COMPETITION COMMISSION

Woolworths Group PLC and Bertram Group Limited

A report on the completed acquisition by Woolworths Group PLC of Bertram Group Limited

4 September 2007

Website: www.competition-commission.org.uk

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The Competition Commission has excluded from this published version of the 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 ✄.

Acquisition by Woolworths Group PLC of Bertram Group Limited

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Summary

1. On 3 April 2007 the Office of Fair Trading (OFT) referred the completed acquisition of Bertram Group Limited (Bertram) by Woolworths Group PLC (Woolworths) to the Competition Commission (CC) for investigation and report. The reference was made under section 22 of the Enterprise Act 2002 (the Act). We are required to publish our final report by 17 September 2007.

2. Woolworths was formed in August 2001 following demerger from Kingfisher plc. Woolworths has both retail and wholesale operations. Its principal business activities are in the UK retail sector, and its stores stock a narrow range of books. Woolworths' book wholesale operations are handled through its subsidiaries Entertainment UK Limited (EUK) and Total Home Entertainment Distribution Limited (THE). EUK operates as an in-house distributor of home entertainment products (HEPs—CDs, DVDs, video games and consoles etc) and books to Woolworths' retail business, but it also supplies books to various supermarket customers. THE was acquired by Woolworths in September 2006; it operates in the wholesale distribution of HEPs, books and some accessories. Its contracts to supply books to supermarkets were transferred to EUK following the acquisition and it now supplies books to a variety of non-supermarket customers.

3. Bertram originated as a family-run business set-up in 1968, which grew to become a national book wholesaler. Bertram's primary activities are acting as a wholesaler through its Bertram Books division, and as a library supplier through Bertram Library Services (BLS).

4. On 11 October 2006, Bertram advised EUK that a sale process for the business was underway. EUK entered into exclusive negotiations with Bertram on 31 December 2006, and it acquired sole control of Bertram on 1 February 2007 when it acquired all of the issued Bertram preference shares and when its offer to purchase the ordinary share capital in Bertram became unconditional as to acceptances. EUK's compulsory acquisition of the remaining shares completed on 6 April 2007.

5. As a result of this transaction, Bertram has ceased to be distinct from enterprises carried on by, or under the control of, Woolworths. The UK turnover of Bertram exceeds £70 million, so the turnover test in section 23(1)(b) of the Act is satisfied. We therefore conclude that there is a relevant merger situation within the meaning of the Act.

6. On 28 February 2007, Woolworths gave initial undertakings to the OFT under section 71 of the Act. When the merger was referred in April 2007, the CC adopted those undertakings. We considered whether any further changes were necessary to prevent pre-emptive action by the parties which might prejudice the reference or impede the application of effective remedies at the end of the inquiry. As a result, on 29 May 2007 the CC accepted the interim undertakings given by Woolworths, EUK, THE and Bertram.

7. Book wholesalers supply books to a variety of retailers and libraries:

   (a) large chains, namely Waterstone's, Borders and WH Smith;

   (b) independent bookshops (including small chains of multiple outlets);

   (c) supermarkets;

(d) other retailers (shops whose primary focus is not books, for example newsagents, garden centres, and heritage destinations);

(e) Internet retailers;

(f) book clubs; and

(g) public and academic libraries and schools.

The proportion of books sold through Internet and supermarket channels is increasing.

8. Wholesalers stock and market books from many publishers, on a non-exclusive basis. There are different types of wholesaler supplying different types of customer. Merchandising wholesalers supply supermarkets, and sometimes provide in-store merchandising services; EUK is by far the largest of these. Trade wholesalers typically supply independent book retailers, book retailing chains, book clubs, non-specialist retailers, and Internet retailers.

9. The three largest trade wholesalers are Bertram Books, Gardners Books Ltd (Gardners), and THE; all provide a broad range of titles. There are a few further trade wholesalers that tend to specialize in certain categories of books. Library wholesalers specialize in providing books and services to public and academic libraries.

10. Publishers also offer direct supply to retailers, either by supplying directly themselves or more usually by contracting for the services of a distributor. Distributors stock a publisher's books, take orders and payment, and undertake the physical shipment of books to retailers and wholesalers. Frequently a distributor is owned by one publisher but will distribute books for a number of other publishers.

11. Woolworths calculated that across all retailers, in 2006, over 75 per cent by volume, and 78 per cent by value of book supply to retailers was sourced from publishers and distributors with the remainder being sourced from wholesalers. We found that the proportion served by wholesalers has increased very slightly over the last five years.

12. Wholesalers provide a one-stop shop for retailers, being able to:

(h) supply books from a wide variety of publishers;

(i) hold stocks of books;

(j) offer next day delivery in most cases;

(k) offer a returns service (for unsold stock); and

(l) provide support services to retailers such as advice on appropriate titles to stock, publicity materials and stock control and ordering software.

13. In comparison, distributors will only stock books from the publishers they represent, they may not offer the same overall services as wholesalers, and we were told that few regularly offered next-day delivery with some being substantially slower. Ordering from distributors requires retailers to set up multiple accounts and negotiate terms, place multiple orders and deal with multiple deliveries, invoices and returns systems, although certain technological solutions are available to simplify these processes. However, the discounts off recommended retail price offered by publishers to retailers are generally better than those through wholesalers and returns allowances are usually more generous.

14. Because of these differences, different retailers make different decisions on whether and when to source from wholesalers or distributors, and we found this may vary according to the circumstances of ordering (eg whether rapid delivery was important) and the type of book (eg distributors tend to be more able to deliver front-list—recently released—titles and often offer promotions on these). We found that there was potential for some retailers to switch between the two sources of supply.

15. Publishers generally operate a channel pricing system whereby different discounts are offered to different types of retailer, with supermarket customers receiving more generous discounts than other retailers. The consequence is that there is no potential for supply-side or demand-side substitution between books for supermarket sale and other channels. We concluded that the relevant markets were the supply of books to non-supermarket retailers through wholesalers and direct supply, and separately the supply of books to supermarket retailers through wholesalers and direct supply.

16. A separate market exists for the supply of books to libraries as the additional services provided by library suppliers mean there is no easy ability for wholesalers to switch between library and retailer supply, and similarly library customers rely on the services provided by library wholesalers.

17. The relevant geographic market was the UK.

18. Bertram does not supply the supermarket market, nor had it actively sought such business immediately prior to the merger.

19. The combined market share of Bertram and THE in supply to non-supermarket customers is small. However, this understates the competitive impact of the merger as the shares of all distributors are aggregated whereas for any one title, customers have a choice of just one publisher or distributor. We concluded that many of the retailers could feasibly switch a proportion of their demand to direct supply. This is likely to present a sufficient constraint at the margin to prevent a blanket increase in prices in the wholesale supply of books (and for the same reasons prevent a decrease in quality of service) across all retailers. Publishers would also have the option of promoting closer competition from their distributors if they believed wholesalers were operating in a way which adversely affected the publishers' interests in selling books. We also expect that Gardners would seek to compete aggressively if THE/Bertram were to seek to increase prices.

20. We considered whether there would be potential for the merged parties selectively to discriminate against customers, or in particular purchasing circumstances, where the ability to switch to direct supply is limited. The share of Bertram and THE in the supply of books to all non-supermarket retailers through wholesalers is substantial. Of these retailers, independents are the group most likely to be vulnerable to changes in the wholesale market.

21. We found that independent retailers sourced around half of their books from wholesalers. Some independent retailers told us that because of the greater administrative complexity of dealing with distributors they preferred to deal with wholesalers. Others said that they could not switch to direct supply where rapid delivery was important (eg where a customer had ordered a specific book from them), where dealing with small publishers, and for back-list books where we were told availability and pricing from distributors was not as favourable as for front-list books.

22. We therefore looked at the potential for wholesalers to raise prices or lower service to independent retailers, or to raise prices or lower service for orders requiring rapid delivery and purchases of back-list books.

23. We found that a policy of discriminating against independent retailers was unlikely to be profitable because such retailers varied in the ability and willingness to increase their purchases from distributors, and there was no obvious means of determining the willingness of individual retailers to switch to direct supply.

24. We noted that various initiatives and technical developments are in place or are under development to simplify purchasing from distributors, that consolidation in publishing and distribution mean that around 75 per cent of all books sold can now be sourced from the six largest distributors (measured by value of books, the proportion of published titles is lower), that distributors have been improving their standards of service including delivery times, that some distributors already improve their speed of delivery in the period before Christmas when demand increases, and that publishers are likely to have an incentive further to encourage distributors to meet the needs of independent retailers if they perceive that wholesalers are acting against the publishers' interests in selling their books.

25. We thought that Gardners would, in these market conditions and given its investment and ambitions, be likely to seek to expand its share of supply to independent retailers. The number of independent retailers has been in decline and we also thought that wholesalers may take account of the vulnerable position of these retailers before increasing prices.

26. Retailers usually place orders for a number of books at the same time in order to meet minimum order values to qualify for free delivery. Consequently if an order to a wholesaler is triggered by the need for rapid delivery on one title, or for a book which is unavailable through distributors, it will be bundled in with other titles such that the wholesaler cannot easily identify the specific books ordered for particular reasons. If prices were raised for the whole order, rather than just for the book which triggered the order, the retailer may be more likely to seek alternatives (such as seeking supplies elsewhere and/or putting the order on hold) and so it may risk losing sales of the whole bundle of books ordered.

27. Wholesalers would be unlikely to consider providing different standards of service for books needing rapid delivery as their existing business model is built on providing one standard of service and speed of delivery; revising this is likely to be expensive. For these reasons and because of the constraints identified in paragraph 23, we thought that there was not an ability profitably to discriminate against independent retailers and against certain circumstance of order.

28. Where a retailer's primary wholesaler is unable to supply a book because it does not stock the title or it is out of stock, the order may be cascaded to a second-choice wholesaler. We also considered whether a secondary wholesaler might be able to increase its prices post-merger, because the number of broad-range trade wholesalers had fallen from three to two, and therefore the secondary wholesaler would not face any competition for secondary orders. However, such orders only account for a small proportion of business, and the same constraints apply as identified in paragraphs 23 and 26, direct supply forms a potential substitute in some cases, and the order triggered is likely to include a bundle of other books which could easily be sourced elsewhere.

29. We thought that the merger would not give rise to any vertical issues because of Woolworths' limited involvement in book retailing. We also concluded that the merger

would not be likely to give rise to any coordinated effects between wholesalers because of a lack of transparency in the market and the constraints posed by the potential for switching to direct supply.

30. With regard to the supply of books to libraries, we found that there was very little direct supply from distributors. While BLS held a significant market share, it faced several other significant competitors, and Woolworths had a negligible involvement in this market prior to the merger. We found that BLS's ability to offer a wider range of products and services following the merger would not be expected to increase its competitive strength in bidding for library supply contracts. Concern was expressed by other library suppliers that BLS was able to source books from Bertram, thus avoiding publishers' channel pricing which typically charges higher prices to library suppliers than trade wholesalers. However, we found this was already happening prior to the merger and had not been enhanced by the merger.

31. We concluded that the merger of Woolworths and Bertram has not resulted in and may not be expected to result in a substantial lessening of competition (SLC) in the market for the supply of books to retailers (both for supermarkets, and for other retailers) in the UK, and that the merger has not resulted in and may not be expected to result in an SLC in the market for the supply of books to libraries in the UK.

Findings

1. The reference

1.1 On 3 April 2007 the OFT referred the completed acquisition of Bertram by Woolworths to the CC for investigation and report. The reference was made under section 22 of the Act. Our terms of reference are set out in Appendix A. We are required to publish our final report by 17 September 2007.

1.2 This document, together with the appendices, constitutes our findings which we are required to publish and notify to Woolworths under the CC's *Rules of Procedure*.[1] We commissioned a survey of book retailers; a report of the survey is published on our website. Further information, including non-commercially-sensitive versions of main-party and third-party submissions, summaries of evidence, and our provisional findings report published on 27 July 2007 can also be found on our website.[2] We cross-refer to these documents where appropriate.

2. Industry background and the parties

2.1 This section provides a brief overview of the book industry; it then describes the parties to the merger.

Industry background

2.2 Sales of books in the UK have increased in recent years, with consumer sales in 2006 amounting to £2.3 billion. Consumer expenditure on books has been growing modestly since 2002, at a compound annual growth rate of around 3.2 per cent; it slowed in 2005, but grew by almost 3 per cent in 2006.[3] In volume terms, consumers bought 316 million books in 2006, 5 per cent more than in 2005. Publishers reported total sales (including educational and professional sales) of 472 million books in 2006, up 2.9 per cent on 2005, and 7.3 per cent on 2002.[4] The average price of a book fell from £7.46 in 2003 to £7.32 in 2006.[5] This seems to be due, at least in part, to increased discounting of books by retailers, particularly supermarkets and Internet retailers. The average recommended retail price (RRP) of books sold has increased slowly, from £9.03 in 2001 to £9.30 in 2005, with a slightly higher rate of increase for best-sellers. Adjusted for inflation, RRPs have fallen by around 9 per cent in real terms from 2001 to 2005.

2.3 Woolworths told us that publishers in the UK launched on average 120,000 new titles each year. As at February 2006, there were almost 2 million titles in print in the UK.[6]

2.4 UK publishers received revenues of £2.81 billion from books in 2006 (ex-warehouse prices), up 1.6 per cent on 2005; of this, £1 billion of books were exported. Of £1.81 billion home sales, £184 million were school or English Language teaching books, and £399 million were academic and professional books. The remaining £1.2 billion were sold into the UK consumer market.[7]

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[1] *Competition Commission: Rules of Procedure, CC1.* Paragraph 10.3.
[2] www.competition-commission.org.uk.
[3] OC&C Report, Project Raven.
[4] *UK Book Publishing Industry Statistics Yearbook, 2006*, The Publishers Association.
[5] *Book Facts Online*, BML. *UK Book Publishing Statistics Yearbook, 2006*, The Publishers Association.
[6] Nielsen BookScan, quoted in HMV/Ottakar's, Competition Commission, TSO, May 2006).
[7] *UK Book Publishing Industry Statistics Yearbook, 2006*, The Publishers Association.

Parties in the book industry

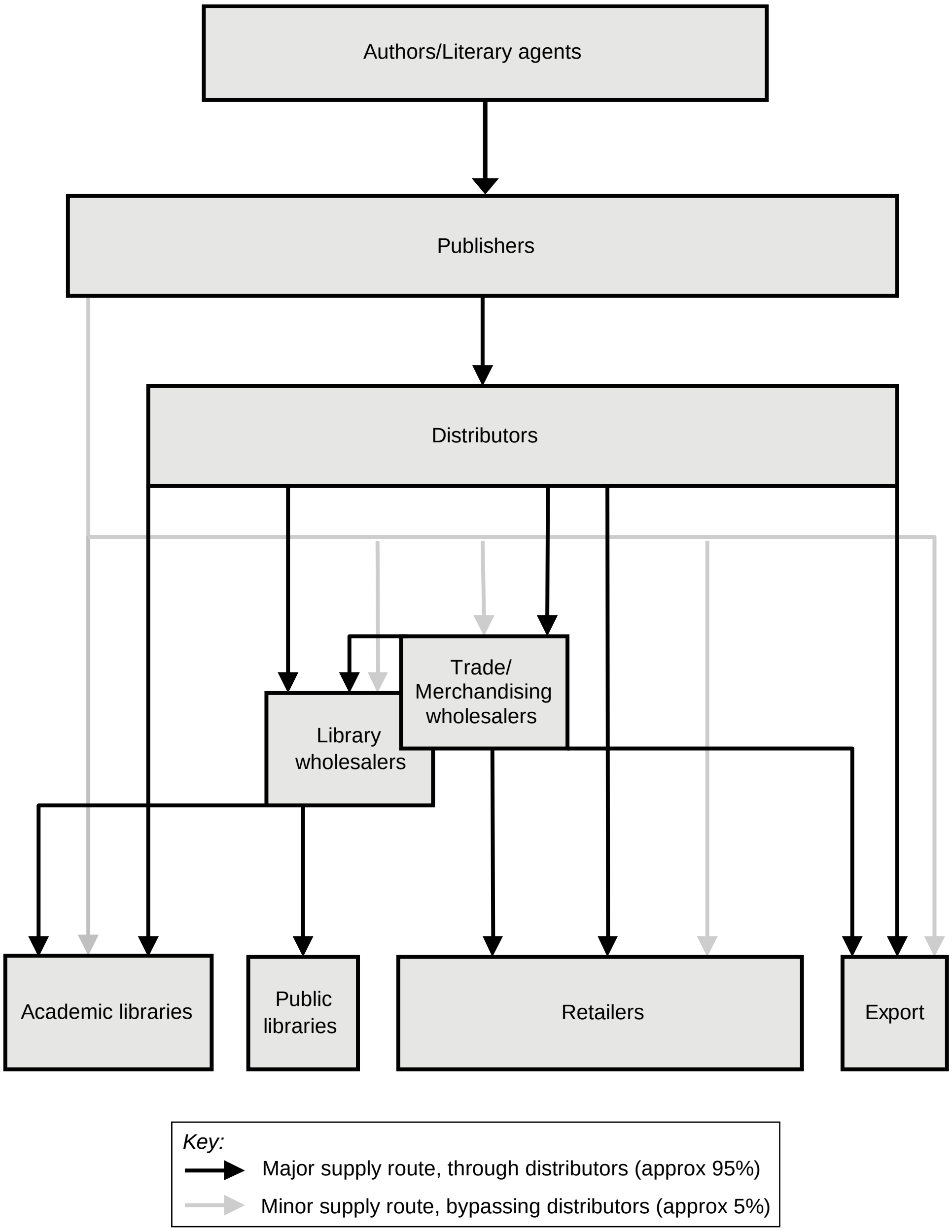
2.5 The key participants in the book industry are:

- authors and their agents;
- publishers;
- distributors;
- wholesalers; and
- retailers (or libraries).

The structure of the industry is illustrated in Figure 1.

FIGURE 1

Structure of the book industry



Source: Woolworths.

Publishers

2.6 Publishers enter into contracts with authors to print and market their works. Publishers are responsible for the selection of manuscripts and the commissioning of titles, editing of manuscripts, negotiation of authors' terms, having the book printed, and promotion of titles to retailers and the general public. Publishers set the RRP which is nearly always printed on books for retail sale, and publishers are usually responsible for rights management (ie they usually hold the copyright licences on behalf of authors). Publishers may store and distribute their books themselves or arrange for distribution direct from the printers, but more usually they contract with distributors to provide this service.

2.7 There are over 10,000 publishers in the UK but four publishers account for more than 50 per cent of books sold to consumers. These are Hachette Livre (Hodder Headline, Orion, Little, Brown Book Group), Bertelsmann (Random House, Transworld), Pearson (Dorling Kindersley, Penguin) and Harper Collins.

Distributors

2.8 Distributors undertake the physical shipment of books to customers, such as retailers and wholesalers. Frequently a distributor is owned by one publisher but will distribute books for a number of other publishers. The ownership of the main distributors, and their client publishers, is detailed in Appendix B.

Wholesalers

2.9 There are various different types of wholesaler:

- *Merchandising wholesalers*, who supply supermarkets (and sometimes provide in-store merchandising services). Typically such wholesalers deal with a relatively narrow range of titles and hold far fewer titles in stock than trade wholesalers. The largest merchandising wholesaler is EUK (owned by Woolworths).

- *Trade wholesalers*, who typically supply some or all of independent specialist book retailers, book retail chains, book clubs, non-specialist retailers, and Internet retailers. The three largest trade wholesalers are Bertram Books (acquired as part of Bertram by Woolworths in February 2007), Gardners, and THE (acquired by Woolworths in 2006); THE has until recently operated both as a merchandising wholesaler, and as a trade wholesaler supplying non-supermarket retailers. These wholesalers are described in paragraphs 2.41 to 2.50 and 4.5 respectively. The number of wholesalers has reduced substantially in the last 10 to 20 years—see paragraph 4.8.

- *Library wholesalers*, who specialize in providing books and bespoke services (described in paragraph 2.18) to public and academic libraries. Woolworths and Bertram estimate that 98 per cent of all supplies of books to libraries occur through library wholesalers.

Retailers/libraries

2.10 Books are distributed to end-consumers through various types of retailer or through libraries. There is no standard classification of retailer; they can be divided into various categories although the boundaries between them are not precise, for example many 'bricks and mortar' retailers offer Internet services. In broad terms a classification of retailers is:

(a) *Large chains* (chains), namely Waterstone's, Borders and WH Smith. These are specialist book retailers with multiple branches, stocking a wide range of titles and book categories.

(b) *Independent bookshops* (including small chains of multiple outlets), which vary in their approach; some stock a wide range of titles, while others specialize in particular book categories.

(c) *Supermarkets* have greatly increased their sales of books in the last few years. They tend to stock a relatively narrow range of titles, many of these being best-sellers.

(d) *Other retailers* include shops whose primary focus is not books. For example, newsagents, garden centres, cookshops and heritage destinations may all sell a small range of books, possibly relevant to their primary activities.

(e) *Internet retailers* deliver books to the customer's specified address. Many Internet suppliers tend to rely primarily on one of the trade wholesalers fulfilling and dispatching orders on their behalf. Other Internet retailers, if they have their own warehouses, may also be able to buy books from publishers and wholesalers for delivery to their warehouses from where they can be distributed to customers by the retailers.

(f) *Book clubs* supply members with discounted books, but may require membership fees or a commitment to purchase a minimum quantity.[8]

(g) *Libraries and schools* purchase books from library suppliers or retailers for lending purposes.

