 99p stores, and that pricing for Family Bargains stores is determined independently of 99p. The Parties said that the 99p Plus stores product range

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<sup>13</sup> [X]

<sup>14</sup> A square foot is equal to 0.093 square metres. The large majority of information that we received on store sizes used square feet rather than square metres as the unit of measurement. In the interests of simplicity, we have not adjusted this information to quote figures in hectares.

<sup>15</sup> Nomura research report: Poundland group (10 March 2015), p8.

<sup>16</sup> [X]

<sup>17</sup> Nomura research report: Poundland group (10 March 2015), p8.

<sup>18</sup> Poundland Initial submission to the phase 2 inquiry (29 May 2015), paragraph 12 (Poundland’s submission).

<sup>19</sup> Exane BNP Paribas, Poundland (21 July 2014), p9.

<sup>20</sup> Exane BNP Paribas, Poundland (21 July 2014), p9.

<sup>21</sup> A distribution route that is not the manufacturer’s authorised or normal distribution chain.

<sup>22</sup> [X] Figures rounded up to the nearest 50.

is comprised of [X] % of the 99p stores range and approximately [X] % of Family Bargains best-sellers across most categories.<sup>23</sup>

- 2.19 Poundland's estimated sales density of almost £400 per sq ft is significantly higher than the equivalent figures for 99p and Family Bargains – which are £300 and £200 per sq ft, respectively.<sup>24</sup>

### **The value retail sector**

- 2.20 The value (or discount) retail sector spans a number of categories. We focus on the value retailers whose product categories overlap to some degree with those of the Parties.

- 2.21 Within this sector, there are several types of retailers with a 'value' positioning. These include the following:

- (a) Single price point retailers (**SPP retailers**), colloquially known as 'pound shops'. Retailers in this category sell all (or the vast majority) of their product lines for a single, fixed price, often of £1 or 99 pence. In addition to Poundland and 99p, this category includes the following:
- (i) Poundworld, an SPP retailer that operates 232 stores located across the UK.<sup>25</sup> Founded in 1974, Poundworld was acquired by private equity group TPG in May 2015 for a reported sum of about £150 million.<sup>26</sup> Like Poundland and 99p, the number of Poundworld stores has increased significantly in the last three to four years, with 30 to 40 new stores opening each year.<sup>27</sup> We refer to Poundland, 99p and Poundworld as **large SPP retailers**.
- (ii) There are a large number of smaller SPP retailers (**small SPP retailers**). These include Sam 99p, which operates 21 stores in the South East of England, and Max 99p, which operates three stores in the South of England and one in Wales.
- (b) Grocery discounters, including Aldi, Lidl and Iceland. We refer to these three stores as limited assortment discounters (**LADs**). The LADs distribute predominantly own-branded grocery products which are often sourced from wholesale suppliers. This enables them to offer alternatives to the branded products available at supermarkets and at lower price

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<sup>23</sup> [X]

<sup>24</sup> Canaccord Genuity, UK Equity Research: Poundland (6 March 2015), p5.

<sup>25</sup> [X]

<sup>26</sup> 'US buyout group TPG snaps up UK discounter Poundworld', *The Financial Times* (14 May 2015).

<sup>27</sup> Summary of hearing with Poundworld on 29 June 2015, paragraph 1.

points. The range of products offered is narrower than the range available at the national multiples.

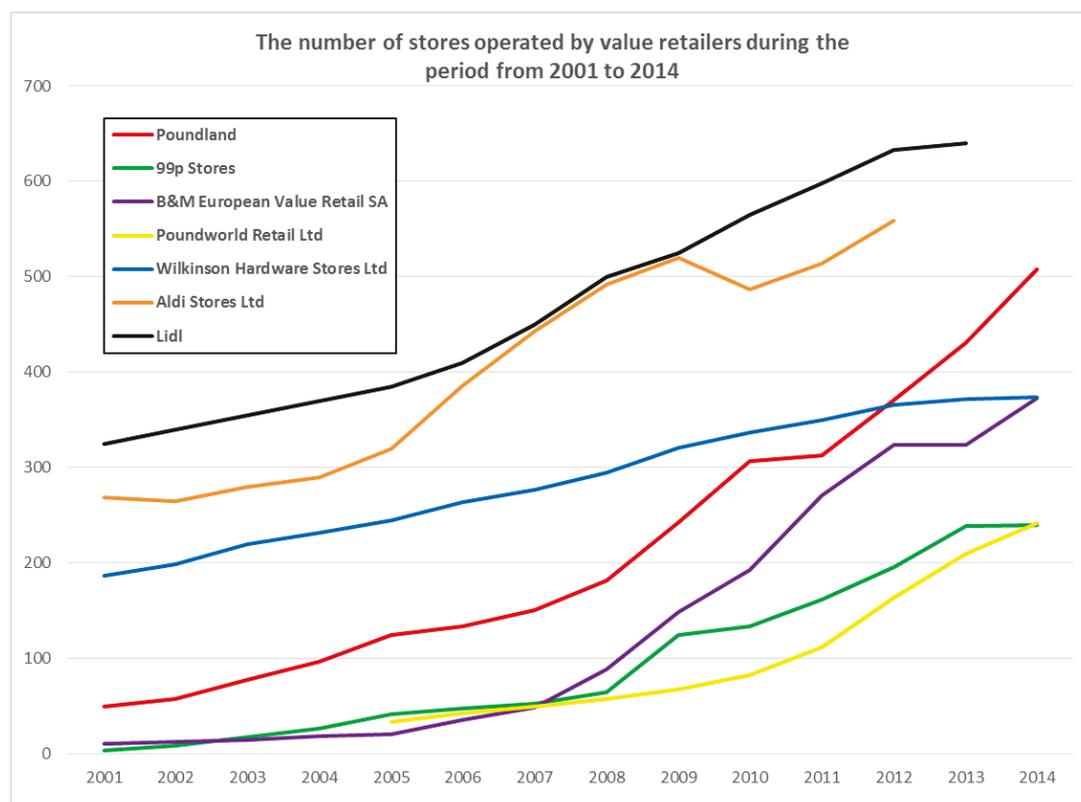
- (c) Value general merchandise retailers (**VGM retailers**), including B&M, Home Bargains, Poundstretcher and Wilko as well as Poundworld's Bargain Buys branded stores and 99p's Family Bargains branded stores. These companies sell a wide range of products including food and drink, health and beauty items, home and seasonal products at a variety of price points and in outlets that are significantly larger than the SPP retailers' stores. The VGM retailers typically offer a larger proportion of branded products than the LADs.
- (d) Value retailers focusing on a small number of product categories, such as Savers, which specialises in home, health and beauty products (**specialist value retailers**).

2.22 Analysts report that the value retail sector has grown significantly over the past decade, with net sales rising from £2.1 billion in 2005 to approximately £6 billion in 2015 and forecast to grow to £8.1 billion in 2017.<sup>28</sup> Analysts suggest that net sales growth has and will continue to be driven by new store openings, with like-for-like sales limited to 'low single digit' growth. Like the large SPP retailers mentioned above, VGM retailers and LADs have also opened a significant number of stores in recent years, as shown by Figure 3 below. Associated changes in customer behaviour are discussed in paragraphs 6.4 to 6.7.

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<sup>28</sup>  Poundland IPO Prospectus, p33.

**Figure 3: The rise in value retail stores**



Source: Poundland's submission, p19.

2.23 Research conducted for B&M indicated that it could expand its estate to 864 sites, while Home Bargains has plans to expand to 700 sites.<sup>29</sup>

2.24 All third parties who responded to our questions on expansion plans told us that they were planning store openings<sup>30</sup> in the current year. With one exception, all third parties were looking to increase the number of stores they operated.

2.25 In 2015, SPP and VGM retailers and LADs were operating over 4,700 stores. From the evidence we have gathered on current and future expansion plans, we estimate that the number of stores will increase by approximately 300 each year for the next two to three years, representing an annual growth rate of around 6%. New store openings is one of the key drivers behind the expected growth in sales revenue in this sector.

2.26 Exane BNP Paribas stated in July 2014 that 'after the space race', consolidation in the value retail sector looked to be inevitable.<sup>31</sup>

<sup>29</sup> OC&C research for B&M, reported in Deutsche Bank, Initiation of coverage: B&M, (23 July 2014), p32.

<sup>30</sup> However, one company will also close as many stores.

<sup>31</sup> Exane BNP Paribas, Poundland (21 July 2014), p30.

## **Other retailers and their 'value' propositions**

- 2.27 Analysts have stated that UK grocers are now in a 'price war', which was initiated by Asda in late 2013 and followed by its peers. Analysts report that the price war has been focused on branded ambient goods.<sup>32</sup> One analyst reported that the price of an indicative basket of branded ambient goods fell by nearly 9% between the end of December 2014 and the second week of March 2015. An analyst commented that it had seen no evidence that the price gap between Poundland's products and those of the major UK supermarkets had narrowed since the price war commenced, although another said the opposite and argued that 'across the entire range of branded products that can be matched, their price gap has narrowed from 14% cheaper to 4% cheaper'.<sup>33,34,35,36</sup>
- 2.28 Asda has a specific '£1 Shop' range which it promotes in dedicated bays within its stores. It told us that this has been available for more than [REDACTED].<sup>37</sup>
- 2.29 Tesco first introduced its 'Brand Outlet' concept into a selection of around 20 of its stores in 2013 (originally under the name 'Poundshop'). Brand Outlet takes the form of a dedicated aisle within its stores. These aisles are stocked with a range of over 300 products, with many being sold for £1 or 99 pence. Tesco said that the products stocked within Brand Outlet are not duplicated elsewhere in its stores as they are either unique to Brand Outlet or because they are sold with a different pack size (and at a different price) elsewhere in stores. Tesco told us that the concept was introduced [REDACTED].<sup>38</sup> Tesco had installed Brand Outlet aisles in [REDACTED] of its stores by July 2015.<sup>39</sup>
- 2.30 Morrisons told us that it had responded to a general downward movement of market prices, which was driven by discount stores generally. One example of this was its 'I'm Cheaper' campaign, when it moved prices on a large number of staple goods, specifically core products that it sold to a large number of its customers. This was a direct response to feedback that people were buying these items at Aldi and Lidl. This campaign largely focused on fresh produce, but also included some own-brand grocery food items.

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<sup>32</sup> Products sold at non-chilled or non-frozen temperature.

<sup>33</sup> Credit Suisse, UK Discount Retail channel check (2 July 2015).

<sup>34</sup> Nomura, Poundland report (10 March 2015), p6.

<sup>35</sup> Deutsche Bank, Poundland initiation report, (23 July 2014), p36.

<sup>36</sup> AB Bernstein, UK Food Retail (24 June 2015), p21.

<sup>37</sup> [REDACTED]

<sup>38</sup> [REDACTED]

<sup>39</sup> [REDACTED]

### 3. The merger and relevant merger situation

#### *The Transaction*

- 3.1 In the latter part of 2013, [REDACTED] approached 99p to discuss the possibility of a potential merger. These discussions did not progress to a formal stage, ending in the early part of 2014.
- 3.2 KPMG Corporate Finance (KPMG CF) told us that it had been aware of the discussions and believed that the owners of 99p were interested in selling the business and exiting. KPMG CF told us that it proposed to 99p an approach to Poundland. KPMG CF considered that Poundland was the most likely buyer as it [REDACTED] and as it had recently floated, it may have had the funds available to make an offer that the owners of 99p would find acceptable.<sup>40</sup>
- 3.3 On 14 May 2014, KPMG CF, acting on behalf of 99p, sent Poundland an initial enquiry letter.<sup>41,42</sup> Poundland initially responded with an indicative offer of £[REDACTED], the valuation being on a debt-free/cash-free basis, assuming no material contingent or pension liabilities, no minority interests and assuming a normalised level of working capital. Following discussions, the offer was confirmed at £[REDACTED] on 9 June 2014, subject (among other things) to due diligence. Poundland's offer was based on high level financial information provided by 99p, including an EBITDA run rate for the period ended 31 January 2014 of £[REDACTED] and forecast EBITDA for FY15 of £[REDACTED].<sup>43</sup>
- 3.4 In the period from 28 July 2014 to 30 January 2015, 99p and Poundland entered into a succession of exclusivity agreements. KPMG CF told us that during the period when technically Poundland was out of exclusivity, 99p was not marketed to other parties as there was still a commitment to sell to Poundland.
- 3.5 Poundland engaged [REDACTED] to undertake financial due diligence which commenced in September 2014. Legal due diligence by [REDACTED], commenced in October 2014.
- 3.6 [REDACTED]<sup>44</sup>

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40 [REDACTED]

41 [REDACTED]

42 [REDACTED]

43 [REDACTED]

44 [REDACTED]

- 3.7 The Agreement for the sale and purchase of 99p Stores Limited (SPA), which came into effect on 5 February 2015,<sup>45</sup> was made between the shareholders of 99p and Poundland for the sale and purchase of 100% of the entire issued share capital of 99p.
- 3.8 The Transaction gross consideration is £55 million, consisting of £47.5 million in cash<sup>46</sup> and the issue of new Poundland shares with a value of £7.5 million at closing.

### ***Rationale for the merger***

- 3.9 Poundland told us that ‘this transaction is fundamentally about increasing Poundland’s footprint’.<sup>47</sup> It stated that its rationale for the merger was to expand its presence quickly in a ‘fast-growing and dynamic marketplace.’ This, it stated, will allow it to compete across a wider range of locations with its many competitors. Poundland submitted that it will allow it to compete ‘more effectively with the large retailers it faces on high streets across the country’.<sup>48</sup> In addition, it submitted that the ‘transaction will provide very material benefits to customers, of which the principal source is Poundland’s superior (and preferred) proposition to that of 99p’.<sup>49</sup>
- 3.10 Poundland’s expansion plans were set out in its 2014 IPO prospectus, which states ‘the Directors believe, supported by external research conducted by the Javelin Group, that there is potential for more than 1,000 Poundland stores in the UK, making it possible to more than double its existing UK portfolio’.<sup>50</sup> Organically, Poundland was budgeting in FY15 to acquire 60 net new stores with geographic emphasis on the South West/South East with an increasing proportion located in retail parks and with larger sales areas. It stated in its board minutes of 30 October 2014 that in FY15 it had opened [redacted] new stores and closed [redacted].<sup>51</sup>
- 3.11 Poundland’s financial model for the transaction assumed a net increase in stores of [redacted]. It was assumed that [redacted]<sup>52</sup> [redacted] stores would be converted, including [redacted] stores that were in locations where Poundland already operated. [redacted]

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<sup>45</sup> The SPA was signed by the different shareholders on various dates between 8 January and 5 February 2015.

<sup>46</sup> [redacted]

<sup>47</sup> [redacted]

<sup>48</sup> Poundland’s submission, Annex 2.

<sup>49</sup> Poundland’s submission, Section 10.

<sup>50</sup> [Poundland IPO Prospectus](#), paragraph 5.2.

<sup>51</sup> [redacted]

<sup>52</sup> 99p operated [redacted] stores at the time of modelling. Since that time, 99p has opened new stores and now operates 250 stores.

## ***Jurisdiction***

- 3.12 Under section 36 of the Act and our terms of reference (see Appendix A), one of the questions we are required to decide is whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.
- 3.13 Section 23 of the Act provides that a relevant merger situation is created if:
- (a) two or more enterprises have ceased to be distinct and within the statutory period for a reference;<sup>53</sup> and
  - (b) the ‘turnover test’ or the ‘share of supply test’ (as specified in that section of the Act) is satisfied, or both are satisfied.

### ***Enterprises ceasing to be distinct***

- 3.14 The Act defines an ‘enterprise’ as ‘the activities, or part of the activities, of a business’. A ‘business’ is defined as including ‘a professional practice and includes any other undertaking which is carried on for gain or reward or which is an undertaking in the course of which goods or services are supplied otherwise than free of charge’.<sup>54</sup>
- 3.15 Each of Poundland and 99p sells goods in retail outlets for reward, and we are therefore satisfied that each is an enterprise for the purpose of the Act. We are also satisfied that as a result of the Transaction described in paragraph 3.7, both enterprises would be brought under the control of Poundland and accordingly would cease to be distinct, for the purpose of section 26 of the Act.<sup>55</sup>

### ***Turnover test***

- 3.16 The second limb of the jurisdictional test seeks to establish that the Transaction has sufficient connection with the UK on the basis of the turnover test or share of supply test.

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<sup>53</sup> As set out in [section 24](#) of the Act.

<sup>54</sup> Sections 129(1) & 129(3) of the Act.

<sup>55</sup> Section 26(1) of the Act provides that ‘any two enterprises cease to be distinct enterprises if they are brought under common ownership or common control (whether or not the business to which either of them formerly belonged continues to be carried on under the same or different ownership or control)’.

