

7th January 2011

Mr R Dedushaj
Economist . Mergers
Office of Fair Trading
Fleetbank House
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LONDON
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Dear Mr Dedushaj

Proposed Acquisition of Mills Group by One Stop Stores plc

Thank you for your letter of 23rd December inviting a response from ACS (the Association of Convenience Stores) to your consideration of the Mills Group acquisition. Our response has been developed in lines with the questions you set.

ACS recommends that the Office of Fair Trading (OFT) should exercise its power under the Enterprise Act 2002 and refer this acquisition for full investigation by the Competition Commission. We further believe that the dominant position of Tesco Stores Ltd should prevent this company from making this acquisition.

The named buyer of the Mills Group is One Stop Stores Limited which is a wholly owned Tesco Stores Ltd subsidiary. We believe that for the purposes of assessing the impact of the acquisition on national and local choice the OFT should make no distinction between a store operated as a One Stop fascia and other Tesco fascias. Secondly, the OFT should consider the consumer impact of the One Stop fascia to satisfy itself of the reasons why this format exists, how it differs from other Tesco formats and whether consumers are adequately informed about the relationship between One Stop and Tesco.

According to respected industry sales monitoring service Tesco currently has a 30.6% share of the UK grocery market.¹ We know that a large market share alone does not constitute reason for blocking an acquisition. However, the cumulative impact of aggressive growth in the market for convenience shopping has significantly changed the market. We urge a full assessment of the implications of this growth on consumer choice, routes to market for new products and marketing, price and service in retail outlets.

¹ Kantar World Panel – Grocery Panel up to 31st October 2010.

1. *What are your views as to the degree of competitive constraint the Mills Group stores pose on other convenience stores, including Tesco Metro and One Stop stores (for example in terms of product offering, geographic concentration, pricing strategy, past and expected expansion, etc)? Please explain briefly.*

Mills Group is an important member of the independent convenience market, rated last year as 22 in the top 50 independent businesses by The Grocer magazine. The growth and success of the Mills group chain has significantly increased competition, most notably with its expansion in regions such as south Wales and the West Midlands. It is of course in the North East that Mills Group has the strongest presence and the greatest consumer heritage. As Mills group stores are converted to Tesco owned fascias customers in all these areas will lose choice.

2. *Do you consider that there are any significant barriers to entry or expansion on convenience stores? Please list (if any) and briefly explain your answer. We would also welcome any supporting evidence or documents in relation to entry barriers in convenience store.*

We are aware of recent conclusions in competition investigations concerning the dynamism and low barriers to entry in the convenience sector. We believe that these conclusions have hampered proper analysis of the implications of previous mergers and also led to unsatisfactory conclusions about competition between convenience stores in the Grocery Market Inquiry 2006-2008.

There are two important considerations:

- Overall the number of convenience stores in the UK declines at an average of 458 per year since 2000. The decline is overwhelmingly due to the exit of independent convenience store operators the total number of independents has declined by 608 per year.

	2000	2001	2002	2003	2004	2005
Total UK C-Stores	46,412	45,478	45,343	44,857	45,304	43,973
Indie C-stores	41,558	40,370	39,951	39,487	39,628	37,876
Decline		1,188	419	464	141	1,752
		2006	2007	2008	2009	2010
Total UK C-Stores		43,689	43,284	43,503	41,845	41,832
Indie C-stores		37,536	36,947	37,448	35,571	35,481
Decline		340	589	501	1,914	90

Source: William Reed Knowledge Store Grocery Retail

- The convenience sector (defined as general grocery stores, normally under 280sqm of retail floor space) cannot be grouped for analysis as easily as supermarkets. There are clear differences in the barriers to entry and expansion between different types of convenience store format.

A small convenience store, is often more closely akin to a Confectionary, Tobacco and News (CTN) retailer, or newsagent than the larger convenience stores offering a more complete range. Non-affiliated independent retailers predominate in this format and there is a persistent level of churn as stores close and new ones open. However for the larger convenience stores there is far less turnover and the barriers to entry are significantly higher. As consolidation continues the number of operators buying or building stores in this smaller group is contracting.

In considering the impact of this merger it would be a mistake for the OFT to consider all the stores that are defined as convenience stores as of equal competitive constraint one on the other, or that barriers to entry are generally low across the sector as a whole.

3. *Overall, considering the merger as a whole do you have any competition concerns about this transaction, at the local², regional³ or national level, in terms of competition in grocery retailing and/or grocery retailing through convenience stores? Please explain your answer and focus on PQRS aspects of competition as defined above.*

We believe that Tesco penetration into convenience format is already of sufficient scale to be of national competition concern. The combined sales of Tesco Express and One Stop convenience stores make them the largest player in terms of sales through its small format stores. When added to the large volume of sales that take place in Tesco larger format stores that could be considered as convenience shopping trips, we can see just how dominant Tesco is in this market place.

Significant weight is attributed to the consumer benefits that are likely to result from a Tesco acquisition arising from the advantages of existing scale and its ability to deliver lower prices, improved range and better service. However where acquisitions have contributed to the growth of the One Stop format, there is reason to question whether the benefits of scale and immense competitive advantage are actually transferred to the consumer.

