

**NBTY EUROPE LIMITED/JULIAN GRAVES LIMITED MERGER
INQUIRY**

Provisional findings report

Published: 22 July 2009

The Competition Commission has excluded from this published version of the provisional findings report information which the Inquiry Group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by ✂.

NBTY Europe Limited/Julian Graves Limited merger inquiry

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Glossary

Summary

1. On 20 March 2009, the Office of Fair Trading (OFT) referred the completed acquisition of Julian Graves Limited (JG) by NBTY Europe Limited (NBTY) 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 3 September 2009.
2. NBTY, through Holland and Barrett Retail Limited (H&B), and JG overlap in the retailing of nuts, seeds and dried fruit, including coated and flavoured products (NSF).
3. NBTY submitted to us: (a) if it had not acquired JG, the JG business would have failed, would not have been restructured and would have exited the market as there was no likelihood of Baugur Group hf (Baugur), the former majority owner of JG, finding an alternative buyer within the required timescale; and (b) the market for NSF was very broad, with many retailers offering comparable products at competitive prices, including all the large supermarkets, convenience stores, and health food retailers. We considered both these arguments.
4. We found that, prior to the acquisition by NBTY, JG was failing, principally because it was overburdened with debt, and would only have survived with an investment of new equity. We found that Baugur was unlikely to have made this investment, but there were several other parties, in addition to NBTY, which were very interested in doing so. We have provisionally concluded that, if NBTY had not bought JG, another buyer would have done so. We believed that, under the ownership of this buyer, JG would have continued to offer a wide range of NSF and, with a more robust financing structure and adequate working capital, would have returned to profitability.

5. We analysed the competitive interaction between H&B, JG and other retailers of NSF, in particular the supermarket retailers. We found that supermarket retailers sold at least 65 per cent of the NSF supplied to consumers in the UK. We were not able to gather much information from independent health stores or other specialist retailers of NSF, though we did obtain information from NSF wholesalers, which informed us on the range of products available from some independent health food stores and their recommended retail prices. We considered whether the NSF offerings of H&B and JG differed substantially from the NSF offerings of other retailers, in particular in terms of price and range. We also considered whether H&B and JG targeted one another more closely than other retailers when they determined their NSF prices and promotions. Lastly, we considered evidence on customer views and behaviour.

6. With regard to prices, we found that, while JG's prices appeared to be substantially lower than those of the other NSF retailers in our sample, H&B's prices were similar to the supermarket retailers. We found that, while the prices of H&B and JG appeared to move together quite closely over time, H&B's margins were more closely correlated with a supermarket retailer than with J&G. The results suggested that, in terms of both prices and price movements, H&B and JG did not appear to operate in a distinct market to the supermarkets. With regard to range, we found that there were very few products stocked by H&B or JG which were not also stocked by at least one of the supermarkets, but we found that both H&B and JG (in particular JG) stocked some larger pack sizes than the supermarkets.

7. With regard to price setting, we found that H&B monitored the prices of JG and some of the supermarkets but, when H&B recommended changing its prices on the basis of the difference between its prices and the prices of a competitor, JG's prices appeared to be most significant. We found that neither H&B nor JG targeted each other specifically in either their national pricing activity or their local promotions.

8. We gathered evidence on customer views and behaviour from a survey commissioned by NBTY and from an analysis of the effect on an incumbent H&B store of another retailer opening a new store selling NSF in the same vicinity. We found from the survey that customers of H&B and JG perceived supermarkets as their first-choice alternative if their chosen H&B or JG store was not available and that a majority of them also shopped elsewhere for their NSF, with a supermarket being their most popular alternative. We found from our analysis of the effects of entry that a JG store opening within 1 mile of an H&B store had a greater effect in reducing the incumbent's NSF revenues than any other store opening in the same vicinity, but a large or medium-sized supermarket store opening within a 10-minute drive-time, and to some extent within a 30-minute drive-time, also had a negative effect.
9. We concluded that H&B and JG were close competitors for NSF, but the relevant product market included supermarket stores and any other retailers, including independent health food stores, where a sufficiently large range of NSF products was available at similar prices. We recognized that the retailing of NSF was differentiated and we did not believe that it was necessary for a retailer to offer exactly the same range of NSF as H&B and JG, or at exactly the same prices, in order to provide a competitive constraint. Rather, we found that some NSF retailers would be closer competitors to H&B and JG and other NSF retailers would be more distant competitors, but we concluded that we should consider all sources of competitive constraint on H&B and JG in each geographic market.
10. We found that there were some features of the market which were local and other features of the market which were national. We recognized that both H&B and JG, and most of the supermarkets, set prices nationally, but also that the ability of customers to switch between retailers of NSF was limited to a local level. We found that the size of the relevant local area depended on the type of store providing the

constraint and was likely to depend on the area concerned (ie customers might be willing to travel further in rural areas). We concluded that the market was likely to be local but we could not conclude on a precise geographic market definition for every local area as the size of each geographic market was likely to vary.

11. We considered what filters to apply to determine the local areas where the loss of competition between H&B and JG might be of concern. First, we found that the merger was unlikely to give rise to adverse effects in local areas where there were four competitors remaining in the market after the merger. Second, we found that a retailer selling 50 or more NSF stock-keeping units (SKUs) was likely to provide a reasonable competitive constraint on H&B and JG.
12. We found that, in all but 18 locations where an H&B store overlapped with a JG store, there were at least three other retailers stocking 50 or more NSF SKUs within a 10-minute drive-time of the H&B store. Of the 18 locations where there were two or fewer other retailers selling 50 or more NSF SKUs, we found that the JG store in one location was likely to close in the near future in any event, so the merger would not result in any loss of competition. Given the degree of variability in the geographic market definition, we considered how the strength of competition might alter if, instead of a 10-minute drive-time, we used a 30-minute drive-time around each of the remaining 17 H&B stores. We found that, if we defined each local market in this way, there were seven locations with two or fewer other retailers selling 50 or more NSF SKUs.
13. We considered whether the loss of competition in these 7 to 17 locations would result in national or local effects, such as higher NSF prices or reduced ranges and quality.

14. We found that a reduction in the number of retailers selling 50 or more NSF SKUs to three or fewer in a maximum of 17 locations (approximately 3 per cent of H&B's store portfolio and less than 5 per cent of JG's store portfolio) would not be sufficient for it to be profitable for the merged entity to increase substantially its prices of NSF, or to reduce its range (or any other feature of its NSF offering), on a national basis.