- 3.17 The turnover test is satisfied where the value of the turnover in the UK of the enterprise being taken over exceeds £70 million.<sup>56</sup> 99p recorded revenues of £[X] million in FY15 (£370.4 million in FY14).
- 3.18 Therefore, the turnover test is satisfied and there is no need to consider whether the share of supply test is also satisfied.

#### *Provisional conclusion on jurisdiction*

- 3.19 For the reasons given in paragraphs 3.15 and 3.17, we are satisfied that a relevant merger situation will be created by the acquisition of 99p by Poundland, and that we therefore have jurisdiction to decide whether the creation of that situation may be expected to result in an SLC within any market or markets in the UK for goods or services.

## **4. Market definition**

- 4.1 The purpose of market definition is to provide a framework for the CMA's analysis of the competitive effects of the merger. The relevant market (or markets) is the market within which the merger may give rise to an SLC and it contains the most significant competitive alternatives available to the customers of the merged companies. However, market definition is not an end in itself, and 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. The CMA may also take into account constraints outside the relevant market (or markets).<sup>57</sup>
- 4.2 In its response to the issues statement, Poundland told us that:
- (a) it competes all along the high street. It sells the same products to the same people as a broad range of retailers, including VGM retailers, supermarkets, category competitors, local independent and others; and
  - (b) the Parties compete at the national level and there is neither ability nor incentive for Poundland to deviate from this policy. Nevertheless, if the CMA wants to carry out the analysis at the local level, then the boundaries are likely to be wider than the one mile 'rule of thumb' and this is especially true for some competitors, such as supermarkets, that have wider catchment areas.

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<sup>56</sup> Section 23(1)(b) of the Act.

<sup>57</sup> [Merger Assessment Guidelines \(CC2 \(Revised\), OFT1254\)](#), paragraphs 5.2.1 & 5.2.2.

- 4.3 [X], by contrast, submitted that the main competition faced by the large SPP retailers comes from other large SPP retailers, with this rivalry occurring in the localities where they are active. This is because there are material differences between SPP retailers and VGM retailers in terms of their pricing, the mix and range of products they sell and the size of their stores.
- 4.4 Some of the other retailers (Wilko,<sup>58</sup> TJ Morris,<sup>59</sup> Poundstretcher<sup>60</sup>) told us that customers would consider them as alternatives to 99p and Poundland, at least for certain categories. They did not give any views on geographic market definition.
- 4.5 In line with normal practice, we examine in this section two dimensions of market definition:
- (a) the product dimension (paragraphs 4.6 to 4.26); and
  - (b) the geographic dimension (paragraphs 4.28 to 4.37).

### ***Product market***

- 4.6 The assessment of the relevant product market starts with the product offerings of the Parties, in this case the retail of a range of grocery products and general merchandise at a single price point of around £1 (SPP retail offering), in which the two Parties overlap. Using the theoretical framework of the hypothetical monopolist test, we explore the extent of substitution by customers between the Parties' SPP retail offerings and other retail offerings in response to a deterioration in their offering.<sup>61</sup> In this assessment we have focused predominantly on the extent of substitution between Poundland stores and 99p stores as this represents the vast majority of the overlaps between the Parties, though we have also considered Family Bargains and 99p Plus in our competitive assessment.
- 4.7 In order to reach a view on the closeness of competition between the Parties and other retailers, we examined a range of evidence, including Poundland's benchmarking documents, published analyst reports, research commissioned by the Parties, and the views of competitors. This evidence is set out in detail in section 6, paragraphs 6.39 to 6.77, where we use it to reach a view on the

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<sup>58</sup> [Summary of hearing with Wilko on 2 July 2015](#), paragraph 21.

<sup>59</sup> [Summary of hearing with TJ Morris on 23 June 2015](#), paragraphs 15 & 16.

<sup>60</sup> [Summary of hearing with Poundstretcher on 19 June 2015](#), paragraphs 11–14.

<sup>61</sup> In this case it is more appropriate to refer to a deterioration in the offering than to a price increase, because of the SPP business model of the Parties.

nature of the competitive process and the cumulative effect of the competitive constraints that may be exerted by other retailers on the Parties.

- 4.8 In defining the market, the aim is to isolate the most significant competitive alternatives available to the customers of the merger firms and include the sources of competition to the merger firms that are the immediate determinants of the effects of the merger (ie the CMA's aim when identifying the relevant market is to include the most relevant constraints on behaviour of the merger firms).<sup>62</sup>
- 4.9 We relied on three sources of evidence in order to define the product market:
- (a) Econometric analysis of the effect of the opening and closing of retail outlets on the revenues of the Parties' stores (the CMA econometric analysis).
  - (b) A survey of Poundland and 99p customers in which we asked them what action they would have taken if the party's store and all its other branches were closed for several months for refurbishment (the CMA survey).
  - (c) A comparison of the ranges of the Parties with each other and with the ranges of other retailers to identify similarities and differences between those offerings (the CMA range review).

#### *The CMA econometric analysis*

- 4.10 In order to assess which firms impose competitive constraints on each of the Parties, we estimated the effect of the entry and exit of different retailers on Poundland's and 99p's store level revenue. The change in an incumbent's store revenues following a local entry or exit event (referred to as a 'local event') will capture the effect of customers diverting from the incumbent store to the entrant, or from the exiting store to the remaining incumbent, as the Parties do not generally flex their offering in response to competition (as explained in paragraphs 6.33 to 6.38. The methodology is set out in detail in Appendix E.<sup>63</sup>
- 4.11 Our analysis focused on the difference in revenues (the 'revenue impact') before and after the local event, which provided us with a measure of the relative strength of the competitive constraint these entrants posed on the Parties. Tables 9, 13 and 14 in Appendix E show the impact on the Parties'

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<sup>62</sup> [Merger Assessment Guidelines](#), paragraph 5.2.1.

<sup>63</sup> The Parties submitted a different type of econometric analysis, called Performance Concentration Analysis. We explain in Appendix E why we do not consider this type of analysis to be informative in the specific circumstances of this merger.

sales of a local event taking place within 0.5 miles of the Party's store. We draw out in the following paragraphs the main findings from this analysis. It shows that local events involving Poundworld, 99p or Poundland had a negative impact (of over [redacted]%) on the sales of the existing Poundland or 99p stores. In general, the local events involving VGM retailers also had an effect, although it was less pronounced than the effect of any of the three large SPP retailers and varied between them. Local events involving Poundstretcher had no statistically significant effect on the sales of either Poundland or 99p, while local events involving Bargain Buys, Home Bargains and B&M had the largest impact of the VGM retailers. Local events involving small SPP retailers (Sam 99p and Max 99p) had an impact on the sales of Poundland, but the impact was not significantly larger than the impact of VGM retailers. No conclusions could be reached about their impact on 99p given the small number of observed events.

- 4.12 In the case of supermarkets, local events sometimes resulted in no statistically significant effect or a statistically significant positive effect (ie an average increase in sales). Of all of the supermarkets, only Morrisons had a negative impact on 99p's sales. However, we did not consider that these results were informative of a lack of competitive constraint from the supermarkets due to the possible effect of supermarkets in driving footfall to the local area.<sup>64</sup>

#### *The CMA survey*

- 4.13 We carried out face-to-face interviews in 15 local areas with 5,459 customers of the Parties as they were leaving either a Poundland or 99p store. The methodology we used for this survey, comments made by the Parties and our views of these comments are set out in Appendix D.<sup>65</sup>
- 4.14 We asked customers what they would have done if the store they had just visited and all the other branches of the same retailer had been closed for several months for refurbishment; how many of the items (if any) they would have bought, and from whom. Customers were not restricted in their choice of alternative retailer, and could say 'don't know'. We used the responses to

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<sup>64</sup> As mentioned for example by Savers ([Summary of hearing with Savers on 24 June 2015](#), paragraph 13) and [redacted].

<sup>65</sup> Poundland carried out an online survey of its customers (Poundland's survey). We explain in Appendix D what we consider to be the weaknesses of this survey. Because of the issues we have identified, we do not consider Poundland's survey to be a reliable source of evidence for the assessment of the relative strength of different competitive constraints and therefore do not refer to it further in this section. However, we consider it to be a useful source of evidence to identify all competitive constraints across the Parties' stores, because of its geographic coverage.

calculate diversion ratios<sup>66</sup> from each of the Parties to the other and to other retailers. The average diversion ratios for retailers (excluding areas where that retailer was not located within 0.5 miles of either Poundland or 99p) are shown in Table 2 below.

**Table 2: Diversion ratios\* based on the CMA survey**

	<i>From Poundland</i>	<i>From 99p</i>
Other merging party	36	41
Tesco†‡	[X]	[X]
Poundworld	[X]	[X]
Home Bargains	[X]	[X]
Wilko	[X]	[X]
Asda§‡	[X]	[X]
B&M	[X]	[X]
Poundstretcher	[X]	[X]
Sainsbury's‡	[X]	[X]
Savers	[X]	[X]
Aldi	[X]	[X]
Sam 99p	[X]	[X]
Morrisons‡	[X]	[X]
Lidl	[X]	[X]
Iceland	[X]	[X]

Source: CMA survey.

Note: Results shown are for all 99p stores surveyed, which include two 99p Plus stores. Taking the average only over 15 other surveyed 99p stores does not materially change the results.

\*Average diversion ratio across the areas in which the named competing retailer operates within 0.5 miles.

†Using the data available, we also looked at areas where there was no Tesco within 0.5 miles and calculated a diversion ratio of 9% for Tesco stores located between 0.5 miles and 1 mile from the Party's store.

‡With these retailers, our survey was unable to distinguish between diversion to different store formats (eg between local and large supermarkets).

§As with Tesco, based on the data available, we calculated a diversion ratio of 4% for Asda stores located between 1 and 2.1 miles from the Party's store.

- 4.15 The analysis indicates that customers consider the Parties to be the closest substitutes to one another. It indicates that Poundworld, Tesco and Home Bargains are the next closest alternatives. Asda, B&M and Poundstretcher have somewhat lower diversion ratios. The diversion ratios to convenience supermarket formats (ie Tesco Express, Sainsbury's Local or Morrisons M Local) were very low as were the diversion ratios to other types of retailer, including the LADs, smaller SPPs, Savers and other specialist value retailers. The closeness of competition between the Parties and between them and other retailers is further addressed in paragraphs 6.39 to 6.84.
- 4.16 Poundland has raised a number of concerns about the results of the CMA survey, which it submitted 'contains demonstrable anomalies' attributable to the under- or over-representation of particular demographic sub-groups in the dataset in comparison with the results of previous research it has

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<sup>66</sup> Broadly, we calculated diversion ratios for each retailer as the proportion of revenue weighted spend that respondents said they would divert to that particular retailer from 99p/Poundland compared to all spend that would have diverted from 99p/Poundland. For a more detailed description of the diversion ratio calculation, see paragraphs 13 to 15 of Appendix D.

commissioned. In particular, Poundland has submitted that the CMA survey findings over-index the 'time-rich' (eg the elderly and non-working) and under-index working customers (especially C1s)<sup>67</sup> and 'busy customers who go into the Parties' shops to buy one or two items'. These and other concerns raised by the Parties in relation to the CMA survey are addressed in detail in Appendix D. However, as explained in Appendix D, paragraph 29, we designed the CMA survey in such a way as to address potential shortcomings in research design (including shortcomings which we considered undermined the validity of some aspects of Poundland's own survey). As explained in paragraph 11(c), we also carried out a rigorous quality assurance process during the fieldwork.

- 4.17 We recognise that, like all surveys, the CMA survey has some weaknesses (see appendix D, paragraph 12); sampling variation, the potential for non-response bias and the hypothetical nature of the diversion questions are, in common with most merger inquiry surveys, potential sources of error. In this survey, we also had some initial concerns about the quality of some of the fieldwork, although these were, in our view, satisfactorily addressed. Nonetheless, for the reasons set out in more detail in Appendix D, paragraphs 29(a) to 29(g), we consider the CMA survey to be more reliable than the one conducted by Poundland, particularly with regard to estimates of diversion ratios. We note in particular that the CMA survey achieved a good number of interviews per surveyed store and a high response rate. Interviewing customers as they left the store minimised potential recall issues. Our survey questionnaire was designed specifically to address evidence gaps in our understanding of consumer behaviour in this inquiry. We have therefore used the CMA survey results except where Poundland's survey asked questions that were not included in our questionnaire. The CMA survey and the CMA econometric analysis both indicate that the SPP retailers are each other's closest competitors and that supermarkets and VGM retailers are also competitors to the Parties, though to a lesser extent. We note the diversion ratios from the Parties to Poundworld that we have derived from the CMA survey are lower than those implied by the econometric analysis.
- 4.18 Where there were differences between the CMA survey and the CMA econometric analysis in the ranking of competitive constraints, in general, we considered that greater weight should be given to the CMA econometric evidence for the following reasons:

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<sup>67</sup> Supervisory, clerical, junior managerial, eg shop floor supervisor, bank clerk, salesperson.

- (a) The CMA econometric analysis was based on revealed preferences (actual customer behaviour) rather than stated customer preferences.
- (b) The CMA econometric analysis was based on a large number of observed local events occurring across the whole of the Parties' networks of stores while the CMA survey was based on a smaller number of areas. Consequently we considered that the extent to which the results of the CMA survey were representative of closeness of competition in general may be more limited than the results of the CMA econometric analysis.<sup>68</sup>

4.19 However, in relation to supermarkets, we attached more weight to the results obtained from the CMA survey than from the CMA econometric analysis for the reasons set out in paragraph 4.24(a).

#### *The CMA range review*

4.20 We compared the ranges and prices for a selection of products of Poundland accounting for around 13% of Poundland's sales with those of the following retailers: 99p, Poundworld, B&M, Home Bargains, Poundstretcher, Wilko, Morrisons convenience stores, Aldi, Iceland, Savers, Sam 99p and Max 99p.<sup>69</sup>

4.21 We carried out the comparison by product class (eg toothpaste, shampoo) on the basis that products within a class were likely to be to some extent substitutable to one another from a customer's perspective.

4.22 We selected 19 product categories within which we carried out our assessment, which showed the following:

- (a) 99p, B&M, Max 99p, Poundstretcher, and Wilko had a comparable or wider range of products available in the selected product classes.
- (b) The ranges of Aldi, Morrisons convenience, Savers and Iceland had a comparable or wider range of products available in some product classes, but not others.

4.23 For most product classes it was not possible to directly compare prices as it was not possible to identify a sufficient number of matching products to carry out a 'like-for-like' comparison of prices. However, for some product classes where products appeared sufficiently similar (eg kitchen roll, toilet rolls, milk) we compared prices per unit. We recognise that this is a particularly small

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<sup>68</sup> In this respect, we note that the results from the CMA survey in relation to Poundworld and some of the VGMS were based on a small number of areas (Poundworld 5, Poundstretcher 4, B&M 5, and Home Bargains 4)

<sup>69</sup> The information provided by Home Bargains or Poundworld was not useable, as the former appeared incomplete and the latter combined data for the Poundworld and Bargain Buys fascia.

product category sample, but we note that the vast majority of the selected retailers price those products at a similar level to Poundland.

*Provisional conclusions on product market definition*

- 4.24 In making our assessment, we took account of the strengths and weaknesses of the three analyses we carried out. In particular, we noted the following:
- (a) The econometric analysis is based on revealed preferences and assesses the average impact of a large number of entry and exit events across the Parties' portfolio of stores. In general, where it shows statistically significant negative effects between local events and revenue, we consider these results to be robust. However, the absence of a statistically significant negative impact on sales resulting from the entry of supermarkets is more difficult to interpret. This is because entry by supermarkets may result in the opposing effects of increasing footfall, and therefore the total retail revenue in the local area, and causing customers to divert from the incumbent store to the entrant.
  - (b) The survey results were based on a small number of selected areas and in areas where there were fewer competitors, diversion ratios from the survey would be higher than in areas where there were a greater number of competitors. The survey, however, provides a more detailed understanding of what lies behind diversion ratios in these selected areas.
  - (c) The range review concerns a relatively small selection of products and so may not be representative of all the products sold by the Parties. This type of analysis is informative of the potential for substitutability, rather than actual substitutability as it is narrowly focused on the products offered rather than the substitutability of the overall shopping experience. Therefore, a good overlap in range does not necessarily imply actual substitutability but a lack of overlap in range is indicative of a lack of substitutability.
- 4.25 In reaching our provisional conclusions on the boundaries of the product market, we attached significant weight to the results that were consistent between the survey and the econometric analysis, and in relation to the constraint posed by supermarkets, we relied on the results of the CMA survey. In relation to the competitive constraint posed by supermarkets, the econometric analysis is uninformative and the survey evidence implies that there is a strong constraint from Tesco and some constraint from Asda. Although generally less informative, the CMA range review supported the CMA econometric analysis showing that LADs and Savers were not good substitutes for the Parties' offerings. Our competitive assessment (in

section 6) directly takes account of the strength of the competitive constraints from different retailers within each of these categories in more detail.