2.11 Trends in the supply of books through different retail channels are shown in Table 1. Internet sales and the supermarkets' share of supply have been growing. Mail order (including book clubs) has been declining. This needs to be judged in the context of a slowly growing market overall; values of sales through the different channels, drawn from Taylor Nelson Sofres (TNS), are shown in Figure 2.

TABLE 1 **Trends in supply of books to final consumers through retail channels**

per cent

	2002	*2003*	*2004*	*2005*	*2006*
Independent booksellers	10.6	10.0	10.6	10.6	10.2
Chains	41.3	43.1	43.3	42.4	39.6
Supermarkets*	6.4	7.2	6.4	8.4	9.0
Internet	6.2	7.5	9.2	11.2	13.2
Mail order/clubs	20.5	18.8	17.7	15.8	14.9
Other†	15.0	13.4	12.8	11.6	13.1
Total	100.0	100.0	100.0	100.0	100.0

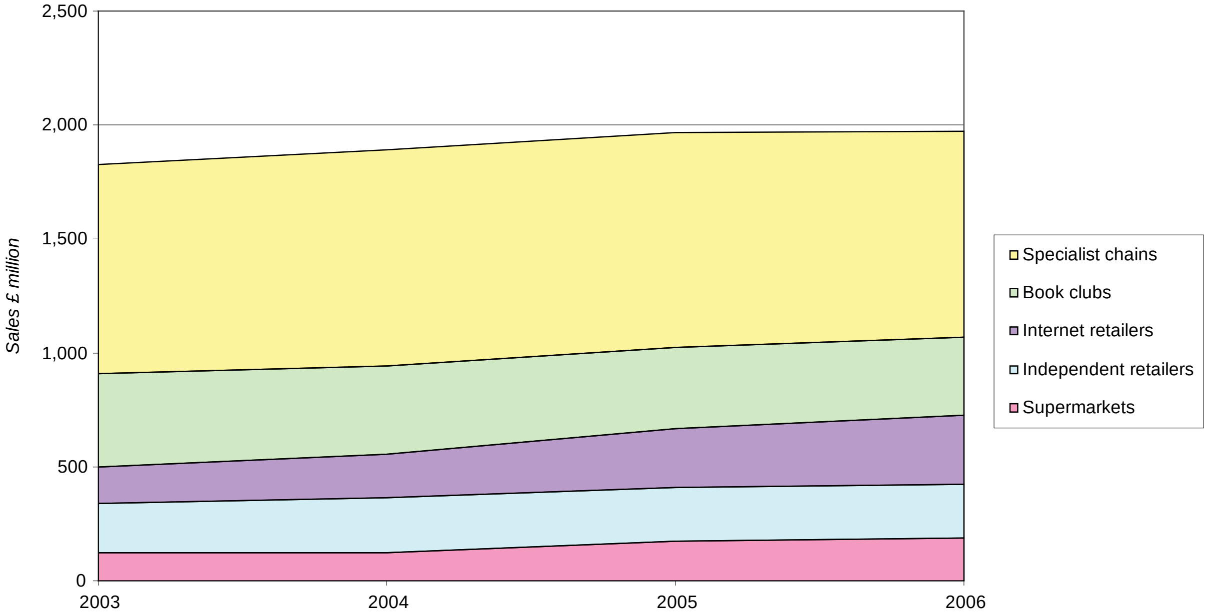
Source: TNS.

*Includes Woolworths.
†Includes campus shops, bookstalls, music shops, garden centres etc.

[8]Book Clubs, such as BCA (owned by Bertelsmann) and The Book People, offer members selected books at low prices. Some, but not all, require members to buy a minimum number of books.

FIGURE 2

Annual book sales values, 2003 to 2006, through different retail channels



Source: CC from TNS data.

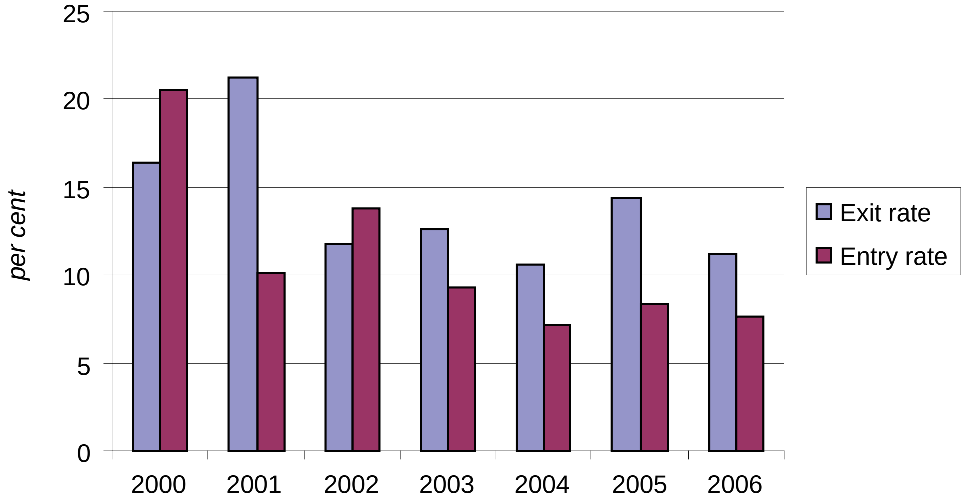
2.12 Independent bookstores have broadly maintained their share in value terms, although Woolworths said that the independent retailers' share was falling in terms of number of books. TNS data shows average monthly sales (measured in terms of RRP) by independent retailers increasing by 14 per cent from 2003 to 2006. There are indications of significant entry and exit by independent retailers, and we were told that many independent bookstores had closed because of competitive pressures from Internet and supermarket suppliers.[9] Data on entry and exit of independent book retailers in a number of shopping locations throughout the UK is plotted in Figure 3.[10] This indicates that while there has been some decline in the number of independent retailers in most years, entry offsets many of the exits. Net exit was particularly marked in 2001 and 2005. The Booksellers Association (which represents most book retailers) reported that the total number of outlets operated by its membership had fallen by 2 per cent between 2006 and 2007, but had increased by 38 per cent since 2000, as supermarkets had joined the association. The number of stores covered by independent retailers with five or fewer outlets had fallen by 4 per cent between 2006 and 2007, and by 17 per cent since 2000.

[9]For example, *The Bookseller* (11/5/07) reported that one independent book retailer had closed every week for the last ten months.

[10]This analysis is based on a dataset compiled by Experian GOAD. The dataset covers 1,115 shopping centres across the UK between 1999 and 2007. Closures and openings at different locations are therefore excluded. These locations are defined consistently throughout the dataset though they have no fixed size in geographic or demographic terms. A further 867 locations appeared in the dataset over the course of this period; however, we have removed these to maintain the consistency of the sample. A survey is conducted in each location every 12 or 24 months to identify the changes in the identity and activities of retailers in the area. Changes in ownership are not regarded as entry or exit.

FIGURE 3

Entry and exit rates for independent booksellers in certain shopping locations



Source: CC analysis.

Book supply: wholesalers and distributors

2.13 Retailers order books either from wholesalers or direct (from publishers or their distributors),[11] or a mixture of the two. Woolworths estimated that 22 per cent of books reach retailers via wholesalers, but the great majority, 78 per cent, are distributed direct.

2.14 Trade wholesalers' (ie wholesalers supplying all retailers except supermarkets) principal activities include the following:

(a) On receipt of customer orders, trade wholesalers will pick books from their stock, pack them and send them to the retailer via a third party carrier (pick, pack and ship distribution). The wholesaler sources books from publishers, either direct or via distributors, and manages its range of titles and stock levels to try to meet anticipated demand.

(b) Retailers are generally granted a returns[12] allowance and trade wholesalers need to manage the return of unwanted stock.

(c) Trade wholesalers offer advice to customers on core stock lists, and produce reviews of new titles. They also offer marketing material such as posters, and magazines to retailers.

(d) Trade wholesalers may offer stock management and product-ordering software (eg THEsis, Bertline and Gardlink) to customers.

(e) Trade wholesalers increasingly offer customer direct fulfilment services where, if a customer places an Internet order with a retailer, the picking and dispatch is

[11]In this report we use the term 'direct supply' to denote distribution from publishers both through distributors and directly by the publishers, and excluding distribution through wholesalers.

[12]Returns are unsold books that the retailer may send back to the distributor or wholesaler in exchange for a credit. The vast majority of books are supplied to retailers on a 'sale-or-return' rather than firm-sale basis, although we were told that publishers tended to operate much more generous returns allowances, often 100 per cent, than wholesalers, whose returns allowance may be around 10 per cent, although sometimes this can be higher. The returns process is described in Appendix C.

handled on the retailer's behalf by the wholesaler. Some wholesalers offer web-hosting services to small retailers, and the wholesaler's call centre may take orders or offer customer service on behalf of retailers (thus appearing to the end-customer to be part of the retailer's operations).

2.15 Merchandising wholesalers supply supermarkets and similar large retailers. These retailers usually stock a limited range of titles and will not order books for customers outside this range. Such wholesalers, notably EUK, therefore purchase a limited range of books in large quantities and seek to process them (including applying retailer-specific price promotion stickers) and distribute them to stores quickly. Proportionately, a far smaller volume of books and number of titles are held as back stock than is the case with trade wholesalers. Supermarkets may manage their own purchasing decisions, or may contract with the merchandising wholesaler to take responsibility for range selection, determine store orders based on data received from the retailer's EPOS systems, develop planograms[13] on behalf of the retailer, and merchandise stock at a retailer's premises (eg stocking and replenishing shelves).[14]

2.16 Distributors offer pick, pack and ship distribution for those publishers that they represent. Consequently the choice of books they offer is not made by the distributor; negotiation of account terms is between the publisher and retailer, although Woolworths told us that retailers' credit terms were often set by the distributor. The distributor handles returns and will offer advice and promotional materials relating to its own publishers' ranges.

2.17 Different categories of retailers vary in the extent to which they use wholesalers. The trade wholesalers do proportionately little business with the chains or with 'other' retailers (non-specialist bookshops), but primarily service Internet orders and independent retailers. THE has had considerable merchandising business with supermarkets although these contracts are now being fulfilled by EUK; EUK, as a pure merchandising wholesaler, only serves this segment. Gardners told us that its main areas of supply were to independent retailers and in meeting Internet orders. Bertram and Gardners both have sizeable export businesses.

2.18 Library wholesalers specialize in providing books and bespoke services to public and academic libraries. These ancillary services include:

(a) Coding and tagging of books—so that the books are recognized by library catalogue systems. This involves manual stickering processes which will be slightly different for each library customer.

(b) Cataloguing of books (by book type, genre, star ratings etc)—to enable libraries to choose their selections more easily. This includes bespoke cataloguing requirements.

(c) Reinforcing books or fitting protective covers to them.

(d) Range selection—aiding libraries to select ranges appropriate to a particular library.

(e) Supporting library promotions—to attract different types of reader to use library services.

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[13]A planogram is a proposed shelf layout for a retail outlet.
[14]The wholesaler may also appoint a field marketing agency to visit stores and merchandise the stock.

2.19 The main library wholesalers are described in paragraphs 4.64 and 4.65. BLS is a library wholesaler owned by Bertram. Woolworths told us that THE did supply libraries but only to a limited extent; its library supply operations were limited to servicing the British Army's overseas libraries and supplying library wholesalers and academic book suppliers.

2.20 The value of supply of books to libraries is estimated to be around £380 million.[15] Sales to schools represented sales of £207 million in 2006, public libraries £100 million and higher/further education institutions £72 million. Public library books are increasingly purchased through buying consortia which represent multiple local authorities. These consortia have grown in significance, representing only 10 per cent of purchases in 1998 but 55 per cent in 2006.[16]

Sources of supply to retailers

2.21 'Bricks and mortar' retailers, both chains and independent retailers, are not usually bound by contracts to an exclusive source of supply. Retailers may negotiate terms on the promise of placing certain volumes of business with a wholesaler but they will have the freedom to source supplies from other wholesalers where they so wish, such as where a wholesaler does not hold stock of a particular title. Supermarkets typically have an exclusive contract with a merchandising wholesaler. Internet orders may be serviced by a trade wholesaler on behalf of the Internet retailer, and libraries typically place tenders for exclusive contracts with library suppliers. Volume rebates may sometimes apply but we were told by the parties that these were relatively rare.[17]

2.22 Retailers generally order stock under three circumstances:

(a) Retailers will take a view on books they believe are likely to sell which they have not stocked before, including high-selling titles (charts of best-sellers are readily available to the trade through Nielsen BookScan services and trade publications such as *The Bookseller*), new releases and forthcoming titles. Appropriate ordering of advance titles is a key skill for booksellers.

(b) Retailers typically look at their daily sales and take a view on whether to replenish or order additional copies of stock which has been sold.

(c) Some retailers, particularly independents and chains, will order out-of-stock books for customers.

2.23 In deciding on their source of supply, retailers need to weigh up the different aspects of the service offered by wholesalers and distributors, including administration, pricing and promotions, minimum orders, delivery times, and returns policies.

2.24 Given these considerations, different retailers take different views on the optimal sources of supply.

2.25 The chains source most of their books from publishers, although they may purchase top-up stock from a wholesaler if the publisher is out of stock or if copies are needed urgently. WH Smith told us, for example, that 99 per cent of the books in its shops were sourced direct from publishers and the remainder from wholesalers.

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[15]*OC&C Report on Project Raven*.
[16]Ibid.
[17]18 per cent of respondents to the ORC survey (see paragraph 4.27) said that they received retrospective rebates (see also paragraph 4.15).

Waterstone's told us that it sourced the majority of its books from publishers direct (customer orders could be an exception).

2.26 Independent booksellers make greater use of wholesalers than do the chains. Woolworths estimated that, in 2006, wholesalers sold £71 million of books to independent bookstores which, when grossed up, would have been the equivalent of £118 million[18] at retail sales value. Sales data submitted by Bertram, Gardners and THE for 2006 totalled to a retail sales value of £[✂] million. Independent bookstores were estimated to have had sales of £229 million[19] in 2006 and thus wholesale supply would have accounted for roughly half of this, compared with the average of 22 per cent to retailers overall.

2.27 Amazon, the largest Internet book supplier, told us that a significant proportion of the books it sold in the UK were supplied by wholesalers, including those supplied direct to the consumer by Gardners. Other Internet booksellers, including 'bricks and mortar' retailers that may be sourcing books direct for their stores, use wholesalers for their Internet sales. WH Smith uses THE as its main supplier for whsmith.co.uk, and Waterstone's.com uses Bertram Books. Some independent booksellers, which may be supplied by wholesalers, may also sell books on the Internet. Gardners, for example, offers support to independent booksellers wishing to build an Internet business.[20]

2.28 Tesco[21] uses a wholesaler, EUK, to supply its books; Morrisons' and Sainsbury's contracts with THE are now also fulfilled by EUK. Asda sources its adult books direct from publishers and told us that it would be doing the same for its children's books which had been supplied by Handleman UK Limited (Handleman—see paragraph 4.6). It said that it expected to move to direct supply by September 2007.[22]

2.29 'Other retailers' vary in type. We were told that such retailers sourced books from trade wholesalers, specialist wholesalers, wholesalers which primarily operated in other lines of business, and some publishers which specialized in supplying such businesses. Another outlet is through book clubs, which generally source all their books through arrangements direct with publishers.

2.30 For any one title, potential suppliers are the publisher and the wholesalers. Retailers therefore tend to maintain accounts with a number of publishers; they are also likely to maintain accounts with more than one wholesaler, so that if a book is unavailable through the primary wholesaler, the retailer has the option of seeking it from another wholesaler.

Ordering systems

2.31 Retailers can order books from publishers and wholesalers in a number of ways. It is generally possible to place orders by fax, through a call centre, through the supplier's website or by using an electronic ordering system. These systems are sometimes integrated into the shop's stock control systems.

2.32 Bertram Books, THE and Gardners all supply ordering and stock management software to booksellers (Bertline, THEsis and Gardlink respectively). Orders can be

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[18]CC calculation.
[19]TNS data supplied by Woolworths.
[20]It can be seen that the use of wholesalers by Internet booksellers may be relatively attractive: they do not need to tie up working capital in stock, instead simply passing the order on to the wholesaler for fulfilment when it is received.
[21][✂] Books sold on tesco.com are supplied by Gardners.
[22]Asda said that it had and would continue to source a limited number of books from third-party wholesalers.

placed online, customer orders recorded, stock levels monitored and returns authorized online. When ordering, the default supplier on all three systems is the relevant wholesaler though this may be overridden manually in favour of a different wholesaler or direct supply.[23] Similar ordering systems, and integrated EPOS/ordering/stock control systems, are also available from independent sources.

2.33 A retailer may have to deal with many different publishers if it does not order through a wholesaler. A number of services have been created to make it simpler for the bookseller to deal with multiple publishers; these are described in Appendix C. There are electronic and web-based ordering systems (eg Nielsen's TeleOrdering, Nielsen's BookNet Web Services and PubEasy) which allow orders to be placed online with most large publishers, and services that simplify invoice processing by consolidating invoices from multiple suppliers to participating bookstores, eg Batch.[24] The e4books project initiated by Book Industry Communication (BIC) in 2004 is intended to promote the use of e-commerce in the book industry supply chain, so that by 1 May 2008 ('e-Day'), there is electronic provision of product information, electronic ordering, processing of order acknowledgements and delivery notes, and electronic returns management including authorization of returns (see Appendix C).

New technology

2.34 We looked at whether new technologies may affect the way in which books are distributed, in particular e-books and print on demand (POD) technology.

2.35 E-books are texts which may be loaded on to a digital device known as a 'reader'. Readers have improved in size, cost and image quality, and online bookstores have been established offering a wide variety of titles. However, we were told that e-books are unlikely significantly to displace printed books in the next few years because the readers still cost around £200, customers prefer the feel of books and, unlike music, there is little need for the ability to store the text of many books on one device as users typically read only one book at a time.

2.36 POD is a publishing method, using digital printing technology, in which a book can be printed, bound, trimmed and laminated once an order is received. However, we were told that conventional printing is much cheaper for books with a large print run. POD may be economic for some books which are expected to sell in small numbers, but it is not expected to impact significantly on the mainstream book sector in the next few years.

The parties

2.37 We now briefly describe the parties involved in the merger. The details of the transaction, and the parties' stated rationale for the transaction, are discussed in the next section.

Woolworths Group PLC

2.38 Woolworths was formed in August 2001 following demerger from Kingfisher plc. Woolworths has both retail and wholesale operations, but it told us that its principal

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[23] If a title is out of stock at a wholesaler, the retailer can choose either to wait for it to become available, or the order can be cascaded to a secondary supplier. These systems may be available free (dependent upon placing a minimum level of orders in the first year), or an installation fee may be charged. Thereafter there is usually no obligation on the retailer to order books through the system supplier.
[24] Owned by The Booksellers Association.

business activities were in the UK retail sector. Through Woolworths plc it operates 803 'mainchain' stores, located in small towns and city suburbs, as well as larger stores located on prime shopping streets in major regional shopping centres. The products offered in stores cover toys, children's clothing, events, confectionery, home and entertainment; larger stores include a more comprehensive range of home products and children's clothing. Woolworths also operates 17 out-of-town superstores, which offer a wider selection of toys and entertainment products. Woolworths' stores stock a small number of books—see paragraph 7.83. Woolworths also offers Internet and catalogue retailing (*The Big Red Book*) through which some 20,000 book titles are offered.

2.39 Woolworths is also a distributor of HEPs,[25] and books, through its subsidiaries EUK and THE.

2.40 In the year ended 3 February 2007, Woolworths' revenue was £2,737 million and it made an operating profit of £18 million pre-exceptional items. Table 2 sets out an analysis of Woolworths' revenue and profits. Woolworths has experienced substantial decline in the profitability of its retail business (going from a profit to a loss last year), but not in its wholesale business, and profits from its wholesale operations have recently offset losses from its retail operations.

TABLE 2 **Woolworths segmental analysis, 2007**

£ million

	Retail	*Entertainment, wholesale and publishing*	*Other*	*Total*
Revenue	1,813.2	923.8	-	2,737.0
Operating profit after exceptional items	–14.8	49.2	–7.7	26.7

Source: Woolworths Group plc, Annual Report and Accounts 2007, note 1.

Notes:
1. Period is 53 weeks to February 2007. In the 52 weeks to 28 January 2006, Woolworths derived £30 million operating profit from its retail business, and £48.2 million operating profit from its wholesale business.
2. Revenue is net of inter-company sales.
3. Companies included within entertainment, wholesale and publishing are EUK, THE, BGL, and 2entertain Ltd (a joint venture, independent publisher of music and video with turnover of about £200 million).

EUK

2.41 EUK operates as an in-house HEP and book distributor for Woolworths' retail business, but also serves other retail customers. It was founded in 1966 by EMI Records, under the name Record Merchandisers Ltd, to distribute music to non-specialist UK retailers. The company gradually expanded into distribution of other HEPs and books. In 1986 it was acquired by Kingfisher plc and two years later changed its name to Entertainment UK Ltd. The company was then spun off in 2001 to form part of Woolworths. Woolworths said that the supply of HEPs to a variety of retail chains and supermarkets continued to be EUK's main business focus. In the year to 31 January 2007, [✂] per cent of EUK's revenues came from books, and [✂] per cent of its gross margin.

2.42 EUK's books arm served Woolworths, and from 2004 Tesco. Following Woolworths' acquisition of THE, its contracts to supply Morrisons and Sainsbury's are now fulfilled by EUK. In February 2007, Woolworths acquired Bertram through EUK. Further financial details for EUK are set out in Appendix D.

[25]HEPs include CDs, DVDs, games hardware (such as games consoles) and games software.

THE

2.43 THE is a wholly-owned subsidiary of AMP Enterprises Limited (AMP). THE and AMP were acquired by Woolworths in September 2006. THE operates in the wholesale distribution of HEPs, books and some accessories.