15. We also found that it was unlikely that the merged entity would find it profitable to raise its prices substantially, or to reduce the range or quality of its NSF offering, in any local market, for several reasons:
 - In each local market, in addition to the one or two retailers selling more than 50 NSF SKUs, there were some other retailers selling less than 50 NSF SKUs, which provided a further, albeit more limited, competitive constraint.
 - The extent of the constraint provided by one supermarket was likely to be greater in a situation where there were no other supermarkets (ie in an area with only one supermarket, NSF consumers might perceive this supermarket as the principal alternative to H&B and JG; whereas in an area with many supermarkets, NSF consumers might perceive many different alternatives).
 - H&B and JG currently set prices nationally and there would be a cost to deviating from this policy which would be likely to outweigh any potential benefits (we noted that, prior to the merger, H&B and JG set prices nationally, despite facing limited NSF competition in some locations).
 - Both H&B and JG sold other products and any deterioration in quality or service would affect the other parts of the merged entity's business (prior to the merger H&B and JG did not vary the range, quality or service of their NSF offerings between locations, despite facing limited NSF competition in some locations).
 - Small-scale new entry on a local level was relatively easy.

16. For these reasons, we have provisionally concluded that we do not expect the completed acquisition of JG by NBTY to result in an SLC in the retail supply of NSF in the UK or in any local market in the UK.

Provisional findings

1. The reference

1.1 On 20 March 2009, the OFT referred the completed acquisition of JG by NBTY to the CC for investigation and report. The reference was made under [section 22](#) of the Act. We are required to publish our final report by 3 September 2009. Our terms of reference are set out in Appendix A.

1.2 This document, together with the appendices, constitutes our provisional findings, which we are required to publish and notify to NBTY under the CC's Rules of Procedure.¹ Further information, including non-commercially-sensitive versions of main-party and third-party submissions, and summaries of evidence, can be found on our website.²

2. Industry background and the parties to the merger

2.1 This section provides a brief overview of the parties to the merger and the activities in which they overlap.

The parties to the merger

Julian Graves

2.2 JG is a speciality food retailer, selling NSF, confectionery, baking and cookery products, herbs and spices, and specialty teas and coffee. JG also stocks a range of non-food products, including house ware and cookery ware.

2.3 JG was founded by Mr Nick Shutts, who began the business in 1984 by selling loose baking ingredients on a market stall. After expanding the number of his stalls, Mr Shutts opened his first high street store in 1987 and, in 1993, he and his partner,

¹ *Competition Commission Rules of Procedure, CC1, paragraph 10.3.*

² www.competition-commission.org.uk.

Mr Nigel Morris, opened the first JG store ('Julian' and 'Graves' being the founders' middle names). The business expanded rapidly and there are now 346 JG stores, of which 341 are in the UK. Almost 50 per cent of JG's stores have been opened in the last five years. JG also has its own packing operation, where it packages most of the NSF sold in its stores.

2.4 In 2003, Mr Shutts sold a controlling interest in JG to a consortium led by Baugur for £[X] million, though he retained a [X] per cent shareholding in Barney Holdings Ltd (Barney), the new holding company for the business. At this point, Mr Morris left the business. Subsequently, in December 2005, Barney purchased Whittard of Chelsea plc (WOC). In November 2007, the business was refinanced and, from this time on, WOC operated separately from JG.

2.5 For the year to 31 March 2008, JG's UK turnover was £[X] million. Approximately [X] per cent of JG's sales were food items, and approximately [X] per cent of its sales were NSF.

2.6 Further information on JG is presented in Annex 1 of Appendix B.

NBTY, Inc

2.7 NBTY, Inc is a global manufacturer, wholesaler and retailer of nutritional supplements based in the USA. The business was founded in 1971 as Nature's Bounty Inc, a subsidiary of Arco Pharmaceuticals, and by 1992 it was the largest publicly-owned vitamin supplier in the USA. NBTY, Inc now offers over 22,000 products worldwide, including food supplements, health foods and herbal remedies. NBTY, Inc is a public company with its shares listed on the New York Stock Exchange.

NBTY Europe

2.8 NBTY is a wholly-owned subsidiary of NBTY, Inc and is the holding company for most of the group's European activities, including GNC (a specialist retailer of sports nutrition supplements and other vitamins, minerals and supplements (VMS)) and H&B.

Holland & Barrett

2.9 H&B is a retailer of health foods and nutritional products. Founded in 1920, it has 522 stores in the UK and also operates an Internet retail business. NBTY acquired H&B in 1997. H&B also has its own modern and well-equipped packing operation, where it packages most of the NSF sold in its stores.

2.10 H&B sells body building and sports nutrition products, aromatherapy products, digestive aids, food supplements, slimming products, herbal and homeopathic products, and NSF. All H&B's food products are suitable for vegans, and contain no genetically modified products or artificial ingredients. H&B staff are trained to advise customers about the uses of their various products, although no specific training is given about NSF products.

2.11 For the year to 30 September 2008, H&B and GNC together achieved total sales of £[x] million. NSF accounted for around [x] per cent of H&B's turnover through its stores.

The merger

2.12 On 16 September 2008 NBTY purchased the entire issued share capital of JG from Pyle Limited (Pyle), a subsidiary of Barney, for £[x] million on a debt-free and cash-free basis.

2.13 Further information on the transaction is given in Appendix B.

Industry background

2.14 H&B and JG overlap in the retailing of NSF,³ which includes products such as Brazil nuts, cashew nuts, almonds, pistachios, pumpkin seeds, dried apricots, raisins, sultanas and dried bananas. NSF products are often eaten as snacks or consumed with other products, like yogurt or cereal, and they are also used in home baking and a wide range of dishes.

Health foods

2.15 In the last ten years, NSF and other health foods have become increasingly popular, with demand for these products stimulated by government campaigns and media programmes promoting healthier diets and good nutrition, such as *You are what you eat*.⁴ Mintel's *Health Food Retailing* report, April 2008, stated that the supermarkets have become the main driver of growth in health food sales.⁵

NSF revenue trends

2.16 As a result of the growth in consumer demand, NSF products are now available in many retail outlets, including supermarkets, health food stores, convenience stores, pharmacies, petrol stations, and on the Internet. NBTY told us that, in particular, the supermarkets had become increasingly focused on health food products like NSF and their share of supply of NSF has increased substantially over the last five years. NBTY quoted Mintel's *Nuts, Seeds and Dried Fruit* report, August 2008, to support this view. Later in the inquiry, NBTY also provided data from TNS, showing that, between 2006 and 2008, H&B's share of supply of NSF fell from [X] to [X] per cent,

³The parties also overlap in the supply of VMS. However, JG's share of the VMS market is extremely small, with sales in 2008 of only £[X] million, including herbal and aromatherapy products. Therefore, we did not consider the VMS market any further.

⁴*You are what you eat* was a television programme starring Gillian McKeith, which was launched on Channel 4 in 2004 and ran in various formats until 2007.

⁵Mintel Report *Health Food Retailing* April 2008, p7.

while the combined share of the supermarkets increased from [x] to [x] per cent. We considered the data from Mintel (see paragraphs 2.17 to 2.20) and TNS (see paragraphs 2.21 and 2.22). We also compared this information with data from the Office for National Statistics (ONS) (see paragraphs 2.23 to 2.26) and data we received from H&B, JG and some of the supermarkets (see paragraphs 2.27 and 2.28). We found that there were some inconsistencies between the data from the various sources, which made it difficult for us to form a definitive view on the market size and the trends in its growth.