4.26 In the context of product market definition, we provisionally conclude that:

- (a) the Parties' closest competitors are other SPP retailers (Poundland, Poundworld and 99p);
- (b) the evidence from the CMA econometric analysis and the CMA survey indicates that the VGM retailers are good alternatives to the Parties, though less close competitors than other large SPP retailers;
- (c) the evidence from the CMA survey implies that some of the supermarket large format<sup>70</sup> stores pose a competitive constraint on the Parties, though this may vary between supermarkets. The evidence does not support the inclusion of convenience store formats in the relevant product market; and
- (d) the evidence from the CMA econometric analysis and the CMA survey does not support the inclusion of other retailers such as, but not limited to, small SPP retailers,<sup>71</sup> the LADs, and specialist value retailers (including Savers) within the relevant product market.

4.27 The assessment of pre-merger competition (see paragraphs 6.32 to 6.88) examines in more detail the competitive constraints exerted on the Parties, by companies both within and outside the relevant product market.

### ***Geographic market***

4.28 Our starting point is the recognition that customers shop in local retail outlets within a given travel time from their home or work. Therefore, competition between retail outlets is determined by the distance that customers are prepared to travel to alternative retailers.

4.29 In Section 6, we consider in detail the nature of the competitive process, including the ability, costs and incentives of the Parties to flex their offering at the local level in response to competition. We recognise that currently neither the Parties, nor VGM retailers compete in this way, but given that the national PQRS offer will reflect the aggregate local competitive conditions and given the forward looking nature of our competitive assessment of the effect of the merger, it is necessary to consider what competitive constraints the Parties

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<sup>70</sup> For example, excluding convenience stores (Tesco Express, Sainsbury's Local or Morrisons M Local).

<sup>71</sup> The evidence on the constraint posed by small SPP retailers is mixed. This issue is discussed further in paragraph 6.80. On balance, we provisionally conclude that small SPP retailers should not be included in the relevant product market.

would face at the local level. In this case, there are 152 (99p stores) when including Poundland's pipeline stores<sup>72</sup>) 99p stores within a mile of a Poundland store, and there are 169 (99p stores) when including Poundland's pipeline stores) Poundland stores within a mile of a 99p store.

- 4.30 As explained in the Merger Assessment Guidelines,<sup>73</sup> when assessing mergers involving a large number of local geographic markets, the CMA may start by examining the geographic catchment area within which the great majority of the relevant site's custom is located. Catchment areas will typically be narrower than the relevant geographic market and are used as a tool to assist the CMA's analysis of the competitive effects of the merger, and therefore do not represent an alternative conceptual approach to the hypothetical monopolist test. Rather, they provide a starting point for identifying local areas for further analysis without reaching a firm conclusion on the boundaries of that particular relevant geographic market. This is the framework we have adopted in this case.
- 4.31 The CMA econometric analysis and CMA survey both provide insight into the size of the catchment areas around the Parties' stores.
- 4.32 The results of the CMA econometric analysis indicate that the impact on Poundland's sales of a small or large SPP or a VGM retailer store opening or closing at a distance of less than 0.5 miles is greater than the impact on sales of a similar store of 0.5 to 1 mile. Similarly, the analysis indicates that the impact on 99p's sales of a Poundland store is greater at less than 0.5 miles than between 0.5 miles and 1 mile, but we cannot conclude that another SPP or a VGM retailer has a greater impact at less than 0.5 miles than between 0.5 miles and 1 mile. The results also indicate that the opening or closing of a SPP<sup>74</sup> or VGM store located further away than 1 mile has no statistically significant effect on either Party's sales.
- 4.33 For the purpose of geographic market definition, we grouped the results of the CMA econometric analysis in the following way in order to separate out the convenience stores (owned by one of the Big Four) from their larger formats:
- (a) Large SPP stores – Poundworld.
  - (b) Small SPP stores – Sam 99p; Max 99p

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<sup>72</sup> Pipeline stores are stores that have a planned opening date. In some areas, one Poundland store has more than one 99p store within a mile, and vice versa.

<sup>73</sup> *Merger Assessment Guidelines*, paragraph 5.2.25.

<sup>74</sup> Other than a Poundland store, which has an impact on the existing Poundland store sales even when located further away than 1 mile from it.

- (c) VGM stores – B&M, Bargain Buys, Home Bargains, Poundstretcher, Wilko, Family Bargains and 99p Plus.
- (d) Local supermarkets – Sainsbury’s Local, Morrisons M Local, Tesco Express.
- (e) Big supermarkets – Sainsbury’s, Morrisons, Tesco Extra, Tesco Metro, Tesco Superstore, Asda.

**Table 3: Impact on the Parties’ sales of a local event taking place at different distances from the store**

	<i>Less than 0.5 miles</i>	<i>0.5 to 1 mile</i>	<i>1 to 2 miles</i>
<i>From Poundland</i>			
Poundland	[X]*	\$	[X]*
99p	[X]*	[X]†	\$
Large SPP store	[X]*	\$	\$
Small SPP store	[X]*	[X]†	\$
VGM store	[X]*	[X]†	\$
Big supermarket	\$	[X]†	\$
Local supermarket	[X]‡	\$	[X]*
<i>From 99p</i>			
Poundland	[X]*	\$	\$
99p	[X]†	\$	\$
Large SPP store	[X]*	\$	\$
Small SPP store	\$	[X]‡	\$
VGM store	[X]*	\$	\$
Big supermarket	\$	\$	[X]‡
Local supermarket	\$	\$	\$

Source: CMA econometric analysis of retailers’ data.

\*Significant at a 99.9% confidence level.

†Significant at a 99% confidence level.

‡Significant at a 95% confidence level.

§No statistically significant effect.

**4.34 The CMA survey indicates that:**

- (a) most competitors tend to be located within 0.5 miles rather than 0.5 to 1 mile of each other, which may reflect the geography of town centres; and
- (b) a very high proportion of the spend that customers would divert to other stores in response to the closure of the target store would go to stores located within 0.5 miles.

**4.35** There were, however, some exceptions, with some competitors, notably Asda and Tesco, receiving a material amount of diverted spend at distances beyond 0.5 miles.

**4.36** It can also be inferred from the CMA survey evidence on travel time that a distance of 0.5 miles is likely to be the maximum distance that most customers currently travel to a Poundland or 99p store:

- (a) For those whose main or only reason for making their journey is to visit the store, 38% travel on foot and 80% of those travelling on foot travel for 15 minutes or less, which roughly equates to a distance of 0.5 miles (in a straight line).
- (b) 63% of the respondents said that going to the store was not their main or only reason for the trip, and those respondents are likely to travel a shorter distance to go to it than those whose primary purpose is to visit the store in question.
- (c) Therefore, the data implies that in total approximately 80% of respondents are likely to travel for 15 minutes or less (or 0.5 miles in straight line).

#### *Provisional conclusions on geographic market definition*

4.37 We therefore provisionally conclude that catchment areas of up to 1 mile are appropriate for the quantification of the competitive effects of the merger (set out at paragraphs 6.97 to 6.155 and that the analysis of the competitive effects should take account of the diminishing constraint of competitors at a distance between 0.5 miles and 1 mile. We also provisionally conclude that the constraint of stores located at a distance of over 1 mile from a Poundland or 99p store is likely to be negligible.

## **5. Counterfactual**

5.1 Before we turn to the effects of the merger, we need to assess what we expect would have been the competitive situation in the absence of the merger. This is called the 'counterfactual'.<sup>75</sup> It provides a benchmark against which the expected effects of the merger can be assessed. The CMA may examine several possible scenarios, one of which may be the continuation of the pre-merger situation; but ultimately only the most likely counterfactual scenario will be selected as the counterfactual.<sup>76</sup> The CMA will typically incorporate into the counterfactual only those aspects of scenarios that appear likely on the basis of the facts available to it and the extent of its ability to foresee future developments.<sup>77</sup>

5.2 With regard to Poundland, all the evidence we have seen indicates that absent the Transaction, Poundland would continue its expansion strategy

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<sup>75</sup> [Merger Assessment Guidelines](#), paragraph 4.3.1.

<sup>76</sup> [Merger Assessment Guidelines](#), paragraph 4.3.6.

<sup>77</sup> [Merger Assessment Guidelines](#), paragraph 4.3.6.

through organic growth, in line with the aspirations that it outlined in its IPO announcements.

5.3 With regard to the future of 99p, Poundland told us that, [REDACTED].<sup>78</sup>

5.4 99p invited us to consider the following counterfactual scenarios:

(a) [REDACTED].

(b) [REDACTED].

5.5 We first examine the financial performance of 99p both before and after the SPA was signed, before turning to the examination of three alternative counterfactual scenarios:

(a) continuation of the pre-merger situation;

(b) sale of 99p to an alternative purchaser; and

(c) failure of 99p.

### ***The financial and operational performance of 99p***

5.6 99p grew from one store in 2001 to 121 stores by 2009. Between 2010 and 2012, 99p expanded rapidly, increasing its store portfolio by 70%, and by the end of 2012, the company was operating 205 stores. During this period of rapid expansion, 99p also launched its new multi-price offering through its Family Bargains fascia. These stores were significantly larger than the traditional SPP stores and offered a range of products that were not stocked elsewhere in the 99p estate. 99p has continued to open new stores after 2015, but the rate of store openings has declined year-on-year since 2012, with it now operating 250 stores.

5.7 In FY11, 99p recorded sales of £231 million and pre-tax profits of £6.3 million. In FY12, sales grew to £270.2 million and pre-tax profits rose to £7.2 million. Sales revenue continued to grow in FY13 and FY14, reaching £370.4 million in FY14. [REDACTED]. Like-for-like sales [REDACTED] in FY13 and [REDACTED] in FY14 and 99p reporting pre-tax losses of £0.6 million in FY13 and £0.7 million in FY14. [REDACTED] In FY15, total sales [REDACTED].

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<sup>78</sup> [Response to the issues statement](#), paragraphs 4.4 & 4.5.

5.8 We sought to understand [REDACTED] the actions taken by 99p's management [REDACTED]<sup>79</sup> [REDACTED]:

(a) [REDACTED]

(b) [REDACTED]

(c) [REDACTED]

(d) [REDACTED]

(e) [REDACTED]

(f) [REDACTED]<sup>80</sup>

5.9 99p's new COO told us that the 99p brand had been [REDACTED].<sup>81</sup> [REDACTED]

5.10 On 3 April 2014, the directors of 99p agreed a strategy and detailed plan to prepare the business for flotation or sale within three to four years (the three-year plan). In practice, this involved the introduction of various retail systems and better management discipline into the business (see Appendix B, paragraphs 8 to 14 for more detail). [REDACTED]<sup>82</sup> [REDACTED]<sup>83</sup> [REDACTED]

5.11 In addition to changes to working practices (including moving from a six-day to a five-day working week), the recruitment of new managers for all key functions of the business and store refits, the business focused on four priorities:

(a) Pick-by-store.<sup>84</sup>

(b) Space/range planning.

(c) Warehouse efficiency.

(d) Merchandising systems.

5.12 In [REDACTED] December 2014 due diligence of 99p, it was reported that 99p's management team estimated that a [REDACTED] sales uplift in FY15 alone would have

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<sup>79</sup> [REDACTED]

<sup>80</sup> [REDACTED]

<sup>81</sup> Electra Partners' assessment of 99p in 2012 was that that 'the operational side of the business was [REDACTED]. [REDACTED].

<sup>82</sup> This also involved an attempt [REDACTED].

<sup>83</sup> [REDACTED]

<sup>84</sup> 'Pick-by-store' is defined as 'the assembly of a single or multiple store order by an operator who travels in a logical sequence through the warehouse gradually accumulating and picking products onto a pallet or roll cage from pick points located in designated areas of the warehouse'. See Supply Chain Analysis, 'Supply Chain Glossary'. 99p introduced this system to improve stock management and thus reduce distribution costs.

resulted from the refit programme, space and range planning initiative and improved distribution efficiencies. In addition, a further [redacted] sales uplift would be achieved over the Christmas season following the changes made to the operation, Christmas range and the introduction of a supplier conference. According to 99p's management team, this would have increased EBITDA from [redacted] to [redacted] in FY15.

- 5.13 However, the pick-by-store system [redacted].<sup>85</sup> [redacted]
- 5.14 Although there were some successes,<sup>86</sup> [redacted]. 99p's COO told us that in the period from June to December 2014, the implementation of the strategy had cost [redacted], while a new EPOS would have cost [redacted], and there were further stores that needed to be refitted. In his view, [redacted].<sup>87</sup> [redacted]
- 5.15 Nevertheless, as at November 2014, 99p was still forecasting an EBITDA of £[redacted] million. Board minutes to the end of 2014 recorded progress against the plan [redacted].
- 5.16 Board minutes of 28 January 2015 report on the financial performance of the business but for the first time since the three-year strategy was agreed (on 3 April 2014), there is no reference to the three-year plan, or any of the initiatives that had been pursued. The minutes recorded an EBITDA forecast of [redacted] for FY15.
- 5.17 FY15 [redacted] amounted to [redacted]. In the first three months of FY16, sales were [redacted] ([redacted] than in the first three months of FY15) and reported EBITDA [redacted].

### ***Our assessment of the counterfactual***

#### *Scenario 1: continuation of the pre-merger situation*

- 5.18 In considering the likelihood that 99p would have continued to operate as it had done in the period preceding the Transaction, we weighed carefully the representations made to us by 99p's management and contemporaneous documentary evidence.
- 5.19 We noted the appointment of two directors with extensive retail experience and a clear remit to turn the business around, and a few months later the apparent commitment of the 99p board to the three-year plan that the newly

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<sup>85</sup> 99p implemented pick-by-store internally rather than using a third party as was previously planned as the cost would have been [redacted].

<sup>86</sup> Examples of successes included following: the Leeds store [redacted] increase following a merchandising revision [redacted].

<sup>87</sup> 99p provided a breakdown of the [redacted]. We therefore consider that the true cost of the three-year plan would have been considerably lower than the estimate provided to us by 99p's management.

recruited COO had put forward. We also noted the presence of Barclays Ventures representatives at the board meetings in which the new COO was given his mandate and full control over the management of the stores. In January 2014, 99p issued equity shares for the consideration of £[redacted] million to a private independent shareholder, which implied that external parties were prepared to invest.<sup>88</sup> In addition, the business significantly expanded its management capability with the recruitment of 20 heads of department. These facts indicated to us that there was significant impetus behind the three-year plan that was actively pursued and supported by the 99p board in the following months.

- 5.20 [redacted] the contrast between the developments set out in paragraph 5.19 and [redacted].
- 5.21 Against this background, we considered it likely that the three-year plan would have been affected by [redacted], which coincided with the start of Poundland's due diligence, [redacted]. We also noted that a [redacted] EBITDA improvement resulting from the three-year plan was put forward by the management team as part of KPMG due diligence (see paragraph 5.12) and that [redacted]. In addition, from August 2014, the COO became aware of the negotiations with Poundland. Consequently, we consider it likely that from this point onwards, his pursuit of the three-year plan would have been affected by [redacted].
- 5.22 [redacted] By contrast, the COO told us that the initiatives implemented in 2014 aimed to lay the foundations for the business turnaround and that it was normal at this stage in the process for performance to worsen before it would improve.
- 5.23 The evidence we received supported the view that although 99p had serious operational difficulties, it was not structurally unsound. Some third parties commented on the favourable location and size of its stores.<sup>89</sup> The newly appointed COO also considered 99p's offering to be [redacted]. The evidence showed that the business and its management had [redacted]. 99p's CFO told us that 99p's management was aiming for every measure that it had put in place

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<sup>88</sup> The investment did not provide new funding for 99p. On 31 January 2014, the company issued 2,971,936 ordinary shares for a total subscription price of £[redacted] million, [redacted]. This was used by the company to: acquire the ordinary shares of Barclays Unquoted Investments Limited and Globe Nominees Limited; fully redeem Barclays Ventures loan notes; and make payments to Barclays Ventures in consideration of unpaid dividends.

<sup>89</sup> Electra commented: '99p has a relatively decent portfolio of stores with a large number of the stores being located in the "right places". Another potential upside was that the stores were for the most part not "over-rented"'. [redacted] told us that a significant number of 99p's stores were in high street locations which had high footfall and of a size (4,000–6,000 sq ft) that was rare to find in these locations.

to pay back within a year, and based on board minutes, it appears that the implementation of the three-year plan started in July 2014.

