

ANTICIPATED ACQUISITION BY CELESIO AG OF SAINSBURY'S SUPERMARKETS LIMITED UK PHARMACY BUSINESS

Statement of issues

26 January 2016

The reference and our issues statement

1. On 29 December 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 Celesio AG (Celesio) of Sainsbury's Supermarkets Limited UK Pharmacy Business (the target business) for further investigation and report by a group of CMA panel members (the inquiry group).
2. The CMA must decide:
 - whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and
 - if so, whether the creation of that situation may be expected to result in a substantial lessening of competition (SLC) within any market or markets in the UK for goods or services.
3. In this statement we set out the main issues that we are likely to consider in reaching our decision. This does not preclude the consideration of any other issues that may be identified during the course of our investigation.

Background

4. Celesio is an international pharmaceutical wholesaler and retailer which is ultimately owned by McKesson Corporation. Lloyds is a wholly owned subsidiary of Celesio and operates 1,542 Lloyds pharmacies across the UK. Lloyds also has a shareholding in a number of consortia pharmacies and operates contracts providing outpatient dispensing (OPD) pharmacy services to hospitals. Celesio owns AAH, which is a wholesaler of pharmaceutical products in the UK.
5. The target business operates 277 pharmacy stores throughout the UK. It also provides OPD pharmacy services under three contracts to hospitals.

6. On 29 July 2015 Celesio and Sainsbury's entered into a Business Sale Agreement (BSA) and a Cooperation Agreement. Lloyds will acquire Sainsbury's in-store community pharmacy business and hospital pharmacy business. Celesio and Sainsbury's entered into a Cooperation Agreement to govern the nature of their ongoing relationship as the pharmacy stores, to be rebranded as 'Lloyds Pharmacy', are located within or next to a Sainsbury's supermarket.
7. The target business will be active in the sale of prescription-only medicines, pharmacy-only medicines and pharmacy services. Sainsbury's supermarket business will continue to purchase and sell general sales list products independently of the target business.

The markets in which the parties operate

8. The purpose of market definition is to provide a framework for the analysis of the competitive effects of the merger. The relevant market contains the most significant competitive alternatives available to the customers of the merger firms and the most relevant constraints on the behaviour of the merger firms. We note that the market definition and the competitive effects analysis largely overlap (since they will both be driven by considerations of the 'closeness' of substitution between the parties' offers and those of alternatives).¹

Product

9. Celesio and the target business (the merger parties) overlap in the retail supply of (a) prescription-only medicines, (b) pharmacy-only medicines, and (c) pharmacy services to customers in the UK. The Parties also overlap in the supply of OPD services to hospitals. In addition, there is a vertical relationship due to the presence of Celesio's subsidiary AAH in the wholesale distribution of prescription-only and pharmacy medicines.
10. Our initial view is that there is little demand-side substitution between prescription-only medicines and pharmacy-only medicines. On the supply side, there are differences in pricing as the price for prescription medicines is set nationally by the NHS whereas pharmacies set their own retail prices for pharmacy-only medicines. As a result our initial view is that prescription-only medicines and pharmacy-only medicines are separate markets. Our initial view is that pharmacy services are also likely to form a separate market. However, we consider that it is not necessary to define narrower markets for

¹ For more detail see the CMA's [Merger Assessment Guidelines](#), section 5.2.

individual prescription-only medicines, pharmacy medicines or pharmacy services.

11. We will consider whether the market should be segmented into different types of customers (for instance those requiring a prescription urgently and those who can wait or individual customers and care homes). We will seek to identify whether customer preferences differ and whether retailers would be capable of altering their competitive offering to target specific groups of customers. This evidence will help to show whether the degree of competition between the merger parties is affected by differences in their customers' preferences.

Geographic

12. Our initial view is that the operation of pharmacies in the UK is an appropriate relevant market within which to assess theories of harm. This is because (a) the parties overlap in this market; (b) the most direct competition faced by a pharmacy competitor comes from other pharmacies; and (c) this definition will provide an appropriate framework for evaluating any constraints on the merged company's conduct in relation to the overlap products.
13. We will assess the geographic extent over which competition takes place and will consider the effects of the acquisition at local and national levels. When assessing local effects of the acquisition we consider that proximity of a pharmacy to customers and GP surgeries plays a key role in customer choice of which pharmacy to visit. Competition between the parties and their competitors is therefore dependent on the distance between pharmacies. We will test whether GP location is a good proxy for customer location and whether delivery of prescriptions from GPs has an impact on the analysis.

Constraints

14. We will assess the importance of constraints from products both inside and outside the relevant market in our analysis of the competitive effects of the transaction. We will consider the constraint exercised by:
 - other pharmacies;
 - internet pharmacy services;
 - GP and hospital pharmacies (including OPD services); and
 - other wholesale suppliers.