2.44 THE was formed in 1991 when John Menzies plc amalgamated two wholesale companies: Terry Blood Distribution was a wholesaler originally of music products and then additionally video products; Hammick's Wholesale was a book wholesaler. In 2001, THE was subject to a management buyout who created a holding company called AMP Enterprises.

2.45 In 2004, AMP was itself initially part sold and then in 2005 completely sold to 3i and changed its name in the process to Total Home Entertainment Distribution Limited (with a new holding company taking the AMP name). THE was purchased by Woolworths in September 2006; the acquisition was cleared by the OFT on 15 December 2006.

2.46 In the year to May 2007, under one-quarter ([✂] per cent) of THE's revenue came from books. Its supermarkets business made up approximately half its book sales until this was transferred to EUK. Further financial details for THE are set out in Appendix D.

Bertram Group Limited

2.47 Bertram Books was formed in 1968 as a family-run business, which grew to become a national book wholesaler. In 1999, Bertram Group Limited was formed by Raymond Gray from the merger of Bertram Books and Cypher Group with private equity backing from HgCapital (and LDC).

2.48 Cypher Group was a specialist library supply business formed from the merger of three existing library supply businesses in 1997—Morley Books, Greenhead Books and JMLS. Cypher Group was rebranded as Bertram Library Services in 2005 and it remains a separate division of Bertram, based in Leeds.

2.49 In 2005, Bertram Publisher Services was launched; this is a distributor for a few small publishers, namely City & Guilds, Royal College of General Practitioners and Severn House (for library products).

2.50 Bertram Books currently accounts for the greatest part (about [✂] per cent) of the group's sales, and BLS accounts for the vast majority of the remainder. Bertram Books, BLS and Bertram Publisher Services are structured as divisions of Bertram Trading Limited, which is the main operating company owned by Bertram. In May 2004, Bertram relocated its distribution activities (and its Head Office) to a purpose-built distribution centre on the outskirts of Norwich. Further financial details for Bertram are set out in Appendix D.

3. The merger

3.1 This section sets out in more detail the transaction by which Woolworths, through EUK, acquired Bertram, other bidders for Bertram, the rationale for the merger and the intended restructuring of EUK's, THE's and Bertram's activities.

Outline of merger situation

3.2 HgCapital started looking to refinance its investment in Bertram in 2006; Bertram said that HgCapital considered it time to redeem the fund that had invested in the business. It had acquired Bertram in 1999. Bertram said that a trade sale was initiated when it became apparent that there were parties in the market willing to buy it.

3.3 On 11 October 2006, Bertram advised EUK that a sale process for the business was under way. EUK submitted a non-binding offer on 9 November 2006, and entered into exclusive negotiations with Bertram on 31 December 2006.

3.4 In addition to EUK, Bertram told us that several purchasers expressed an interest in acquiring Bertram (see Appendix D). EUK was ultimately selected as preferred bidder.

3.5 On 17 January 2007, EUK announced that it had reached agreement with the majority shareholders of Bertram on the terms of the acquisition by EUK of the entire issued share capital of Bertram, at a cost of approximately £29.1 million for the equity (preference and ordinary shares), representing an enterprise value of £41.1 million.

3.6 EUK received irrevocable undertakings in January 2007 from the majority Bertram shareholders to sell their entire holdings of Bertram ordinary shares to EUK (representing in aggregate more than 90 per cent of each of the various classes of Bertram shares). EUK acquired sole control of Bertram on 1 February 2007 when it acquired all the issued Bertram preference shares and when its offer to purchase the ordinary share capital in Bertram became unconditional as to acceptances. EUK's compulsory acquisition of the remaining shares was completed on 6 April 2007.

The rationale for the merger

3.7 At the time of the acquisition, Woolworths[26] stated that:

> the acquisition of Bertram is another important step in the strategic development of the Group's Entertainment Wholesale business. It further diversifies our customer base and increases exposure to the growing books market. The acquisition speeds our entry into the library servicing sector and provides an international sales base on which to build ... The acquisition of Bertram complements the Group's existing book distribution capability.

3.8 Woolworths told us that EUK's 2006 acquisition of AMP/THE represented a first step in accessing the wholesale market, and was initiated particularly in order to get access to the Sainsbury's HEP and book contract. Woolworths said that the acquisition of Bertram was an important next step in the strategic development of its entertainment wholesale business, which would:

(a) allow the combined business to offer improved prices and services to retailers, in direct competition with the publishers themselves;

(b) enable Woolworths to diversify its customer base in this area further, and increase its exposure to the books market, which it viewed as currently more resilient to the digital technology threat than the HEP sector;

[26]Press release dated 17 January 2007.

(c) provide EUK/THE with the opportunity to become involved in new POD technology;

(d) create the opportunity to enter the library servicing and book distribution sectors; and

(e) provide an international sales base on which to build.

3.9 Woolworths said that the acquisition of Bertram would provide EUK with scale with resultant cost savings. Woolworths has estimated annual synergies available from the acquisition to be approximately £[✂] million for 2007/08 and £[✂] million thereafter (ie from 2008/09). These synergies will be derived from rationalization of the sites, the people and infrastructure, as described in paragraphs 3.10 to 3.12.

Restructuring post-merger

3.10 EUK's integration plans are summarized below, although these have in part been put on hold following the agreement of interim hold separate undertakings (see paragraph 3.13).

3.11 EUK told us that it planned to split the THE book business, so that:

(a) all THE's supermarket contracts (Sainsbury's, Morrisons and Somerfield) would be served by EUK from its facility in Hayes—this has been implemented because the integration of THE's and EUK's activities is not the subject of this investigation;

(b) all independent book retailers and specialist chain retailers would be served by Bertram Books from its Norwich facility; and

(c) all library customers would be served out of BLS from its Leeds facility.

3.12 EUK said that Bertram Books would become Bertram/THE and would operate as a separate division from EUK's book business (which would be focused on supermarket business). EUK said that it intended to run Bertline and THEsis software packages side by side until a viable hybrid system that met customer needs was realized. EUK said that it intended to convert THE distribution centres in Newcastle-under-Lyme to serve as a base for storing and dispatching products (other than HEPs and books) sold by the Woolworths online operation.

Undertakings

3.13 On 28 February 2007, Woolworths gave initial undertakings to the OFT under section 71 of the Act. When the merger was referred in April 2007, the CC adopted those undertakings. We considered whether any further changes were necessary to prevent pre-emptive action by the parties which might prejudice the reference or impede the application of effective remedies at the end of the inquiry. As a result, on 29 May 2007 the CC accepted interim undertakings given by Woolworths, EUK, THE and Bertram (see Appendix A).

Jurisdiction

3.14 Under section 22 of the Act, we are required to decide whether a relevant merger situation has been created. A relevant merger situation is created where two or more enterprises have ceased to be distinct within the statutory period for reference and either the share of supply test or the turnover test specified in the Act is satisfied.

3.15 As a result of the transaction described in paragraphs 3.2 to 3.6, Bertram has ceased to be distinct from enterprises carried on by, or under the control of, Woolworths.

3.16 The UK turnover of Bertram exceeds £70 million, so the turnover test in section 23(1)(b) of the Act is satisfied.

3.17 We therefore conclude that there is a relevant merger situation within the meaning of the Act. This conclusion has not been disputed by any party during the course of our inquiry.

4. Pre-merger competition in the market

4.1 We now address the nature and extent of competition in the supply of books prior to the merger, first considering the supply of books to retailers, and second, the supply of books to libraries.

Competition in the supply of books to retailers

Structure of supply

4.2 Bertram and Woolworths overlap in book wholesaling. Books are supplied to retailers both through wholesalers and via direct supply from publishers through distributors. Woolworths calculated that across all retailers, in 2006, over 75 per cent by volume, and 78 per cent by value, of book supply to retailers was sourced from publishers and distributors. These proportions have decreased very slightly over the last five years, partly reflecting the growth in supermarket supply sourced from EUK and THE. The shares for the supply of books to retailers in the UK via both wholesale and distributor channels, for the last five years based on Woolworths estimates, are shown in Table 3.[27] In this section we therefore consider supply both through wholesalers and direct, and consider the extent to which there is competition between them.

[27]These estimates were broadly confirmed by sales figures for other named suppliers.

TABLE 3 **Shares for the supply of books to retailers in the UK via wholesale and distributor channels, for the last five years**

per cent

	2002	*2003*	*2004*	*2005*	*2006*
Share based on volume (units)					
EUK/THE	0–5	0–5	5–10	5–10	5–10
Bertram Books	0–5	0–5	0–5	0–5	0–5
EUK/THE/Bertram Books	*5–10*	*5–10*	*10–15*	*10–15*	*10–15*
Gardners	5–10	5–10	5–10	5–10	5–10
Handleman	0–5	0–5	0–5	0–5	0–5
Other wholesalers	0–5	0–5	0–5	0–5	0–5
Direct supply	75–80	75–80	75–80	75–80	75–80
Total	100.0	100.0	100.0	100.0	100.0
Share based on value (£)					
EUK/THE	0–5	0–5	0–5	5–10	5–10
Bertram Books	5–10	0–5	0–5	5–10	0–5
EUK/THE/Bertram Books	*5–10*	*5–10*	*5–10*	*10–15*	*10–15*
Gardners	5–10	5–10	5–10	5–10	5–10
Handleman	0–5	0–5	0–5	0–5	0–5
Other wholesalers	0–5	0–5	0–5	0–5	0–5
Direct supply	80–85	80–85	80–85	75–80	75–80
Total	100.0	100.0	100.0	100.0	100.0

Source: Woolworths.

4.3 The large publishers distribute their books through distributors. Smaller publishers may also contract with distributors, and there is a large tail of small publishers in the UK who may self-distribute or rely on wholesalers. There is considerable concentration among distributors; Woolworths said that the six largest distributors handle around 75 per cent of UK publishers' books (measured by sales rather than titles). Distributors tend to be owned by publishers but often have distribution contracts with other publishers. The main distributors are Bookpoint (owned by Hachette), Harper Collins, Littlehampton Book Service (owned by Hachette), Macmillan Distribution, Penguin (owned by Pearson whose other imprints include Dorling Kindersley and Pearson Longman), The Book Service (TBS) and its subsidiary Grantham Book Services (both owned by Random House). The distributors, and their client publishers, are listed in Appendix B.

4.4 Woolworths provided estimates of the share of supply of books to retailers through the wholesaler channel—see Table 4. There was a substantial increase in EUK's volume of business in 2004 when it acquired Tesco's book contract after the previous wholesaler ceased trading.

TABLE 4 **Shares for the supply of books to retailers in the UK via the wholesale channel only, for the last five years**

per cent

	2002	*2003*	*2004*	*2005*	*2006*
Volume (units)					
EUK/THE*	15–20	15–20	30–35	35–40	40–45
Bertram Books	20–25	20–25	20–25	15–20	15–20
EUK/THE/Bertram Books	*35–40*	*35–40*	*50–55*	*55–60*	*55–60*
Gardners	35–40	40–45	35–40	35–40	30–35
Handleman	0–5	0–5	0–5	0–5	0–5
Other wholesalers	15–20	15–20	5–10	5–10	5–10
Total	100.0	100.0	100.0	100.0	100.0
Value (£)					
EUK/THE*	15–20	15–20	25–30	25–30	30–35
Bertram Books	25–30	20–25	20–25	20–25	20–25
EUK/THE/Bertram Books	*40–45*	*35–40*	*45–50*	*50–55*	*50–55*
Gardners	40–45	40–45	40–45	40–45	35–40
Handleman	0–5	0–5	0–5	0–5	0–5
Other wholesalers	15–20	15–20	0–5	5–10	5–10
Total	100.0	100.0	100.0	100.0	100.0

Source: Woolworths.

4.5 Gardners, located in Eastbourne, is the other principal trade wholesaler, offering a similar range of services to Bertram Books and THE. It serves a range of customers from major ‘bricks and mortar’ and Internet retailers to independent bookshops, smaller online retailers and bargain bookstores. Gardners provides selection and inventory management services, as well as distribution services, for Waitrose. It lists around 730,000 titles from a range of more than 3,500 publishers and holds up to 325,000 of these in stock at any given time.

4.6 The Handleman group is an independent category manager and distributor of HEPs and books in the USA, Canada and the UK. Handleman entered the UK market in 1999; we were told that because of Handleman’s close relationship with Wal-Mart in the USA, it was encouraged to enter the UK market to act as a distributor for Asda’s stores. Handleman’s role branched into distribution of children’s books as a merchandising wholesaler for the supermarket. However, Handleman told us that Asda had notified it in May 2007 that its business was being taken in-house, leaving Handleman without any book wholesaling business. It said that it would seek further supply contracts with supermarkets.

4.7 Several smaller trade wholesalers were also identified:

(a) The Eason’s group is involved in the wholesale, distribution and retail of newspapers, magazines, books, stationery and cards in the island of Ireland. It told us that it serviced about 1,000 customers with books throughout Northern Ireland and the Republic of Ireland. Eason’s Wholesale stocks about 60,000 titles. It also owns British Bookshops and Sussex Stationers, a chain of 52 bookshops in south-east England.

(b) Bookspeed is an Edinburgh-based book supplier operating throughout the UK. It supplies some 25,000 titles covering gift, heritage, ‘Mind, Body, Spirit’, and the ‘health and wellbeing’ genres. It told us it specialized particularly in supplying full-price books to visitor centres at heritage sites throughout the UK, and advised those sites on appropriate ranges.

(c) Advance Marketing (AMS) entered the UK market in 2003 and established Advance Marketing (UK) Limited, involved in both wholesale and distribution activities in the UK. Woolworths told us that AMS serviced approximately 2,500

customer locations, including Costco, as well as to garden centres, gift shops, department stores, grocery chains and speciality retail outlets. AMS filed for bankruptcy in the USA and certain assets, including Advance Marketing (UK) Limited and its holding company Advance Marketing (Europe) Limited, were sold to Baker & Taylor, a leading US book wholesaler, in March 2007. Separately, in April 2007, AMS's UK book distributors, Publishers Group UK and HI Marketing, were sold to private purchasers.[28]

(d) STL Distribution, a division of Send the Light Limited, is a wholesaler of religious books based in Carlisle, and offers around 40,000 Christian titles.

(e) The parties also referred to some wholesalers of children's books. Additionally some suppliers, who are often primarily retailers, specialize in supplying books to schools.

4.8 The only recent examples of entry into the provision of wholesaling were Handleman and AMS; Handleman has lost its contract to supply its only customer and AMS's UK operations have been sold. There has, however, been considerable consolidation and exit from the industry in recent years. Woolworths said that the following trade, merchandising and library wholesalers have exited the market during the last ten years:

(a) Barnicoats (a Cornwall-based wholesaler): ceased trading, Woolworths said that its infrastructure was subsequently acquired by Borders.

(b) Cork International (which focused on wholesaling and merchandising for supermarkets): ceased trading.

(c) Meresborough Books (a small wholesaler, whose main focus was on publishing and running two small bookshops): ceased trading.

(d) Heathcote Books: sold to THE.

(e) Morley Books, Greenhead Books, JMLS: became part of Cypher Group, which is now BLS.

(f) Canons: According to Woolworths, 'German wholesaler Libri supported the launch of a new UK wholesaler, Canons, in 2004 to offer academic and foreign language titles to UK booksellers … the venture failed within 12 months'.

Pricing in the supply of books

4.9 The pricing framework within which the book industry previously operated, in the form of the Net Book Agreement (NBA), was abolished in 1997. Until this time the NBA had required book retailers to sell books at the RRP shown on the publication. Since the abolition of the NBA, almost all books continue to show the RRP. This is set by publishers according to their judgement of what the market will bear. However, many books are now sold at retail at less than their RRP, and publishers will sometimes offer funding or additional discounts to encourage retailers to offer books at discounted prices.[29] Discounting from RRP by retailers is most common among front-

[28] Source: AMS website, www.advmkt.com.

[29] Publishers may provide promotional incentives to support discounted selling prices or three-for-two type offers at retailers. Wholesalers may also offer promotions on selected titles. These are usually offered pre-publication or for a period until shortly after the title has been released.

list books, but relatively rare among back-list books.[30] Policies on discounting varied between retailers, with some independent retailers discounting front-list stock in the same way as the chains, while other independent retailers, particularly specialists (shops specializing in particular genres of books), rarely discount. Supermarkets generally offer substantial discounts across their range, while Internet providers tend to offer higher discounts on front- than back-list titles.

4.10 Prices charged to wholesalers and retailers are typically expressed as a percentage discount off RRP. Thus, as a hypothetical example, for a book with a £10 RRP, a publisher might sell it to a wholesaler at 55 per cent discount, charging the wholesaler £4.50. The wholesaler might sell it to a retailer at 40 per cent discount, charging the retailer £6.00. The retailer can sell the book at any price up to £10. As each participant in the book supply chain only receives some fraction of the cover price of the book, any change in absolute discount rates has a multiplied impact on their gross margin. For example, if the wholesaler increased the discount rate from RRP offered to the retailer by 1 per cent, it would now sell the book to the retailer for £5.90. However, this 1 per cent change in discount rate increases the retailer's gross margin by 2.5 per cent, and decreases the wholesaler's gross margin by 6.67 per cent (ie a 10p reduction on a margin of £1.50). Consequently a 1 per cent change in the discount rate from RRP can have substantial implications for both the wholesaler's and the retailer's gross margins and the effects of the merger should be evaluated in the context of such changes in discount.

4.11 Woolworths told us that publishers tended to offer different discounts according to the retailer category or channel. It said that these rates tended to be applied regardless of the volume of orders and there was little or no opportunity to negotiate any discounts from these rates. It provided the estimates of channel discount rates shown in Table 5. Several sources told us that pricing by the major publishers tended to be clustered in a much tighter range than indicated in the table. We were told that educational titles received the lowest discounts, and this may be carried over to educational titles ordered by any of the channels, including wholesalers; hardback books may attract a slightly lower discount than paperbacks, and front-list titles may also attract a better discount rate than back-list titles. Discount book clubs are usually supplied by publishers; they tend not to list titles until a few months after release and may sell special editions or print-runs.

[30] There seems to be no standard definition of front-, mid- and back-list books. Bertram's Project Bodley Preliminary Information Memorandum (June 2006) defines back-list titles as generally having an established sales history, mid-list is described as well-known titles that do not require significant marketing spent, and front-list as titles that have been in publication for under three months. These are not therefore necessarily equivalent to the best-sellers. Other parties have defined front-list books as those published that calendar year, or published within the last 12 months. Apart from Bertram, we found that most parties did not distinguish between mid- and back-list books; Bertram said that the distinguishing factor with mid-list books was that despite not having been published recently, they were fast-moving and had a similar number of stock days as front-list titles.

TABLE 5 **Woolworths' estimate of typical discounts from publishers**

	Typical discount from RRP %
Educational suppliers	15–30
Library suppliers	35–45
Independent booksellers	35–45
Trade wholesalers	45–55
Chains	45–55
Internet retailers	50–60
Supermarkets	55–65
Discount clubs	65–80

Source: Woolworths estimates.

4.12 Publishers confirmed to us that channel pricing applied. Some publishers maintained that the different discount rates basically reflected differences in volumes and, to a lesser extent, the cost of distribution through different channels, and also reflected the commercial negotiating strength of each side.

4.13 Trade wholesalers usually purchase at a 45 to 55 per cent discount rate, and then sell books on to retail channels at a lower discount rate, in order to cover their own costs and earn a return. EUK, as a merchandising wholesaler, is able to purchase books for supermarkets from publishers at the discount rates applicable to supermarkets. Where THE was supplying supermarkets, it had had to purchase at trade wholesaler rates and then claim back the additional discount from publishers when it was able to prove that those books had been sold to supermarkets.

4.14 Within channel pricing, there can be additional promotions which improve discount rates; these may be conditional on the promotions being reflected in retail prices. For example, publishers may choose to offer certain new releases at higher discount rates, and retailers may be given funds to advertise titles or to promote them in-store, give them favourable display positions, include them in new release magazines and so on. There was some use of volume-related rebates by publishers but this was rare.

4.15 Retailers are typically offered a base rate of discount by wholesalers, of perhaps [✂] per cent. Retailers seek to negotiate better discount rates with wholesalers and so there is considerable variability in the rates that are achieved. Woolworths told us that as a general rule, high-volume business will attract higher discounts over time than sporadic, low-value retailer orders. There may also be volume-related incentives offered in the wholesaler's pricing structure.[31] There are usually minimum order values to qualify for free delivery. Retailers therefore often have an incentive to route as much of their wholesale purchasing as possible through a chosen primary wholesale supplier. In addition, retailers often maintain accounts with more than one wholesaler in case the primary supplier is unable to deliver an urgent order. It is common for retailers to enjoy substantially better terms from their primary wholesaler than those given by a secondary wholesaler; our analysis of pricing data provided by the three largest wholesalers found an average difference of two percentage points between terms for purchases from a primary wholesaler and a secondary wholesaler.

[31]For example, Bertram offers additional discounts of an extra [✂] per cent on orders above £[✂] at retail and [✂] per cent discount on orders above £[✂] at retail. In addition, customers may be eligible for retrospective rebates, which take the form of cash rebates made at the end of the year once a set level of orders has been made during the course of the year. These retrospective rebates are usually agreed following individual negotiations between wholesalers and retailers; Woolworths told us that Bertram Books made little use of these compared with other wholesalers.