- 5.24 We therefore attached less weight to the claim made by [REDACTED] than to other evidence. Taking the evidence in the round, we consider that by January 2015 (when the three-year plan seems to have been [REDACTED]),<sup>90</sup> it was still too early in this three-year plan to judge whether the strategy was working and in any event, [REDACTED] were at least partly caused by the short-term incentive created by Poundland's due diligence process. Had the negotiations with Poundland not taken place in the background, we considered it likely that the strategy would have been executed at a slower pace and that [REDACTED] could have been avoided.
- 5.25 We noted that, [after January 2015, no mention is made in the 99p Board minutes of the three-year plan] [REDACTED].<sup>91</sup> [REDACTED] Given these decisions were made at a time when the Transaction was close to being completed, we consider that under normal circumstances the management of 99p would not have [REDACTED]. [REDACTED] In our view, this further illustrated the negative impact of the Transaction on the three-year plan.
- 5.26 We nevertheless recognise that in the short term, the business' performance would have been likely to [REDACTED]. [REDACTED]
- 5.27 We therefore considered whether 99p would have been likely to divest some stores in the absence of the merger, in order to [REDACTED].
- 5.28 We noted that in late 2013, 99p had considered selling [REDACTED] stores [REDACTED].
- 5.29 In its 14 December 2014 board minutes, Poundland noted that 'we are aware that recently a number of retailers have approached Penny<sup>92</sup> to attempt to acquire sites. [REDACTED]<sup>93</sup> [REDACTED] This suggests that by disposing of a small number of sites, Penny would be able to [REDACTED].
- 5.30 [REDACTED]<sup>94</sup>

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<sup>90</sup> [REDACTED]

<sup>91</sup> [REDACTED] the new coffee machinery roll-out; the new merchandising system at a cost of [REDACTED] million [REDACTED].

<sup>92</sup> 99p.

<sup>93</sup> This is the same as referred to in paragraph 5.28.

<sup>94</sup> [REDACTED]

5.31 We considered whether 99p might have divested or sold the Family Bargains stores, as [REDACTED] (see Appendix B, paragraph 23 and Table 6):

(a) 99p told us that [REDACTED] had expressed an interest in taking over ten of those sites [REDACTED]. It did not, however, comment on the possibility and attractiveness of selling the entire Family Bargains portfolio [REDACTED].

(b) 99p told us that divesting stores was [REDACTED].

(c) [REDACTED] 99p did not provide the context in which this analysis was performed nor support for how the figure was calculated.

5.32 [REDACTED]

5.33 We accept that 99p may have been reluctant to approach landlords on a large scale again with a view to terminating leases (although we noted that as of 2014, [REDACTED] leases were due to expire within the next three financial years)<sup>95</sup> and that a large scale divestment of stores would have presented potential challenges.

5.34 However, we consider it likely that as part of its three-year plan and/or in order to [REDACTED], 99p would have considered the tactical disposal of stores, as not doing so and [REDACTED] would appear to us to be an irrational response for a business that was embarking on a turnaround strategy. Although this might have had an impact on its competitiveness in some specific local areas, the evidence we received from 99p implies that it was unlikely it would have sought to divest a large enough portfolio of stores to impact on its competitive position overall. It appeared to us that both operationally and financially, the divestment of the 27 Family Bargains stores would have been the most likely option to pursue, particularly as some interest for a third of these stores had already been expressed by one party.

#### *Scenario 2: sale of 99p to an alternative purchaser*

5.35 We considered whether absent the merger, an alternative purchaser would have been found for the business. As 99p had not been marketed formally in the period since May 2014, we did not have direct evidence on which to base our assessment.

5.36 99p told us that in FY14 it [REDACTED].

5.37 We noted that since 2011, [REDACTED] and the reasons [REDACTED] had been varied. We received evidence from seven private equity firms on the attractiveness of the

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<sup>95</sup> Source: KPMG [REDACTED].

value retail sector in general and 99p in particular. All considered the sector to be attractive because of its growth. 99p was seen as an interesting opportunity by four of them, although lack of understanding of the company's financial position prevented them from commenting further. This is described in more detail in Appendix C.

- 5.38 We asked trade buyers whether they would have been interested in buying 99p. The evidence is set out in detail in Appendix C paragraphs 7 to 13.
- 5.39 Although one of these companies, [REDACTED], had expressed an interest in principle, the negotiations had not been sufficiently advanced when they came to an end for us to consider the sale of 99p to this particular company as the most likely counterfactual in the circumstances of this case. Other potential trade buyers expressed no interest in purchasing 99p.
- 5.40 Our view is that given [REDACTED] and the evidence we received from the various potential purchasers we identified, a counterfactual scenario involving the sale of the entire business to an alternative purchaser (absent the events relating to the prospective sale to Poundland) during the period from May 2014 to the making of the SPA in February 2015 was less likely than scenario 1, ie the continued implementation of the three-year strategy.

### *Scenario 3: failure of 99p*

- 5.41 [REDACTED]
- 5.42 [REDACTED]<sup>96</sup> [REDACTED]
- 5.43 As explained in the Merger Assessment Guidelines, in considering whether there is a 'failing firm' counterfactual scenario, the CMA will look at the facts of the case to assess whether one of the firms would have exited. In the context of a firm exiting for reasons of financial failure, consideration is given both to whether the firm is unable to meet its financial obligations in the near future and to whether it is unable to restructure itself successfully. The CMA will examine the firm's balance sheet to determine the profile of assets and liabilities. It will also consider the action the management has taken to address the firm's position and will review contemporaneous documents such as board minutes, management accounts and strategic plans.<sup>97</sup>
- 5.44 In the context of the counterfactual, we have considered whether the [REDACTED] would have resulted in 99p exiting through failure in the absence of the

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<sup>96</sup> This is after exceptional items that add up to [REDACTED].

<sup>97</sup> [Merger Assessment Guidelines](#), paragraphs 4.3.13 & 4.3.14.

Transaction. As explained in paragraphs 5.21 to 5.26, we consider that the negotiations with Poundland would have had an impact on management's incentives and consequently on the financial performance of the business. The evidence we have seen [REDACTED].

- 5.45 However, we do not consider that [REDACTED], had the negotiations with Poundland and the Transaction not taken place. As explained above, the business was not structurally unsound (paragraph 5.23), it had successfully attracted private support in January 2014 (paragraph 5.19), and it had a new COO, supported by additional operational management capability and a three-year plan, which it was implementing. It also had the option of selling some stores [REDACTED]. We therefore consider that the exit of 99p through failure is not a likely counterfactual scenario.

### ***Provisional conclusions on the counterfactual***

- 5.46 We reached the following provisional views on the most likely counterfactual, based on the analysis of the above three scenarios. In making our assessment, we noted discrepancies between the representations made by 99p's management and contemporaneous evidence (including 99p's and Poundland's board minutes and 99p's three-year plan and analysis), in particular with regard to [REDACTED]. Under those circumstances, we considered it appropriate to attach more weight to contemporaneous evidence than to the opinions and interpretations of past events presented to us by 99p's management in the course of our inquiry.
- 5.47 99p had a three-year plan and a commitment to this plan. The first stage of this plan would have been likely to result in a worsening of the financial situation. We consider, however, that absent the merger, [REDACTED], given less pressure for a quick implementation. We consequently consider that [REDACTED].
- 5.48 However, [REDACTED] would have meant that measures would have been required. Given the evidence we have received from potential buyers, we consider that 99p might not have been able to secure large scale financial backing from a private equity house in the short term.
- 5.49 However, the business is in a growth industry and the evidence we have received shows that it had some competitive advantages. We have no reason to believe that the business was structurally unsound and could not be fixed.
- 5.50 We cannot second guess what measures the management would have taken to enable the business to continue, but we note that the disposal of stores, particularly the portfolio of Family Bargains stores, would have been possible.

We also note that 99p had been successful in attracting a £[~~8~~] million investment from an independent private investor in January 2014.

5.51 We therefore consider the most likely scenario is that the implementation of the three-year plan would have continued, possibly in conjunction with targeted divestment. We recognise that in the short term, the competitiveness of 99p may have declined (and that such decline would have been likely to postpone any store opening) but given the underlying trend of the industry overall and the recent injection of professional management, we consider that 99p would have been likely to survive, largely operating the same business. It is possible that the business would have needed recapitalisation and additional management expertise before the completion of the three-year plan, but we did not consider it necessary to speculate on this matter, as we were satisfied that there was enough evidence to support our view that absent the Transaction, 99p would have continued to run a substantial SPP operation, albeit a weakened one in the short term at least.

## **6. Assessment of the competitive effects of the merger**

### ***Introduction***

6.1 In this section we first examine the nature of pre-merger competition, including the behaviour of customers, the approach to the setting of competitive parameters by the Parties, and the closeness of competition between the Parties and other retailers (building on the evidence and analysis set out in section 4 on market definition). We then analyse the local effects of the merger and the effects of the merger at the national level.

### ***Customer behaviour***

#### ***Introduction***

6.2 In this section we examine evidence relating to:

- (a) trends in customer shopping behaviour;
- (b) reasons given by customers for visiting SPP retailers;
- (c) whether customers use Parties' stores as a shopping destination or as a place to 'top up'; and
- (d) demographic characteristics of customers, basket size and shopping frequency.

6.3 In forming our views about consumer behaviour we relied on:

- (a) statements made by the Parties and by third parties in the course of our inquiry;
- (b) the CMA survey;
- (c) an online customer survey commissioned by Poundland during phase 1 (Poundland's survey);<sup>98</sup>
- (d) other customer research commissioned by Poundland or 99p in the normal course of their business;<sup>99</sup> and
- (e) (where applicable) customer research provided by other parties (including Poundworld).<sup>100,101</sup>

### *Trends*

- 6.4 Poundland told us that there has been a structural shift in UK retailing. It said that consumers from all backgrounds have adopted new shopping patterns and are much more value-conscious than was previously the case.<sup>102</sup> Poundland also said that customers are more inclined than before to divide their baskets between different retailers and different types of retailers.<sup>103</sup>
- 6.5 Poundland's survey showed that about [redacted] of customers were more conscious of price than a few years ago. PWC's 2013 study for Poundland in preparation for its flotation on the stock exchange found that around [redacted] of customers said they had increased their spending in discount stores, while only [redacted] said they had decreased it. Customers' forecasts for the future were similar.<sup>104</sup>
- 6.6 Poundworld's survey in 2014 found that [redacted]% of surveyed customers claimed to be using discount retailers more than they were a year ago.<sup>105</sup> In that survey, [redacted]% of customers said they would not shop less with discount retailers if they had more disposable income.<sup>106</sup>
- 6.7 Several of the retailers we talked to told us that shopping habits had changed:

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<sup>98</sup> [redacted]

<sup>99</sup> Customer research provided by Poundland: [redacted]

<sup>100</sup> Research provided by other parties: [redacted], referred to in this report as 'Poundworld's survey'.

<sup>101</sup> See Appendix D for a discussion of the methodologies of the CMA survey and Poundland's survey.

<sup>102</sup> [redacted]

<sup>103</sup> [redacted]

<sup>104</sup> [redacted]

<sup>105</sup> [redacted]

<sup>106</sup> [redacted]

- (a) Morrisons said it would divide its customers into those who had extremely busy families and were prepared to pay a bit more to get everything they needed from one shop, and those who had the time to plan their shop, visiting several different retailers to take advantage of as many offers as possible. Morrisons thought that the habits of highly price-conscious shoppers had spread much further through the population since 2008 and that UK customers were very price-aware.<sup>107</sup>
- (b) Poundstretcher said that its knowledge of customer behaviour indicated that many people were cash-poor but time-rich, and that this encouraged them to visit more than one retailer when shopping. It believed that such customers would buy their core grocery items from discounters and top up their shopping at a supermarket for the items they could not obtain from discounters. It felt that shoppers were becoming more price-conscious and better aware of different retailers' offerings.<sup>108</sup>
- (c) Savers said that it thought customers were now more price-aware and that this had caused a change in shopping habits. Savers said it thought that customers were regularly checking the prices of goods online and were now shopping more regularly, often to 'top up' a larger internet shop. It thought that supermarkets had been able to take advantage of this behaviour to some extent with their high street and convenience shops.
- (d) TJ Morris said it thought that customers no longer had reservations about shopping in discount stores. It said that certain customers would visit all of the discount stores in their local area and that in general people shopped around more than previously.<sup>109</sup>
- (e) Wilko told us that it was evident that an almost habitual change had taken place in customers' awareness of value for money – something it felt slight improvements in the economy would not change. There was no simple way of identifying which social demographic types would be more likely to visit discount retailers, and Wilko said that, as an example, Aldi or Lidl now have a very broad spectrum of customers. It felt that customers are now prepared to shop around and are more open to all retailers. Wilko said that in high street and retail park locations, customers often came to shop across all the retailers in that location as opposed to one specific retailer.<sup>110</sup>

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<sup>107</sup> [Summary of hearing with Morrisons on 23 June 2015](#), paragraph 13.

<sup>108</sup> [Summary of hearing with Poundstretcher on 19 June 2015](#), paragraphs 11 & 13.

<sup>109</sup> [Summary of hearing with TJ Morris on 23 June 2015](#), paragraph 15.

<sup>110</sup> [Summary of hearing with Wilko on 2 July 2015](#), paragraph 16.

## *Reasons given by customers for visiting Poundland or 99p*

- 6.8 Customers' motivations in deciding which retailer to visit help us to understand which aspects of PQRS customers find particularly important, and can help to inform which retailers are viable alternatives in the eyes of customers.
- 6.9 In the CMA survey, when asked for their top-of-mind, main reason for shopping at a Party store rather than at a competitor's store, 64% of respondents said their main reason was the affordability of the Parties' offer. The next most frequently mentioned main reasons were range (20%) and location (10%). Only about 1% of respondents mentioned the simplicity of the SPP proposition as their top-of-mind, main reason for choosing a Party store.
- 6.10 When customers' main and secondary reasons for shopping at Poundland or 99p are combined, the following ranking of store attributes emerges from the CMA survey:
- (a) Affordability (87%).
  - (b) Range of products (62%).
  - (c) Location (31%).
  - (d) Shopping experience (12%).
  - (e) The simple offer (the SPP proposition) (8%).
  - (f) Retailer's reputation (4%).
- 6.11 The Parties told us that customers were attracted to their format in part because of the simplicity of their customer proposition. Poundland pointed out that the SPP format helps customers budget, and gives them confidence in the company's 'amazing value, every day' proposition.<sup>111</sup>
- 6.12 The Parties have also characterised their customers as highly savvy, willing and able to compare prices on a unit basis, and ready to switch to whichever retailer provides the best value for a given product.<sup>112</sup> Poundland's survey found that between [redacted] and [redacted] of customers know the price of everything they buy, while around [redacted] in ten know the price of their key items.<sup>113</sup>

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<sup>111</sup> [redacted]

<sup>112</sup> [redacted]

<sup>113</sup> [redacted]

- 6.13 In Poundland's survey, the three reasons for visiting a Party's store that were most often described by respondents as being either 'essential' or 'very important' are all aspects of affordability ('value for money', 'cheaper than other stores' and 'low prices/pack sizes I can afford'). The next most highly valued were aspects of location ('convenient location', 'easy for me to get to'), range of products ('good range of products', 'availability/they don't sell out of what I want to buy', 'stock well-known brands'), and shopping experience ('good customer service'). Of the 15 reasons that customers were asked about in Poundland's survey, 'all products are the same price' [REDACTED].<sup>114</sup>
- 6.14 Poundworld told us that its consistent use of the £1 price point was attractive to customers seeking price reassurance and to spend a fixed amount.<sup>115</sup> B&M said that SPP retailers had a huge advantage over retailers such as itself because customers already knew the price of products before entering. It said that it was part of the shopping mission for certain customers to buy items for £1.<sup>116</sup> Wilko said that it was emerging that customers were starting to consider both unit and absolute prices, but that absolute prices were still a more dominant contributor to decisions.<sup>117</sup> However, we note too that VGM retailers (Poundstretcher, B&M) also tended to describe their customers as savvy and value-conscious.
- 6.15 Poundworld's survey found that the most important reasons for deciding to visit its stores [REDACTED].<sup>118</sup>

### *Destination shopping*

- 6.16 The Parties submitted that most of their customers do not travel specifically in order to shop at their stores. Instead, they generally visit a number of retailers in a single shopping trip, using the Party stores to 'top up'.<sup>119</sup>
- 6.17 The results of the CMA survey show that for 35% of surveyed Poundland customers and 39% of surveyed 99p customers, shopping there was the only or main reason for making a trip that day. Overall, two-thirds of Poundland customers (67%) and a slightly smaller proportion of 99p customers (63%) had planned their trip to Poundland/99p that day. The rest (33% of Poundland

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<sup>114</sup> [REDACTED]

<sup>115</sup> [Summary of hearing with Poundworld on 29 June 2015](#), paragraph 46.