Mintel data

- 2.17 Mintel estimated that sales of NSF had grown faster than the growth in health foods overall, rising by 38.1 per cent between 2003 and 2007, as shown in Table 1. Mintel estimated that, by 2007, the overall supply of NSF in the UK was worth £511 million.

TABLE 1 UK retail sales of NSF, by value, 2003 to 2007

	2003		2005		2007		% change 2003–2007
	£m	%	£m	%	£m	%	
Nuts	232	63	275	61	309	60	+33.2
Seeds	7	2	15	3	26	6	+271.4
Dried fruits	131	35	159	36	176	34	+34.4
Total	370	100	449	100	511	100	38.1

Source: Mintel *Nuts, Seeds and Dried Fruit*, August 2008.

- 2.18 Mintel estimated that the supermarkets' share of NSF sales in the UK had increased from 66 per cent in 2003 to 71 per cent in 2007, as shown in Table 2.

TABLE 2 UK sales of NSF, by value by type of outlet, 2003 to 2007

	2003		2005		2007		% change 2005–2007
	£m	%	£m	%	£m	%	
Multiple grocers/Co-ops	243	66	311	69	363	71	21.9
Independents & health stores	37	10	39	9	41	8	7.7
CTNs*	17	5	18	4	20	4	11.1
Off-licences	2	5	2	-	-	-	-
Garage forecourts	9	2	12	3	15	3	16.7
Sub-total	308	83	382	85	439	86	19.6
On-trade food service†	62	17	67	15	72	14	11.9
Total	370	100	449	100	511	100	18.5

Source: Mintel *Nuts, Seeds and Dried Fruit* August 2008. This table is quoted directly from the Mintel report.

*Convenience stores, tobacconists and newsagents.

†Including pubs, clubs, wine bars, vending food service and other trade outlets.

2.19 Mintel’s estimates included the sales of H&B and JG in the ‘independents and health stores’ category, though Mintel noted that JG’s business model and retail proposition were quite different from traditional health food stores. Mintel estimated that the total sales for this category were £41 million in 2007. However, H&B told us that its total NSF sales for 2007 were £[redacted] million and JG told us that its sales were £[redacted] million, giving a total of £[redacted] million, which caused us to treat Mintel’s estimates with some caution.

2.20 Mintel also forecast that sales of NSF would continue to grow, increasing by a further 32 per cent by 2013.⁶ However, several retailers told us that, while growth had been good historically, sales of NSF had been flat more recently, or even slightly in decline, and they did not expect significant future growth.

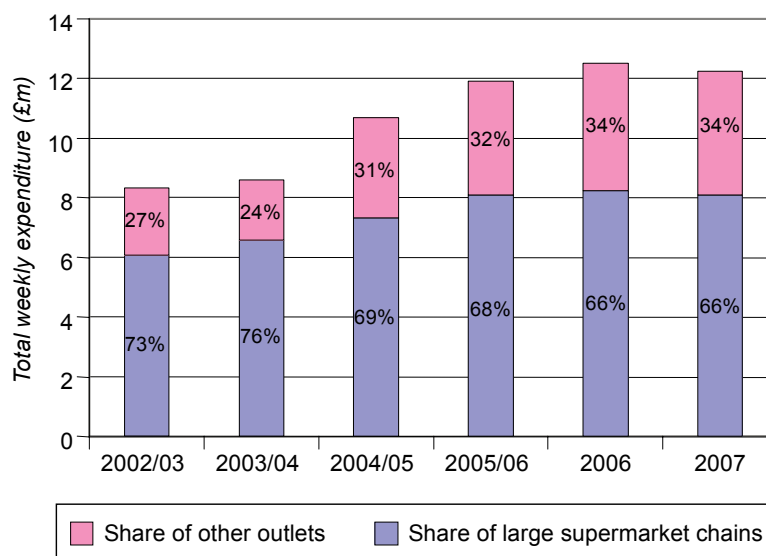
TNS data

2.21 NBTY provided us with data from TNS for the period 2006 to 2008, which summarized the shares of supply of NSF for each of the supermarkets and H&B, though this data excluded any spending on NSF products used for home baking. JG was not

⁶Mintel *Nuts, Seeds and Dried Fruit*, August 2008, p43.

FIGURE 1

Share of sales by outlet, based on ONS data



Source: CC analysis of ONS data.

2.25 According to ONS data, the large supermarket chains' share of NSF sales has fallen from 73 per cent in 2002/3 to 66 per cent in 2007.

2.26 We noted that the ONS estimates of total consumer expenditure on nuts and dried fruits at other outlets appeared more consistent with the sales figures from H&B and JG. However, NBTY told us that the ONS data was not a reliable indicator of shares of supply as the data was not gathered for this purpose.

Data from the supermarkets, H&B and JG

2.27 We obtained data on the sales of NSF from H&B, JG and three supermarkets, as summarized in Table 4.

TABLE 4 UK sales of NSF, by value by outlet, 2002 to 2009

	H&B £m	Change %	JG £m	Change %	[X] £m	Change %	[X] £m	Change %	[X] £m	Change %
2002	[X]		[X]							
2003	[X]	[X]	[X]	[X]	[X]					
2004	[X]	[X]	[X]	[X]	[X]	[X]				
2005	[X]	[X]	[X]	[X]	[X]	[X]				
2006	[X]	[X]	[X]	[X]	[X]	[X]				
2007	[X]	[X]	[X]	[X]	[X]	[X]	[X]		[X]	
2008	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]

Source: CC analysis of data provided by NBTY, JG, [X].

[X]

2.28 The figures suggested that, between 2003 and 2005, H&B, JG and [X] increased their sales of NSF, though H&B and JG increased at a faster rate. Since 2005, we observed that H&B’s sales of NSF have been in decline while both JG and [X] have continued to grow. The limitations in the data did not allow us to observe trends for the other supermarkets

3. Jurisdiction

3.1 Under [section 35](#) of the Act, and pursuant to our terms of reference (see Appendix A), 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.⁸ We were satisfied that both H&B and JG were ‘enterprises’ for the purposes of the Act.⁹

3.2 Any two enterprises cease to be distinct if they are brought under common ownership or control. The acquisition of JG by NBTY was completed on 16 September 2008, and included the transfer of all JG’s trade and assets. As a result of the acquisition, the JG enterprise ceased to be distinct from enterprises carried on by, or under the control of, NBTY.

⁸Section 23 of the Act.

⁹Section 129(1) of the Act.