The One Stop offer is substantially different to the offer in all Tesco branded formats. For example, there have been a number of media investigations and

² The list and addresses of the acquisition stores can be accessed here:
http://www.offt.gov.uk/shared_offt/mergers_ea02/2010/MillsGroupstores

³ The acquisition stores are located in the North-East, Cumbria, Yorkshire, the East Midlands, West Midlands and South Wales.

consumer reports suggesting that One Stop is more expensive than Tesco Express (examples of recent media investigations enclosed).⁴

Previous studies provide some indication of cause for concern, for example a study by the University of Southampton in 2007 demonstrated higher prices and poorer consumer offer in a group of One Stop stores compared before and after they were converted to the Tesco Express format.

Largest differences between perceptions of Tesco Express now and One Stop stores prior to conversion

- Shop is cleaner +62.2%
- Shop layout has improved +58.7%
- Range of fresh fruit & vegetables has improved +58.7%
- Range of other food has improved +55.4%
- Quality of fresh fruit & vegetables has improved +54.8%
- Quality of other foods has improved +47.9%

We believe that the reasons behind the stark variation in consumer offer and its implications must be fully understood before any further expansion of One Stop is sanctioned. This should take the form of an independent and comprehensive analysis of the price, range and consumer experience comparison between Tesco and One Stop.

4. *Leaving aside any effects that this merger may have, are you aware of any feature of this/these market(s), or activities of the firms acting in them, that you consider to restrict or distort competition between firms? If so, please give details.*

Tesco wields significant buying power in the UK grocery market. Their national market share and control over routes to market is crucial to the success of any supplier seeking national or regional penetration for their product. This has been proven to result in advantageous buying terms. In the Grocery Market Inquiry, the Competition Commission concluded that the differential between the largest buyers and the remainder of the supply chain was 13%.⁵ This significant buying advantage affects ability of other businesses to compete.

The main impacts are in significantly better gross profit margin and ability to invest in growing their network. In the case of new store acquisitions the impact of Tesco development into convenience has been to inflate the cost of most commercially viable sites reducing significantly the number of businesses that can compete for stores in this format. It is this differential that is at the root of the fast growth of the

⁴ Marcus Leroux, Times; [Tesco's Secret Chain Charges More](#). Sean Poulter, Daily Mail; [Tesco Charging Higher Prices for Groceries in its Chain of One Stop Local Shops](#)

⁵ CC GMI Final Report

Tesco Express format and its rise to be the largest convenience operator (in terms of sales) in a very short period.

The implications are reduced competition leading in some local markets to a concerning lack of local choice. Over the long term the increasing cross format dominance of Tesco is likely to be coupled with price flexing, consolidation of range and significantly reduced accessibility to services.

5. *Comments on Previous Merger Investigation Methodology*

There have been a number of investigations into the competitiveness of the grocery market since the first supermarkets Inquiry in 2000. However we maintain that none of the investigation conducted to date have provided an adequate analysis of competition developments in the market for convenience shopping. Investigations culminating in the most recent Grocery Market Inquiry (2008) have sought to assess the competitive position and consumer impact of competition between the large format supermarkets. The market investigations in 2000 and 2008 never adequately analysed the dynamics of competition and consumer impact of the shifting composition of the market for convenience shopping.

It is ACS's view that the relevant market to be considered in this investigation is the market for convenience shopping; this should be determined by the use of the shop in question by consumers. In particular we would refer to impulse and top up shopping for grocery, tobacco, news and magazines, certain non-food lines and key services such as bill payment and lottery.

Recent mergers have been more increasingly more sophisticated in their definition. For example Co-operative/Balfour (2004) and Tesco/Capper & Co (2009) better reflect the evolving definition of the market than the original 2000 Inquiry's two market definition. For convenience stores] the methodology draws around each of the relevant stores an isochrone of the following dimensions:

- all convenience stores within a five minutes drive time in all areas;
- all mid-size stores located within five minutes' drive time from it (or within 10 minutes' drive if it is located in a rural area).
- all one-stop stores located within 10 minutes' drive time from it (or 15 minutes' drive time if it is located in a rural area); and

We agree with these isochrone definitions, but remain concerned about the fascia threshold for identifying possible lack of competition. Most recently this threshold has been the absence in the agreed isochrones of 3 different competing fascias. This is the same as is employed in the case of large format supermarkets.

This threshold is not sufficient the case of convenience shopping. There are significantly more convenience stores in most local markets that there are

supermarkets. There is also much greater diversity with a much larger presence of small and medium size enterprise operators.

The analysis has to pay attention to smaller business for two important reasons

- i. consumers convenience shopping needs are met by a broader range of retail provision than other food shopping. In large format supermarkets, the national competitor set is already, almost entirely, reduced to a small number of national or international brands. In convenience shopping there remains an important small business community that provides an important alternative choice for consumers.
- ii. on balance the impact of a Tesco takeover, and an assumed increase in turnover of that store, is more likely to have a detrimental commercial impact on smaller players and presents a greater threat of exit and loss of consumer choice.

It is therefore ACS recommendation that the fascia criteria for this merger should be at least 3 competing national brands and 2 independent or regional retailers.

We welcome the opportunity to submit views to the investigation of this merger, and would be keen to provide whatever evidence that may be useful to you as you determine this matter. Please contact me on either 01252 533009 or email shane.brennan@acs.org.uk

Yours sincerely

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