<sup>116</sup> [Summary of hearing with B&M on 24 June 2015](#), paragraph 10.

<sup>117</sup> [Summary of hearing with Wilko on 2 July 2015](#), paragraph 22.

<sup>118</sup> [REDACTED]

<sup>119</sup> See, for example: [REDACTED] Poundland's submission, paragraph 27, citing research by food and grocery research and training charity IGD.

customers and 37% of 99p customers) were impulse shoppers, ie shoppers who had not planned their trip to Poundland/99p.

- 6.18 Poundland's survey concluded that about [redacted] of Parties' customers shop around for some or all of their items. Poundland's survey found that, on average, customers visited several other stores on the same day as their visit to a Party store.<sup>120</sup>
- 6.19 Poundworld's survey found that [redacted] of surveyed customers planned to visit the Poundworld store before they set out.<sup>121</sup> It also found that [redacted] of surveyed customers did not plan to visit any other discounters during the same shopping trip.<sup>122</sup> [redacted]<sup>123</sup> However, in general, [redacted] of Poundworld customers also shopped at other discounters.<sup>124</sup>

### *Demographic characteristics of customers, basket size, shopping frequency*

#### *Demographic characteristics of customers*

- 6.20 Around seven in ten respondents to the CMA survey were female. Compared with the UK adult population (ie people over the age of 15),<sup>125</sup> the CMA survey respondent profile was a little older, and there were more C2DE respondents overall.<sup>126</sup> The median household income was in the range of £10,000 to £15,000.
- 6.21 CMA analysis of the raw data from Poundland's survey showed that [redacted] of its respondents were female, and had an age profile broadly similar to the UK's as a whole. Respondents to Poundland's survey were approximately evenly split between ABC1 and C2DE social grades.<sup>127</sup>

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<sup>120</sup> [redacted]

<sup>121</sup> [redacted]

<sup>122</sup> [redacted]

<sup>123</sup> [redacted]

<sup>124</sup> [redacted]

<sup>125</sup> Annual Mid-Year Population Estimates for the UK, ONS, 2015.

<sup>126</sup> 2011 Census: Approximated social grade – Household Reference Person (HRP) aged 16-74, local authorities in the United Kingdom, ONS, 2014.

Socio-economic grade (SEG) is a classification system based on occupation. It enables a household and all its members to be classified according to the occupation of the Chief Income Earner (CIE). The groups are most often defined as follows:

A – Higher managerial, administrative, professional, eg Chief executive, senior civil servant, surgeon.

B – Intermediate managerial, administrative, professional, eg bank manager, teacher.

C1 – Supervisory, clerical, junior managerial, eg shop floor supervisor, bank clerk, salesperson.

C2 – Skilled manual workers, eg electrician, carpenter.

D – Semi-skilled and unskilled manual workers, eg assembly line worker, refuse collector, messenger.

E – Casual labourers, pensioners, unemployed, eg pensioners without private pensions and anyone living on basic benefits.

<sup>127</sup> [redacted]

- 6.22 In its representations, 99p referred to research it commissioned in 2014 which showed its customers were younger, overall, than those represented in the CMA survey findings:<sup>128</sup> [REDACTED]
- 6.23 In Poundworld's survey, [REDACTED] of respondents were women,<sup>129</sup> while the socio-economic background of respondents was [REDACTED].<sup>130</sup>

#### *Basket size*

- 6.24 The Parties told us their average basket size – the amount spent per customer per visit – was £4.72 for Poundland and £[REDACTED] for 99p.<sup>131,132</sup>
- 6.25 Among the customers interviewed in the CMA's survey, median spend was '£3.01 to £5'. The average basket size was £5.84 at Poundland and £5.33 at 99p. [REDACTED] Poundworld's survey showed an average spend of [REDACTED].<sup>133</sup>

#### *Shopping frequency*

- 6.26 The results of the CMA survey show that customers of the surveyed stores had visited the shop 3.3 times in the preceding two weeks, on average.<sup>134</sup> Shopping frequency was higher for C2DEs compared with ABC1s (3.5 and 2.8 respectively), for shoppers who planned ahead of time to go to the store (3.7 compared with 2.6 for impulse shoppers) and for those who went to the store as the only/main reason for their trip (3.8 compared with 3 for those whose visit was not the main reason for their trip).
- 6.27 Our analysis of the raw data from Poundland's survey showed that the median shopping frequency of surveyed customers was [REDACTED]. Respondents from lower socio-economic groups were [REDACTED].
- 6.28 Poundworld's survey found a median shopping frequency of [REDACTED].<sup>135</sup>

#### *Provisional conclusions on customer behaviour*

- 6.29 The evidence we have received from value retailers, combined with findings from the CMA survey and other surveys, shows the following:

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<sup>128</sup> [REDACTED]

<sup>129</sup> [REDACTED]% of Poundworld customers and [REDACTED]% of Bargain Buys customers. [REDACTED]

<sup>130</sup> [REDACTED]

<sup>131</sup> [Poundland Annual Report & Financial Statements 2015](#), p14.

<sup>132</sup> Poundland's submission, paragraph 7. For Q1 of FY16, 99p calculated an average basket size of £[REDACTED].

<sup>133</sup> [REDACTED]

<sup>134</sup> Including the visit after which they were interviewed.

<sup>135</sup> [REDACTED]

- (a) There is an increased propensity for UK customers from all socio-demographic groups to visit value retailers, including SPP retailers.
- (b) A significant proportion of the retailers we talked to told us that shopping habits had changed over the past eight years or so, with the single weekly shop being replaced to some extent by more frequent so-called ‘top-up’ shopping or multi-outlet shopping involving a variety of stores, including value retailers. This in turn has led to significant growth in the value retail sector, as described in paragraph 2.22.
- (c) The size of the average SPP shopping basket is small.<sup>136</sup>

6.30 Compared with the population of the UK as a whole, SPP retail customers are more likely to be women, and to have a lower average household income.

6.31 The CMA survey shows that customers are primarily attracted to Poundland and 99p because of the affordability of their offer, and while they also value the simplicity of the SPP offering, they appear to attach less importance to it when deciding to visit the Parties’ outlets.

### ***The nature of pre-merger competition***

6.32 In paragraphs 6.33 to 6.77, we describe the qualitative evidence, including documentary evidence that we have considered to reach a view on how the Parties compete with each other and with other retailers. We first explain how the Parties set their offering (paragraphs 6.33 to 6.38). We then set out evidence relating to the monitoring and benchmarking activities carried out by the Parties as part of their day-to-day management of their businesses (paragraphs 6.39 to 6.54). At paragraphs 6.55 to 6.77, we describe the competitive interactions between the Parties and between them and other retailers. We bring together this qualitative evidence with the evidence from the CMA econometric analysis, CMA survey and CMA range review at paragraphs 6.78 to 6.84. Our overall provisional conclusions on the nature of pre-merger competition are set out at paragraphs 6.85 to 6.88.

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<sup>136</sup> Although we do not have evidence on the size of shopping baskets for small SPP retailers, there is no reason to believe that they would be larger than the shopping baskets for large SPP retailers.

### *How the Parties set their offering*

- 6.33 The Parties seek to attract customers to their stores and those customers typically shop in local retail outlets within a given travel time from their home or work.
- 6.34 The Parties set their customer offering against the traditional retailer metrics of price, quality, range and service (PQRS).<sup>137</sup> As the Parties use a SPP for the vast majority of their products, the effective price of the products they sell is determined by the products' pack size. Poundland told us that its focus is on offering customers the best possible value and that a key part of offering a value proposition to customers is to maintain a significant pricing differential against the supermarkets, and that in the majority of cases where it cannot meet that differential it would [REDACTED].<sup>138</sup>
- 6.35 Each of the Parties told us that all components of PQRS (including range, pack size, store layout and staffing) are set centrally in a uniform way across all local areas.<sup>139</sup> Each said that its offer is the same in all of its stores irrespective of the local competitive conditions and that, in particular, across its stores:
- (a) its prices are the same;
  - (b) its range is the same (though larger stores may have a wider range than smaller stores);
  - (c) its stocking policy is the same;
  - (d) [REDACTED]
  - (e) its level of service is the same;
  - (f) its level of staffing (including store management) is the same; and
  - (g) its margins are the same, as explained in greater detail below.<sup>140</sup>
- 6.36 We therefore considered the extent to which the Parties have varied PQRS locally in the past.

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<sup>137</sup> [REDACTED]

<sup>138</sup> [REDACTED]

<sup>139</sup> [REDACTED]

<sup>140</sup> Poundland's submission, paragraph 10.

6.37 Overall, the evidence<sup>141</sup> shows that the Parties<sup>142</sup> vary some parameters of competition locally, but not others:

- (a) Both have a pricing policy that is largely consistent across stores. Poundland in particular sells [almost all] of its products at the £1 price point, with the exceptions mentioned in paragraphs 6.55 to 6.59.
- (b) Poundland varies its range by size of store. Pack sizes do not vary across stores. For both Parties, the limited variation in gross margins across their stores supports the view that there is limited variation in the range and pack sizes available (given their consistent pricing policies).
- (c) For both Parties, there does not appear to be material variation in staffing by store, with staffing levels being determined as a fixed proportion of the level of store turnover.
- (d) For both Parties, refits and refurbishments are necessarily targeted at specific stores.
- (e) There is variation in the opening hours of both Parties' stores.

6.38 However, we also note from this evidence that the variation in PQRS has not been related to the local competition faced by the Parties, with few exceptions:

- (a) Both Poundland and 99p have carried out a number of promotional periods during which prices have been temporarily discounted at a given store.<sup>143</sup> In the case of Poundland, almost all of these promotions have been carried out in response to the [X] retailer (with some in response to entry by a [X] retailer). However, these promotions accounted for only [X]% of Poundland's total net sales over the period (FY13 to FY15) and took place in only [X] out of 533 Poundland stores.<sup>144</sup> These examples indicate that it is possible for the Parties to deviate from a national pricing policy in response to local competition, but their very limited incidence implies that the benefits of doing so may not currently outweigh the costs.
- (b) Variations between the ranges offered by Poundland in different stores are determined by the sizes of the stores only, and not by the level of local competition faced by the stores.

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<sup>141</sup> As set out in Appendix F.

<sup>142</sup> Excluding Family Bargains and 99p Plus.

<sup>143</sup> [X] also highlighted several instances of the Parties engaging in local 'price wars'.

<sup>144</sup> See paragraphs 18 to 31 of Appendix F for more information on the pricing changes.

- (c) Refits and refurbishments do not appear to be important parameters of competition, with Poundland only spending an average of £[redacted] on refits across its store network over the last three years. Further, there is no evidence that either Poundland or 99p carries out refits or refurbishments in response to local competition.
- (d) The evidence did not indicate that competition is an important determinant of opening hours relative to other factors.

### *Competitor monitoring and benchmarking*

#### *Market reports*

- 6.39 We reviewed a number of reports submitted by Poundland but prepared by external parties. In particular:
- (a) [the first report] – commissioned by Poundland in connection with the proposed admission to Premium Listing of the business<sup>145</sup> [redacted]; and
  - (b) [the second report] – commissioned by Poundland as part of [redacted].
- 6.40 The [first report] looked at Poundland stores in areas where there was competition from other retailers and the impact of competitors entering into given areas. The conclusion was: ‘Stores that are competed by 99p experience a reduction in sales by approximately [redacted] in the first 12 months recovering to [redacted] the effect of Poundworld openings has a similar effect on sales as 99p.’ According to the report: ‘Both B&M and Home Bargains are not ‘direct single price point competitors’ and [redacted]. Over a 12 month period, stores competed by B&M and Home Bargains reduced by [redacted] and [redacted] respectively. After 36 months, sales had [redacted] sales levels respectively.’<sup>146</sup> We note that these results are broadly consistent with the results of the CMA econometric analysis.
- 6.41 We note that the [first report] suggests that there may be a distinction between competition from direct competitors to Poundland, such as other SPP retailers like 99p and Poundworld, and other competitors such as [redacted]. The report does provide evidence of [redacted] having an impact on a Poundland store when they open within close proximity, implying a degree of competitive interaction. [redacted]

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<sup>145</sup> [redacted]

<sup>146</sup> [redacted]

- 6.42 The [second report] suggests that Poundland's closest competitors [redacted] the [redacted] report provides some evidence to suggest that [redacted] are closer competitors to each other than other types of retailers. It states that '[redacted] appear to have more of an impact on [Poundland] store profitability than other operators'. [redacted]<sup>147</sup>
- 6.43 However, the emphasis in the report is clear that, in [the second report]'s view, VGM retailers are also direct competitors to Poundland. When considering local impacts on [redacted], small SPP retailers are included as competitors, implying that the report considers them as competitors.
- 6.44 The report suggests that there is also competition from other types of retailers, with the strongest other type being grocery multiples (eg Tesco). [redacted] The report does not include grocery multiples or LADs as competitors when analysing the effect of local competition on [redacted].<sup>148</sup>

*Benchmarking and reactions to supermarkets*<sup>149</sup>

- 6.45 Poundland submitted a large amount of benchmarking material to demonstrate how it monitors competitors.<sup>150</sup> Poundland told us that [redacted] it monitors the prices of its best-selling FMCG products to those of the Big Four supermarket chains (Tesco, Asda, Sainsbury's and Morrisons), and larger specialist suppliers of other FMCG products including Superdrug and Boots.
- 6.46 We note that the benchmarking conducted by Poundland reveals that there is a large price differential between it and the Big Four.<sup>151</sup> For example, extracts from Poundland's 'weekly comp shop tracker' show that the Big Four are on average [redacted] more expensive than Poundland (for the comparable SKUs captured).<sup>152</sup>
- 6.47 [redacted]
- 6.48 Poundland provided a detailed example of correspondence between a Poundland [redacted] Buyer and a supplier showing how it sought to change its own offer on [redacted] lines in response to changes in price at [redacted].

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<sup>147</sup> [redacted]

<sup>148</sup> [redacted]

<sup>149</sup> The term 'supermarket' here is to be interpreted in a broad sense, as we sought to identify all competitive constraints. We note that generally when referring to supermarkets, Poundland means the Big Four. We have used specific terms where appropriate.

<sup>150</sup> [redacted]

<sup>151</sup> See phase 1 decision.

<sup>152</sup> [redacted]

- 6.49 In addition, Poundland provided a further six examples of where it had improved the value of its offer [REDACTED].<sup>153</sup>
- 6.50 We note that [REDACTED], and consequently that they do not provide direct evidence of the need to maintain a differential in pricing for the majority of products where it is currently cheaper than the Big Four. However, we consider that [REDACTED] indicate a degree of competition between Poundland and the Big Four in general.

#### *Range reviews*

- 6.51 Poundland told us that it takes into account a range of factors when reviewing the performance of a particular range, but that the focus is on offering customers the best possible value.<sup>154</sup> Our analysis of the range review documents provided by Poundland indicates that Poundland does seek to offer good value (for example in terms of pack size) compared to a range of other retailers for specific product categories. We noted some examples within the range review documents indicating that Poundland seeks to maintain a differential with other retailers.

#### *Store opening documents*

- 6.52 Poundland supplied the CMA with documents produced as part of proposed new store openings between January 2012 and March 2015 (the proposal documents).<sup>155</sup> A range of competitors are mentioned in the reports. These include the large SPP retailers, VGM retailers (including B&M, Home Bargains, Poundstretcher, Wilko and Discount UK (the previous name of Poundworld-owned VGM now called Bargain Buys) and numerous small value retailers.
- 6.53 In addition to the competitor analysis, the majority of reports also contain a section highlighting ‘competitor threat’, where the potential for additional competitors to also open stores in the area is assessed, with the risk of entry being described as ‘low’, ‘med’, or ‘high’. The only competitors mentioned in this analysis are the [REDACTED]. The impact of their potential opening is estimated to be significant. [REDACTED]<sup>156</sup> [REDACTED]
- 6.54 While the store opening documents imply that Poundland considers a range of different retailers to be competitors, including VGM retailers and small

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<sup>153</sup> [REDACTED]

<sup>154</sup> [REDACTED]

<sup>155</sup> [REDACTED]

<sup>156</sup> [REDACTED]

value retailers, they also imply that Poundland considers Poundworld and 99p as [REDACTED].