3.3 [Section 23\(3\)](#) of the Act provides that the share of supply test is met if, as a result of the merger, NBTY increases its share of the supply of goods or services of any description in the UK, or in a substantial part of the UK, to at least 25 per cent as a result of the merger or, if it already supplied at least 25 per cent, it has increased its share as a result of the merger. Taking the relevant description of goods as the sale of NSF through health stores and other specialist retail outlets (see paragraphs 2.2 and 2.10), we believed that NBTY had over 25 per cent of the share of supply and, as a result of the merger, its share of supply had increased (see [Table 2](#) and paragraph 2.19).¹⁰

3.4 For the reasons set out in paragraphs 3.1 to 3.3, we concluded that a relevant merger situation within the meaning of the Act had been created and, therefore, we did not consider whether the turnover test was met.

4. The merger and the counterfactual

4.1 This section describes the merger and each party's rationale for completing the transaction. It also sets out the evidence we have received and our considerations with regard to the counterfactual, against which we compared the competitive effects of the merger. The details of this analysis are presented in Appendix B.

The merger

Baugur's rationale for selling JG

4.2 Representatives from Baugur told us that, in 2007, Baugur decided to try to sell JG because it had serious concerns about the business's competitive position in the market, in particular because it perceived that other retailers were increasingly encroaching on JG's core offering. However, at this time, the offers it received for the

¹⁰[Section 23\(6\)](#) of the Act provides that references to the supply of goods which are subject to different forms of supply may be construed by reference to the form of supply taken together, separately or collectively, as considered appropriate. In this case, H&B and JG are both specialist retailers of NSF so we considered that a form of supply through independent health stores and other specialist retailers of NSF was most appropriate for the purposes of determining jurisdiction.

business were not commensurate with its price aspirations. Therefore, in November 2007 it refinanced the business and it only restarted the sale process in June 2008. By this time, Baugur was also aware that [REDACTED].

NBTY's rationale for acquiring JG

4.3 NBTY told us that, in acquiring JG, it saw the opportunity to turn around a business that was in a parlous state, by utilizing its expertise in running successful retail businesses and by generating synergies, [REDACTED]. However, NBTY had considered acquiring JG on two previous occasions, after being approached by JG's owners, well before JG became financially distressed. Indeed, at the time of the acquisition, H&B's Managing Director stated that H&B had always identified JG as a key competitor. NBTY's vision for JG was for the business [REDACTED]. NBTY told us that it intended to maintain JG's stores under their existing brand, except for those stores trading at a loss which could not be made profitable, which were likely to be closed.

The counterfactual

4.4 In order to assess the effects of the merger on competition, we evaluated the competitive constraints with the merger compared with the situation that we expected would have prevailed without the merger (the 'counterfactual').¹¹

NBTY's views

4.5 NBTY submitted that, if it had not acquired JG, the JG business would have failed and exited the market. NBTY said that it was unlikely the business could be restructured and there was no likelihood of Baugur finding an alternative buyer.

¹¹CC2, paragraph 1.22.

CC analysis

4.6 We considered whether the three tests for a failing firm argument were met, ie whether:

- JG would have been unable to meet its financial obligations in the near future;
- JG would have been unable to restructure itself successfully; and
- there was not a less anti-competitive alternative to the merger.

Test one: unable to meet its financial obligations in the near future

4.7 We found JG was highly leveraged, partly as a result of Baugur's acquisition of WOC and the subsequent refinancing of the business in November 2007. JG was struggling to maintain its debt payments to Landsbanki and management was resorting to desperate measures to generate cash, including significant price discounting and opening stores in new locations simply in order to receive landlord incentive payments. Many suppliers had put stop orders on JG as a customer, causing JG's stock levels to fall and JG's range of available products to contract, and landlords were beginning to take legal action to pursue rent payments. At the time of the acquisition the business was still trading but had negative net assets. JG's auditors did not feel that they could sign off their audit opinion on the accounts to March 2008, which would require a belief that the business was a going concern, until they had received a letter of parental support from NBTY following the acquisition. We concluded that JG would have been unable to meet its financial obligations in the near future.

Test two: unable to restructure itself successfully

4.8 At the time of the merger, JG was desperate for cash to meet its financial obligations. However, it was already significantly over-leveraged and we did not believe that the business could obtain any new debt on the basis of its capital structure at the time and its recent trading performance. The Baugur representatives told us that Baugur was not willing to invest new equity in JG, so the only other option was some kind of

equity investment from another party, either a debt for equity swap by Landsbanki or an acquisition and refinancing of the business by someone else. We considered these options under test three. With regard to test two, we concluded that it was very unlikely JG would have been successfully restructured to become economically viable again on its own.

Test three: not a less anti-competitive alternative

- 4.9 We noted that, following the acquisition and an injection of £[~~3~~] million from NBTY, and the secondment of a new general manager from NBTY, JG had returned very quickly to being cash-flow positive. JG had resumed standard payment terms with most of its suppliers, settled debts with landlords and had ceased its practice of unsustainable widespread discounting. We believed that this turnaround demonstrated that, with a relatively small amount of new capital and some new management expertise, it was possible to begin to return the business to profitability.
- 4.10 We also noted that Baugur received two second round offers for JG in addition to the offer from NBTY. These offers were from private equity bidders. Neither of these bidders were invited into the final stage of confirmatory due diligence, but both of them had invested significant time and resource in considering the opportunity so far. Both of these bidders told us that they had established a good knowledge of the business, through discussions with management and access to an online data-room. Both of these bidders had also undertaken some commercial due diligence, though one of the bidders suggested that it probably had some further work to do. Neither of these bidders had debt financing in place by the time of their second round bids, but one of the bidders was willing to buy the business on an all-equity basis (including making an allowance for new working capital), and the other bidder was hoping that Landsbanki would be willing to roll over some of its debt in the business. Both of these bidders had experience of transactions in the retail sector and their bids were

highly credible. Both of them recognized that there were problems in the business which needed to be addressed but both bidders told us that, under their ownership, JG would have continued to sell its core NSF offering. We concluded that, if NBTY had not been involved in the sale process, it was very likely that one of these alternative private equity bidders would have acquired JG by the middle of September 2008. Furthermore, we noted that Baugur received first-round offers from four other bidders, including a bid from the existing management team, though these parties were not invited to proceed to the second-round stage.

- 4.11 We also believed that, even if a transaction had not completed at that time and if, in due course, the business had gone into administration, an acquisition by one of the second-round private equity bidders, or another party, would still have represented a more attractive option to the administrator and Landsbanki than the alternative of liquidation. In this scenario, the acquirer might have acquired a smaller portfolio of JG stores than if the business had been acquired prior to administration, but we believed that the acquisition would still have represented a less anti-competitive alternative to the merger.
- 4.12 We concluded that, compared with the sale of the business to NBTY, there were other less anti-competitive alternatives for JG or its assets.