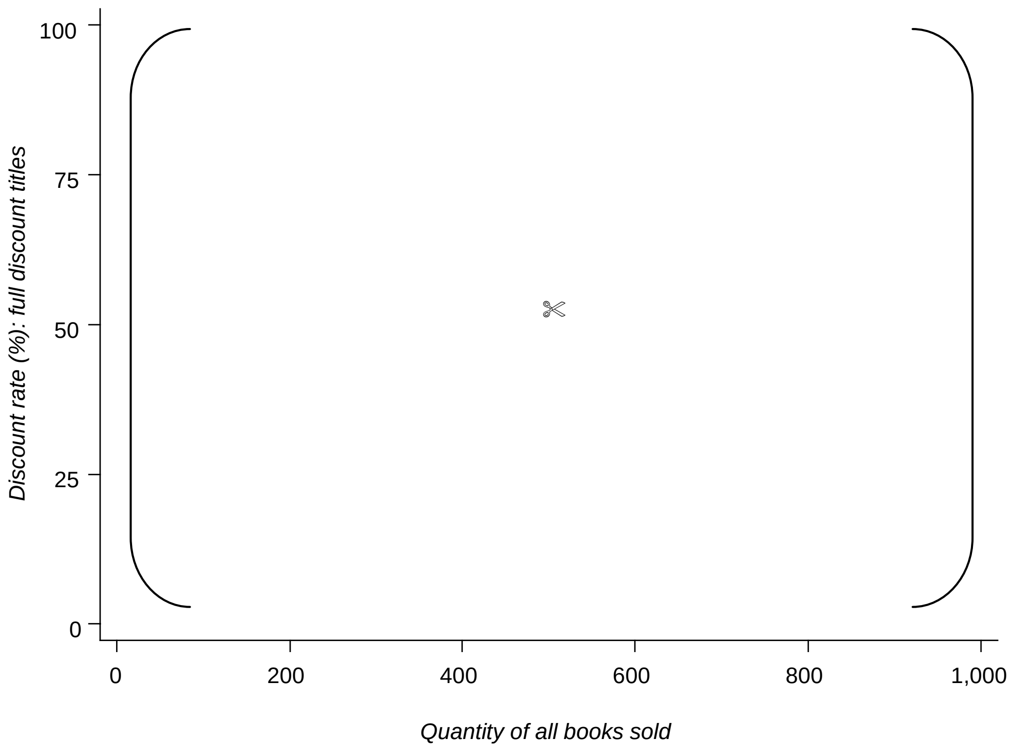
4.16 Different terms are offered by both Bertram Books and THE depending on whether their buying terms with the publisher are over [✂] per cent discount. If so, full stock terms (ie the usual discount rate) are offered. Stock titles where buying terms are less than [✂] per cent are offered at the customers' 'short discount terms' (a lower discount rate), and non-stock titles are offered at title-specific variable terms related to Bertram Books' buying discount.[32] As a general rule, short discount terms will usually reflect a [✂] per cent differential against Bertram Books' buying discount and non-stock items will reflect a [✂] per cent differential against Bertram Books' buying terms. THE's pricing system differs but has a similar outcome.

4.17 Additionally, wholesalers may offer promotional deals (sometimes with publisher support), mostly targeted at independent booksellers. This is usually formatted on the basis of extra margin, eg an extra [✂] per cent on base terms for new titles, Christmas catalogue titles or Back-to-School promotions. In 2006, Bertram Books ran [✂] separate promotional offers to customers.

4.18 Figure 4 shows Bertram Books' realized full stock discount rates for retailers that purchased less than 1,000 books in the first quarter 2007. This figure indicates that retailers ordering a larger number of books tend to obtain higher discount rates. Differences in realized discount rates will arise from differences in the extent to which retailers took advantage of promotions and special offers; however, a large proportion of variation in discount rates remains unexplained by differences in order sizes.

FIGURE 4

Bertram: discount rates and volume sales in Q1 2007



Source: Bertram, CC calculations.

[32]Woolworths said that short discount titles made up [✂] per cent of Bertram Books' range, and about [✂] per cent of THE's range. However, sales are much more biased to full discount books.

4.19 Bertram and THE said that it was not their practice to decrease discount rates agreed with retailers. Representatives from Bertram, EUK and THE told us in the course of hearings that discount rates would not be reduced, or only in exceptional circumstances such as if there were concerns about a retailer's credit worthiness. We were told that customers would consider it unacceptable for a wholesaler to cut agreed discount rates and such an action would result in the permanent loss of the retailer's account to a wholesaler. We were also told that these companies had not cut their discount rates to customers; rather that discount rates would be maintained and if changed they would only increase over time.

4.20 However, using account level data provided by the parties, we identified a number of occasions where there were substantial reductions in achieved discount rates to independent retailers; while these results could reflect the mix of titles being purchased and the extent to which a retailer takes advantage of generally available promotions, the changes appeared in several cases to be sizeable and sustained. We also heard from other sources that it was general industry practice to manage discount rates up and down. We put these reductions for THE and Bertram to Woolworths asking for an explanation of these apparent movements.

4.21 Subsequently, Bertram presented an analysis of its discount revisions made during 2006. It identified [✄] cases out of [✄] discount rate changes (on some 1,200 accounts) as discount reductions, ie increases in price, in 2006 (and [✄] discount reductions out of [✄] discount rate changes between 2005 and mid-2007). Woolworths said that these reductions related to:

(a) instances where independents switched very large identifiable proportions of their business to other suppliers (and where the Bertram sales team was unable to induce the independent to keep those volumes with Bertram in return for better discounts);

(b) where the retailer had closed an account (yet continued to trade with Bertram from time to time);

(c) where customers were offered higher discounts in return for increased purchases, but where the increase in purchases did not materialize; or

(d) adjustments back to standard terms where rates were temporarily improved for a particular period (such as for a book fair).

4.22 THE told us that the small number of specific cases identified by the CC where rates had apparently been subject to significant falls related to changes in the retailer's circumstances such as changes in store ownership (coupled with a decision by the new retailer not to use THE as its primary supplier) or small-chain retailers re-locating or closing one of their stores.

4.23 Taking into account all the analysis and explanations we concluded that the clear statements made to us by the parties were at variance with subsequent evidence. There were indications of active account management, particularly by Bertram, for example through offering temporary discount rate adjustments and incentives to increase sales. While these changes in discount were based on normal business reasons, they contradicted the arguments that any reductions were impossible. The implication from the hearings that a further constraint existed on their ability to raise prices following the merger was therefore not accepted. We drew our serious concerns about the misleading nature of the statements made to us to the attention of the parties and their advisers.

4.24 We were told that in general, direct supply, particularly of front-list titles, usually carries a more favourable discount rate than supply from wholesalers, but these differences depend on the specific terms that a retailer has been able to negotiate with wholesalers and publishers. Woolworths said that currently, discounts offered by publishers were, on average, approximately 5 per cent higher than those offered by wholesalers. Independent bookstores may also achieve higher discounts from publishers through membership of buying groups (see paragraph 7.63), which seek to negotiate extra discounts, possibly on condition of purchasing a minimum number of copies of selected titles in a given period and agreeing to promote them. Such schemes have been supported by some publishers and wholesalers.

Competition in the supply of books to retailers

4.25 Wholesalers and distributors compete across a range of competitive factors: price; the range of books listed; and service elements such as speed of delivery, accuracy of order picking, proportion of books in stock, customer support, opening hours, the provision of returns policies and stock management and ordering systems, etc. In this section we consider evidence on which factors customers rate as important. We then address how customers choose between direct supply or supply through a wholesaler, and look at the nature and intensity of existing competition between wholesalers.

4.26 Woolworths reported results of a 2006 survey of Bertram Books' customers which asked them to rate which of three factors was most important to them in terms of purchasing books. The responses were: price, 29 per cent; range, 31 per cent; service, 37 per cent; and 'other', 2 per cent. The results may be somewhat biased to price-sensitive customers as they were offered a price inducement to respond, but it suggests that all these elements are significant.

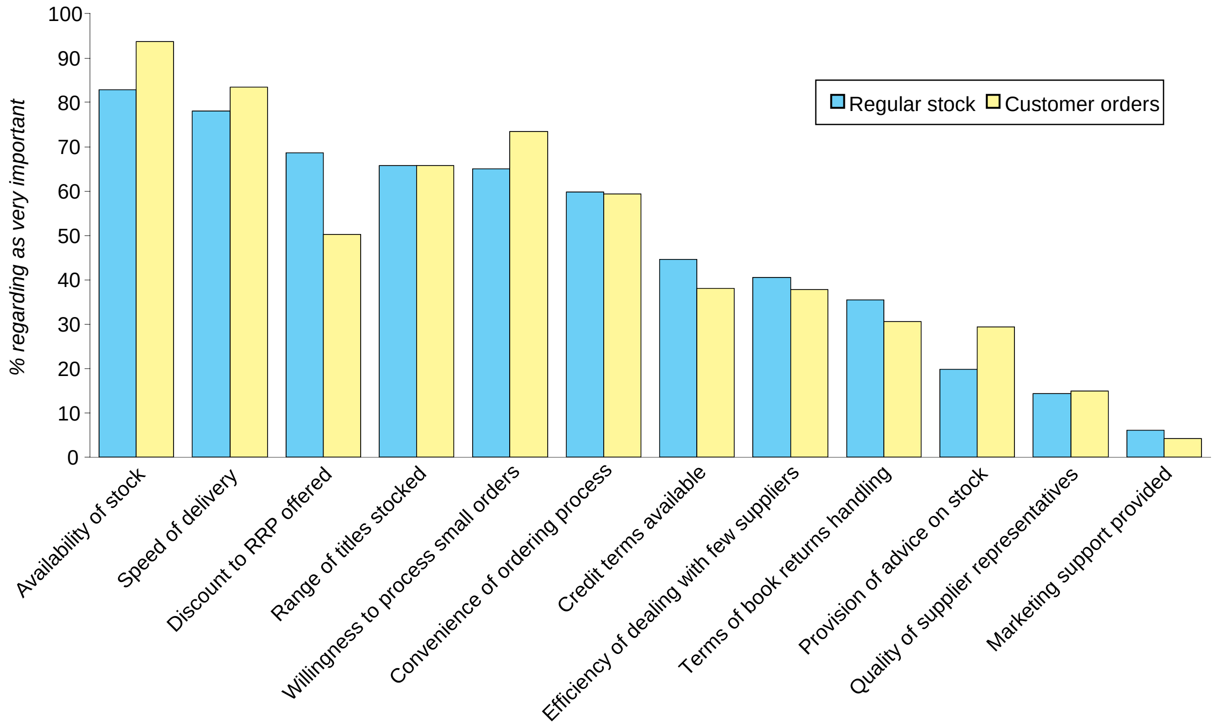
4.27 The CC commissioned market research agency ORC International to conduct a survey within the independent retail bookseller sector (the ORC survey). The overall aim of the survey was to gather information on the behaviours and perceptions of independent book retailers with regard to their purchase of books. The survey fieldwork was carried out during May 2007. Invitations to participate were sent to a structured sample of 2,000 retailers; 275 completed paper questionnaires and online responses were received. The sample was structured so as to be broadly representative of the UK independent book retailing sector[33] by retailer size and region, though fewer responses were received from customers of wholesale supplier Gardners than might have been expected from its market share. The analysis of responses to the ORC survey has been published on our website.

4.28 In the ORC survey, we asked respondents how important they considered various aspects of supply to be. Results are shown in Figure 5 for the proportions of respondents who rated any factor as very important (rather than somewhat important or unimportant). The respondents were asked to distinguish between orders for regular stock, and purchases to meet specific customer orders.

[33]Chains, Internet-only retailers and supermarkets were excluded from the sample, but retailers whose primary business was not necessarily book selling were included.

FIGURE 5

Percentage of respondents who rated a factor of service as very important



Source: ORC survey.
Note: Each proportion is based upon the number of respondents who rated the factor. This ranges from 187 to 250.

4.29 'Availability of stock' and 'speed of delivery' are regarded as the most important factors in choosing a supplier, for both types of order. 'Discount to RRP' is more important in choosing a supplier for regular stocking than for fulfilling an individual customer order. Conversely, 'willingness to process small orders' is more important in choosing a supplier for fulfilling a bookshop customer order than for regular stocking.

4.30 For regular stock ordering, on average, book retailers whose primary supplier was a publisher attached less importance to the 'convenience of the ordering process', the 'efficiency inherent in dealing with few suppliers', 'range of titles', 'speed of delivery' and the 'terms for book returns handling'.

4.31 Some of the retailers surveyed had a very small turnover of books, suggesting that books were only a small sideline to their main business. We therefore investigated whether there were differences in responses according to the retailer's turnover, and some differences were identified in the responses to questions based on retailer size. This is seen most strongly in their views on 'willingness to process small orders'. 83 per cent of the retailers with total expenditure on books in 2006 of less than £1,000 rated this very important, compared with only 44 per cent of those with expenditure over £65,000. There is some evidence that a higher proportion of small retailers also consider 'efficiency of dealing with few suppliers' very important.[34]

4.32 There are similar significant differences between small and large retailers with regard to the importance of different factors for customer order. The survey provides strong

[34]Statistically significant difference at a 5 per cent confidence level.

evidence that a higher proportion of small retailers consider both 'willingness to process small orders' and 'efficiency of dealing with few suppliers' very important.[35] There is also moderate evidence that a higher proportion of small retailers also consider 'quality of supplier representatives' very important.[36]

Competition between wholesalers and direct supply

4.33 We now consider the extent to which retailers source books from wholesalers and direct supply, and the extent to which there is competition between these two sources. Whilst the great majority of books are supplied direct to retailers by publishers and distributors rather than wholesalers, independent retailers tend to make the greatest use of wholesalers. We therefore looked at evidence on multi-sourcing by retailers, especially independents.

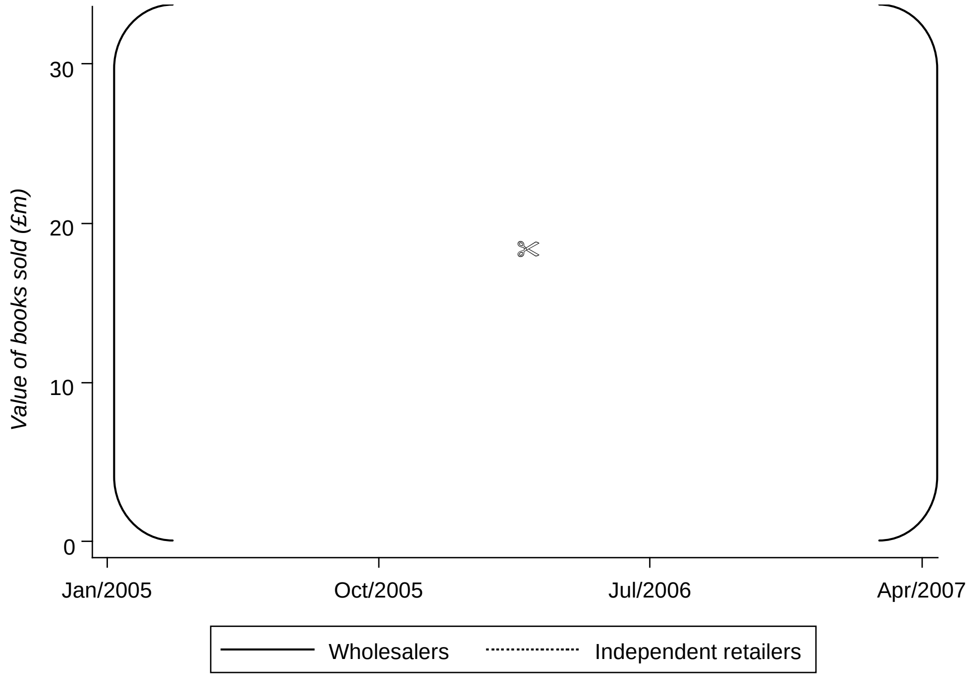
4.34 Some retailers, particularly the large chain retailers, told us that they sourced most of their supply directly from publishers and distributors. However, many of the independent retailers we spoke to told us that they would only purchase from publishers under certain circumstances (see paragraph 7.28), and others said that they deliberately chose to deal solely with wholesalers, unless a title was only available from the publishers or their distributors.

4.35 We obtained data from TNS showing book sales (at realized prices) through independent retailers, and we compared this to sales to independent retailers drawn from Bertram Books, Gardners and THE.[37] This is shown in Figure 6. The gap between the two lines represents direct supply and sales by wholesalers other than these three. It shows that on average, independent retailers purchase just under half their books from wholesalers, with a marked increase in the proportion coming from direct supply in the months running up to Christmas. The proportion of independent retailers' purchases drawn from the three largest trade wholesalers is shown in Table 6. This indicates that these three wholesalers account for just under half ([✂] per cent) of all purchases over a year. However, the proportion sourced from these wholesalers dips in November and December, falling below 40 per cent. These two months have the highest retail sales rates through independents, each exceeding 10 per cent of the yearly total.

[35]Statistically significant difference at a 1 per cent confidence level.
[36]Statistically significant difference at a 5 per cent confidence level.
[37]While this comparison excludes smaller wholesalers, we believe their share of supply to be small.

FIGURE 6

Monthly value of book sales through independent retailers and their purchases from wholesalers



Source: Bertram, THE, Gardners, TNS, CC calculations.
Note: Sales by wholesalers include sales by Bertram, THE and Gardners only. Wholesalers' sales are measured in terms of RRP. Retailers' sales are measured in terms of values of actual sales.

TABLE 6 **Proportion of total sales by independent retailers sourced from wholesalers, 2006**

per cent

Month	*Proportion of annual total supply from the three wholesalers*	*Proportion of annual total supply from the direct supply and small wholesalers*	*Supply from the three wholesalers as a percentage of total for that month*	*Proportion of annual sales by independent retailers made in each month*
January				
February				
March				
April				
May				
June				
July				
August				
September				
October				
November				
December				
Total				100.0

Source: Bertram, THE, Gardners, TNS, CC calculation.

4.36 Woolworths reported results drawn from a survey of Bertram Book customers conducted in January 2006.[38] Woolworths said that the Bertram survey found that:

(a) for at least [✂] per cent of independent retailers for whom Bertram Books is the primary wholesaler, direct supply provides the second largest source of supply;

(b) in the Bertram survey of its customers (where it would be expected that Bertram Books is more often the main supplier), a distributor/publisher was the main supplier on [✂] per cent of occasions above THE and Gardners (at [✂] per cent each; Woolworths also remarked that these figures referred to a single distributor/publisher, while cumulatively across all such suppliers, their importance as main supplier would be higher); and

(c) 56 per cent of independent retailers use at least three suppliers, at least one of which is a distributor/publisher.

4.37 In the ORC survey, we asked respondents what proportion of their expenditure was with the largest single supplier, out of Bertram Books, Gardners, THE, other wholesalers, publishers/distributors, and other sources. It was found that 60 respondents out of 244 (25 per cent) spent at least 95 per cent of their expenditure with a single supplier or group of suppliers (all the distributors were aggregated as one option, and so there could have been multiple sourcing from different primary suppliers). Others multi-sourced to a greater degree, with a few respondents reporting that their primary supplier accounted for under 30 per cent of their total expenditure. As the survey included non-specialist retailers (such as newsagents and garden centres), the turnover attributable to books was low for some respondents. There were differences in the broad overall pattern of sources used depending on turnover, as follows:

(a) the largest retailers (which will include most or all of the independent specialist bookshops) are the most likely group to use publishers as their primary suppliers;

(b) medium-sized retailers tend to multi-source, using a wholesaler as their primary supplier; and

(c) the smallest retailers (for whom we expect sales of books is unlikely to be their main business) tend to single-source from one wholesaler as their primary supplier.[39]

4.38 In the ORC survey, we examined the shares of expenditure respondents placed with their primary supplier, and the second choice supplier. The results indicate from where respondents to the survey chose to multi-source. Table 7 covers those respondents who multi-source, and who have a wholesaler as primary supplier. The results are weighted by 2006 expenditure. The samples of retailers were not designed to be representative of the overall market (they were chosen to ensure that we could test for differences between sizes and types of retailer), and responses

[38] All Bertram customers were invited to respond and were offered 5 per cent off their next order. This may lead to a bias towards price-sensitive customers ([✂]). Woolworths argued that the survey was likely to *understate* the use of direct supply as those most likely to have responded to the survey would have sourced a large share of their requirements from Bertram due to the financial incentive offered. Bertram customers may not be representative of the broader market—the ORC survey indicated that those retailers using Bertram as primary supplier were, on average, smaller (by total expenditure) than those using any other primary source. The Bertram 2006 customer survey may therefore over-represent small retailers, whilst the ORC survey used a sampling approach that under-represented small retailers. We also noted that the responses to the Bertram survey were not anonymous.

[39] The mean 2006 expenditure for the 'Multi-source: wholesaler is primary supplier' category is about £30,500; the mean for the 'Single source: wholesaler is primary supplier' category is about £5,000.

from customers whose primary supplier is Gardners are under-represented. Wholesalers were the secondary book supplier for retailers representing around 62 per cent of expenditure in the survey sample. Publishers/distributors were the secondary option for 34 per cent of the sample by value.

TABLE 7 **Value of business placed with secondary suppliers for all multi-sourcing retailers with a wholesaler primary supplier in the ORC survey**

£*

	Primary book supplier				
Secondary book supplier	*Bertram*	*Gardners*	*THE*	*Other wholesalers*	*Total*
Bertram	-	465,200	1,495,100	1,011,700	2,972,000
Gardners	1,847,500	-	372,400	140,000	2,359,800
THE	655,600	259,200	-	170,000	1,084,800
Other wholesalers	325,900	274,000	153,600	-	753,500
Publishers/distributors	1,715,100	385,100	896,000	953,100	3,949,300
Other sources	190,500	44,800	201,000	21,200	457,400
Total	4,734,600	1,428,200	3,118,000	2,296,000	11,576,800

Source: CC analysis of ORC survey.