### *Qualitative evidence on competitive interactions*

#### *Pricing responses to entry*

6.55 Poundland told us that over the past two and a half years, it has trialled a small number of promotional events in an attempt to disrupt the initial entry of a new competitor.<sup>157</sup> Poundland provided us with details of the pricing initiatives carried out at each store and the identity of the competitor that they were responding to. It showed that the only competitors it responded to (the number of promotional events is indicated in brackets)<sup>158</sup> were:

(a) [REDACTED]

(b) [REDACTED]

(c) [REDACTED]

(d) [REDACTED]<sup>159</sup>

6.56 Similarly, 99p has also made use of short-term variations in price at certain local 99p stores in the past, termed as ‘tactical pricing’ by the company.<sup>160</sup> 99p provided us with 13 examples of where it had reduced prices and the reasons for those prices, which included store closures and trial promotions for new stores.<sup>161</sup>

6.57 We noted that ten promotions were run at the same time Poundland was also running a pricing promotion in its nearby store, and that in each of these areas there was a Poundland within 1 mile. This implies that the pricing responses were a competitive reaction between the Parties, although we note that there are pricing promotions from Poundland that 99p does not appear to have reacted to.

6.58 Third parties told us that there had been price reactions between 99p and Poundland at a local level following store openings.<sup>162</sup>

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<sup>157</sup> [REDACTED]

<sup>158</sup> Some store promotions were in response to more than one opening.

<sup>159</sup> [REDACTED]

<sup>160</sup> [REDACTED]

<sup>161</sup> [REDACTED]

<sup>162</sup> [REDACTED]

6.59 We note that [redacted] [nearly all of these promotional events were] undertaken in response to the entry of an [redacted] retailer.

*Supermarket discounting*

6.60 Poundland submitted that evidence from [redacted]:<sup>163</sup>

(a) [redacted]

(b) [redacted]

(c) [redacted]

6.61 Poundland submits further that since late 2014, the major supermarkets undertook aggressive promotional and price reduction programmes in response to declining market share and mounting investor pressure. This activity accelerated into early 2015, with a number of price initiatives at the supermarkets in January to March 2015, including Morrisons' announcement in February 2015 that it would be cutting prices on 130 staple goods by an average of 22%.<sup>164</sup>

6.62 The [redacted] data shows that Poundland [redacted],<sup>165</sup> [redacted]<sup>166</sup> [redacted], it is not clear how directly the change in [redacted] links to [redacted], and in particular the [redacted] of [redacted].<sup>167</sup> It does, however, indicate a [redacted].

*Product case studies*

6.63 Poundland submitted that evidence of the constraint from supermarkets was that [redacted]. For example, [redacted].<sup>168</sup>

6.64 Poundland submitted [redacted] further examples of products where [redacted].<sup>169</sup>

6.65 We noted that these examples only cover a relatively small proportion of products, and it is therefore difficult to know how representative they are of the [redacted] on other products. However, we noted that these examples [redacted] and so may not be directly informative of [redacted] that may occur [redacted].

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<sup>163</sup> [redacted]

<sup>164</sup> [redacted]

<sup>165</sup> [redacted]

<sup>166</sup> [redacted] It is not clear from the [redacted] which retailers are included under the definition of 'total grocers', but it appears to us that it covers a broad range of retailers.

<sup>167</sup> [redacted]

<sup>168</sup> [redacted]

<sup>169</sup> [redacted]

6.66 However, overall we considered this evidence implied an element of substitutability between Poundland and the supermarkets, [REDACTED].

### *Supermarket responses*

6.67 Poundland submitted evidence from third party commentators which implied that the supermarkets competed with Poundland. For example, Poundland submitted excerpts from 'The Grocer' which said that Asda and Tesco were trying to replicate the success of the pound shop model.<sup>170</sup>

6.68 Poundland also submitted evidence from Morrisons' and Asda's public statements which implied that they competed with Poundland. This included statements from Morrisons about it monitoring Poundland along with other value retailers,<sup>171</sup> and from Asda's press releases about its response to value retailers.<sup>172</sup>

6.69 Poundland submitted that the introduction of £1 aisles in Tesco, Sainsbury's joint venture with Netto and its extensive advertising of £1 goods,<sup>173</sup> and Morrisons' £1 promotions<sup>174</sup> were evidence that the supermarkets have adjusted their offering to compete with Poundland and SPP and VGM retailers.

6.70 [REDACTED] Morrisons told us that SPP retailers were not primary competitors. For example, Morrisons said that it did not monitor or respond to Poundland and 99p's prices because their product ranges did not overlap greatly.<sup>175</sup> Sainsbury's told us the SPP retailers were competitors that were low down on its list of priorities and that the Parties were so small that 'they do not appear on Sainsbury's regular "competitor radar"'.<sup>176</sup> However, we note that Asda has a specific £1 Shop range.<sup>177</sup>

6.71 Tesco told us that it competes with all stores selling groceries at national and local level.<sup>178</sup> Additionally, in 2013 it introduced the 'Brand Outlet' concept, originally under the name 'Poundshop' (as mentioned in paragraph 2.29). This is an aisle offering products at the £1 price point within a Tesco store. Tesco said that the concept was introduced [REDACTED].<sup>179</sup> Brand Outlet has expanded from

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<sup>170</sup> Poundland's submission, paragraph 31a.

<sup>171</sup> Poundland's submission 'Excerpt from Morrisons Interim Management Statement Conference call'.

<sup>172</sup> Poundland's submission, paragraph 32.

<sup>173</sup> [REDACTED]

<sup>174</sup> [REDACTED].

<sup>175</sup> [Summary of hearing with Morrisons on 23 June 2015](#), paragraph 11.

<sup>176</sup> [REDACTED]

<sup>177</sup> [REDACTED]

<sup>178</sup> [REDACTED]

<sup>179</sup> [REDACTED]

approximately 20 to over 300 Tesco stores.<sup>180</sup> [REDACTED]<sup>181</sup> Brand Outlets contain [REDACTED].<sup>182</sup> Tesco research found that [REDACTED].<sup>183</sup> [REDACTED]<sup>184</sup>

### *Historical change in Poundland's margins*

- 6.72 Poundland submitted evidence on its gross margins over time.<sup>185</sup> Poundland submitted that its gross margins have been broadly unchanged over the period 2000 to 2015, despite the dramatic changes in the proportion of local areas where it faces competition from 99p. It submitted that the implication of this finding was clear – despite significant changes in the ‘average’ level of competition from 99p, Poundland has not varied its national offer. The same is also true when one considers Poundland’s share among SPP retailers only, which has fallen considerably since the early 2000s. Despite Poundland’s share of this ‘market’ falling from 90% to 60%, its gross margin has remained broadly constant. In other words, despite a significant increase in the degree of overlap with 99p and Poundworld, Poundland has not altered its national offer.
- 6.73 We note that there has been little change in Poundland’s gross margins over time and also that since 2000, Poundland has faced increased competition (in terms of a greater number of local overlaps) from both SPP and VGM retailers. However, this analysis does not control for other factors that have also changed over this period. For example, Poundland has significantly expanded its network of stores and the sector has seen shifts in consumer behaviour. Without controlling for these other factors, it is not possible to identify a relationship between gross margins and intensity of competition.
- 6.74 We also note that Poundland told us that it aims to [REDACTED].<sup>186</sup>

### *Third party evidence*

- 6.75 [REDACTED]. It felt this was partly due to increased footfall and partly because these retailers provide a direct comparator on price which highlights to customers [REDACTED] better value.<sup>187</sup>

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<sup>180</sup> [REDACTED]

<sup>181</sup> [REDACTED]

<sup>182</sup> [REDACTED]

<sup>183</sup> [REDACTED]

<sup>183</sup> [REDACTED]

<sup>184</sup> [REDACTED]

<sup>185</sup> [REDACTED]

<sup>186</sup> [REDACTED]

<sup>187</sup> [Summary of hearing with Poundworld on 29 June 2015](#), paragraphs 32–34.

6.76 VGM retailers told us that although they do compete with the Parties, their main competitors were other VGM retailers. TJ Morris said that 99p Stores' Family Bargains tried to emulate the approach of MPP retailers.<sup>188</sup> [redacted]<sup>189</sup> B&M said that it actively looked to move away from the £1 price point because it was better executed by the SPP retailers.<sup>190</sup>

6.77 Most of the LADs told us [redacted].<sup>191</sup> However, Iceland told us that Poundland and 99p are [redacted] competitors, [redacted].<sup>192</sup>

*Assessment of evidence on the closeness of competition between the Parties and other retailers*

6.78 In order to reach a view on the closeness of competition between the Parties and other retailers, we bring together evidence from the CMA survey, the entry/exit econometric analysis, the CMA range review (described in the market definition section) and our analysis of qualitative evidence described in paragraphs 6.38 to 6.77.

6.79 Overall, we consider that the evidence available to us strongly supports the view that the large SPP retailers (Poundland, 99p and Poundworld) are each other's closest competitors. In particular:

- (a) the CMA econometric analysis<sup>193</sup> shows that local events involving Poundworld, 99p or Poundland had a similar and substantial negative impact (of over [redacted]%) on the sales of the existing Poundland or 99p stores;
- (b) diversion ratios between the Parties from the CMA survey<sup>194</sup> were in general substantially higher than to any other retailer. Diversion ratios to Poundworld were high but somewhat lower than between the Parties, but we note were based on only a small number of areas where Poundworld was present;
- (c) store opening documents indicated to us that Poundland considered [redacted]; and

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<sup>188</sup> Summary of hearing with Home Bargains on xx, p26.

<sup>189</sup> [Summary of hearing with Poundstretcher on 19 June 2015](#), paragraph 9.

<sup>190</sup> [Summary of hearing with B&M on 24 June 2015](#), paragraph 10

<sup>191</sup> [redacted]

<sup>192</sup> [redacted]

<sup>193</sup> See Appendix E.

<sup>194</sup> See Appendix D.

- (d) promotional pricing events undertaken by Poundland were [redacted] in response to the entry of [redacted]. 99p reacted to the entry of a Poundland store by lowering its prices.
- 6.80 We consider that there is evidence of some competitive constraint exerted by smaller ‘independent’ SPP retailers, in particular Sam 99p and Max 99p, though this evidence is somewhat limited. In particular, we note that our analysis of entry/exit found statistically significant negative impacts of entry by these retailers on Poundland revenues (but not on 99p revenues). The CMA range review implies that Max 99p had a comparable or wider range of products available in the product classes selected, but that the overlap between Sam 99p and Poundland was more limited. The diversion to Sam 99p in the CMA survey was relatively low.
- 6.81 Based on the evidence available to us, we consider that the VGM retailers are a competitive constraint on the Parties, though they are less close competitors than SPP retailers. We also note that the relative closeness of competition varies by VGM retailer, and that Poundstretcher in particular appears to be a relatively weak competitive constraint:
- (a) The CMA range review implies that in relation to Poundland, the VGM retailers had a comparable or wider range of products available in the product classes selected.
- (b) The local events involving VGM retailers had a significant effect on Poundland revenues, although it was lower than the effect of the SPP retailers and varied according to the VGM retailer. In particular, local events involving Poundstretcher had no statistically significant effect on the sales of either Poundland or 99p, while local events involving Bargain Buys, Home Bargains and B&M had a statistically significant impact.
- (c) Diversion ratios from the CMA survey were approximately [redacted]% on average to Wilko and Home Bargains, but only [redacted]% to B&M and Poundstretcher.
- (d) Poundland’s internal documents including store opening reports and reports prepared by external advisors suggested that the Parties viewed the VGM retailers as competitors, [redacted].
- (e) In general, the VGM retailers submitted that they competed with the Parties, but that VGM retailers were closer competitors to them.
- 6.82 We consider that there is evidence supporting the view that the supermarket large store formats are a competitive constraint on the Parties, but that their convenience formats are not. The strength of this constraint may vary by

supermarket. In particular, the evidence indicates that Tesco is a stronger competitive constraint on the Parties, followed by Asda, while there is little evidence supporting that Sainsbury's and Morrisons are close competitors:

- (a) In general, we did not find a statistically significant effect on Poundland's revenue from the entry/exit of supermarket fascia. However, we did not consider that this was informative of a lack of competitive constraint from the supermarkets as this result may be due to the effect of supermarkets in driving footfall to the local area.
- (b) The CMA survey implied some competitive constraints from supermarkets, in particular Tesco, and to a lesser extent Asda. The diversion ratios to Tesco in the exit survey were approximately [redacted]% on average. The diversion to Asda was [redacted]%, and to other supermarkets was lower (Sainsbury's [redacted]%, Morrisons [redacted]%).
- (c) Poundland regularly benchmarked its prices against the supermarkets, with a focus on the Big Four, and had on occasion sought to improve the value of its products as a result of this benchmarking.
- (d) [redacted] by the supermarkets for certain products [redacted].
- (e) Tesco introduced its Brand Outlet aisle selling products for £1, and Asda has a specific £1 Shop range.

6.83 Based on the evidence available to us, we consider that the competitive constraint from other retailers, including the LADs and specialist value retailers is weak. In particular:

- (a) the CMA range review implied that the ranges of Aldi, Savers and Iceland were comparable to Poundland in some product classes but not others;
- (b) the CMA econometric analysis did not find a statistically significant effect on the revenue of the local Poundland store from local events within 0.5 miles of the store for Iceland and Savers; and
- (c) the diversion ratios to Savers, Aldi, Lidl and Iceland resulting from the CMA survey were all very low.

6.84 With respect to 99p's Family Bargains fascia, we note evidence from the Parties and third parties implying that it has a similar retail offer to other VGM retailers. We also note the results of the CMA econometric analysis, which found a negative statistically significant impact of local events involving Family Bargains on 99p store revenues but not on Poundland store revenues. However, we note that these results are based on a very small number of

observations, so we treat them with some caution. On the basis of this evidence, we consider that it is likely to be a less close competitor to Poundland than the 99p fascia and may be similarly close to Poundland as other VGM retailers. However, we did not need to conclude on this point as it does not materially affect our assessment of the effects of the merger below.

### ***Provisional conclusions on the nature of pre-merger competition***

- 6.85 We note that the Parties have not varied components of PQRS locally in response to competition in the past, with very few exceptions.
- 6.86 On the basis of the evidence above, we provisionally conclude that the closest competitors to Poundland are the other large SPP retailers.
- 6.87 Of the VGMs, the evidence supports the provisional conclusion that Home Bargains, B&M, Wilko and Bargain Buys are competitive constraints on the Parties but not as close as the large SPP retailers. We note in particular from the CMA econometric analysis that the impact of entry or exit by VGM retailers on Poundland's revenues is [~~30~~] that of SPP retailers.<sup>195</sup> We have therefore weighted these competitors by 0.5 in our methodology for assessing the national effects of the merger at paragraphs 6.143 to 6.153 below. The evidence above indicates that Poundstretcher is a weaker competitive constraint than the other VGM retailers. We therefore excluded Poundstretcher from our methodology for assessing the national effects of the merger.
- 6.88 With respect to the supermarkets, on the basis of the evidence above, in particular the evidence from the CMA survey, we provisionally conclude that Tesco and Asda exert a similar or somewhat closer competitive constraint on the Parties to that exerted by the VGM retailers, although we note that this evidence implies the constraint from Asda may be somewhat weaker than that from Tesco.<sup>196</sup> We have therefore applied the same weighting to these competitors as to the VGM retailers<sup>197</sup> (by 0.5) in our methodology for assessing the national effects of the merger below. The evidence above indicates that Sainsbury's and Morrisons are weaker competitive constraints. It also indicates that convenience formats are weak competitive constraints.

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<sup>195</sup> See Appendix E, Tables 9, 13 and 14.

<sup>196</sup> We have tested the sensitivity of this assessment to the exclusion of Asda from the competitor set, given the evidence implies the constraint from Asda may be somewhat weaker than that from Tesco.

<sup>197</sup> Excluding Poundstretcher, which is not in the competitor set used in our analyses of the effects of the merger.

## ***Effects of the merger***

### *Introduction*

6.89 In our statement of issues,<sup>198</sup> we identified three ways in which the Transaction could give rise to an SLC:

- (a) **Theory of Harm 1: loss of a current competitor at the local level** – 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.
- (b) **Theory of Harm 2: loss of a current competitor at the national level** – in general, as stated in the CMA’s commentary on retail mergers,<sup>199</sup> 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 Transaction may be expected to result in competition concerns in local areas representing a significant proportion of the Parties’ overall business, the Transaction may create an incentive to worsen any of the aspects of the Parties’ offerings that are set on a national basis.
- (c) **Theory of Harm 3: loss of a potential competitor at the local level** – a loss of competition similar to the loss of a current competitor 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 Transaction, even though they do not overlap in those areas at present.

6.90 In relation to Theory of Harm 3, as explained in Section 5, absent the merger, the most likely scenario is that 99p would have continued to implement its three-year plan, but [X], which may have led it to divest some stores. We considered it likely that in the short term it would not have been able to pursue the expansion plans that it previously had had, and given the expansion plans of others, we considered that when and if it resumed expansion, this was

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<sup>198</sup> Stores for which there is a planned opening date.

<sup>199</sup> Commentary on retail mergers (March 2011), paragraph 3.7.

unlikely to be with the same pipeline of stores. We therefore did not take account of 99p's previous expansion plan in our assessment of potential competition.