Assessment of the competitive effects of the acquisition

Counterfactual

15. We will consider the possible effects of the acquisition on competition, compared with the degree of competition in the counterfactual situation (ie the competitive situation without the acquisition). We will therefore assess what would have happened without the acquisition.

Theories of harm

16. Possible ways in which an SLC could arise as a result of the acquisition are referred to as theories of harm. The CMA may revise its theories of harm as its assessment of the acquisition progresses. The identification of a theory of harm does not preclude an SLC being identified on another basis following further work by us or the receipt of additional evidence. The theories of harm we are considering are detailed below.

Unilateral horizontal effects at a local level

17. The concern under this theory of harm is that the removal of one party as a competitor, in some (or all) of the areas where the parties are geographically close competitors, could provide the incentive for the parties:
 - for pharmacy-only medicines – to increase prices (prices for NHS prescriptions are fixed);
 - for prescription and pharmacy-only medicines – to lower the quality, reduce their product range, reduce staffing or another element of their service offering or close stores (insofar as permitted by regulation);
 - for pharmacy services – to increase price (for some services),² lower the quality, reduce the range of services they offer, reduce staffing or another element of their service offering or close stores (insofar as permitted by regulation).
18. There are a large number of pharmacies in different geographic locations, offering different ranges of products from prescription-only counters to large multi-product stores and one-stop shop supermarkets. The extent to which the parties are close competitors and the extent to which alternative retailers pose a sufficient residual constraint following the removal of the constraint that the

² There is tendering for some pharmacy services and some others are private services.

parties exert on each other depends on how customers perceive their offering relative to alternative retailers.

Unilateral effects from loss of competition for NHS outsourcing contracts

19. NHS hospitals commonly contain OPD pharmacies, which although mostly operated in-house can also be outsourced. When deciding to outsource an OPD pharmacy, hospitals invite pharmacy retailers to tender.
20. The concern is that the merger may create incentives for the merging parties to worsen their bids. This might occur if they are both significant suppliers to NHS hospitals, and if they are commonly among the top ranked bidding firms. This is because if one of the parties did not win a contract there would be a high likelihood of it being awarded to the other party. Since these contracts are contested by the large multiple pharmacy operators, competition appears most likely to occur at UK-wide level, although the regulatory regime is different, most notably in Scotland.

Vertical effects from a change in downstream incentives on Celesio's wholesale business

21. Vertical effects may arise where the merger gives rise to the ability and incentive to fully or partially exclude a downstream rival from the market. Celesio and the target business are both active in the provision of community pharmacies, and Celesio is active in the wholesale supply of drugs to community pharmacies.

Assessment of theories of harm

22. To assess these theories of harm we plan to assess:
 - in which geographic areas the merger parties are both present and whether the merger parties are close competitors in those areas. We will also assess the extent that other retailers exert a competitive constraint on the merger parties in those areas;
 - the relationship between store margins (and/or aspects of the pharmacy's local offer) and the concentration of stores at the local level;
 - where the merger might create the incentive for the merged company to close one of its existing stores, and what the implications for local customer choice would be;

- the impact of relevant events in local areas such as entry/exit of the other party or other pharmacies;
- the incentive of the merger parties to raise price (pharmacy-only medicines and some pharmacy services) or reduce quality (prescriptions, pharmacy-only medicines and pharmacy services);
- how closely the merger parties compete for OPD services; and
- whether wholesale customers of Celesio could source their supply from another provider if Celesio were to stop supplying them or increase its prices (termed full or partial input foreclosure). We will assess whether the merger affects Celesio's ability or incentive to engage in input foreclosure.³ We will assess this at the national and the local level.

Countervailing factors

23. We will consider whether there are countervailing factors that are likely to prevent or mitigate any SLC that we may find. In particular, we intend to consider the following:
- (a) Whether entry and expansion might be expected to be timely, likely and sufficient to prevent any SLC that might otherwise arise. We will assess:
- (i) the history of actual entry and expansion by the merger parties' competitors, and any future plans of expansion;
 - (ii) the cost/barriers to entry and expansion, including the analysis of regulatory barriers to entry and exit and changes to other parameters of quality and service (such as opening hours).
- (b) We will examine any evidence available to us in relation to efficiencies arising from the merger. In particular, we will examine whether there are merger-specific rivalry enhancing efficiencies that can be expected to mean that the merger does not result in an SLC.
24. We are not currently aware of any other countervailing factors.

³ For a fuller discussion of foreclosure see the [Merger Assessment Guidelines](#), paragraphs 5.6.9–5.6.13.

Possible remedies and relevant customer benefits

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

Responses to the issues statement

27. Any party wishing to respond to this issues statement should do so in writing, by no later than 5pm on 9 February 2016. Please email celesio.sainsburys@cma.gsi.gov.uk or write to:

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