*Results weighted by total expenditure in 2006.

4.39 Woolworths argued that as multi-sourcing was widespread, retailers must regard wholesalers and direct supply as alternative sources of supply. Woolworths concluded from this that the different sources were in competition. We found that multi-sourcing was common. However, these results are not necessarily indicative of the closeness of competition between the two, for example the secondary supplier may be serving a different function from the primary supplier, such as filling the gaps in range that the primary supplier could not meet. Accordingly the secondary supplier need not necessarily be the next best alternative as the primary supplier and vice versa.

4.40 We therefore looked at the factors that could influence a retailer’s choice of source of supply and whether this varied for different types of books or circumstances of purchase.

4.41 Various retailers identified a number of factors which could impact on their sourcing decision:

(a) First in favour of publishers:

- publishers often offer slightly better discount rates than wholesalers, particularly on front-list stock;
- publishers are more likely to promote front-list stock than wholesalers, making discount rates on these titles more attractive;
- publishers usually offer more generous returns allowances than wholesalers; and
- publishers are more likely than wholesalers to be able to arrange certain promotional activities, such as in-store author signings.

(b) On the other hand, the following aspects may favour wholesalers:

- All wholesalers offer next-day delivery throughout most of the mainland UK. Independent retailers told us that next-day delivery is particularly important for customer orders and enhances the independent bookseller’s reputation for service. However, we were told that distributors varied greatly in their speed of service, but that the service had in many cases improved markedly in recent years, some offering 48-hour or even next-day delivery, while many could take considerably longer. There were concerns over service levels offered by some of the distributors, such as with the accuracy of order fulfilment.

- While publishers and wholesalers both tend to require minimum order values (or suffer a financial penalty, and we were told that some distributors may delay dispatch on small orders, although sometimes minimum order requirements can be waived), there is more freedom to construct a qualifying order from a wholesaler as the retailer is not confined to a single publisher's products.[40]

- Dealing with multiple publishers requires setting up accounts and negotiating discount terms with multiple publishers, placing different orders, receiving and checking multiple deliveries, paying different invoices and handling differing returns procedures. Consequently, independent retailers told us that it was easier to deal with wholesalers than publishers. Ordering through wholesalers simplifies administration and ordering, and returns may be simpler to manage if they are sent back to one wholesaler rather than many different publishers.

- Wholesalers claimed that they would seek to support retailers who were starting up, whereas publishers might be reluctant to grant any credit until the retailer had at least six months' track record, although Bertram also reported survey evidence finding that the great majority of newly-established bookshops sourced at least some of their suppliers from publishers and distributors. Wholesalers are also seen to provide support for retailers such as in advising on range, providing publicity material, and providing hosting services for smaller and niche booksellers to have an Internet presence.

4.42 Retailers told us that publishers were relatively more attractive as a source of supply for front-list than back-list orders, particularly for orders placed before publication, because of the relative price advantage and promotional support they offered. Also such orders were often for multiple copies which would meet minimum order thresholds, and ordering in advance renders slower delivery times less important. In contrast, we heard that wholesalers were the preferred source in many cases for mid- and back-list orders because of the speed of service, simplicity of ordering and processing deliveries, and the ease of meeting minimum order thresholds. These generalizations did not always apply; some independent retailers told us that they were able to use direct supply for most of their needs. Some retailers told us that they found it more convenient to order front-list titles from wholesalers even if there was a small financial penalty compared with direct supply; others may also add front-list books to a wholesaler order in order to reach the minimum order threshold for free carriage.

4.43 In the ORC survey, we asked retailers what they would do if their primary supplier could not supply a title in time for when a customer needed it. Of those who indicated a plausible diversion option, 79 per cent of those who used a wholesaler as their primary supplier would seek to use another wholesaler instead, compared with 21 per cent who would go to the publisher. This indicates that retailers have a preference for wholesalers for certain functions, although it does not necessarily indicate that publishers are not a realistic alternative. However, there were some

[40]Although we were told that where distributors served several publishers, books from each publisher could count towards the minimum order value rather than being applied separately for each publisher.

inconsistencies and uncertainties in the pattern of response to the survey diversion question (for example, in that some respondents gave the same supplier as both their primary source and their first diversion option) so the analysis can only be indicative.

4.44 Documents prepared to support the sale of Bertram[41] indicate that wholesalers recognize that they face differing competitive pressures from publishers for front-list compared with mid- and back-list titles, and Bertram's figures indicate that it primarily stocks non-front-list titles.[42] Front-list titles appear to account for a large proportion of total retail book sales. Data from Nielsen BookScan reports that in 2006 45.3 per cent of sales by value and 47.2 per cent of sales by quantity of books were front-list (where front-list is defined as published in the year being analysed, and so is a broader classification than that reported by Bertram and THE) but only 12.5 per cent by number of titles sold (measured by ISBN[43] count) were front-list. In 2006, over a third ([✂] per cent) of Bertram's total sales by value were front-list (with a further [✂] per cent defined by Bertram as mid-list), and over half ([✂] per cent) of THE's total sales were front-list. The parties gave evidence that the average length of time they held a book in stock was shorter for front-list and mid-list titles than back-list titles.

4.45 Woolworths argued that customers purchased from publishers in all categories of sales. It submitted evidence drawn from a survey of Bertram Books' customers in April 2007, where they were asked what type of books they purchase from their suppliers. Of the [✂] independent retailers who responded, [✂] used distributors; of these, nearly [✂] bought a full range of titles (front-list, mid-list and back-list) from publishers, and a further [✂] per cent bought two of the three categories (ie front-list/back-list and mid-list/back-list). [✂] sourced only front-list titles from publishers. However, these results are not weighted for value and so may reflect isolated purchases, for example where wholesalers do not hold stock.

4.46 There are technological solutions available to retailers to reduce the complexity of dealing with multiple publishers (see paragraph 2.33); these are described in Appendix C. These can simplify ordering and administration, although they do not address all the concerns, for example on the need to negotiate terms with publishers individually.

4.47 Publishers will market their books through a variety of means. The larger ones will generally employ representatives who may call on the larger bookshops. Penguin, for example, has a sales force dedicated to the independent bookshop sector and a separate sales force managing bookstore accounts at a national level. Representatives will discuss forthcoming titles, make point-of-sale or other marketing material available, arrange author signings in some cases and take orders from the bookshop. We have been told that publishers employ fewer representatives than in the past. In addition, publishers will advertise new publications in the trade and consumer press. Publishers may further promote their books by funding three-for-two offers and, in the case of the chains, funding other promotion activities which may secure a title a prominent position in the bookstore.

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[41] Project Bodley Information Memorandum.
[42] The Project Bodley documents state on the proportions of titles stocked by Bertram 'The majority of Bertram Books sales are of titles from the "back-list" (i.e. books previously published with an established sales history, [✂] per cent of titles) and "mid-list" (i.e. well-known titles that do not require significant marketing spent, 10% of titles). The remaining stock consists of "front-list" titles, which are generally sold to large retailers by publishers direct.' By its definitions, front-list does not necessarily represent all recent releases; the document states: 'c. [✂] per cent of new books published each year, are front-list titles (i.e. latest best-sellers) and the remaining mid-list and back-list (Bertram Group's core market)'. Woolworths told us that it and Bertram did not consider these definitions of front-list, mid-list and back-list to be accurate.
[43] An ISBN is a unique identifying number assigned to a particular edition of a title.

Competition between the wholesalers

4.48 We found that Bertram Books, Gardners and THE all offered a similar range of services. We heard from many retailers who had widely varying perceptions of the strengths and weaknesses of each of the wholesalers, and the lack of consistency across retailers suggested that their perceptions were heavily shaped by other factors such as personal relations with representatives of the businesses. However, there are substantial differences between the wholesalers in the number of titles stocked, and the number of titles available to order, as shown in Table 8. In the ORC survey, range of titles stocked was rated as very important by 66 per cent of respondents for both regular stock and for meeting customer orders (availability of that stock was rated as the most important factor, with 83 per cent saying that it was very important for regular stock, and 94 per cent for customer orders—see Figure 5).

TABLE 8 **Ranges of books stocked and listed by Bertram, Gardners and THE**

number of titles

	Range of books stocked	*Range of books listed*
Bertram Books	210,000	532,000
Gardners	325,000	730,000
THE	80,000	110,000

Source: Bertram, Gardners, THE.

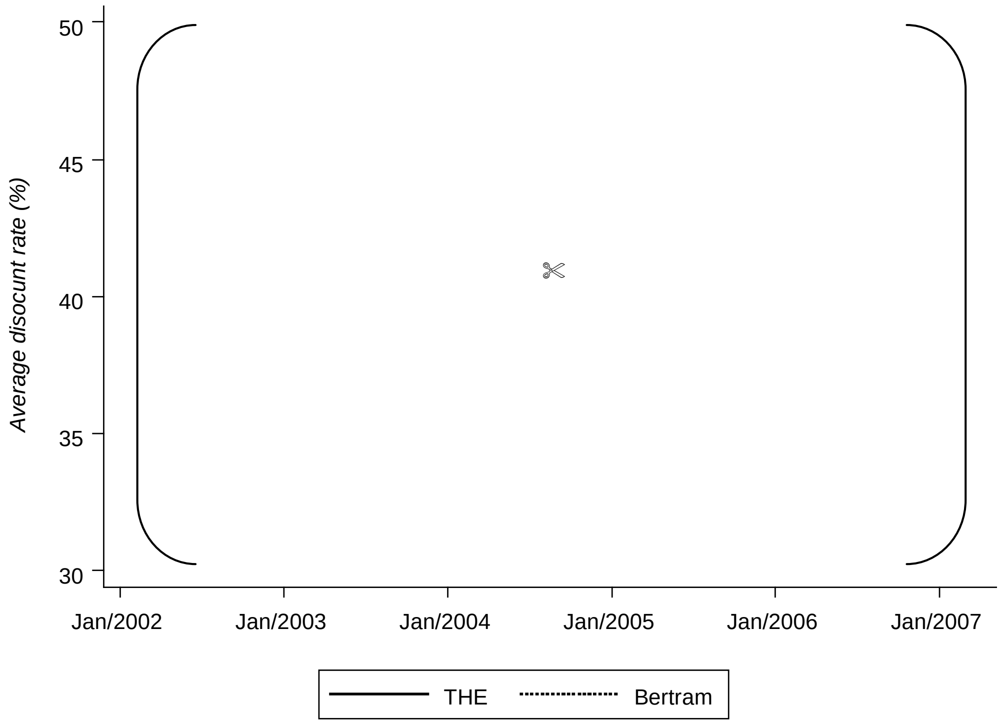
4.49 The three main trade wholesalers compete on elements of service; they offer similar services to retailers through providing ordering and stock control systems (see paragraph 2.32), they provide advice on titles to stock, and offer book news, reviews and recommendations.[44] The wholesalers make differing use of representatives to visit retailers; we heard that THE employs only [✄] representatives ([✄] of whom also have wider management roles) through the UK, whereas Bertram has reduced its number of representatives to just [✄].

4.50 We were told that the three largest trade wholesalers did not appear to have markedly different approaches to pricing, price levels and promotions. We examined average discount rates for Bertram Books and THE between 2002 and 2007—see Figure 7. There was an increase in average discount rates of some [✄] per cent over the period. Generally the average rates for Bertram and THE were remarkably similar with no substantial deviations between their rates. Average RRPs have been increasing in recent years (see paragraph 2.2), and consequently increased average discount rates may have been partially offset in terms of wholesalers' revenue per book.

[44] *Bertram's Buyers Notes*, for example, is a 400-page publication with descriptions of titles, in some cases a synopsis and in all cases a star rating from ***** ('Superseller') to * (basic stock). Each month it lists titles which its reviewers believe have strong sales potential for independent booksellers and on which it offers up to a 50 per cent discount. Gardners produces a similar publication. Like Bertram it selects a short selection of titles each month that is offered at a deep discount to independent bookseller. Its highest discount is 55 per cent. Forthcoming titles are described and given a star rating.

FIGURE 7

Bertram, THE: average discount rates over time



Source: Bertram, THE, CC calculations.

4.51 Woolworths submitted data showing wins and losses of accounts, and where known the extent to which these were from, or went to, either of the two other main wholesalers, from 2004 to 2007. It acknowledged certain problems with this as, in general, there are no formal contracts between retailers and wholesalers, and retailers often hold multiple accounts with wholesalers in case of a need to source titles unavailable at their primary source. Therefore customers tend to shift the bulk of their orders rather than switching all orders completely, and so it is unusual for accounts to be closed. Nonetheless, the parties' switching analysis found the following price changes induced account closures:

(a) of the [✂] accounts lost by Bertram to another wholesaler [✂], where information is available, customers were offered increased discounts of [✂] percentage points on average;

(b) of the [✂] accounts won by Bertram because of [✂], the average increase in discount was [✂] percentage points; and

(c) on average, Bertram had to offer [✂].

4.52 Woolworths argued that this was evidence of high price sensitivity. However, the number of instances quoted is small in relation to the total number of open accounts and the years covered. The absolute size of the price adjustments appear to be significant relative to the typical spread of discount rates achieved by retailers—see Figure 4). This may be because retailers will rarely choose to close an account rather than adjust the level of use of different accounts. In paragraph 4.19 we found that there were [✂] changes in discount terms in 2006 on Bertram accounts, including multiple revisions to some accounts. Woolworths explained that this was largely driven by changes in sales volumes (or the lack of achievement of sales objectives) but we think that this is consistent with some active account management which could be more suggestive of price-sensitive customers.

4.53 Woolworths told us in hearings that the costs and margins in this industry were such that it encouraged wholesalers to seek to maximize sales in order to cover fixed costs. However, data submitted in support of a critical-loss analysis (see paragraph 7.10) indicated that the great majority of costs were variable, comprising particularly the cost of purchasing the books, warehouse labour and distribution costs. Fixed costs—such as the warehouse, packing lines, IT systems, heat and lighting, administrative and supervisory staff etc—accounted for a relatively small proportion of costs. Therefore, any reduction in sales volumes suffered by wholesalers will to a considerable extent be offset by variable cost reductions.

4.54 Woolworths argued that Gardners was much more relevant than THE as a competitive constraint on Bertram Books. It said that this was because THE's limited range made it less attractive to retailers.

4.55 The win-loss analysis referred to in paragraph 4.51 indicated that where Bertram Books lost an account, it was in around [✂] of cases to Gardners and only [✂] to THE, and where it won business it was [✂] as likely to be from Gardners as from THE. Where THE won accounts, these were primarily won from [✂]; of those lost, they were most likely to go to [✂]. Therefore Woolworths argued that Bertram Books was primarily competing with Gardners rather than THE. It also claimed that THE was competing equally with Gardners and Bertram Books.

4.56 Respondents to the Bertram (2006) survey were also asked where, apart from their main supplier, they were most likely to source supplies from. Gardners was three times as likely as THE to be named as the secondary supplier, where the primary supplier was Bertram Books. However, we matched up customers' purchases from sales records provided by the three largest wholesalers, and analysed patterns of purchases from primary and secondary wholesalers. This showed that for retailers whose primary wholesale supplier was Bertram, [✂] per cent of secondary spend was with Gardners and [✂] per cent with THE. For retailers whose primary wholesale supplier was Gardners, [✂] per cent of expenditure through the two secondary wholesalers was with Bertram and [✂] per cent with THE. This indicates that a sizeable minority used THE as a secondary wholesaler despite its narrower range.

4.57 We were told by some retailers that THE was perfectly adequate as a primary supplier, provided a broad-range wholesaler was available as a secondary supplier. We note that THE had an [✂] per cent share of supply through wholesalers (excluding supermarkets) in 2006—see Table 10. Therefore we think that THE was an active competitor both as a primary and secondary wholesale supplier, notwithstanding the fact that its more limited range may have harmed its attractiveness to some retailers.

4.58 There appear to be few barriers to retailers switching between different wholesalers. Our discussions with retailers suggested that many retailers place considerable importance on the relationships they have built up with wholesalers over time, and while many attributed high levels of customer service, stock availability and range, or speed of supply to their own supplier, this was attributed to all the wholesalers by different retailers. Consequently there appears to be a degree of inertia among retailers meaning that some at least are reluctant to change wholesalers.

4.59 Retailers may be able to negotiate improved discounts with wholesalers over time, but it appeared that other wholesalers were also willing to make competitive offers to achieve primary supplier status. Retailers could continue to use stock control and ordering systems provided by a different wholesaler if they switched primary wholesaler. Some retailers felt that they may receive a lower level of support for these systems, and if a retailer were to move to a different system they would need to re-train and possibly re-enter all stock details. Nonetheless we found many instances of retailers successfully moving between wholesalers, but equally many retailers had stayed with the same primary retailer for many years. There have been changes in market share between the three largest trade wholesalers. Sales to independent retailers between 2005 and 2006 declined by [✂] per cent for Bertram and [✂] per cent for THE, but during the same period sales by Gardners increased by [✂] per cent (see Appendix E).

4.60 So far we have concentrated on competition between wholesalers to serve independent book retailers. Other channels may differ; for example, large Internet retailers may change between different suppliers based on prices and availability. The chains may adopt a more formal tendering process for wholesalers to gain the status of primary wholesale supplier. Retailers who specialize in products other than books may source from wholesalers or direct from publishers who particularly serve that line of business. Many such retailers will require a simple range of titles and these requirements can sometimes be met by a category merchandiser.

Competition in the wholesale supply of books to libraries

4.61 Library wholesaling is the provision of books and bespoke services to public libraries and academic libraries and institutions. The parties told us that virtually all sales of books to public libraries occur through such wholesalers, as do the majority of books to academic libraries. Schools (or specialist academic book suppliers) may use wholesalers but many or most of their book requirements will be acquired by other means (for example, through specialist academic and other bookshops).

4.62 BLS supplies mostly public libraries (which account for about [✂] per cent of its business[45]), with a few sales (about £[✂]) to schools and academic institutions. Apart from BLS, major library suppliers are listed in paragraphs 4.64 and 4.65. Woolworths told us that THE supplied no books (other than some audio books[46]) to public libraries, but it sold around £[✂] to specialist academic book suppliers (ie school suppliers) in 2006.

4.63 Wholesalers tend to split between those specializing in supplying public libraries and those supplying academic libraries (where the volume of purchases of any one title tend to be very much smaller).

4.64 Public library suppliers include Askews Library Services, Holt Jackson, and Browns Books (Browns). All serve public libraries, schools, academic institutions, and the business community throughout the UK, and abroad, and provide a range of services including sourcing, selection support, cataloguing, shelf-ready processing, and promotional support for their customers. Browns is a sister company of Gardners, from whom it obtains its library book requirements. Lindsay & Croft is a UK subsidiary within the YBP Library Services group of US book wholesaler, Baker & Taylor. Some suppliers specialize in particular genres, for example Peters in children's books.

4.65 The following suppliers specialize in serving academic libraries:

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[45][✂] per cent of BLS's customers are library buying consortia which purchase on behalf of several local authorities, with the remainder being authorities purchasing books for their own public libraries.
[46]Amounting to around £[✂] in sales last year. THE also sold some books to Askews, Dawsons and Coutts, which are library wholesalers themselves, amounting to about £[✂].

(a) Dawson Books is regarded by Woolworths as the lead player in serving academic libraries and institutions around the world.

(b) Coutts also has a strong reputation for academic library supply. In December 2006, Coutts Information Services was purchased by Ingram Industries Inc (the global wholesale book distributor). Like Dawsons, some of its customers are retailers, such as academic bookshops.

(c) Blackwell Book Services (BBS) supplies public, academic, and research libraries both in the UK and throughout the world (although Woolworths did not believe it serviced many, if any, public libraries in the UK).

4.66 Several library suppliers have gone out of business in the last three years. Farries (a library book-supply business based in Dumfries) ceased trading, and Books for Students (an academic and library wholesaler) was sold to Browns Books.

4.67 The parties presented estimates of the market shares of wholesalers who supply books to libraries (this being public libraries, academic libraries, schools and other academic institutions) in the UK for the last three years by volume and value, calculated on the basis of Loughborough University (Library and Information Statistics Unit) data and BLS sales data and parties' estimates—see Table 9. A significant share was attributed to publishers' direct supply but as no parties considered this to be a viable option for most library purchasing, we have excluded this from the table below. Schools often use retailers to source books.

TABLE 9 **Shares for the supply of books to libraries (including public libraries and academic libraries/ institutions)**

per cent

	Volume (units)			*Value (£m)*		
	2003/04	*2004/05*	*2005/06*	*2003/04*	*2004/05*	*2005/06*
Peters	5–10	5–10	5–10	0–5	5–10	0–5
Books for Students	5–10	0–5	0–5	0–5	0–5	0–5
BLS	10–15	10–15	10–15	5–10	5–10	10–15
Coutts	0–5	0–5	0–5	5–10	5–10	5–10
Dawsons	5–10	5–10	5–10	15–20	15–20	15–20
Blackwells	0–5	0–5	0–5	0–5	0–5	0–5
Holt Jackson	10–15	5–10	10–15	5–10	5–10	5–10
Askews	10–15	10–15	10–15	10–15	10–15	5–10
Browns	0–5	0–5	0–5	0–5	0–5	0–5
Book Clubs	10–15	10–15	10–15	10–15	10–15	10–15
Retailers	15–20	15–20	15–20	15–20	15–20	15–20
Other wholesalers*	5–10	5–10	5–10	5–10	5–10	5–10
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: CC analysis of Woolworths' data.

*Other wholesalers includes THE's supply of books to school suppliers.

