

## Somerfield/Morrison stores inquiry

### Statement of issues

#### The reference

1. On 23 March 2005, the Office of Fair Trading (OFT) referred to the Competition Commission (CC) a merger which involved the acquisition by Somerfield plc (Somerfield) of 115 stores<sup>1</sup> and other assets from Wm Morrison Supermarkets plc (Morrisons). The purchase of almost all of the stores has now been completed. For convenience we refer to this transaction as 'the acquisition', and to the stores concerned as the 'acquired stores'.
2. In making the reference to us, the OFT said that it had identified 22 mid-range stores and one one-stop store which raised possible competition concerns, although our investigation is not confined to these stores and we are obliged to look at all 115 stores. The stores identified by the OFT are listed in its decision document, which it published shortly after the reference to us setting out its reasons for doing so.<sup>2</sup> The OFT also noted one potential problem convenience store, where it was possible barriers to entry may be sufficiently low to address the competition issue.
3. On the basis of the reference and the evidence we have received to date, the issues we are considering are as follows.

#### The relevant market(s)

4. In its decision document, the OFT stated that the acquisition gave rise to an overlap in grocery retailing primarily through mid-range stores and to a lesser extent through convenience and one-stop stores. The distinction between these categories of store are consistent with those used by the CC in its 2003 report on the proposed mergers of Asda Group Limited, Morrisons, J Sainsbury plc and Tesco plc with Safeway plc (the Safeway report). In that report, the CC took the view that one-stop shopping in grocery stores of 1,400 sq metres (15,000 sq feet) and above was a relevant market for the purposes of those inquiries, because most consumers visited such stores to carry out their main weekly shop. The market for one-stop shopping was regarded as essentially local, because most consumers were prepared to travel only a limited distance for their main grocery shop, although there was also a national dimension to such competition. That is to say, key decisions affecting the operation of stores and other aspects of their business were taken centrally, and competition in local markets would to a significant extent reflect factors present at the broader level; such factors included the costs of groceries purchased from suppliers, the costs of operating the business and the overall strength of competition operating through local markets.
5. The CC also considered in the Safeway report the effect of those potential mergers on convenience stores, which were defined as stores below 280 sq metres (3,000 sq feet); and on stores between 280 and 1,400 sq metres (15,000 sq feet), which provided for 'secondary' or 'top-up' shopping (and which we refer to as mid-range stores). The Safeway report recognized that some one-stop shopping also took place in stores smaller than 1,400 square metres and that very large one-stop shops down

---

<sup>1</sup>Although the OFT's decision document referred to 114 stores, as does the material on our web site, we understand a further store may also be part of the transaction we are required to examine.

<sup>2</sup>A link to the OFT's decision document is on our reference web site <http://www.competition-commission.org.uk/inquiries/ref2005/somerfield/index.htm>

to very small convenience stores all competed to some extent for customers' secondary shopping needs. A number of parties that have expressed an interest in the current inquiry have pointed out to us that the focus of the Safeway report was on one-stop shops, and that the CC did not reach a conclusion on defining the market in which mid-range stores operated. Some 100 of the acquired stores in the current inquiry are 'mid-range' stores of between 280 and 1,400 sq metres.