- 6.91 [X] further submitted in relation to Theory of Harm 3 that, as a result of the Transaction, Poundland's incentives to expand the combined 99p/Poundland network will change, potentially leading to a reduction in the number of planned store openings, or a decrease in the level of competition in the markets in which new stores are entering. It said that in both instances this would impact future market conditions, which would reduce future rivalry at the national and local level, and further negatively impact the merged business' incentives to competitively set national parameters of rivalry.
- 6.92 For this to be the case, there would need to have been significant expansion from the Parties absent the merger, and these expansion plans would need to be such that they would be substantially more likely than other competitors to enter into new overlap areas. Given the point raised above regarding the counterfactual and 99p's expansion plans, and the evidence provided regarding the expansion plans of other large and small SPP and VGM retailers (paragraphs 2.24 and 2.25), we do not consider that this theory of harm is credible in the context of this inquiry.
- 6.93 We therefore did not consider Theory of Harm 3 further and concentrated our analysis on Theories of Harm 1 and 2. We took account of the pipeline stores<sup>200</sup> of Poundland in those assessments.
- 6.94 We first assess the Parties' ability and incentive to modify any aspect of their retail offer (for example, price, quality, range and customer service or PQRS) in specific local areas following the Transaction, and in particular the costs and benefits of adopting more local policies. To the extent that the Parties would not vary competitive parameters locally following the merger, any market power that would otherwise be derived from a loss of local competition would be constrained by the need to maintain a national policy, and consequently by the competition the Parties face in other areas in aggregate. In this case, it would not be appropriate to assess the effects of the merger individually in each local area (in other words in relation to Theory of Harm 1) and instead assess the effects of the merger at the aggregate level (in other words in relation to Theory of Harm 2).
- 6.95 As explained in paragraph 5.51, we consider that absent the Transaction, 99p would have continued to run a substantial SPP operation, albeit a weakened

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<sup>200</sup> Stores with a planned opening date.

one in the short term at least. We have carried out our analysis based on 99p's competitive position, as shown by its past and current performance and behaviour. To the extent that its future competitive position may be weakened in the near future (as discussed in Section 5) the competitive effects of the merger could be less pronounced than indicated by the results of our analysis.

- 6.96 In the course of our investigation, it was argued by one company ([X]) that a potential harm resulting from the merger was the increased scale of Poundland, which would enable it to negotiate better and exclusive arrangements with suppliers that other competitors would struggle to match. In general, the CMA would regard an improvement in the negotiating strength of the merging parties as beneficial to customers if enough competition remains in the downstream market, so that lower prices or quality improvements that would be negotiated are passed on to customers. This issue therefore only arises if we find that the merger may be expected to result in competition concerns in our assessment of unilateral effects under Theories of Harm 1 and 2. Our provisional conclusions on these are set out in paragraphs 6.131 and 6.154.

### *Local effects*

#### *Introduction*

- 6.97 This section considers whether the loss of an existing competitor at a local level as a result of the merger may be expected to give rise to competition concerns.
- 6.98 Poundland submitted<sup>201</sup> that this theory of harm was not consistent with the evidence:
- (a) Poundland does not vary its local offering based on the degree of local competition, and there is no reason at all to believe that the Transaction will lead it to change its strategy in this respect. The small number of previous trials of local promotions were not successful. Poundland has no incentive to adopt an approach which does not work.
  - (b) Poundland faces competition all along the high street such that there is no prospect that it could profitably degrade its offer (even absent the threat of new entry).
- 6.99 As discussed in paragraphs 6.33 to 6.38 above, we have found that:

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<sup>201</sup> Poundland response to phase 2 issues statement (9 July 2015), paragraph 4.7.

- (a) Poundland varies some aspects of PQRS locally, but not others. In particular, Poundland does not vary price or pack size locally but varies its range by size of store; and
- (b) the historic variation in PQRS has not related to the local competition faced by Poundland, with very few exceptions.

6.100 We therefore consider here whether the merger may create the incentive for Poundland to vary PQRS locally even though it has not done so in the past. To make this assessment we have considered what the costs and benefits of changing its policy would be.

6.101 In addition, we have considered whether any loss of competition in local areas due to the merger could lead to the closure of existing Poundland or acquired 99p stores and whether this could result in consumer harm.

#### *Cost of flexing the local offering*

6.102 As a starting point, we note that to the extent that the Parties have not varied PQRS locally in the past, this may imply that there are currently costs of doing so.

6.103 Overall, the evidence from the Parties and third parties indicates that there are costs to varying parameters of competition locally, but that this varies by parameter of competition.<sup>202</sup>

6.104 We note Poundland's submission that there may be material reputational impact if it were to raise its prices, particularly given its brand. Most of the VGM and SPP retailers ([REDACTED]) operate national pricing policies. No third party submitted that they believed that Poundland might raise its prices following the merger.

6.105 In relation to varying its range, Poundland submitted that doing so would result in material costs from increased systems capability and headcount. However, the evidence to support this submission appears somewhat weak. In particular, we note that Poundland already varies its product range by size of store and consider that the incremental cost of introducing a small number of additional store categories to reflect areas where Poundland faces less competition may not be substantial. Further, we note that most VGM and large SPP retailers also flex their product range by size of store and that [REDACTED]

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<sup>202</sup> Our detailed analysis of the cost to Poundland of flexing its local offering is set out in Appendix F.

and [REDACTED] currently vary range to some extent according to the local environment and customer demand.

6.106 We note from Poundland's submissions that there may be some less quantifiable costs directly arising from introducing greater complexity, for example in relation to forecasting and compliance. However, there do not appear to be large incremental costs from introducing a small number of additional store categories.

6.107 We note from Poundland's submissions that there may be some costs resulting from fragmenting sales volume with suppliers and thus obtaining lower volume-related discounts. It appears that some of these costs would be mitigated to the extent that customers would switch to other products in Poundland's range, were it to withdraw certain lower-margin products from certain stores. It is not possible for us to assess exactly how substantial these costs would be, though we note that:

(a) [REDACTED]

(b) [REDACTED]

6.108 In relation to pack sizes, evidence from suppliers does not suggest that supplier concerns about brand integrity would be an issue that would restrict Poundland's ability to sell multiple pack sizes of the same product.

6.109 With respect to the costs from fragmenting sales volume with suppliers due to lower discounts relating to volume, it does not appear that buying multiple pack sizes from the same supplier would necessarily materially reduce Poundland's negotiating strength with that supplier. [REDACTED] and [REDACTED].

6.110 [Another retailer submitted] that the merged firm, given its scale, would not have difficulty in competitively sourcing multiple pack sizes from suppliers. We note further from supplier responses to our market questionnaire that most branded suppliers do not currently offer bespoke pack sizes to the Parties. This may mean that the Parties are to some extent limited to offering the pack sizes that are already available. However, this does not appear to be an issue with respect to own-label products.<sup>203</sup>

6.111 We note Poundland's submission that additional SKUs would cause increased logistical costs due to their warehousing requirements. However, it is not clear to us how material these costs would be, particularly given that these may change as a result of Poundland's enlarged scale following the merger.

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<sup>203</sup> In 2014, Poundland sold [REDACTED]% own label products. [REDACTED]

6.112 For the reasons set out above, we were not persuaded that Poundland would not be able to flex its offering at the local level or that the cost of doing so would be prohibitive. Therefore, we considered next whether Poundland might have the incentive to do so following the merger.

*Incentive to flex the local offering*

6.113 Setting PQRS locally would allow Poundland to increase profits locally in response to local demand and competition. For example, it may wish to degrade its PQRS where it faces less competition and improve it where it faces more competition.<sup>204</sup>

6.114 The benefits of setting local PQRS are therefore greater if there is a greater degree of variation in local demand (for example customer demographic and preferences and the size of the local addressable market) and in local competition. The merger may increase the benefits of setting PQRS locally rather than nationally if it increases the degree of variation in competition or local demand across local areas faced by Poundland. To assess Poundland's incentive to flex its local offering, we therefore considered the likely effect of the merger on the variation in competition faced by Poundland.

6.115 The merger has two possible effects on the variation in competition faced by Poundland:

- (a) The merger will change the market structure in areas where Poundland and 99p overlap (in these areas, both the Poundland store and the 99p store will face a reduction in the number of competitors they face). This may increase the overall variation in the degree of competition faced by Poundland across its network of stores, in particular if its overlaps with 99p are in areas where it faces little other competition.
- (b) As a result of the merger, in absolute terms Poundland will operate in a greater number of areas with relatively few competitors ('less-competitive' areas), but also in a greater number of areas with a relatively large number of competitors ('more-competitive' areas). This means that it will face a greater absolute variation in the local demand it faces. Relative to the size of its overall network of stores, the addition of 99p's network has the potential, in principle, to either increase or reduce the degree of variation Poundland faces. This will depend on whether there is greater variation in the competition and local demand faced by 99p relative to

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<sup>204</sup> The mechanism whereby Poundland might benefit from altering other parameters of competition locally is discussed in Appendix F.

Poundland and also on the extent to which Poundland and 99p overlap (ie point (a)).

- 6.116 The extent to which the relative or absolute level of variation in competition is important depends on the extent to which Poundland's costs of varying parameters of competition locally increase with the number of stores. If the costs of varying parameters of competition locally are proportional to the number of stores, then only the variation relative to the store network is important. At the other extreme, if costs are fixed then it is the absolute level of variation that is important. Our analysis of these costs implies that most, but not all, of these costs would increase with a greater number of stores.<sup>205</sup>
- 6.117 We have therefore focused our analysis primarily on the change in variation in competition faced by Poundland post-merger relative to the size of its overall network of stores.
- 6.118 To capture the impact of the merger on the variation in competition, we have focused on the change in the number of stores where Poundland faces limited competition from the competitors identified in our assessment of closeness of competition, and the proportion of Poundland's total estate that these stores comprise.
- 6.119 Based on our provisional conclusions on the closeness of competition between the Parties and other retailers (see paragraphs 6.86 to 6.88) our analysis includes the following competitor set: 99p, Poundworld, B&M, Home Bargains, Wilko, Bargain Buys, Tesco and Asda. Based on the same provisional conclusions, we have applied the following weights to reflect the varying strength of the competitive constraint posed by these competitors:<sup>206</sup>
- (a) 99p and Poundworld by 1.
  - (b) Home Bargains, Wilko, Bargain Buys, Tesco and Asda by 0.5.
  - (c) Where these competitors are located between 0.5 miles and 1 mile, by 0.5.
- 6.120 Table 4 below shows the effect of the merger on the proportion of Poundland stores that face various levels of competition pre- and post-merger, as measured by the number of 'weighted' competitors (computed by applying the weights described in paragraph 6.119). For this analysis, we show only areas where there are two or fewer weighted competitors.

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<sup>205</sup> Discussed in more detail in Appendix F.

<sup>206</sup> See paragraphs 6.86 to 6.88 above.

- 6.121 We consider that the variation in the proportion of stores in 'less competitive' areas pre- and post-merger, ie the left hand side columns of Table 4, may be more informative than the right hand side columns for two reasons. Firstly, we would expect the potential benefits of varying locally to be strongest in areas with the least competition. Secondly, areas where Poundland faces no close competitors are likely to be easier for Poundland to identify than areas where it has to evaluate the aggregate constraint of a number of competitors (as captured by weighting competitors in our methodology).
- 6.122 We noted that the number of weighted competitors (shown on the top line of Table 4) represents different competitive situations in practice:
- (a) The number of areas where there is 0.25 of a weighted competitor or fewer: these would be areas where there is no more than one competitor weighted by 0.5 (eg B&M, Tesco) and this competitor is located between 0.5 miles and 1 mile from Poundland.
  - (b) The number of areas where there is 0.5 of a weighted competitor or fewer – these would be areas where:
    - (i) there is no more than one competitor weighted by 0.5, and this competitor is located within 0.5 miles of Poundland;
    - (ii) there are no more than two competitors weighted by 0.5, and these competitors are located between 0.5 miles and 1 mile from Poundland; or
    - (iii) there is no more than one competitor weighted by 1 (ie Poundworld or 99p) and this competitor is located between 0.5 miles and 1 mile from Poundland.
  - (c) The number of areas where there is 0.75 of a weighted competitor or fewer.
  - (d) The number of areas where there is one weighted competitor or fewer.
  - (e) The number of areas where there are two weighted competitors or fewer.
- 6.123 Accordingly, when interpreting the numbers in Table 4 below, we took account of the overall level of concentration they implied and the implications of the way in which they were computed for the practicality of establishing and monitoring the level of competition in areas where Poundland would not be the only competitor post-merger.

**Table 4: Poundland’s number of weighted competitors pre- and post-merger**

<i>Number of competitors</i>	<i>0</i>	<i>0 to 0.25</i>	<i>0 to 0.5</i>	<i>0 to 0.75</i>	<i>0 to 1</i>	<i>0 to 2</i>	<i>Total stores</i>
Number of stores pre-merger	36 (6%)	55 (10%)	124 (22%)	142 (25%)	205 (36%)	371 (65%)	570
Number of stores post-merger	63 (8%)	105 (13%)	226 (28%)	279 (34%)	396 (48%)	610 (74%)	819*

Source: CMA analysis.

\* One 99p store, for which we have no sales data since week 26 of FY14, is excluded from this analysis, as it is temporarily closed.

6.124 Table 4 shows that the merger has a limited impact on the number of monopoly stores as a proportion of Poundland’s total network of stores (6 to 8%). The impact of the merger on the number of stores where Poundland faces 0.5 of a weighted competitor or fewer is somewhat greater, and greater still where Poundland faces one weighted competitor or fewer. As stated above, we considered it appropriate to place greater weight on the results relating to local areas with fewer weighted competitors (in other words, those in the left hand side columns of the table). These results do not appear to show a material change in the variation in competition faced by Poundland.

6.125 We tested the sensitivity of these results to changing the competitor set. In particular, as one sensitivity we added Poundstretcher to the competitor set and as another dropped Asda from the competitor set. There was not a significant impact on the interpretation of the results.

6.126 In addition, as described in paragraphs 2.24 and 2.25 we are aware that a number of competitors have plans to expand their store numbers in the near future. As competitors open new stores, some of these are likely to be in areas where Poundland is already present, changing the local competitive landscape. This could affect the incentive for Poundland to move away from setting policies at a national level by increasing the cost and complexity of monitoring and adjusting local offerings to respond to frequently changing local competitive conditions.

6.127 We therefore consider that the effect of the merger described in paragraph 6.115 is unlikely to be material.

#### *Store closure*

6.128 We considered whether any loss of competition in local areas due to the merger could lead to the closure of existing Poundland or acquired 99p stores, resulting in consumer harm, even if all other parameters of competition would not be varied at a local level.

6.129 We therefore considered what the direct impact on consumer welfare of store closures would be. We note that store closures affect customer welfare by reducing convenience because customers of the closed store will have to

travel further to an alternative store and by reducing the choice of retailer available to the customer. However, in this case we note that the average distance between the Parties' stores in overlap areas is small (approximately 0.1 miles). Further, we note that in this case the Parties are relatively undifferentiated in what are likely to be the other key aspects affecting customer preferences. In particular, they are very similar in terms of range, pricing, store layout, staffing and opening hours.

6.130 Therefore, we did not consider that store closure would be likely to result in material consumer harm, and this would not in itself be justification for assessing the impact of the merger at a local level.

*Provisional conclusion on the local effects of the merger*

6.131 Overall, the evidence shows that Poundland does not flex PQRS at the local level in response to local competition, and we have provisionally found that the Transaction would not materially affect its incentives to do so. We do not consider that the closure of stores in overlap areas following the Transaction would be likely to result in material consumer harm because of the apparent lack of differentiation between the Parties' offerings, including in particular the small distance between the Parties' stores in overlap areas. We therefore provisionally conclude that the merger would not be likely to result in competition concerns due to the loss of a current competitor at the local level.

6.132 We therefore provisionally concluded that the merger may not be expected to lead to competition concerns under Theory of Harm 1.

*National effects*

*Poundland's submission*

6.133 Poundland submitted that the Transaction will not lead to any loss of competition. This is due to a number of factors, in particular the structural shift of the UK retail industry according to which a greater proportion of consumers is expecting greater value at lower prices.<sup>207</sup>

6.134 Poundland further submitted that the evidence does not support an adverse finding under Theory of Harm 2 or any of its constituent elements. In particular, it notes that the Parties' combined share of supply, considering

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<sup>207</sup> Poundland response to the issues statement, paragraph 4.18.

SPP and VGM retailers alone (which radically underestimates the competitive constraints that the parties face), is only [20–30]%.<sup>208</sup>

*[X]'s submission*

6.135 [X] submitted that, taking into account only national SPPs, 70% of the merged entity's SPP stores will enjoy a local monopoly and that this would represent a substantial change in local competitive market structure. Further, it said that number of the merged business' stores which are local duopolies would fall to only 30% of their store networks and that the Transaction will nearly halve the average number of local SPP chain competitors which Poundland faces across the UK. It submitted that this suggests that the Transaction may result in an SLC at the national level.