Purchasing

4.68 The supply of books to UK public libraries is governed by a regulated tender process. At the beginning of that process a local authority will stipulate clearly the extensive range of book processing and added-value services required to support the provision of books. If a business cannot comply with the process and service requirements, price is irrelevant. However, once the criteria were met, the parties told us that price became the overriding factor governing the choice of provider. Tenders often provide for different contracts for the supply of different categories of book (eg adult fiction, children's fiction, reference, and audio-visual materials). These contracts can be awarded separately and we were told that there were no advantages to bidders being able to meet all elements which were open for tender. Askews told us that libraries might be reluctant to depend on just one supplier and would prefer to have alternative suppliers available.

4.69 In the case of public libraries, once a contract is awarded, virtually all their needs will be supplied by the library wholesaler that has been selected. Consequently, there is no direct competition for the supply of books outside tender periods.

4.70 In the UK there are currently 15 public library consortia. These consortia are typically geographically based, eg the Greater Manchester Library Consortium, Yorkshire Book Consortium etc. The consortia operate primarily as a buying club, aggregating the funds available for several local authorities into one tender process. The objective of the consortia is to reduce the overall costs of the tender process, and to leverage greater buying power. Woolworths told us that as a general rule, in relation to libraries, the larger the supply contract the higher the discount.

4.71 Woolworths told us that 52 per cent of local authorities are consortia members, an estimated increase of 12 per cent in the past five years. The largest consortium in the market is the Central Buying Consortium (CBC) with 32 members, and an estimated combined spend of £16 million. Some consortia told us that they had achieved a significant increase in discounts for members.

4.72 The pricing structure for public library contracts is usually split into two parts: first, the price of the book, represented in terms of a discount from RRP; and secondly, the price of 'servicing charges', priced per item. Library discounts and servicing charges are usually fixed for the term of the contract.

4.73 Woolworths told us that the channel pricing imposed by publishers meant that these library wholesalers only qualified for between a 35 and 45 per cent discount off RRP (or less) from publishers, whereas trade wholesalers were able to obtain 45 to 55 per cent. Until February 2006, BLS, together with other major public library wholesalers, obtained the majority of their supply requirements direct from publishers. However, Bertram decided that it would acquire books for its library customers through Bertram Books, and it said that a similar supply mechanism was also in place between Gardners and its sister library arm, Browns Books. Bertram said that [✂]. However, we were told that at least one or two publishers had improved their discounts to competing library suppliers following Bertram's actions.

4.74 Woolworths told us that the price differential at publisher level was sufficiently large for it to be cheaper for other library wholesalers also to use trade wholesalers, rather than the publishers direct, for their supply requirements. This was not confirmed as a general policy by other library wholesalers. Suppliers dealing with academic library and educational sectors still need to be supplied direct by academic publishers.

4.75 Bertram claimed that these cost advantages and increased efficiency had been used to provide BLS customers with improved discounts. It said that in 2004 the average sole supply discount offered by BLS was [✂] per cent whereas in 2007 the average sole supply discount was [✂] per cent. The parties said that over the same period discounts from publishers had seen very little change. Discount improvements might also reflect the growth of purchasing consortia.

4.76 The ways in which the public use libraries has been changing. For example, they are much more frequently used by the public as a source of Internet provision. We were told that there had been a reduction in funds being made available by local authorities for book purchases, and that there were proposals for a radical reconfiguration of the public library supply chain. This programme, being developed by the Museums, Libraries and Archives Council (MLA), aims to create by 2012 a new framework for stock procurement by public libraries in England. If introduced, it is likely to impact significantly on competition for the supply of books and services to libraries over the next five years.[47]

5. The counterfactual

5.1 In deciding whether the merger would be likely to give rise to an SLC, we need to compare the situation that we expect following the merger to that which would be expected to prevail had the merger not occurred (the counterfactual).[48] The counterfactual need not be the same as the existing, pre-merger conditions, for example if there are expected changes in the structure of the market or if alternative developments affecting the merging companies may be expected in the absence of the merger.[49]

5.2 This section sets out the counterfactual for this merger. We considered the situations that might have applied to Bertram, and also to THE and EUK.

Bertram

5.3 Our analysis indicates that Bertram is in a satisfactory financial position:

(a) it has made profits historically and is forecast to make profits in the future;

(b) the profits generated by Bertram are also reflected in positive cash flows;

(c) if Bertram's preference shares are treated as debt, then Bertram has net assets of approximately £12 million; and

(d) the decision to sell Bertram was driven by its owners' need for a return of their investment rather than a failure at Bertram.

5.4 The evidence we have received indicates that there remains a viable (and profitable) future for Bertram as an independent wholesaler over the period we are considering. However, as its previous owner appeared unwilling to keep it, it is possible it would have been sold to another buyer.

5.5 Bertram told us that it had had discussions with a number of possible buyers of Bertram with several tabling bids—see Appendix D. We consider that there were several credible purchasers of Bertram; all had book wholesale operations outside the UK and were not involved to any significant extent in supplying the UK market.

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[47]The MLA told us that the Better Stock, Better Libraries programme aimed to create a significantly improved framework for English public libraries stock procurement, enabling libraries to obtain books better matched to customer needs, as quickly as high-street and online booksellers, and at a highly competitive price. The programme is designed to help libraries to build services around community needs—improving availability and choice of stock for customers—and increase the efficiency and effectiveness of library stock management. Savings of £22 million are projected for reinvestment into local services. It said that work is progressing in five main areas (including shared bibliographic services provided through a nationally coordinated route, a model stock supply contract and an internal marketplace for the supply of some stock and specialist services).
[48]The CC's Merger Guidelines state that: 'In applying the SLC test, the Commission will evaluate the competitive constraints on firms with the merger compared to the situation that would have been expected to prevail without the merger (sometimes referred to as the "counterfactual"). The counterfactual will be that situation which the Commission expects to arise in the absence of the merger under consideration.' *Merger References—Competition Commission Guidelines, CC2.*
[49]See, for example, paragraph 1.22 of *CC2*.

5.6 Several other possibilities were considered, all of which we thought were a less likely option than the counterfactual identified above. It was put to us that other potential purchasers may have been interested in buying Bertram, for example distributors which may have sought to enter the wholesale market. Nevertheless the business models of distributors and wholesalers are different and we received no indications of interest from such parties, nor was it clear that they would have to enter via acquisition. An alternative option would be for acquisition through private equity and/or a management buyout. The lack of potential synergies may mean that only a lower price could be justified, and so we believe that these options also appear to be less likely counterfactuals than acquisition by a foreign wholesaler. We saw no reason to believe that Bertram was likely to fail in the short to medium term, or that its owners would seek to run Bertram for cash with a view to an eventual exit from the market.

5.7 The most likely counterfactual for Bertram appears to be that it would have been acquired by a foreign book wholesaler. The status quo ante is also likely in the short to medium term. In either case, the most likely counterfactual appears to be that Bertram remains as a book wholesaler, serving both retailers and libraries, in the UK independent of both EUK/THE and Gardners.

EUK/THE

5.8 We also considered whether, in the absence of the merger, the competitive position of either EUK or THE would be expected to change from the pre-merger situation.

5.9 EUK's merchandising wholesale activities are profitable, and have the support of a large parent. EUK also provides Woolworths with a material income stream, and is part of Woolworths' long-term strategy.

5.10 We considered whether the THE book business would remain in the market absent the merger. EUK told us that it had been developing plans to transfer THE's supermarket business for integration with EUK's existing business before the merger with Bertram had been agreed. We therefore considered the possibility that absent the merger, following transfer of THE's supermarket business to EUK, THE would be left with a small and potentially unviable business forcing it to leave the market. However, Woolworths did not indicate that THE's exit from trade wholesale business had been considered as a short-run option, and we identified reasons to expect that closure would not be the most attractive option to Woolworths:

(a) It is not clear to us that the extraction of the profitable supermarket business from THE would definitely have been undertaken absent the acquisition by EUK of Bertram. Woolworths stated that this was its intention but it may have chosen to maintain THE's existing structure.

(b) We found that THE derives a high gross margin from its wholesale of books to independent bookshops. Woolworths told us that an activity-based costing exercise initiated before the acquisition of Bertram found that THE's supply to independent retailers was not profitable. However, it should be noted that:

- activity-based costing exercises are difficult to rely on as they require a reasonably subjective allocation of costs;

- the non-supermarket business continues to make a positive contribution; and

- rather than closing THE, an alternative approach would be to invest in it to create a sizeable third wholesaler of books, although Woolworths did not indicate that this had been considered as an option.

5.11 This suggests that the combined EUK/THE would most likely have continued as a competitor in the relevant markets in the short to medium term, without any major changes to the scale or nature of their activities.

Conclusion

5.12 We therefore conclude that in the absence of the merger, Bertram would have remained as a viable operation, probably under different ownership. In addition, THE/EUK would remain active in the UK in the short and medium term at least. EUK would function as a merchandising wholesaler, while THE would continue as a trade wholesaler.

6. Market definition

6.1 The purpose of market definition in merger analysis is to provide a framework for the analysis of competitive effects. It identifies a collection of products, and an appropriate geographic area, that delineates the market within which the effects of the merger can be assessed.

6.2 Woolworths put it to us that the relevant product market included the supply of books through wholesalers and distributors to all retailers and libraries. It argued that all categories of retailers tended to source books from both wholesalers and distributors, and ease of supply-side substitutability meant that there was no separation between different categories of retailer. However, we were also presented with views from some retailers that wholesalers and distributors were poor substitutes, particularly under certain circumstances, such as where overnight delivery is required to meet a specific customer order. There were also suggestions that the market was fragmented between different categories of retailer, in part because of the impact of publishers' channel pricing. Woolworths proposed a UK-wide market.

6.3 The CC's assessment of market definition conventionally starts by considering the narrowest possible market definition and broadening this successively to include additional products/geographical areas until a market is identified where a hypothetical monopolist could profitably impose a small but significant non-transitory increase in prices (normally 5 per cent), because of an absence of external competitive constraints. The key to market definition is substitutability, both on the demand and supply side. We have adopted this framework in assessing the most appropriate market for this inquiry.

Product market

6.4 Demand-side substitution may depend on a range of factors, eg types and range of books being purchased; and types of customers. The purchasing of book supplies by retailers is not a uniform activity; rather, different types of books are purchased in different ways, and the choice of substitutes available to retailers may differ in each case. Book retailers may fall into one of a number of different categories. For example, supermarkets have in the past tended to stock a narrow range of books, consisting mainly of bestsellers, and have not operated book-ordering services for customers. In contrast, other types of retailers tend to stock a much wider selection of books, and offer book-ordering services to customers, whereby they order in new books that are not currently in stock at the shop. Another important factor is the ability of suppliers to charge different prices to different customers for an equivalent product. All these differences suggest that there may be a number of possible market definitions, some of them very wide and some very narrow. We now discuss these possible wide and narrow markets.

6.5 Individual titles or individual ranges of books may in some cases be considered as separate markets, but we did not consider that such a definition would be helpful in understanding competition between book wholesalers or distributors.

6.6 There may be limits to the number of wholesalers and publishers that retailers can reasonably (and profitably) deal with; the range of wholesalers and publishers used would most likely vary across retailers. While any specific market definition might be appropriate for some purchases and for some retailers, it would certainly not be appropriate for all retailers and all purchases.

6.7 We considered whether markets may be separated by the context of the purchasing decision, such as whether it is to meet a specific customer order, if it is for stock replenishment, or whether it is for new stock, such as for a new release. In these cases, different retailers may have different views on whether or not different sources of supply are a potential substitute. There may also be the potential for supply-side substitution between these different classes of order. Because of the number of possible outcomes we therefore concluded that the question of whether there is potential for these types of purchase to be segmented should be dealt with in the context of the competitive assessment of the merger rather than through defining separate markets.

6.8 Another potential separating factor could be if front-list and back-list titles constituted different markets. However, there is no standardized definition of these terms; the merging parties tend to consider front-list titles as those released within the previous three months, but other sources used the previous 12 months, or the same calendar year, as a definition. Bertram distinguishes mid-list titles (non-front-list titles which nonetheless achieve considerable sales without promotion), whereas THE has no equivalent categorization. There also seemed little reason to believe that the categorization, of itself, impacted on retailers' purchasing decisions which depended on whether there was an anticipated demand for the specific title. Given these differences and the fact that titles rapidly move between categorizations, we concluded that there is no separate market for front- or back-list books, but we consider the implications of these differences in our competitive assessment.

6.9 We looked at whether the market should be split according to the nature of the retail customer. The parties pointed to close supply-side substitution between different customer groups. However, channel pricing has been maintained in the case of supermarkets, where a persistent supply price differential exists from other types of retailer, even where supermarkets and other retailers are supplied by one wholesaler. In this case, THE, as a supplier to both supermarkets and other customers, has had to send proof to publishers of its sales to supermarkets in order retrospectively to claim a rebate on its purchases, to bring its purchase price down from that applying for trade wholesale purchases to that applying for supermarkets. All other channels are supplied off standard trade wholesale discount rates, including library customers and academic books (these normally qualify for short discount terms) and so there is easier substitutability between these different channels by wholesalers.

6.10 Supply to libraries constitutes a separate market to the supply of books to retailers. The suppliers involved are different, and library supply involves supplementary services which are not required in retail supply. No trade or library supplier indicated that transferring into the other line of business would be easy. We therefore conclude that supply-side substitution is constrained and demand-side substitution is similarly constrained by the need libraries have for additional services. These factors will continue to apply even if the distinctions in channel pricing are eroded through the supply of books to library wholesalers from trade wholesalers.

6.11 Due to the many possible product markets, we have sought to define a broad market, containing all effective competitive constraints and excluding everything that does not pose a competitive constraint on the merging parties. However, the potential for different sources of supply to compete may vary depending on the circumstances of any particular order and the nature of the customer. We address the possibility that the effects of the merger may be felt within particular market segments, rather than within a broader market, in the assessment of the effects of the merger.

Geographic market

6.12 Suppliers serve the whole of the UK using common pricing and terms of business, except in so far as delivery to remote locations may take two days rather than one. There did not appear to be any grounds for believing that there was any geographical segmentation of the market.[50] Bertram and Gardners both have considerable export business, but there were no suggestions raised that imports were a viable option for retailers to source books, nor that wholesalers regarded the UK as being part of a wider geographic market.

Conclusions on market definition

6.13 We therefore concluded that there was a market for the supply of books to retailers, through both wholesalers and publishers (and their distributors), although we believed it appropriate to assess the competitive effects of the merger with a view for potential for discrimination between different types and circumstances of order, and between types of retailers.

6.14 The supply of books to supermarkets constitutes a different market because of the requirement by publishers to maintain a separate supply channel for supermarkets from other retailers.

6.15 We regard the supply to libraries as constituting a different market.

6.16 We also consider that the geographic market is the UK.

7. Effects of the merger

7.1 The principal effect of the merger on the supply of books to UK retailers has been to remove an independent competitor and to increase concentration in the supply of books to retailers. These effects are considered below, including the possibility of unilateral effects, coordinated effects, and vertical effects arising from Woolworths' presence as a retailer of books, with particular attention to whether the loss should be evaluated in the context of supply from wholesalers alone. We then consider any impacts of the merger on the wholesale supply of books to libraries. We are

[50] Eason and Son Ltd (Eason), a Dublin based wholesaler, also supplies bookshops in Northern Ireland, in competition with the wholesalers based in Great Britain (see paragraph 4.7). However, no parties told us that Northern Ireland should be considered as a separate market and we were told that some retailers were reluctant to use Eason because it also owned a chain of bookshops through the island of Ireland.

concerned with the potential for either a price increase to retailers (a discount reduction)[51] or a decline in the quality of service.

Unilateral effects on competition in the wholesale supply of books to retailers

7.2 We first looked at whether Bertram Books and THE coming under common ownership would impact on competition in the market for the supply of books to retailers. The merger reduces the number of large, broad-range, independent trade wholesalers from three to two. We therefore considered whether this would increase the market power of wholesalers.

7.3 Based on 2006 sales, the merged parties estimated their share of supply of books to be [✂] per cent by volume and [✂] by value, when considering supply through wholesalers (including both trade and merchandising wholesalers) and direct supply (see Table 3). The increments to share of supply arising from the merger are around one-third of their combined market share at [✂] per cent by volume and [✂] per cent by value.

7.4 If looking at supply through wholesalers only, the merged parties are estimated to have a share of supply of [✂] per cent by volume and [✂] per cent by value, based on 2006 sales. The increments to share of supply arising from the merger are just over one-third of their combined market share at [✂] per cent by volume and [✂] per cent by value on this basis (see Table 4).

7.5 We have concluded that the supply of books to supermarkets is a different market from the supply of books to other types of retailer. We therefore adjusted Woolworths' estimates of market share in Tables 3 and 4 to use account level data provided by the three main wholesalers, and we excluded supplies to supermarkets—see Table 10 for estimates of share of supply including direct supply, and excluding direct supply so that it covers wholesalers only. Our estimate of the share of supply through other wholesalers could not be checked against similar account level data. The results excluding direct supply indicate that for 2006, the share of supply to retailers, other than supermarkets, through wholesalers was [✂] per cent for Bertram and around one-quarter as much ([✂]) per cent for THE. Including direct supply, the shares are small at [✂] and [✂] per cent respectively.

[51]Prices can effectively be increased both by decreasing the headline discount rate, perhaps selectively to different extents for different retailers, but also by resisting more vigorously improvements in discounts that would otherwise be agreed, and by adjusting the terms on which discounts are applied. For example, additional discounts for large volumes of business or for early placement of orders could be tightened up, the mix between full and short discount could be modified, or surcharges, applicable in certain circumstances but which do not currently exist, could be introduced. All these possibilities are grouped together below and considered as a discount rate reduction, although price increases need not necessarily be applied in this way.

TABLE 10 **Shares of supply of books to retailers in the UK excluding supermarket business, by value**

	Via wholesale channel and direct supply		*Via wholesale channel only*	*per cent*
	2005	*2006*	*2005*	*2006*
THE	0–5	0–5	5–10	5–10
Bertram	5–10	5–10	30–35	30–35
THE/Bertram	*5–10*	*5–10*	*40–45*	*40–45*
Gardners	✂			
Other wholesalers				
Direct supply	80–85	80–85	-	-

Source: THE, Bertram, Gardners, CC calculations.

Notes:
1. All figures are based on invoice values and exclude sales to/through supermarkets. TNS data: total sales values converted into invoice values, assuming a margin of 40 per cent and that all sales were made at RRP. 2006 TNS data refers to 52 weeks ended 8 January 2006; 2006 sales refer to 52 weeks ended 7 January 2007.
2. Shares of supply of other wholesalers assumed to equal [✂] per cent of all wholesale supply.

7.6 Woolworths argued that no significant competitive effect could be realized from the merger for four principal reasons: that THE had been a weak competitor in the market prior to the merger and rivalry between Bertram Books and Gardners rather than THE had driven competition in the market; that wholesaling was a low-margin business with significant fixed costs and so any practices which reduced sales in some or all areas of activity would have a substantial impact on its cost base; that wholesalers were in competition with publishers for the supply of books to retailers; and that rivalry with Gardners would continue to ensure healthy competition between wholesalers. We discuss these in turn.

Impact of THE as a competitor

7.7 Woolworths told us that THE had not been a primary competitor in the market prior to the merger in that it was not differentiated by price or service from the other two trade wholesalers, and its competitive position had been weakened by a limited range of stock. We had no indications that THE, Bertram Books or Gardners were substantially differentiated in their product offer or service (other than in terms of breadth of range). Woolworths argued that competition in the market was driven by rivalry between Bertram Books and Gardners and that this would remain after the merger.

7.8 In paragraphs 4.54 to 4.57 we considered evidence from the Bertram and ORC surveys on the extent to which the three wholesalers were in direct competition. Woolworths said that the Bertram survey indicated that THE was a much less significant constraint on Bertram than was Gardners. However, we found that THE was regarded as a credible supplier by a variety of retailers and was used both as a primary wholesaler and a secondary wholesaler by a significant minority of retailers, as shown by the volume of business it supported. Therefore THE's loss as an independent competitor may impact on the options and negotiating power of customers as it removes an alternative previously open to them. Additionally, existing THE customers have now lost Bertram Books as an independent alternative.

Economies of scale in wholesaling

7.9 Woolworths told us that economies of scale were important in ensuring the profitability of wholesaling. It said that maintaining volumes was crucial in covering the costs of running its activities and in holding a wide variety of stock.

7.10 We do not accept that this is necessarily an accurate picture of the costs and incentives facing wholesalers. While the warehouse, IT systems, packing and dispatch facilities and so on may be fixed costs, the primary cost element, the books themselves, are a variable cost. A stock of books needs to be kept in reserve but careful management will match this to anticipated demand and it is likely to be purchased on credit and on sale-or-return terms. Labour for picking stock is also variable at the margin (eg by employing agency staff on temporary contracts) and distribution is paid for on a per-package basis. Woolworths argued that if average order size were to decline, it would still have to pay as much per delivery, even if the delivery boxes were not as full. It also argued that a loss of front-list sales would affect picking costs as it is easier to pick several copies of one fast-selling line than to pick several separate copies of different titles. Woolworths submitted a critical loss analysis to explore the reductions in sales necessary to render an increase in prices unprofitable; this analysis assigned all but [✂] per cent of costs to variable sales costs, and the remainder was partially variable with sales levels.[52]

7.11 The implication of high variable costs is that any decrease in sales levels results in decreased costs offsetting much of the loss in revenue. Therefore the incentives in the industry to emphasize sales volumes over prices are not as strong as it would be if there were a very high fixed cost element in supplying services.

7.12 However, other trade wholesalers could follow a more automated and capital-intensive way of working. We heard that Gardners was undertaking substantial investment in automation. In such cases, the ratio of fixed to variable costs would be higher, possibly impacting on incentives.