6. The issues we are therefore considering are:

- (a) Whether (and, if so, to what extent) one-stop shops, mid-range stores and convenience stores can be regarded as being in separate markets or separate segments of one grocery retailing market. The factors we are taking into account include:
  - (i) the extent to which stores in these categories serve different purposes for shoppers—such as their use for their main shopping as distinct from secondary or 'top-up' shopping;
  - (ii) different factors influencing consumers' use of such stores—for example, the relative importance in using any such different categories of store, of factors such as convenience of store location (including accessibility to transport), amenities (including opening hours, car parking, sale of petrol), product range or price; and
  - (iii) differences in prices and non-price factors (including range and quality of products, the layout of stores and their levels of service) between such categories of store.
- (b) Whether within mid-range stores there should be further delineations. The CC's Safeway report suggested that there was likely to be a scale moving from stores closer to 1,400 sq metres (for which the issues would be similar to one-stop shops) to smaller stores (for which the issues would be more similar to the convenience sector). In the case of the stores we are currently investigating, the OFT considered a further delineation of mid-range stores into those that were 'closer to convenience' (280 to 650 sq metres, 3,000 to 7,000 sq feet), 'mid-range' (using this expression in a new and more restricted sense, namely 650 to 1,020 sq metres, 7,000 to 11,000 sq feet) and 'closer to one-stop shop' (1,020 to 1,400 sq metres, 11,000 to 15,000 sq feet), with smaller shops likely to have smaller catchment areas and possibly face different competitors.
- (c) Whether account should be taken of the particular circumstances of stores in different localities and, if so, which circumstances and how they should be taken into account. (Such circumstances could, for example, include the varying extent to which stores of similar size may be used for 'one-stop' or 'top-up' shopping depending on whether they are in rural or urban areas, as may be reflected by differences in the average value of the basket of shopping purchased in such stores.)
- (d) Whether there has been any change in consumer behaviour since the Safeway report which may affect our assessment.

However, even if we were to conclude that these categories of store were in separate markets or were in separate segments of the same market, we would still need to consider the overlap and competitive constraints between them, in particular the competitive constraints upon mid-range stores imposed by one-stop shops and convenience stores.

## Relevant geographical markets

7. We regard delineation of local areas as important, both in assessing local overlap between existing Somerfield stores (which include its Kwik-Save fascia) and the acquired stores: and in assessing the extent of competition from other grocery retailers in such areas. As noted above, the Safeway report regarded the one-stop shopping market, with which it was primarily concerned, as essentially local, but with a national dimension to competition as explained in paragraph 4. More specifically:
- (a) In the case of one-stop shops, local areas were delineated for analysis by drawing 10 to 15 minutes drive times around each individual store, to create a set of 'isochrones' (ie, lines drawing points of equal travel time), approximating to the area within which most consumers using that store would live and shop. Drive-times of 10 minutes were used for urban areas and 15 minutes for rural areas.
  - (b) For mid-range stores, the CC applied a 5-minute isochrone in urban areas and a 10-minute isochrone in rural areas. However, it recognized that this approach might not accurately reflect the actual attraction of the smallest and largest stores in this category. The largest stores in this category might be expected to attract customers from wider drive times and hence an analysis on 5- and 10-minute isochrones would underestimate the area over which such a store competes, or offers effective choice. Conversely, a store closer in size to convenience stores might be expected to attract customers primarily on foot, such that a drive time analysis might represent an unrealistically large catchment area.
  - (c) Following the Safeway report, in subsequent cases reviewed by the OFT, the OFT considered a catchment area of up to one mile for convenience stores.
8. We noted in paragraph 6 the OFT's consideration in its decision document for this reference of a further delineation of mid-range stores into three size categories. For those categories, it considered using the following local areas:
- (a) a one-mile radius for those stores in the 'closer to convenience store' range;
  - (b) a 5- or 10-minute isochrone (depending on rural/urban split) for those stores in mid-range; and
  - (c) a 10- or 15-minute isochrone (depending on rural/urban split) for those stores in the 'closer to one-stop store' range.

The OFT noted that the vast majority of third parties that it consulted had substantial reservations about such a methodology.

9. Among the issues the CC is now considering are:
- (a) whether the approach outlined in paragraph 7 to assessing the local areas served by the stores acquired is appropriate;
  - (b) in particular, in the case of the mid-range stores, whether different criteria such as those outlined in paragraph 8 should be used for different sizes of mid-range store;
  - (c) the extent to which we should consider the sensitivity of the analysis both of local overlaps and of other sources of competition within such areas to

somewhat different assumptions as to appropriate local catchment areas—to take into account, for example, stores that may lie just outside the local areas on the basis of the criteria referred to in paragraphs 7 or 8;

- (d) whether it would be practical or preferable to assess the extent of competition between stores with reference not to isochrones centred on each store; but based on the main workplace and domestic population centres those stores serve;
- (e) whether allowance should be made store-by-store for any other factors relevant to particular local areas, including the extent to which shoppers walk or travel by bus to and from particular stores (as distinct from driving); and
- (f) whether any sensible alternative methodology for identifying relevant geographical markets can be devised, but recognizing the desirability of criteria which ensure clarity and consistency across all stores.