Conclusion on the counterfactual

- 4.13 We concluded that, on its own, JG would have been unable to meet its financial obligations in the near future and that the business would not have been able to restructure itself successfully. However, we found that there were alternative buyers which had expressed clear and credible interest in acquiring the business and, had NBTY not been involved in the sale process, we believed that one of these buyers would have acquired JG. We found that this acquisition is most likely to have

occurred as a result of the sale process conducted by Deloitte in the summer of 2008, and would have concluded by the middle of September 2008 at the latest but, if the process had been delayed for any reason and if JG had gone into administration, we believed that one of the interested financial bidders would still have bought the business. We believed that either of these counterfactual scenarios would have represented a less anti-competitive alternative to the merger.

- 4.14 We concluded that the requirements for a failing firm were not met. We believed that the counterfactual, against which we should compare the effects of the merger, was the acquisition of JG by a financial buyer. JG would have continued trading, though possibly through a smaller number of stores, and NSF would have continued to be a core part of the business's offering.

5. Analysis of the competitive interaction between H&B, JG and the other retailers of NSF

- 5.1 This section summarizes our analysis of the competitive interaction between retailers of NSF, and our assessment of the relevant geographic and product markets. This analysis of competition prior to the merger enabled us to assess the impact of the merger (see [Section 7](#)).
- 5.2 We noted that there were many different types of retailers selling NSF, and the range of NSF which they sold was often different. For example, some retailers focused on selling bags of mixed products (eg mixed nuts and mixed dried fruit), while others focused on selling bags of one type of product (eg separate bags for cashews, almonds and pistachios). Also, some retailers focused on selling small bags, while other retailers focused on selling large bags, and some retailers sold loose product not using bags at all. We recognized that these features made the retailing of NSF a differentiated product market. We considered whether the relevant product market could be limited to specialist retailers of NSF, including health stores, such as H&B,

and other retailers for which NSF constituted a substantial proportion of their offering, such as JG. We found that in order to answer this question it was critical to assess whether general retailers of NSF, and in particular supermarket retailers, would prevent a hypothetical specialist retailer of NSF with a monopoly position from raising its prices.¹² We would have liked to analyse the constraint on H&B and JG from other independent health stores and specialist retailers of NSF but we were not able to obtain comprehensive and reliable data from these retailers as the vast majority of them were small businesses, often operating through a single store, with very limited administrative resources and records.

- 5.3 We looked first at whether the NSF offerings of H&B and JG differed substantially from the NSF offerings of general retailers, and in particular the supermarket retailers, in terms of either the price or range of their products. However, we recognized that the outcome of this analysis was only informative about potential substitutability, not actual substitutability. Therefore, we also looked at the pricing strategies of H&B and JG to see if there was any evidence in the way they set prices or determined promotions to indicate whether they targeted one another more closely than they targeted other retailers. Finally, we looked at evidence on customer views and behaviour.
- 5.4 We considered whether the geographic market was national or local, and reviewed both how retailers of NSF acted when they set prices, and in their other competitive activity, and how consumers acted when they bought NSF.

¹²The hypothetical monopolist test, sometimes called the SSNIP test, is a helpful tool for defining a market. The test asks whether a hypothetical monopolist (over a range of goods or a geographic area) could profitably sustain a small but significant non-transitory increase in price (SSNIP). If not, the market must be wider, as the hypothetical monopolist is continuing to be constrained by other parties. The test is run iteratively, expanding the market each time, until a SSNIP becomes profitable, at which point the boundary of the market has been reached. In our analysis in this inquiry, the question we sought to answer was the same as the question in the hypothetical monopolist test. We employed the qualitative methodology of the SSNIP test, beginning with the narrowest possible market and considering whether customers could switch to products located just outside of this market in response to a price increase in the candidate market, collecting a range of evidence to inform this judgement. Specifically, we considered whether customers of independent health stores and other specialist retailers could switch to buying NSF from supermarket retailers in response to a relative price change.

NBTY's views

5.5 NBTY told us that UK health food retailing was highly competitive, since health foods, including NSF, were now sold in a variety of outlets. These outlets included specialist health food retailers, other retailers with an emphasis on health—such as high street chemists and specialist organic retailers, supermarkets and convenience stores—and Internet and distance sellers. Furthermore, NBTY noted that, according to Mintel's 2008 report (see paragraph 2.18), the supermarkets' share of total NSF sales had grown from 66 per cent in 2003 to 71 per cent in 2007, while the market share of independent and health food retailers, which includes both H&B and JG, had declined from 10 to 8 per cent.

5.6 NBTY also submitted that H&B and JG have differentiated retail offerings. NBTY told us that, while H&B was a specialist health retailer, JG was a general retailer. To support this view, NBTY noted that H&B's main product was VMS, and NSF was sold as a complementary product to this range. In contrast, JG stocked very little VMS (see footnote 3) and its focus, other than NSF, was on confectionery and some baking products. NBTY added that H&B staff undertook specialist training (albeit principally in relation to VMS rather than NSF), which was not the case at JG. NBTY also noted that NSF represented a much larger proportion of sales for JG than it did for H&B. NBTY also told us that the quality of NSF in H&B was higher than in JG, as its range included organic, non-GM and special dietary NSF products, which were not available in JG.

5.7 NBTY told us that H&B and JG competed with all the general retailers of NSF, and in particular with the supermarkets. NBTY told us that H&B had been monitoring the prices of NSF at the supermarkets, as well as the prices at JG and independent health food stores, for many years. NBTY also told us that the supermarkets had a material competitive advantage through their lower cost structures and higher footfall,

and that the promotional strategies of both H&B and JG were an attempt to compete with the supermarkets by drawing customers to their stores. H&B provided us with data showing that a significant proportion of its sales consisted of products on promotion, and that these promotions represented a significant discount from the retail list prices. NBTY told us that, when these promotions were taken into account, H&B's prices were comparable to those of the supermarkets and, in many cases, were lower. Furthermore, NBTY submitted that the supermarkets competed strongly with both H&B and JG in terms of the range of NSF available. Based on a count of the number of NSF SKUs available in stores, NBTY told us that many supermarkets matched or even exceeded the ranges on offer at H&B or JG. NBTY told us that, when specialist retailers introduced new products, which appeared to be profitable, the supermarkets would quickly follow by introducing the product in their stores. For example, NBTY noted that, recently, the supermarkets had been quick to follow the lead of the specialist retailers with the introduction of goji berries.

- 5.8 NBTY supported its submission with an analysis of the NSF product overlaps between H&B, JG and some of the supermarkets. This analysis looked at the number of NSF SKUs sold by H&B, which are also stocked by JG and at least one of Tesco, Sainsbury's or Asda, using H&B's price tracking data. We noted that this analysis was based on a selection of products rather than on the full ranges available from the different retailers, but NBTY submitted that this analysis showed that:
- (a) The overlap between the supermarkets' NSF ranges and the ranges of H&B and JG was greater than the overlap between the NSF ranges of H&B and JG.
 - (b) For those NSF products which were stocked by both H&B and JG, there were only a few products which were not also stocked by at least one supermarket.
 - (c) The SKUs stocked by both H&B and JG but not by a supermarket tended to be standard NSF products sold in large pack sizes. NBTY told us that these SKUs were constrained by the prices of the same products sold in small pack sizes,

which were available from one or more supermarkets. NBTY submitted data to support this view, showing the effect on sales of large pack sizes from promotions on sales of other pack sizes.