Direct supply

7.13 Around 18 per cent of all books are supplied to retailers (excluding supermarkets, see Table 10) through trade wholesalers. The rest are supplied direct, either from publishers or more usually through distributors. This share varies by category of retailer, with larger businesses being more likely to source direct, but even independent book retailers source around half their supply direct and half through wholesalers. While market shares can be informative, in the case of any individual title, the book can only be sourced from wholesalers or the one relevant publisher or its distributor.

7.14 We considered whether in aggregate, across all types of retailer (other than supermarkets—see paragraph 7.68), there was considerable potential for the wholesalers' customers to divert demand from wholesalers to direct supply in the event of a price rise.

7.15 We saw that the chains had carefully evaluated the extent to which they sourced deep back-list titles from wholesalers rather than attempting to source from publishers themselves. Any change in prices may lead to this decision being reconsidered. We also heard that one chain had put out to tender a contract to

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[52]Bertram subsequently told us that its operating costs were running at [✂] per cent of sales, of which almost [✂] was largely fixed overheads.

supply the latest Harry Potter release and this had been awarded to a wholesaler. It is likely that wholesalers will want to pick up more business of this nature (although the release of the Harry Potter title is an exceptional event). However, the chain could easily switch between wholesalers and direct supply in this context.

7.16 The ability of Internet retailers to switch the source of supply will depend on the way in which they do business. Most, including Waterstones.com, WHSmith.co.uk and Tesco.com, but also many smaller Internet retailers, contract with wholesalers to provide a full support service and this may not easily be transferable to non-wholesalers. The largest Internet retailer, Amazon, has its own warehouses and despatch services and can hold its own stock. It can therefore turn to publishers for direct supply of many titles and so is not so completely dependent on wholesalers for fulfilment. We understand that Waterstone's is contemplating its own warehouse facility to allow it to fulfil Internet orders itself. There is therefore likely to be significant mobility, for those Internet retailers with their own warehouses, between wholesalers and direct supply. For other, non-specialist retailers, there may also be opportunities to switch to specialist publishers, the small and specialist wholesalers, or other types of wholesale supplier who may be able to offer a very narrow range of printed material (eg news wholesalers), as well as substituting non-book products.

7.17 Independent retailers take a greater proportion of their purchases from wholesalers than do chains or the large Internet retailers. Woolworths told us that the proportion of purchases made by independent retailers from wholesalers was in decline, but our own results do not support this, at least in the recent past (see Appendix E). Gardners has increased its sales to independent retailers and overall this has offset a decline in sales by Bertram Books and THE. Increasing use of electronic trading and administration following the anticipated widespread adoption of electronic commerce in the book industry following e-day (see paragraph 2.33) is likely to improve the ability of independent retailers to easily switch between direct supply and wholesaler supply.

7.18 The position of wholesalers as intermediaries between publishers and retailers is potentially significant; publishers will wish to maximize sales of their books, and they are also in a position where they have the ability to monitor any actions by whole-salers which could reduce sales of those titles. Publishers set RRPs for books and the terms on which trade wholesalers purchase stock. Publishers therefore have some ability to influence wholesalers' actions, if they believe these are detrimental to the publisher's interests in selling books. Publishers also have greater influence over the supply terms for distributors, and the business practices of those distributors. Therefore, if publishers believed that wholesalers were adopting practices which harmed the publisher's objectives, they could seek to enhance the competitive threat to wholesalers posed by distributors, such as by improving discount rates or enhancing service. In that regard, we found that there has anyway been an improvement in the standards of service offered by distributors, such as offering year-round hotlines for faster delivery, and we expect these improvements to continue, and to be accelerated if publishers feel that wholesalers are not offering their books to retailers at attractive prices; the channel pricing shown in Table 5 suggests that publishers receive a higher price from direct sales to independent retailers than if they sell to wholesalers (although the distributor has to be paid from this). If delivery improves, wholesalers are likely to lose some of the advantages that they currently hold in standards of service.

Rivalry with Gardners

7.19 We considered how actively we could expect Gardners to choose to challenge and compete with the merged parties. We found that there were few significant barriers to customers switching their custom between wholesalers—see paragraph 4.58. Many retailers maintain accounts with two or three trade wholesalers and will regularly place orders with secondary suppliers. Therefore switching primary wholesaler largely involves just changing the proportions of orders placed with different suppliers. We found that the service offered by the different wholesalers tended to be similar, and so the barriers that remain largely relate to the personal relationships that retailers have established with their suppliers, and a belief by some retailers that stock ordering and control systems would not be supported by their current wholesaler were the retailer to switch, necessitating a change of system (although the wholesalers do not generally require the retailers to purchase books from them to operate these systems in their shops).

7.20 We considered the incentives that would apply to Gardners post-merger; it could seek to compete vigorously for new custom, or it could take note of a reduction in competitive intensity and take advantage of this to increase its prices. Anecdotal evidence indicated that Gardners had been actively seeking to attract customers from the parties following the announcement of the merger, and we considered whether this would continue. Gardners told us that it had just invested in expanding its warehouse capacity, and was investing in further automation of its facilities to expand its capacity and range. It said that its business philosophy would be to continue to seek to grow the number of books it sold through the retailers it supplied regardless of whether or not the merger went ahead.

7.21 Taking note of the constraint from direct supply which would act on Gardners in the same way as it would act on EUK, THE and Bertram Books, and because of its business tactics and its recent investments, we thought that Gardners would be more likely to seek to increase sales volumes rather than to increase its prices should an opportunity arise post-merger.

Conclusion

7.22 In the context of a wide market for all sources of book supply, we find that at least some of the retailers could feasibly switch their demand to direct supply. Given the small proportion of total supply accounted for by wholesalers, this is likely to present a sufficient constraint at the margin to prevent a blanket increase in prices in the wholesale supply of books (and for the same reasons prevent a decrease in quality of service) across all retailers, given the increase in concentration in the market, as shown in paragraph 7.5. Publishers would also have the option of encouraging closer competition from distributors if they believed wholesalers were harming book sales. We also expect that Gardners will compete aggressively if THE/Bertram were to seek to increase prices or cut service levels.

Discrimination in the supply of books to retailers

7.23 We now turn to consider whether there are possible circumstances where the ability to turn to direct supply is limited, and so whether there may be potential for prices to be increased (or service cut) to a defined segment of the market, or for discrimination in the wholesale supply of books to retailers. Discrimination in this context means where customers are charged different prices for reasons other than differences in the costs of doing business with them (the term 'discrimination' does not necessarily imply any abuse of market power or loss of economic welfare). If so, we then need to address whether market power could be exercised in these contexts.

7.24 Concerns were raised with us that there was potential for wholesalers to identify and raise prices to a market segment corresponding to certain categories of customer, or certain circumstances of purchaser, where the potential to switch purchases to direct supply was limited.

7.25 We therefore considered whether there could be potential for price or service discrimination on the basis of identifying:

(a) independent retailers as a particular market segment with less price-elastic demand;

(b) orders placed where rapid delivery is important; and/or

(c) orders for back- or mid-list titles.

7.26 These are considered in turn, examining the possibility of discrimination against the segment as a whole or selectively against retailers within these segments. We then address whether any of the concerns could also apply to any class of retailer other than independents.

7.27 In order for discrimination to be likely, we need to determine that wholesalers would have the ability to discriminate, and an incentive to behave in this way. Price variability between customers already exists (see Figure 4), and evidence presented by Bertram Books showed discount rates being adjusted up and down for individual retailers. This indicates that selective discrimination in pricing is possible. As discounts are individually negotiated, any price and service changes enabled by or resulting from the merger need not be applied to a consistent extent in all cases but rather discretion might be exercised as to how far to apply the changes to any individual retailer.

Independent retailers

7.28 We looked at whether independent retailers were likely to be the least able to switch purchases to direct supply and so could form an identifiable segment against which prices could be raised or service standards dropped. There were two main reasons to believe that independent retailers might have less potential to substitute direct supply for their purchases from wholesalers:

(a) We were told that trade wholesalers offered advantages in simplifying administration of stock purchasing (see paragraph 4.41). Several independent retailers told us that they preferred not to negotiate terms and open accounts with multiple publishers, submit multiple orders, receive multiple deliveries, settle multiple invoices, or deal with separate returns procedures.[53] In comparison, we were told that each wholesaler offered a one-stop service, which many independent retailers considered to be important in simplifying administration. The ORC survey (see Figure 5) found that 'convenience of ordering process' was rated as very important by 60 per cent of respondents for regular stock orders and 59 per cent of respondents for customer orders. Similarly, the responses for 'efficiency of dealing with few suppliers' were 41 and 38 per cent respectively. Minimum order thresholds may be easier to achieve with a wholesaler than with a publisher or distributor; while we were told that minimum order terms may not always be applied, there may be an impact on the speed with which orders are dispatched by distributors. In the ORC survey, 'willingness to process small

[53] Although publishers often offer generous returns allowances of up to 100 per cent whereas wholesalers more typically offer 5 or 10 per cent. The ORC survey found that 'terms of book returns handling' (which may include other factors apart from allowance rates) was rated as very important by 35 per cent of respondents for regular stock orders and 31 per cent of respondents for customer orders.

orders' was rated as very important by 65 per cent of respondents for regular stock orders and 73 per cent of respondents for customer orders (although this factor was rated as very important by a far higher proportion of small retailers than of retailers with high turnover—see paragraph 4.31).

(b) Trade wholesalers generally offer next-day delivery as standard, but we were told that it was rare for publishers/distributors to offer next-day delivery.[54] We were told that independent retailers regarded the ability to offer next-day delivery to meet customers' special orders as an important aspect of their service. Rapid stock replenishment may also be important to retailers meeting demand for titles where this exceeded expectations.[55] The ORC survey found that speed of delivery was rated as very important by 78 per cent of respondents for regular stock orders and 83 per cent of respondents for customer orders.

7.29 In 2006, Bertram, THE, and Gardners sold books with an invoice value of £[✂] million to independent retailers in the UK. Of these books, £[✂]million ([✂] per cent) were sold by Bertram, £[✂] million ([✂] per cent) by THE, and £[✂] million ([✂] per cent) by Gardners. We were not able to gather similar sales data for the smaller wholesalers. Gardners' share of business with independent retailers is lower than its share of business with all non-supermarket retailers, as shown in Table 10.

7.30 We acknowledge that independent retailers are already likely to source from more than one supplier. Independent retailers, on average, source around half their book requirements directly from publishers and distributors; our data suggests that the proportion has not changed in the last two years (despite significant changes in the share of sales achieved by different wholesalers). Some independents may have the sophistication to negotiate and deal with publishers, and we were told that there may be strong financial incentives to buy front-list, particularly pre-release, titles direct, where administration is easier and speed of service less important. The current level of multi-sourcing may not necessarily imply that existing wholesale orders can be switched to direct supply.

7.31 Woolworths argued that the administrative complexities of dealing with a large number of publishers were reduced because around 75 per cent of books sold in the UK were titles available through the six largest distributors. TBS estimated that the four largest distributors could meet 60 to 70 per cent of a typical retailer's requirements. Woolworths said that even if retailers could not switch all its demand to direct supply, enough could easily switch enough at the margin to act as a constraint on wholesaler pricing. It also pointed to mechanisms such as ordering systems (eg PubEasy) and payment systems (eg Batch) which simplified the process or ordering through publishers, making payments, and authorizing returns (see Appendix C).

7.32 Woolworths told us that it was very difficult for a wholesaler to reduce agreed discount rates for an independent retailer; it said that such action would be regarded as against standard industry practice, and consequently would harm its relationship with the retailer and most likely push the retailer towards Gardners or direct supply. Nonetheless, discount rates could be adjusted slowly over time by declining to improve terms that would otherwise be subject to negotiation, or adjusting the levels of order that qualify for improved discounts, time deadlines to receive early-order discounts and otherwise altering the way in which discounts are applied. Moreover, we found a large number of examples where Bertram's discount rates had been cut—see paragraph 4.21. We therefore find that discount rates can be, and are,

[54] Although we observed that some distributors had introduced 48-hour or next-day delivery hotlines—see paragraph 7.36.
[55] One area where this consideration will not apply is for pre-publication orders of new releases, as urgency of delivery is not then an issue.

actively managed by wholesalers, cutting or enhancing them as appropriate on a selective basis with individual retailers. Thus wholesalers would have the ability to adjust prices selectively. However, this account management, including discount enhancements, is also indicative of a need to act flexibly on pricing to retain retailers as customers.

7.33 There has been some decline in the number of independent book retailers—see paragraph 2.12. Despite growth in the overall book market, independent retailers told us that they were vulnerable to competition from: supermarkets (particularly on front-list titles); Internet supply (on front- and back-list titles); and from chains that have tended to have larger, more high-profile sites and that discount front-list books. It was therefore suggested that independent retailers were very vulnerable to any worsening of their terms of supply, and that any attempt by wholesalers to increase prices might drive such retailers out of business, which would negatively affect wholesalers' sales. We note that closures of independent bookstores have, to some extent, been offset by new openings and that the independent booksellers' share of supply shown in Table 1 is broadly stable, as is the absolute value of their sales (see Figure 2). Nonetheless we felt that wholesalers were conscious of the vulnerability of independent customers, and we also considered that it would be difficult for them to identify whether particular retailers were more or less likely to be financially vulnerable before selectively adjusting discounts.

7.34 The position of independent retailers is evolving. There are indications that many are becoming more sophisticated in their purchasing and we expect this to develop over time. In this context, we consider that the developments to facilitate ordering and doing business with publishers electronically, identified in paragraph 7.31, will increase the opportunities viably to turn to direct supply for the types of orders that have in the past been passed through wholesalers, and we note the intended achievement of e-commerce in the book industry supply chain with e-day set for May 2008 (see paragraph 2.33). We expect that publishers will be keen to continue to enhance this and other aspects of their service. An appropriate price incentive would be likely to lead to an increased number of retailers exploring alternative sources of supply for at least some further proportion of their requirements. Even if wholesalers tried to apply such a policy selectively on those customers least likely to switch, we think that it would be difficult to identify enough immobile retailers to impose such a policy to any significant degree. Therefore we doubt that wholesalers could successfully target independent retailers based purely on a retailer's independent status, because of the potential at the margin for substitution with direct supply. In addition, we expect that Gardners will continue to compete actively against the merged company, and that the wholesalers will also find it in their interests to support a healthy independent bookshop sector.

Orders placed where rapid delivery is important

7.35 We were told that wholesalers were unique in being able to offer next-day delivery on a wide range of books, and we considered whether there were opportunities for profitable discrimination against orders placed where rapid delivery is an important requirement for the retailer.

7.36 Concerns over speed of delivery could apply to both independent retailers and chains that also offer a facility for customers to place special orders which are then cascaded to wholesalers. Many publishers are not currently set up to provide rapid supply, and some could take several days or more to meet an order. This suggests that there is little potential for substitution from direct supply for these types of order as a general policy, although there are some exceptions. We also found that some of the largest distributors had introduced hotlines offering next-day delivery, but subject to larger minimum order values and earlier order cut-off times. We were also told that most major distributors introduced such services during the peak-demand season in the run-up to Christmas; Woolworths argued that this demonstrated that distributors could adapt their practices to challenge wholesalers on service if there were an incentive to do so. However, this period is atypical in that there is a large increase in demand which would not be repeated at other times of the year.

7.37 We considered whether it would be feasible for wholesalers to discriminate against orders requiring rapid delivery. Figure 5 shows that, based on the ORC survey results, retailers are less price sensitive when ordering to meet specific customer orders.

7.38 Woolworths told us that when a retailer placed an order with a wholesaler, it tended to be made up of a mixture of titles, ordered for different reasons, aggregated together in order to achieve the minimum order value. While a particular customer request might trigger an order being placed with a wholesaler, it is not possible to identify which titles were the ones ordered for this reason. Consequently Woolworths said that it had no means of identifying the urgent elements of the order, and in any event, its practice was to offer just one schedule of discount rates for all orders such that discriminating for particular circumstances of order would be difficult to apply. Woolworths said that if it applied higher prices to the entire order, it would risk losing the additional books that had been ordered. Woolworths further said that it was not feasible to base its business on supplying special customer orders alone because the volumes involved would be insufficient to achieve the scale necessary to operate an efficient business.

7.39 We also considered whether wholesalers could modify their service levels to differentiate between urgent orders and others, and to differentiate in pricing accordingly. However, all trade wholesalers are currently set up to provide next-day delivery, and it would be expensive to alter practices to provide two different levels of service. Further, as wholesalers are unlikely to have any significant price advantage over direct supply, and are usually more expensive, so they rely on quality of service to attract retailers' custom, and they would not want to harm their reputation for service. We considered that selectively reducing service standards would be unlikely to be worthwhile for wholesalers.

7.40 We therefore conclude that it would not be feasible for a wholesaler selectively to discriminate against urgent orders alone.

Orders for back-list or mid-list titles

7.41 We then considered whether wholesalers face a weak constraint from direct supply on mid-list and back-list titles, and if so whether they could profitably discriminate against such titles by concentrating any discount reductions on mid- and back-list titles. We were told that publishers and distributors tended not to emphasize sales of back-list stock, and that publishers frequently offered promotions on front-list stock which increased the price advantage retailers gained in ordering direct.

7.42 For the reasons given in paragraph 7.38, retailers will often place orders made up of front-list, mid-list and back-list titles all in the same order. It would therefore be difficult for the wholesaler to differentiate in the standards of service between the different types of books.

7.43 Woolworths also told us that differentiating prices for front-list, mid-list and/or back-list titles went against the standard one discount rate, one service level model that wholesalers currently employ. However, wholesalers already employ different discount rates such as a full discount rate, short discount rate (for titles where the publisher's discount to the wholesaler is below [✂] per cent) and non-stock titles (for items that have to be specially ordered from publishers)—see paragraph 4.16. Further, they offer promotions on certain front-list titles. We recognize that there are difficulties in defining which titles are front-list or back-list, as titles will move between categories over time and different definitions are used by different parts of the book trade. However, we thought it may be possible for them to differentiate certain front-list titles, perhaps by offering a selective bonus discount on all pre-release or newly-released titles. Alternatively bonus discounts might be offered on a few best-selling titles, as currently happens in some case (eg Gardners Select).

7.44 Orders placed with direct suppliers by independent retailers are likely, in the main, to be primarily front-list titles, as delivery times are not so important for those orders where titles are pre-publication, publishers tend to offer better prices on these titles, and orders are likely to be for multiple copies making it easier to meet minimum delivery requirements. Nonetheless, Bertram told us that a substantial proportion, [✂] per cent, of its sales in 2006 (by value) to independent retailers were of front-list titles (defined as titles within three months of publication); similarly, [✂] per cent of THE's sales by value to independent retailers in 2006 were front-list titles.

7.45 A distributor, TBS, told us that around 30 per cent of its sales were of books published over 12 months ago. This figure was not identified separately for independent retailers, but indicates that mid- or back-list titles are available at least to some extent through direct supply. In comparison, in 2006 just over [✂] per cent of THE's sales, and nearly [✂] per cent of Bertram's sales were of books over 12 months old. Publishers may also have the opportunity to enhance availability through distributors if they feel wholesalers are not serving the publisher's interests in distributing its mid- and back-list books.

7.46 It appears that there is overlap of supply between wholesalers, and direct sources, for front-list, mid-list and back-list titles. Therefore, in so far as there is potential for retailers to switch further purchases from wholesalers to direct supply in response to changes in relative discount rates, it is likely to apply, at least to some extent, for all classes of title.

7.47 In conclusion, we find that there is not a clear distinction between front-list, mid-list and back-list books, and that there is considerable overlap between the ranges offered by wholesalers and distributors, raising the potential for substitution between these sources. Consequently we think that this would not lend itself to a basis for profitable discrimination.

Other classes of retailer

7.48 We then addressed whether these concerns could also apply to chain, Internet and other retailers' business with trade wholesalers.

7.49 The chains typically use wholesalers to meet customer orders for out-of-stock items. Rapid response is therefore often important. We were told that there was also a significant financial benefit to the chains in outsourcing supply of the slowest-moving lines.[56] However, we were also told that the size of the contracts to supply the chains were sufficient to give them considerable purchasing power in negotiating deals.

7.50 Internet retailers source some books from wholesalers but the larger retailers appear able to switch some of their purchases between different sources of supply for all but the smaller publishers' books. Some Internet retailers, such as bricks-and-mortar retailers who wish to offer an online service, are entirely reliant on the wholesalers to host and supply their operations. Direct supply is not a substitute as distributors do not each offer the same pick and dispatch service, whereas wholesalers have the advantage of already possessing a large and varied stock for rapid dispatch; there would be large costs for an Internet retailer in establishing its own warehouse and holding its own stocks so that it could operate its own despatch service. However, THE has been a minor provider of this service. None of the Internet retailers expressed concern about the impacts of the merger on this aspect of supply.

7.51 Non-specialist retailers that sell books, but not as their core activity (eg newsagents, garden centres, music shops, etc), are also collectively significant customers of the wholesalers. We considered whether there were any differences that made such retailers vulnerable to discrimination. Woolworths argued that because these retailers did not regard book-selling as a core activity, their demand would be more price sensitive because they could substitute entirely different product lines to sell if the margins achievable on books became unattractive. Woolworths also pointed to other sources of supply such as specialist wholesalers, and wholesalers in other sectors. For example, we were told that newsagents could source maps, atlases and some books (such as Mills & Boon where the titles offered are changed frequently) through newspaper and magazine wholesalers. Overall we thought that non-specialist retailers were unlikely to be more vulnerable to discrimination than independent book retailers.