### **The counterfactual**

10. In assessing the effects of the acquisition on the relevant markets, we are also considering the alternatives for Morrisons had these stores not been sold to Somerfield, including whether they might have been sold to one or more other grocery retailers, or to parties not involved in grocery retail.

### **The effect on competition**

11. Although individual stores serve local areas, the OFT's decision document noted the view in the CC's Safeway report that key decisions affecting the operation of stores and other aspects of businesses are taken centrally by the largest companies in the supermarket sector. It referred to one third party raising concerns about Somerfield's post-acquisition national share of mid-range stores.
12. The OFT suggested that competition issues could not arise solely from having high shares in the mid-range segment. It suggested that, given the asymmetry in competition between large stores and smaller stores, Somerfield's mid-range stores would continue to face competition from large stores post-acquisition; similarly, in terms of buyer power, all grocery retailers appeared to procure centrally and not separately for stores of different sizes, so a high proportion of stores of a certain size range was less significant than a high proportion of market share in total grocery retailing. At the national level, Somerfield's share of all grocery sales—which might be indicative of any buyer power—remained fairly modest at between 5 and 10 per cent, with the increment arising from this acquisition being less than 1 per cent.
13. Although little concern has been expressed to us to date about the national effect of the acquisition, we are considering whether there is any reason to be concerned about:
  - (a) any possible unilateral horizontal anti-competitive effects from the increase in Somerfield's national market share in all grocery retailing as a result of the acquisition or, to the extent that mid-range stores may constitute a separate segment that is relatively unconstrained by one-stop shopping, in the mid-range segment.
  - (b) any possible unilateral vertical anti-competitive effects of the merger on Somerfield's buyer power; or

- (c) any possible coordinated horizontal anti-competitive effects resulting from the increase in Somerfield's national market share.

We are also considering whether the acquisition could be regarded as bringing about a reduction in concentration at a national level by strengthening Somerfield's position as one of the leading national grocery retailers.

### ***The effect on local competition***

14. The OFT's decision document listed 23 stores that were of possible concern using the CC's isochrone and fascia-count methodology in the Safeway report set out in paragraph 7. Twenty-two of these were mid-range stores and one a one-stop store (in Johnstone in Scotland). It also identified one convenience store (in Filey in Yorkshire) as a possible problem, but said it was possible that barriers to entry may be sufficiently low to address the competition issue in that case.
15. Of the 22 problem mid-range stores listed by the OFT as of concern using the CC's isochrone and fascia-count methodology, only 15 were considered to be a concern under both the CC's methodology and that of the OFT referred to in paragraph 8. Seven that were of concern using the CC's isochrone and fascia-count methodology were not a problem using the OFT's methodology, but there were a number of other stores which were problematic only on the OFT's proposed methodology.
16. The extent of overlaps giving rise to concern depends in part on the factors relevant to defining both product markets and geographical markets, outlined above, including store size definitions, the relevance of secondary shopping, the size of the isochrones and the extent of competition between one-stop shops and mid-range stores.
17. Key issues in considering the effect on local competition within the product and geographic markets defined include:
- (a) What other fascias might be regarded as effective competitors to the mid-range stores acquired. The approach of the Safeway report was to define the list of effective competitors for mid-range stores as the same as the competitors for one-stop shops (specifically Asda, Booths, Budgens, Co-op, Morrisons, Sainsbury's, Somerfield, Tesco and Waitrose<sup>3</sup>) together with Iceland.<sup>4</sup> We are considering whether the competitor set in this range should also include Aldi, Lidl, Marks & Spencer, Netto and convenience stores (including those forming part of buying groups such as Londis and Spar), including the extent to which the range they carry enables them to compete with mid-range stores.
- (b) The number of competing fascias sufficient to offer effective competition. The Safeway report evaluated this in two stages. Firstly, it regarded a reduction in the number of competing fascias to four or fewer as having the potential to affect competition adversely, and secondly concluded that a reduction to three or fewer fascias was sufficient to affect competition adversely; the latter criterion was used by the OFT in deriving the list of 23 stores giving rise to concern referred to above.
- (c) Whether criteria for reduction in number of fascias may be less relevant in this inquiry. We have noted above that the focus of the Safeway report was on one-stop shops. It has also been suggested to us that the criteria in the Safeway

---

<sup>3</sup>Safeway Report paragraph 5.238.