Third-party views

- 5.9 Most supermarkets told us that specialist health food stores were in a separate market from the supermarkets for the supply of NSF products. Marks and Spencer told us that specialist health food stores were a 'destination shop' in themselves. Waitrose told us that, in its view, specialist stores were generally in high street locations and depended to a greater extent on impulse purchases. Morrisons told us that specialist stores offered specialist advice, which differentiated them from the supermarkets.
- 5.10 Sainsbury's told us that there were differences in price, quality, product range and store location between specialist health food stores and the supermarkets. It said that specialist health food retailers fulfilled a different shopping mission compared with the supermarkets. However, it did note that the constraint between specialist stores and the supermarkets might be asymmetric, ie while specialist stores might not constrain the supermarkets, the supermarkets might constrain specialist stores.
- 5.11 Boots told us that, while the range of NSF products on offer in Boots and specialist health food stores might be similar, a key difference was that Boots' products were packaged for immediate consumption. It said that consumers wishing to purchase large quantities of NSF, for example for baking, would not normally buy their NSF from Boots. It suggested that there might be more competition between specialist health food stores and general food retailers. However, to the extent that customers purchased NSF for immediate consumption, Boots told us that it did compete with specialist health food retailers such as H&B and JG.

5.12 Two suppliers of NSF told us that there was one market for NSF products through all retail channels. They told us that the supermarkets and specialist stores stocked a similar range of products. Some suppliers noted that the introduction of whole food ranges in the supermarkets was evidence of the competition between specialist health food retailers and the supermarkets.

Prices and ranges

5.13 We compared the prices and ranges stocked by H&B, JG and the main supermarkets.

Price comparison

5.14 In theory, prices of goods in the same market tend to be close to one another and will move together over time, all other things being equal. Therefore, we used SKU data provided to us by H&B, JG and three supermarket chains to compare their average retail prices of NSF products at a particular point in time and over time.

5.15 On the basis of products sold by H&B in 2009, we created a number of narrow product categories (eg blanched almonds), and then separated the SKUs sold by each of the retailers into these categories. Using these categories, we calculated the average price per kilogram (kg) for each product type, weighting by the total sales volume of each product in each category. On the same basis, we also calculated weighted averages for costs and margins per kg. We calculated the original prices by dividing the total revenue for each SKU in a particular store on a particular date by the unit sales for the same SKU in the same store on the same date. Therefore, the original prices reflected the actual prices paid by customers rather than list prices.

5.16 Table 5 shows the average prices of all NSF product types which were stocked by both H&B and JG and each of the other supermarkets in 2008.

TABLE 5 The weighted average price per kg of all NSF products sold by H&B, JG and three supermarkets, 2008

Number of product types stocked by all three retailers	Weighted average price per kg (£)				
	H&B	JG	Supermarket A	Supermarket B	Supermarket C
53	[∞]	[∞]	8.70		
41	[∞]	[∞]		11.33	
37	[∞]	[∞]			11.44

Source: CC analysis.

5.17 The results suggested that, on average, JG was the cheapest retailer, followed by Supermarket A, which generally had lower prices than H&B (although this difference was not always significant). Supermarkets B and C both charged more than H&B for a comparable group of products. We found similar results when we looked specifically at the prices of the top ten products sold by H&B and JG in terms of revenue, and compared the prices of these products to the prices of the most similar products sold by the other retailers.

5.18 We also looked at the strength of the association of movements in prices over time for different NSF retailers. Table 6 presents three sets of results: for 2002 to 2009 and all 73 product types stocked by both H&B and JG; for 2003 to 2009 and all 57 product types stocked by both H&B and JG and Supermarket A; and for 2007 to 2009, including only those 33 product types stocked by both H&B and JG and all three supermarkets in our sample. We looked separately at the movements in the weighted average price, cost and margin per kg.

TABLE 6 Price, cost and margin correlation results

Sample	Retailer	Correlation with H&B prices	Correlation with H&B costs	Correlation with H&B margins
73 product types, 2002 to 2009	JG	0.81	[∞]	[∞]
57 product types, 2003 to 2009	JG	0.82	[∞]	[∞]
	Supermarket A	0.70	[∞]	[∞]
33 product types, 2007 to 2009	JG	0.74	[∞]	[∞]
	Supermarket A	0.75	[∞]	[∞]
	Supermarket B	0.69	[∞]	[∞]
	Supermarket C	0.78	[∞]	[∞]

Source: CC analysis.

- 5.19 When we looked at the largest sample, we found some evidence to suggest that H&B's prices were strongly correlated with JG's prices. However, when we looked at the two smaller samples and looked at margins rather than prices, we found that H&B's margins were more strongly correlated with Supermarket C's margins than with those of any other retailer, including JG. In all three cases, we found that the correlation coefficients suggested that prices tended to move together quite closely over time, and there was not a large difference in the strength of the correlation across the different retailers.
- 5.20 We concluded from our analysis of prices that, while JG's prices appeared to be substantially lower than those of the other NSF retailers in our sample, H&B's prices were similar to the supermarket retailers in our sample. We found that, while the prices of H&B and JG appeared to move together quite closely over time, H&B's margins were more closely correlated with one of the supermarket retailers in our sample than with J&G. The results suggested that, in terms of both prices and price movements, H&B and JG did not appear to operate in a distinct market to the supermarkets.

Range comparison

- 5.21 Whilst a comparison of the NSF ranges on offer at different retailers cannot tell us about actual substitution, it can inform us about whether consumers have the option of being able to buy their NSF from different stores. In particular, we noted that if the supermarkets stocked a very different range of NSF products to specialist retailers it could indicate a narrow product market. Therefore, we used the same SKU data

which we used for our price comparison analysis to compare the ranges of NSF products offered by H&B, JG and the three sample supermarkets.¹³

5.22 The results of our analysis are presented in Appendix C.

5.23 We found that, overall, the supermarkets, and in particular the supermarkets' large and medium-sized stores,¹⁴ offered a similar range of NSF products to H&B and JG, though JG offered more of these products in large pack sizes. This evidence suggested that NSF customers of H&B and JG could buy almost all the same products from a supermarket.

Conclusions from our comparison of prices and range

5.24 We concluded that the prices for NSF and the ranges of product on offer were sufficiently similar between H&B, JG and at least three supermarkets that, in response to a price rise by H&B or JG, their customers would be able to switch to an alternative supermarket retailer.

Pricing and promotional behaviour

5.25 The above analysis suggested that NSF customers of H&B and JG could switch to supermarket retailers to buy their NSF, but it did not tell us whether customers would switch if H&B or JG increased their prices (or reduced the attractiveness of their offering in other ways). We recognized that there were other factors, besides price and range, which could affect customer preferences for where to shop.