Residual monopolist

7.52 Where retailers use wholesalers for supply, it is common for them to turn to alternative wholesalers if their primary wholesaler[57] cannot fulfil an order, for example because the wholesaler does not stock the title or it has no copies in stock. We estimated, based on 2006 sales data to independent retailers provided by the three largest trade wholesalers, that just over one-tenth ([✂] per cent) of their sales were to retailers where they were not the primary wholesaler.

7.53 We considered the possibility that a secondary wholesaler would find, following the merger, that it had no other competitor for this business. Therefore if a wholesaler believed itself to be a retailer's secondary supplier, it would know that any orders placed with it arose because the primary supplier was unable to supply the book, and that therefore it was not in competition with any other wholesaler for that order. We described this possibility as the residual monopolist hypothesis.

7.54 Woolworths argued that a secondary wholesaler would not be able to cut discount rates because: it would be pricing in order to try to gain primary supplier status; it would be in competition with direct supply; and it would be difficult to identify and isolate such purchases.

[56] Bertram stated that 'Some chain retailers with head office overhead have estimated that passing the supply of tail lines to a wholesaler saves the equivalent of 5 per cent of margin, and improves service to their customers.' Source: Bertram, *Why do book wholesalers exist?*

[57] Retailers are likely to seek to put as much of their business as possible through one wholesaler rather than routing it through several, as volume of orders is an important tool in negotiating favourable discount rates—see paragraph 4.15.

7.55 We were told by Woolworths that wholesalers would always seek to be the primary supplier because the level of sales achieved as secondary wholesalers was too low to sustain their business. While we recognize that relying purely on secondary business would not be viable, where wholesalers fail to achieve primary status, there is still an opportunity to supply some books as secondary supplier. Woolworths told us that it was not necessarily clear to a wholesaler whether it was the primary supplier or not. Bertram and THE both told us that they would not adjust discount rates if orders from a retailer were lower than had been anticipated, and told us that it was not their practice to lower discounts to retailers once these had been set. However, we found that wholesalers did monitor sales levels and were aware of cases where sales had declined, and cases when slices of business had been lost to rivals (see paragraph 4.19). We also found in such circumstances that Bertram Books would often cut discount rates on the basis that the sales volumes necessary to support a particular discount rate were not there. While such adjustments are standard business practice, they indicate that the constraints identified by Woolworths in paragraph 7.54 do not constrain its freedom to adjust prices in these circumstances.

7.56 It was put to us that THE was not a strong competitor to Bertram Books or Gardners for the position of secondary supplier because of its limited range. We found that it was seen as a potential alternative by a significant proportion of retailers—see paragraphs 4.56 and 4.57.

7.57 While secondary wholesalers are more likely to be a viable or convenient source for difficult-to-obtain back-list titles or those from small publishers, in some cases retailers might be able to turn to direct supply for these orders.

7.58 Where a retailer finds that it needs to turn to a secondary wholesaler for a specific order, it is likely to make the order up to the minimum value threshold with additional books that would otherwise be placed elsewhere. As argued in paragraph 7.38, the secondary wholesaler will be unaware which book initiated the order and so would be unable to selectively discriminate against that particular title; a cut in discount rates then increases the risk that the customer would not place an order because of the higher prices across the whole order. We also noted that retailers have the option of informing their customer that delivery might not be next day if they were to seek supplies from the publisher or wait for the primary wholesaler to obtain stock. Independent retailers may be reluctant to do this as many viewed next-day availability as an important part of their service, but this may not be crucial to some proportion of their customers.

7.59 Many independent retailers told us that the ability to order books for customers for next day availability was an important aspect of their service, but it seemed likely that rapid delivery would not always be crucial. The ORC survey reported that 26 per cent of respondents would wait for their main supplier to provide a book if it were temporarily unavailable, or would cancel the order, rather than diverting to a secondary supplier. While it appears that some respondents did not fully understand the relevant question it suggests that not using a secondary wholesaler may sometimes be regarded as an option by some retailers.

7.60 We concluded that there was unlikely to be a substantial lessening of competition from the residual monopolist possibility because:

(a) in some cases, direct supply may be an alternative to using a secondary wholesaler;

(b) retailers may be price sensitive because they are likely to be ordering a bundle of several books;

(c) in some cases the customer may not require rapid delivery of the book and so the retailer could delay the order until the primary wholesaler can obtain stock; and

(d) the volume of orders placed through secondary wholesalers is relatively small ([✂] per cent of the three largest wholesalers' sales to independent retailers in 2006).

Other potential competitive constraints

7.61 We considered whether other factors might serve as a constraint on market power.

7.62 We were told that POD is not a price-effective alternative to conventional printing. It may provide a viable method of supplying specialist books that are rarely ordered or which would otherwise have very short print runs, or which are regularly updated, such as some academic and professional titles. However, we do not consider it likely that this will encroach on a significant proportion of wholesalers' activities in the next few years. Neither do we expect e-books to compete with or replace conventional printed books to a significant extent within the next three to five years.

7.63 A number of buying groups have been established in the UK, such as the Independent Buying Group and Leading Edge. All these groups concentrate on sourcing a limited number of titles. Buying groups rely on publishers agreeing to grant them improved discounts which means that titles sourced through buying groups are therefore likely to be, in the main, front-list publications which the publishers would like to see promoted. Buying group selections can impact on the retailer's choice of front-list titles, particularly those ordered ahead of publication. However, the range covered is too narrow to affect the majority of wholesalers' business.

7.64 It was put to us that independent retailers have the option of bypassing retailers by purchasing stock from supermarkets or Internet suppliers. We received anecdotal evidence that independent retailers may sometimes purchase stock from supermarkets. However, it did not seem to be on any significant scale and was confined to very high-profile books (such as a new release of a Harry Potter title) where supermarkets sold at retail prices below the price offered by trade wholesalers, and where retailers judged that they had to be seen to be price competitive. There was some use of Internet supply but no retailers seemed systematically to rely on this as a source of supply. It was administratively complex, and for most titles offered no price advantage over trade wholesalers.

7.65 We considered whether the potential for entry into trade wholesaling is a constraint on existing wholesalers. The only recent entrants to book wholesaling have been merchandising wholesalers who subsequently exited the market (see paragraph 4.8). We found that entry into merchandising wholesale was not likely to face large barriers; EUK told us that it had been able to move into wholesale supply to Tesco within a few days of Tesco's previous merchandising wholesaler ceasing trading. We found more significant barriers to entry into trade supply. A trade wholesaler needs a far wider range of stock, including back-list titles, than a merchandising wholesaler. This raises difficulties in identifying a suitable range, and the wholesaler will need to negotiate with a wide range of publishers for supply. The wholesaler will then need to convince retailers that its stock is sufficient to meet their demands, and it has the systems in place to guarantee service standards such as next-day delivery. Without a trading history it may be difficult to attract the first customers to the business (although the fact that customers are generally not tied in to contracts and often multi-source may lessen the importance of this factor compared with some other industries). Other than supermarkets, there do not seem to be customers who are large enough to sponsor entry.

7.66 We spoke to some specialist wholesalers and library suppliers. All regarded trade wholesaling to be different in nature from their existing businesses, and viewed diversification into trade wholesaling as unattractive. Similarly, wholesalers in other lines of business expressed no intention of diversifying into book supply. Some foreign wholesalers had expressed an interest in entering the UK market, but we see that the same barriers to entry would apply to them as to any other potential entrant. We consider it more likely that an overseas wholesaler would prefer to enter the UK market by acquiring an existing supplier.

7.67 It was put to us that distributors already had a very large stock of titles and distribution systems in place. Some had improved their standards of service and support to retailers, and this would enable them to expand easily into offering wholesaling services. However, distributors stock titles of their associated publishers, who govern selection. Consequently the range of titles stocked is not chosen to reflect the breadth of needs of a typical retailer. The distributors do not seem to regard themselves as substitute wholesalers and we did not believe that they could perform their principal prime function as distributors working on behalf of publishers while also trying to offer a competing wholesale service. While we consider that direct supply from distributors can often be a constraint on the wholesalers, that is not to say that distributors could easily offer the same overall service as wholesalers.

Supply of books to supermarkets

7.68 We identified that the supply of books to supermarkets may be regarded as constituting a separate market from the supply of books to other retailers (see paragraph 6.14), because of the constraints on supply-side substitutability arising from channel pricing. Following the acquisition of THE by EUK, since May 2007 THE’s supermarket contracts have been fulfilled by EUK. We were told that this decision was made prior to the Bertram acquisition. As Bertram has no supermarket supply business, its merger with EUK/THE involves no changes in the ownership structure for those wholesalers currently supplying supermarkets. While Bertram was a potential supplier to supermarkets, it has not been actively seeking such business in the last couple of years, and there appears to be potential for the largest supermarkets to switch to self-supply. Consequently we conclude that the merger does not give rise to any competitive effects in the supply of books to supermarkets.

Supply of books to school suppliers

7.69 School supply companies and retailers specializing in books for schools occupy an unusual position in the market. As several pointed out in evidence to the CC, they face competition not only from general retailers but also from some of the publishers and wholesalers from whom they source their books. Bertram in particular was said to be targeting the schools market through BLS and it could source books through Bertram Books at higher discounts than rival school suppliers could achieve. (As noted in Table 5, the discounts offered on educational books are usually smaller than those applying to trade titles, and supply through wholesalers is usually at short-discount terms.) Some suppliers said that THE exhibited a firm understanding of the sector and was supportive to school suppliers. They feared that the merger would remove that support and would mean that the two remaining wholesalers would be direct competitors to school suppliers.

7.70 We considered these arguments but concluded that, essentially, the main challenge school suppliers faced was the competition from its own suppliers, whether publishers or wholesalers; that situation would not be changed by the merger, Similarly, the complaint that BLS was supplying at trade discounts was unconnected to the merger; the practice had been going on for some time. It is addressed more fully below (see paragraphs 7.89 to 7.95).

Summary of potential for unilateral effects

7.71 In the light of the preceding discussion, we consider that significant adverse unilateral effects are unlikely to arise because:

(a) There is potential for retailers to source books from publishers and distributors, as well as wholesalers. In a wide market incorporating all these sources of supply (but excluding supply to supermarkets), the market share of the merged parties is under 10 per cent.

(b) Distributors are improving the service they offer to retailers, such as in speed of service. Technological advances in ordering and administration are making it easier for retailers to deal with direct orders. There is potential for publishers to improve stock availability of mid-list and back-list titles through distributors and improve standards of service from direct supply, and they can influence their own trading relationship with wholesalers (see paragraph 7.18), if they feel that wholesalers are not supporting the sale of their books.

(c) While independent retailers perceive the greatest difficulties in switching away from wholesalers, many already multi-source and many may have the opportunity to divert at least some of their orders from wholesalers to direct supply.

(d) There are concerns that some independent retailers are in a financially vulnerable situation and increasing prices to them may threaten their viability.

(e) Gardners, as the remaining independent trade wholesaler, would have some incentives to seek to compete actively for customers including independent retailers.

(f) There is considerable overlap between the supply of front-list titles through wholesalers as well as distributors, and mid-list and back-list titles through distributors as well as wholesalers, which impacts on incentives to discriminate between these different classes of book.

(g) It will be difficult for wholesalers to identify and discriminate against orders placed for different purposes or under different circumstances.

7.72 We consider it important in reaching this finding that all these factors apply; any one of these on its own would be unlikely to form a sufficient constraint on the ability of the merged company to increase prices, particularly if it was selectively seeking to increase prices to individual customers. For example, were the constraints from direct supply to be relaxed, then the incentives applying to Gardners as a rival supplier may also change allowing it to seek to profit from an increase in market prices. Without the threat from Gardners, there would be greater potential for the merged parties to seek to raise prices to retailers who were reluctant to switch to direct supply.

Coordinated effects in the wholesale supply of books to retailers

7.73 Coordinated effects may arise in concentrated markets where the companies within the market recognize their interdependence and take account of competitors' strategies when making their own business decisions. Consequently, there is potential for companies to realize that a reduction in competition may be in their mutual self-interest where they adopt similar behaviours. Coordinated effects may arise where a merger increases companies' interdependence, or makes coordination within the market either *(a)* more likely, or *(b)* easier and more sustainable. Coordination can take a variety of forms, and does not necessarily require coordination on prices. For example, a coordinated outcome could be one in which the coordinating companies agree not to try to poach one another's customers (known as a market-sharing outcome), or where they agree to save costs by reducing competition on the quality of service.

7.74 The CC guidelines on merger references identify three conditions that are generally regarded as necessary for coordination to exist. The three conditions are:

(a) Awareness of competitor behaviour—the market must be sufficiently concentrated for companies to be aware of the behaviour of their competitors and for any significant deviation from the prevailing behaviour by a company to be observed by other companies in the market.

(b) Incentives to conform to the prevailing behaviour—it must be costly for companies to deviate from the prevailing behaviour, such that it is in their interests to conform. Competitors abandoning the coordinating behaviours may be a sufficient discipline to provide an incentive to conform, depending on the short-term gains from deviation, the speed of reaction by rivals, discount rates, etc.

(c) Weak competitive constraints—competitive constraints in the affected market(s) must be relatively weak, so that the actions of non-coordinating companies, potential competitors and customers do not jeopardize the expected outcome of coordination.

7.75 We found no evidence of pre-existing coordination between wholesalers. There was evidence of wholesalers seeking to undercut competitors, and no suggestion of a lack of competition between them on service. A number of characteristics of the market may have hampered coordination. Transparency may have been limited because prices are individually negotiated between wholesalers and retailers, and the outcome of such negotiations is not transparent. Furthermore, even where customers do switch from one wholesaler to another, this may not be transparent to the third wholesaler that was not involved in the switch, and it might not be distinguishable from a switch to direct supply, making coordination less likely. We also found that to some extent there was potential for some retailers to switch their purchases between wholesalers and distributors, particularly for front-list orders, and to some extent other, non-urgent orders.

7.76 We considered whether there was potential for coordination to emerge in the market and whether the merger would impact on the likelihood of coordination developing, or the impact or sustainability of any coordination. The merger would result in two similarly-sized trade wholesalers, which could face similar incentives, such that they would have an incentive to coordinate.

7.77 We considered that coordination on price between wholesalers would be difficult because of a lack of transparency, as discount rates and any retrospective incentives would be difficult to observe.

7.78 The service offered by wholesalers differentiated them from distributors (such as next-day delivery). It therefore seemed unlikely that wholesalers would have an incentive to reduce their standards of service, as this would reduce the differentiating factors that separated the wholesalers' services from direct supply.

7.79 We therefore concentrated on whether wholesalers could coordinate on the basis of market sharing, using their existing customer allocation as a basis for splitting the market between them.

7.80 However, we believed that a number of features would weaken the sustainability of such coordination. Transparency could be limited in that a loss of sales to a customer might arise because of an increased use of direct supply, or a decline in the retailer's sales, as well as a switch to the other wholesaler, such that wholesalers may find it difficult to determine whether rivals were also engaging in the coordinated behaviours.

7.81 We also found that in the market as a whole, there was some potential for marginal retailers to switch their sources of supply from wholesalers to distributors in response to a decline in relative discount rates. Overall we considered that this could form a significant constraint. The incentives of distributors are substantially different to wholesalers as they are paid a set commission by publishers, which incentivizes them to maximize sales. Publishers already have control of the discount they grant as shown by their channel pricing model. Consequently publishers and distributors could not be expected to join any attempts at coordination between wholesalers.

7.82 In conclusion, we believe that there is insufficient transparency in the market for coordination to be sustainable, or for it to persist without being undermined by substitution of direct supply. We therefore conclude that coordination is not likely to develop as a result of the merger.

Vertical effects

7.83 Woolworths sells books through its high street stores and Internet operations, but told us that it offered only a very limited range of books in its stores. Its range is predominately made up of best-selling authors and mainstream genre ranges such as lifestyle, cooking and crime/thriller. In children's books, its strategy is to offer a substantial 'Kids Books' range at low prices. Woolworths said that it was currently in the process of reordering the product selection in its stores, including shelving space for its HEP and book offerings. The increase in titles stocked by Woolworths as a result of this reorganization was expected to be minimal and there were no plans to diversify the current range (which is virtually all devoted to new release and promotional titles) or to increase floor space for books in stores.

7.84 Woolworths said that it currently offered 22,000 titles through its website, with books sourced via EUK. It said that if the acquisition of Bertram was cleared by the CC, it hoped to use Bertram as its partner to broaden its range.

7.85 Concerns were raised by other retailers in two regards; first, that Woolworths might seek to expand greatly its book-retailing operations, which would incentivize Bertram/ THE to favour Woolworths as a customer over other retailers; and second, that knowledge of book purchases from other retailers might provide Woolworths with useful advance market intelligence.

7.86 TNS data shows that Woolworths' market share in the book retail market has experienced negligible growth over the last three years, of 0.8 per cent in 2004 and 2005 and 0.9 per cent in 2006. Woolworths told us that its offering of books had been, and will continue to be, a far smaller part of its overall product offering than the HEPs (and other products) sold in its stores, and it denied any intention of seeking to expand substantially into book retailing. While we recognize that Woolworths may seek to rebalance its product offer or move into new areas, we do not have reason to believe that it is likely to decide markedly to expand its presence in high-street book retailing significantly.

7.87 In view of Woolworths' limited involvement in the retail market, we consider it unlikely that any gains to its own retail sales by weakening the quality of service or terms offered by Bertram/THE to competing retailers would offset any losses to its wholesaling arm through weakening retail customers and inducing them to shift supplier.

7.88 Sources of market intelligence are readily available in the book industry; books are reviewed and recommendations made from various sources ahead of publication, tables of current best-sellers are readily available, and subscribers to Nielsen's Bookscan can check sales of all books. Ownership of THE already provides Woolworths with potential intelligence on advance sales of books to competing retailers. In these circumstances, we did not believe that the merger would provide Woolworths with any significant advantage in the availability of market information.

Effect on competition in the wholesale supply of books to libraries

7.89 We were told that THE has not been an active competitor in the wholesale supply of books to libraries; THE's direct sales to libraries were limited to one contract, and the library purchasing consortia who provided evidence told us that THE had not been considered as a potential supplier when contracts had been tendered. We do not believe that the merger has removed a significant independent competitor from the market. While THE was a potential competitor in the market, there are already several other potential suppliers in the market.

7.90 We considered other possible ways in which the merger might impact on the market for the wholesale supply of books to libraries.

7.91 Public libraries will often tender for the supply of audio-visual materials at the same time as books. We spoke to several libraries, none of which believed that THE's or EUK's capabilities in the distribution of HEPs would strengthen BLS's ability to win book contracts. Contracts for different elements of supply were usually awarded separately, and we were told that it was common for one purchaser to contract with several different suppliers for different elements of its requirements (for example, adult fiction, children's fiction, reference books and audio-visual materials). We did not believe that any enhancement in Bertram's ability to supply audio-visual materials would result in BLS gaining a competitive advantage in library tenders.

7.92 Bertram has been able to source books for BLS through its trade wholesale arm, by which means it sought to circumvent publishers' channel pricing (see paragraph 4.74). Other library suppliers told us that they were unable to source books in the same way and so were at a competitive disadvantage to BLS. Some publishers told us that they had responded to this situation by increasing discounts available to all library suppliers, although library suppliers told us that they had perceived a recent improvement in terms from only a very few publishers. There was concern that BLS might be able strategically to undercut and exclude other library suppliers, and that if the merger increased Bertram's buying power, it would be able to achieve an even greater price advantage over rivals.

7.93 Bertram has been sourcing books for BLS from Bertram Books since 2006, and therefore this situation has not arisen because of the merger. It is uncertain whether the merged entity will be able to negotiate improved purchasing terms with publishers, because publishers have previously largely maintained channel pricing despite the efforts of large purchasers. Now that publishers appear to realize that this element of channel pricing is threatened, they may be more willing to relax the difference between discount rates applicable to trade and library wholesalers in the future.

7.94 We therefore did not believe that Bertram's ability to seek the strategic exclusion of its rivals was enhanced by the merger.

7.95 Library suppliers sometimes purchase books from trade wholesalers where they are unable to source books from publishers, where libraries require faster service than can be supported by publishers, and recently they have used trade wholesalers as suppliers if these offer books at a cheaper rate than library suppliers could purchase from publishers. A competing library supplier and a purchasing consortium expressed concern that the loss of THE as an independent trade wholesaler left only two remaining trade wholesalers, both of which were associated with competing library suppliers: Bertram Books/THE through BLS, and Gardners with Browns due to its common ownership. It was therefore felt that other wholesalers may suffer a deterioration in terms or service. However, BLS's share in this market is estimated at [✂] per cent and Browns at [✂] per cent by value in 2006 (see Table 9), while the proportion of library suppliers' stock sourced through trade wholesalers tends to be very limited. Therefore, any strategic power to weaken competitors by withholding supply or worsening terms and service would be weak and the potential to benefit directly from this would be marginal. We considered strategic behaviour to be unlikely and any concerns over the loss of an independent source of supply to be the same as those dealt with in the horizontal effects of the merger.

Conclusions on the SLC test

7.96 In answer to the questions in section 36 of the Act, in paragraph 3.14 we concluded that the completed merger by Bertram and enterprises carried on by, or under the control of, Woolworths is a relevant merger situation under section 23 of the Act, and that we therefore have jurisdiction to consider the competitive consequences of the merger.

7.97 For the reasons set out in paragraphs 7.68 to 7.72, 7.87 to 7.88 and 7.94 to 7.95, and in comparison with the situation expected to prevail in the absence of the merger, set out in paragraph 5.12, we conclude that the merger has not resulted, nor may be expected to result in an SLC in the market for the supply of books to retailers (either supermarkets or other retailers) in the UK, and that the merger has not resulted, nor may be expected to result in an SLC in the market for the supply of books to libraries in the UK.