<sup>4</sup>Safeway Report paragraph 5.262.

report were in part based on consideration of the coordinated effects of that merger which may not apply in this case; but in any event we may ourselves need to consider whether coordinated effects could arise in certain local markets in the circumstances of this case, for example on local promotions or on product ranges stocked in some stores.

- (d) Whether, therefore, account should be taken, not only of the number of competing fascias but also of other indicators of the strength of competition, such as relative size or turnover of stores, their national or local market shares or profile, or any other measure of the attractiveness of an individual fascia.
- (e) On the basis of the above, the number and identity of stores whose acquisition gives rise to concern.

## **Barriers to entry**

- 18. The OFT's decision document referred to previous cases in which barriers to entry in one-stop shopping were regarded as high. Economies of scale, in particular favourable buying terms for large incumbent supermarkets, distribution efficiencies and planning restrictions may be instrumental in restricting entry. Hence new entry was not considered by the OFT to be a countervailing factor in the one-stop store segment. The decision document also noted that the convenience store segment had traditionally been dynamic, with a high proportion of independent ownership and rapid turnover of businesses; and that in terms of local planning regulations, once A1 planning permission<sup>5</sup> had been given for any form of retail property, it was possible to use such a property as a convenience store. It also referred to evidence from some large grocery retailers in the Safeway report that barriers to entry for convenience stores were low, but that some smaller grocery retailers had since argued that this sector was becoming increasingly difficult to enter for individual independent retailers, mainly owing to the disparity in buying terms between grocery retailers. Recent increases in rents is a further possible barrier which has already been mentioned to us. The decision document also suggested that the extent to which barriers to entry exist for mid-range stores would depend on how far along the continuum of store size a particular store is placed, but that for the potential problem stores in this segment (all but two of which are over 650 sq metres, 7,000 sq feet) barriers to entry were unlikely to be low enough to alleviate competition concerns.
- 19. We are therefore considering:
  - (a) the barriers to entry relevant to the areas affected by Somerfield's acquisition of mid-range stores; including whether entry barriers may increase with store size either proportionally or step-wise in the three mid-range size segments identified by the OFT;
  - (b) whether barriers to entry are likely to be high in the area affected by Somerfield's acquisition of the one one-stop store which the OFT identified as a possible problem;
  - (c) whether, on the other hand, barriers to entry can be regarded as low in the area affected by Somerfield's acquisition of a convenience store which the OFT identified as a possible problem;

---

<sup>5</sup>A1 planning permission includes shops, retail warehouses, hairdressers, undertakers, travel agencies, post offices and dry cleaners.

- (d) whether any such barriers also vary between new build sites and developments of existing stores; and
- (e) the implications of PPS6, the most recent relevant planning policy document in England and current equivalent documents in Scotland and Wales; and of the need in some cases to undertake associated developments to obtain planning agreement and the cost of doing so.

### **The effect of the acquisition on competition, and other possible adverse effects**

20. On the basis of the issues outlined above, the CC is considering:

- (a) whether the acquisition may be expected to result in a substantial lessening of competition in any of the markets affected by the acquisition; and
- (b) whether as a result of any such loss of competition the acquisition may also be expected to have adverse effects, for example on prices (including local promotional activities) to consumers, or on prices to suppliers; on the range of products available to shoppers; on the choice not only of products, but also of retail outlets available to shoppers; or on other aspects of service to shoppers.

As is evident from our web site, we have received considerable concern about the effects of the acquisition in a number of particular areas, for example from Pocklington and Filey in Yorkshire, and Johnstone and Carlisle in Scotland.

### **Possible remedies**

21. Although the Group will not consider possible remedies until it has reached any provisional finding on whether the acquisition may be expected to result in a substantial lessening of competition, it would welcome comments on whether any structural or behavioural remedies would be appropriate, if so taking any customer benefits into account.