¹³We were unable to collect comprehensive range data from other stores such as independent health stores or other specialist NSF retailers.

¹⁴Large stores are defined as stores with a net sales area over 1,000 sq metres; medium-sized stores are defined as stores with a net sales area between 280 and 1,000 sq metres (see Appendix C). These definitions are consistent with the definitions used in the CC's investigation into the groceries market (see www.competition-commission.org.uk/rep_pub/reports/2008/538grocery.htm).

5.26 In order to investigate the closeness of competition between H&B and JG, compared with some of the supermarkets, we looked at how H&B and JG set their prices and their use of promotional activity. We sought to assess how this behaviour was influenced by each other and by their other potential competitors.

H&B's price tracker

5.27 H&B provided us with its price tracker reports from 2006 to 2009. These reports compared H&B's list prices for a selection of its NSF SKUs with the prices of comparable products sold by four other retailers and with the recommended list prices of a wholesaler which sells to independent health food retailers. We noted that the fact that H&B monitored its prices against these other retailers, including some of the supermarkets, indicated that it was interested in the pricing behaviour of these other retailers and suggested that it perceived them as actual or potential competitors.

5.28 H&B's price tracker reports included a recommendation for how H&B should change the list price of some of its SKUs, given the other retailers' prices. NBTY told us that actual changes to H&B's list prices were not made on the basis of this recommendation alone, and a much wider set of information was considered. We asked NBTY to provide evidence showing how it used the price tracker information in its price-setting decisions but NBTY told us that such documentation was not available. Nevertheless, we believed that the fact that a recommendation was sometimes made could inform us about which competitors' prices H&B perceived to be more important when setting its own list prices. We sought to assess whether there was a relationship between H&B's list prices and the prices of any particular competitor which influenced H&B's recommendation to change its list prices.

5.29 We regressed the ratio of H&B's recommended new list price to its current list price on the ratio of other retailers' prices to H&B's current prices, using separate equa-

tions. We found that where competitor prices are higher relative to an H&B list price, all else held equal, the recommended increment in the H&B list price is higher. This effect was most significant for the difference between H&B's list prices and JG's prices, although the difference to prices at [X] and [X] also had a significant and positive effect.

5.30 The results suggested that the recommended list price changes in H&B's price tracker were positively related to the difference between its list prices and actual prices at JG, but were less sensitive to the difference between its list prices and actual prices at the supermarkets. This evidence suggested that H&B perceived JG as a closer competitor than the supermarkets. However, the amount that we could infer from this result was limited by the fact that the extent to which H&B actually changed its prices on the basis of the recommendations in its price tracker reports was not clear.

Product innovation

5.31 NBTY told us that H&B and JG led the market by introducing new NSF products, which the supermarkets followed (see paragraph 5.7). We identified several instances where H&B was the first retailer to sell a new product, which, subsequently, other retailers stocked. We sought to observe the effect on H&B's sales and prices of the new product when another retailer began selling it but there were problems with this data and analysis. Although we tried a number of different approaches, we were not able to control reliably for general trends in H&B's prices and revenues over time and, therefore, we were not able to reach any robust conclusions.

Promotions

5.32 Both H&B and JG told us that promotions were an important part of their pricing strategies. H&B told us that it determined almost all of its promotions nationally,

though exceptionally [REDACTED]. H&B told us that the opportunities at a local level were not sufficient to make it profitable to deviate from its national pricing and promotions strategy. (The costs to H&B of deviating from this strategy are discussed further in [Section 7](#).) JG told us that it also determined most of its promotions nationally but [REDACTED].

- 5.33 If H&B and JG were close competitors, we might expect to see them running national promotions on the same products at the same time in order not to lose custom to each other. Similarly, we might expect to see a greater incidence of local promotional activity in areas where both stores are present (overlap areas), rather than in non-overlap areas. We noted that the fact H&B did not adapt its prices or promotions locally indicated either that the extent of competition it faced in each of the local areas where it operated, in particular in both overlap areas and non-overlap areas, did not differ significantly; or that, if there were significant differences in the extent of competition, there were not a sufficient number of local areas where H&B faced limited competition to make it profitable to adopt local pricing.

National promotions

- 5.34 Both H&B and JG provided us with the details of all their national and local promotions since 2002. They also provided us with data for each store, detailing revenues, units sold and the gross margin for each SKU from 2002 to 2009. We used this information to investigate whether their use of national and local promotions indicated an attempt to target each other's business.
- 5.35 Using the data on national promotions, we looked at the products which H&B and JG promoted most frequently and we identified a list of ten closely matching or identical SKUs. We then observed how many weeks over the last five years each SKU was on promotion at both H&B and JG, compared with how many weeks each product was

on promotion at either H&B or JG. We found no evidence to suggest that H&B and JG used national promotions on individual SKUs to match each other's prices.