*Methodology of the assessment*

6.136 As explained in paragraph 6.33, competition between the Parties and other retailers takes place locally rather than nationally, primarily because the incentives to compete arise from the need to attract local customers. Therefore, any unilateral effect on competitive parameters set at a national level (in other words consistently across all local stores) will arise from the aggregated effect of the merger on competition at a local level.

6.137 To assess the closeness of competition between the Parties relative to other competitors at an aggregate level we considered both:

- (a) the evidence on closeness of competition between the Parties and other retailers at a local level as set out in paragraphs 6.39 to 6.84 above; and
- (b) the extent of geographic overlap between each of the Parties' network of stores and those of their competitors (as measured by their 'exposure' to different competitors – the proportion of each of the Parties' total number of stores with which each competitor overlaps).

6.138 We do not consider that national shares of supply are informative of the closeness of competition between the Parties and other retailers. This is because:

- (a) they do not take account of the relative closeness of competition of different retailers;

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<sup>208</sup> Poundland response to the issues statement, paragraph 4.22.

- (b) they do not take account of the extent of geographic overlap between the Parties' network of stores and those of competing retailers. This is important as the Parties and competing retailers do not compete for national customers but rather for local customers; and
- (c) if based on the total revenue of competing retailers, they would also capture revenue from products sold that do not overlap with the Parties' products. In particular, we note that VGM retailers typically have wider product ranges than the Parties (as they sell many products of value substantially greater than £1). Including revenues from the sale of these products would materially distort national shares of supply.

6.139 Instead, we have estimated the 'aggregate diversion ratio' between the Parties – that is, the proportion of all customers lost by Poundland sales that would be 'recaptured', ie that would divert to 99p if Poundland worsened its PQRS across all of its stores (and vice versa). The aggregate diversion ratio can be used to assess the overall closeness of competition between the Parties, and consequently their overall incentive to change parameters of competition at a national level.

6.140 We first estimated the diversion ratio from Poundland to 99p (and vice versa) for each store based on the local market structure, in line with our findings on closeness of competition. In more detail, for each of the Parties separately:

- (a) we assume a diversion of 0 to the other merging party for stores where the nearest store of the other merging party is located beyond 1 mile; and
- (b) for stores where a store of the other merging party is located within 1 mile, we estimate the diversion ratio based on the competitors in present in the local area. We first identify the competitors to each store in line with our provisional conclusions on closeness of competition set out in paragraphs 6.86 to 6.88 above and weight them. In more detail, we:
  - (i) identify the competing fascia (including the other merging party) located within 0.5 miles and between 0.5 miles and 1 mile of the store;
  - (ii) weight these competitors by 1 if they are located within 0.5 miles, and weight them by 0.5 if they are located between 0.5 miles and 1 mile;
  - (iii) weight these competitors by type – 1 for Poundworld or the other merging party, 0.5 for B&M, Home Bargains and Wilko, 0.5 for Tesco and Asda; and

- (iv) estimate the diversion ratio for the store by assuming<sup>209</sup> diversion would be distributed between these competitors according to their weighting.<sup>210</sup>

6.141 To estimate the 'aggregate diversion ratio', we then take the average of the diversion ratios for all the stores of each Party and adjust this estimate downwards to take account of the proportion of customers that would divert 'out of the market', in other words would choose to no longer make their purchase if their preferred retailer was not available.<sup>211</sup>

6.142 We interpreted the aggregate diversion ratio in the following ways:

- (a) As a direct measure of the closeness of competition between the Parties, as it is an estimate of the proportion of sales that would be recaptured following the merger were the Parties to worsen their competitive offering.
- (b) We combined it with an estimate of the Parties' variable margins to estimate 'illustrative price rises' using a relatively simple economic model.<sup>212</sup> However, we treated these illustrative price rises with caution on account of the restrictive assumptions required to calculate them.<sup>213</sup> Due to the impact of these assumptions, we interpreted these models as providing only an illustration of the magnitude of the incentives to worsen the Parties' offering rather than estimates of actual price rises.

### *Assessment*

6.143 The following figures show Poundland's and 99p's geographic 'exposure' (the percentage of stores in geographic overlaps) to the SPP retailers, VGMs and supermarkets on a 1 mile and 0.5 mile basis.

6.144 The figures show that a substantial proportion of Poundland's network of stores overlaps with all of the SPP retailers, VGMs and supermarkets. It has

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<sup>209</sup> We note this assumption is broadly supported by the results of the exit survey.

<sup>210</sup> For example, the estimated diversion ratio from Poundland to 99p for a Poundland store where there is a 99p store, a B&M and Poundworld store with 0.5 miles and a Tesco store located between 0.5 miles and 1 mile away would be:  $1/(1+1+1/2+1/4) = 36\%$ .

<sup>211</sup> This adjustment is based on the results of our exit survey, where 20% of customers responded that they would no longer make their purchase if Poundland/99p was closed for refurbishment for several months.

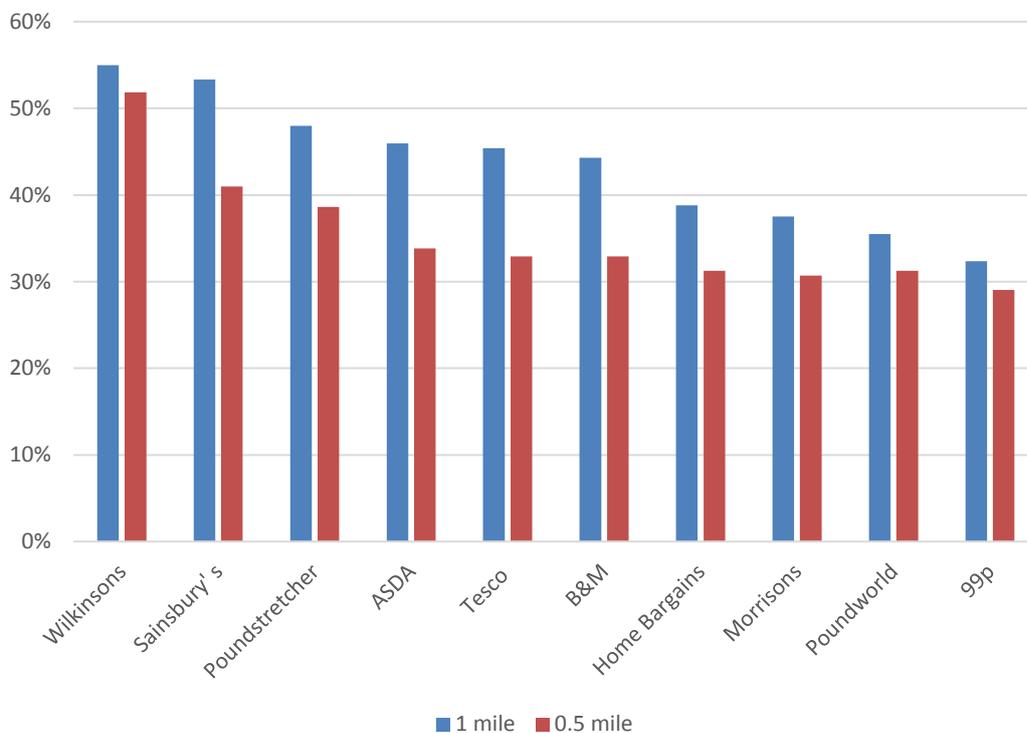
<sup>212</sup> This could use an 'illustrative price rise' (IPR) methodology based on a differentiated Bertrand model of competition and an assumption for the curvature (second derivative) of the demand curve.

<sup>213</sup> In particular, it requires: (a) an assumption for the curvature (second derivative) of the demand curve (in other words how customers' price elasticity (responsiveness to price) changes as the price changes). The current price elasticity can be inferred from the firm's variable margin and an assumption that the firm is profit maximising. However, when considering a hypothetical price increase, even by a small degree, it is no longer possible to directly infer what the price elasticity at this new price would be; and (b) an assumption that the diversion ratio between the Parties post-merger (ie after they have raised price or otherwise worsened their offering) would be the same as the pre-merger diversion ratio we have estimated.

less geographic exposure to the other SPP retailers, 99p and Poundworld, compared to many of the VGMs and supermarkets – in particular, Wilko.

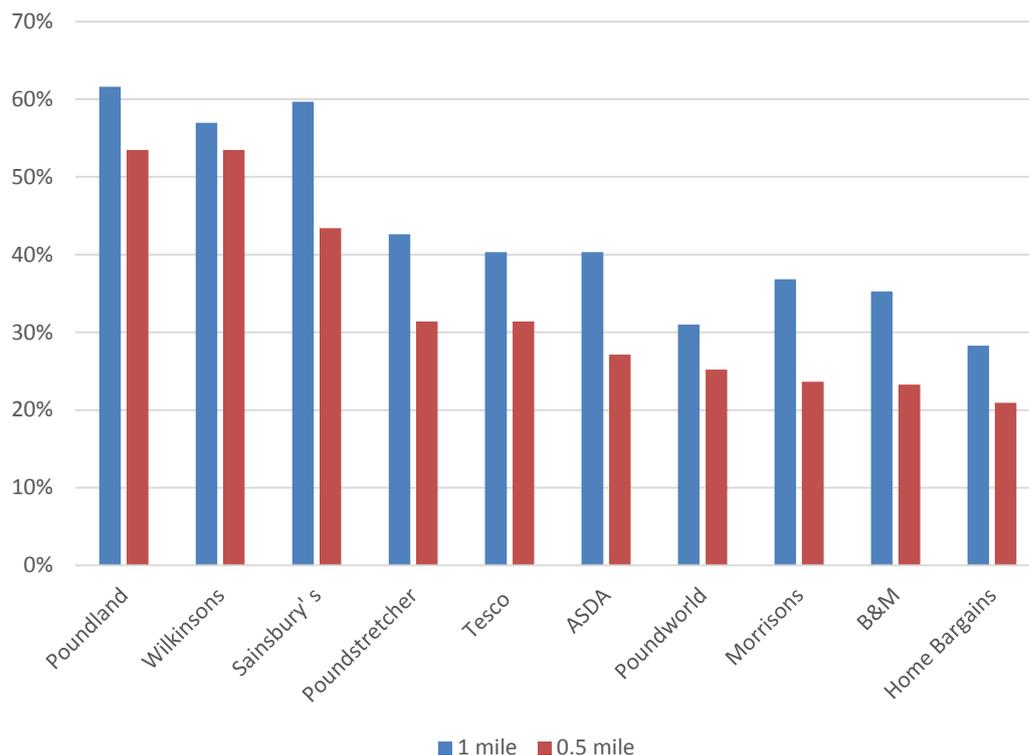
6.145 Similar to Poundland, 99p has substantial geographic overlap with all the SPP retailers, VGMs and supermarkets. However, a notable difference is that 99p has the greatest geographic exposure to Poundland.

**Figure 4: Poundland's exposure to competitors**



Source: CMA analysis.

**Figure 5: 99p’s exposure to competitors**



Source: CMA analysis.

6.146 Using the methodology set out in paragraphs 6.140 and 6.141 above, we estimated that the aggregate diversion ratio from Poundland to 99p was 10%, and from 99p to Poundland was 21%. The weighted average diversion ratio was 13%.<sup>214</sup>

6.147 We considered the sensitivity of these estimates to the competitor set used. In this regard, we noted that we had excluded Poundstretcher, Sainsbury’s and Morrisons in our original estimation and that their inclusion would reduce the aggregate diversion between the Parties. We also estimated the aggregate diversion ratio excluding Asda from the competitor set. This did not result in a substantially higher diversion ratio.<sup>215</sup>

6.148 We also considered the sensitivity of our results to the methodology used by estimating aggregate diversion ratios using alternative approaches. These did not materially alter the results.<sup>216</sup>

<sup>214</sup> The weighted average aggregate diversion ratio is the average of the diversion ratios between the Parties weighted by revenues.

<sup>215</sup> The aggregate diversion ratio from Poundland to 99p was 12%, and from 99p to Poundland was 23%.

<sup>216</sup> In addition, as a sensitivity we have also estimated the aggregate diversion by extrapolation from the CMA survey, in other words assuming that the diversion ratios between the Parties in all overlap areas are equal to the average result from the CMA survey. This is likely to overestimate the diversion ratios between the Parties to the

- 6.149 We noted that our aggregate diversion ratio estimates are not very sensitive to the methodology used or to small changes in the competitor set used. This is because the aggregate diversion ratio is to a large extent determined by the extent of geographic overlap between the Parties. For Poundland in particular, the geographic overlap with 99p is not large (approximately one-third) with the implication that aggregate diversion is relatively low.
- 6.150 We note the asymmetry in the aggregate diversion ratios between the Parties, in particular that the diversion from 99p to Poundland is materially higher than vice versa. This implies that Poundland is a greater competitive constraint on 99p than vice versa (largely arising from the fact that the geographic overlap between the two represents a much greater proportion of 99p's total network of stores). We therefore considered whether Poundland may have the incentive to worsen its offering to reflect the asymmetry of the competitive constraint, in other words predominately at the 99p stores (on the basis that it would recover a more substantial proportion of sales post-merger were it to do so).
- 6.151 In this respect, we note that Poundland has submitted that it intends to convert the 99p network into Poundland stores. We therefore considered that it would be constrained to have the same offering at both the stores it originally operated and the ex-99p network of stores post-merger. This would prevent it from worsening its offering in the asymmetric way described above. On this basis, we considered that greater weight should be given to the weighted average aggregate diversion ratio than the diversion ratios between the Parties. Taking account of our sensitivity analysis, we do not consider that the aggregate diversion ratios that we have calculated implies a material adverse effect from the merger.
- 6.152 We also estimated an illustrative price rise, assuming that the post-merger diversion ratio is the same as the pre-merger diversion ratio<sup>217</sup> and assuming a linear demand elasticity. The Parties have submitted that their variable margins are approximately [~~3~~]%. Using these margins and the aggregate

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extent that the CMA survey areas reflect closer competition between the Parties than other overlap areas. We noted that this may be the case as the CMA survey areas were not chosen at random, but were rather selected to maximise the variation in market structure out of the sample of areas where a realistic prospect of SLC was found at phase 1. This resulted in an aggregate diversion ratio from Poundland to 99p of 11%, and from 99p to Poundland of 25%. The weighted average diversion ratio was 16%. As an additional sensitivity, we estimated the aggregate diversion ratio using the results of the Parties' online survey by scaling by a factor that reflects the difference in the results of our exit survey and the Parties' survey. This resulted in an aggregate diversion ratio from Poundland to 99p of 13%, and from 99p to Poundland of 18%. The weighted average diversion ratio was 13%.

<sup>217</sup> We noted that the assumption that the post-merger diversion ratio (when the Parties' prices have risen) is the same as the pre-merger diversion ratio would likely lead to overestimating the illustrative price rise to some degree. This is because we would expect a greater proportion of customers to choose alternative retailers as the Parties' prices rise relative to these alternatives.

diversion ratios above results in a [X] % for 99p, and a [X] % for Poundland.  
<sup>218</sup> We note that these estimates allow asymmetric rises in price for 99p and Poundland, so do not take account of the possible constraint that Poundland would need to have the same offering at all stores post-merger (this would result in an illustrative price rise somewhere between the two estimates).

6.153 As set out in paragraphs 2.24 and 2.25, we are also aware of a number of competitors, including large SPP and VGM retailers, planning to expand their businesses in the near future. Given our views on the counterfactual as set out in paragraph 5.50, and in particular that 99p would have been unlikely to open any new stores in the short term, we expect that the expansion of competitors would reduce the aggregate diversion ratio between the Parties compared to the aggregate diversion ratio between Poundland and these expanding competitors.

#### *Provisional conclusion on national effects*

6.154 Overall, on the basis of the analysis set out above, we provisionally conclude that the merger may not be expected to lead to competition concerns as a result of the loss of a current competitor at the national level, ie under Theory of Harm 2.

6.155 Given our provisional conclusions that the merger may not be expected to lead to competition concerns under any of the theories of harm that we identified, we did not consider it necessary to reach a view on the countervailing factors that were put forward by Poundland, namely efficiency benefits and potential entry.

## **7. Provisional conclusions**

7.1 We provisionally conclude that the proposed acquisition of 99p by Poundland may not be expected to result in an SLC within any market or markets in the UK for goods or services.

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<sup>218</sup> As a sensitivity, we also estimated the model using the Parties' gross margins of approximately [X] %, which we are confident is an overestimate of their variable margins and so is likely to overestimate the price rise following the merger. This results in a [X] % for 99p, and a [X] % for Poundland.