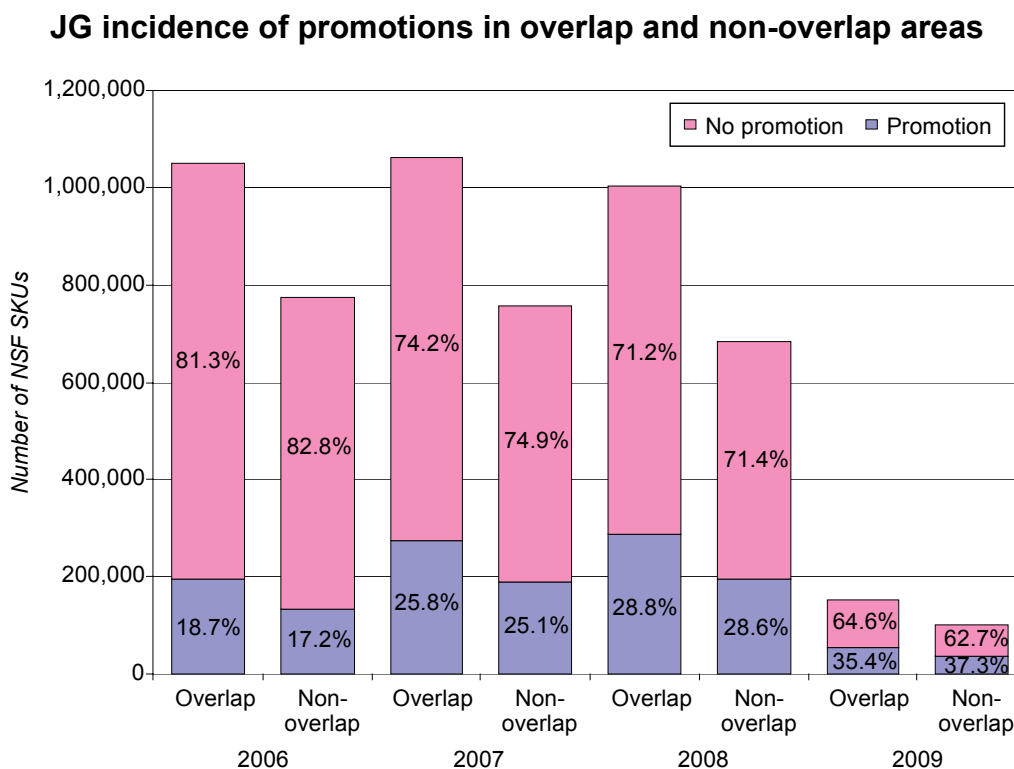
Local promotions

- 5.36 For JG, we noted that there were many incidences of local pricing and so, for the period from 2006 to 2009, we sought to assess whether there were more incidences of local pricing in overlap areas or in non-overlap areas. We noted that, in 2008, [✂]. Therefore, we assessed the results for JG in 2008 with some caution. We believed that the results in all other years were reliable for our purposes.
- 5.37 We investigated how JG determined its local promotions by analysing its sales data. We defined the list price as the maximum price charged for a particular SKU in a given month.¹⁵ We then defined any instance in which a SKU sold for less than 90 per cent of this list price as a local promotion event.¹⁶ We summed these promotion events in each year for overlap and non-overlap areas separately. We then expressed the number of promotions as a percentage of the total number of NSF SKUs available in the year across all stores, both for overlap and non-overlap areas.
- 5.38 Figure 2 shows the incidence of local promotions in overlap versus non-overlap areas for JG, between 2006 and 2009.

¹⁵H&B supplied us with weekly sales data; JG supplied us with monthly sales data.

¹⁶We used a relatively small reduction in price to define a promotion event because there was a risk that the effects of a JG promotion might be hidden in its sales data, due to it running most of its local promotions for one week or less but only providing us with monthly sales information. For example, a 50 per cent reduction against the list price for seven days would only appear as a 12 per cent reduction over the month as a whole.

FIGURE 2



Source: CC analysis.

5.39 We found that there was no significant difference in the number of local promotions as a proportion of total sales run in overlap areas compared with non-overlap areas. We concluded that JG did not appear to use local promotional activity to target H&B as a particular competitor.

Customer views and behaviour

5.40 In order to assess whether customers would switch if H&B or JG increased their prices (or reduced the attractiveness of their offering in other ways), we also considered customers' views and looked at evidence of recent customer behaviour.

Customer survey

5.41 In February 2009, NBTY engaged GfK NOP Limited (GfK), a market research agency, to conduct an in-store survey to gather evidence from the customers of H&B and JG. GfK surveyed customers in ten H&B stores and 50 JG stores and, in total,

interviewed 6,051 customers. NBTY submitted the results of this survey and an interpretation of its results to the OFT.

- 5.42 Limitations in some of the questions asked in the survey meant that we did not believe we could rely on all of the survey results. However, there were some conclusions from the survey which we did believe to be robust and which were informative to our assessment of the competitive interaction between the retailers of NSF.
- 5.43 The survey found that, if customers of H&B or JG could not buy their NSF from their chosen store, 12 per cent of respondents would choose to buy from the same store,¹⁷ 22 per cent of respondents would switch to the other merging party's store, and 37 per cent of respondents would switch to a supermarket. By overlaying each customer's shopping frequency, the survey found that the proportion of customers who would choose to switch to the other merging party was highest for weekly NSF shoppers and declined as the frequency of NSF purchases reduced. However, even for the weekly shoppers, the most popular first-choice alternative was a supermarket.
- 5.44 The survey found that the majority of NSF customers at H&B or JG (53 per cent) bought their NSF from more than one retailer, made up of 9 per cent who also bought from the other merging party, 32 per cent who also bought from a supermarket, 6 per cent who also bought from both the other merging party and a supermarket, and 6 per cent who bought from a combination of other retailers.
- 5.45 The survey also found that the average journey time for customers of H&B and JG to their chosen store at which they purchased their NSF was over 18 minutes (though

¹⁷This result could be interpreted in one of two ways: either respondents were indicating that they would wait until they could purchase their NSF from the same store, or they could have been saying that they would travel to the next nearest available store in the same chain.

the survey did not ask about the mode of transport to reach their chosen store or the distance travelled).

Estimation of elasticities

5.46 In order to assess the degree of actual substitution between H&B, JG and the other retailers of NSF, we tried to estimate own- and cross-price elasticities. We analysed the relationship between quantities sold, price and other factors using data provided by H&B and JG from January 2005 to January 2009¹⁸ and data provided by three supermarkets (though this data covered shorter time periods). We were unable to collect comprehensive data from independent health stores or other specialist retailers of NSF, but we tried to reflect the constraint provided by these parties on H&B and JG in our calculations of their own-price elasticities. We used year and month dummies to capture the effects on demand from factors other than prices.

5.47 However, unfortunately, the results produced by this analysis were problematic due to missing data and inconsistencies in the data we received. We tried various techniques to overcome these problems but the results were not sufficiently reliable and could not be used for our intended purposes.

Analysis of the effect of new store entry on incumbent H&B stores

5.48 We used econometric techniques to assess the effect of different potential NSF competitors opening new stores in the vicinity of an incumbent H&B store. If the new entrant were in the same (geographic and product) market as the incumbent store, we would expect it to gain some market share at the expense of the incumbent store. This shift of consumer demand would result in a reduction in the incumbent's NSF revenues compared with the revenues it would have earned if the entrant had not entered. Alternatively, if the potential competitor were not in the same relevant

¹⁸As noted in footnote 15, JG was able to provide us only with monthly data.

market as the incumbent, either because it was located too far away or because customers of the incumbent store did not perceive its retail offering to be substitutable for the incumbent's NSF offering, we would not expect to see any change in the incumbent's revenues relative to the scenario in which entry did not occur.

- 5.49 The potential competitors to H&B which we considered were JG, high street pharmacy chains and supermarkets. We would have liked to consider the effect of entry by independent health stores or other specialist retailers of NSF but we could not gather sufficient data from these parties to produce any reliable results.
- 5.50 The results of our analysis are presented in Appendix D.
- 5.51 We found that a new JG store appeared to affect an incumbent H&B store if it opened within 1 mile of the H&B store (affecting the H&B store's revenues by 12 per cent over the first month), but had no effect on the H&B store if it opened further away. We also found that the entry of a supermarket store stocking at least 200 NSF SKUs had an effect on an incumbent H&B store if it was located between 1 mile and a 10-minute drive-time away¹⁹ (affecting the H&B store's revenues by at least 4 per cent over the first month), and had a smaller effect on the H&B store if it was located up to a 30-minute drive-time away. On the basis of these results, we concluded that JG appeared to be H&B's closest competitor, particularly where the two stores were located within a mile of each other on the same high street, but supermarket stores offering over 200 NSF SKUs (which included all large supermarket stores and most medium-sized supermarket stores (see paragraph 5.23)) also appeared to provide a constraint on H&B. None of the other results from this analysis were statistically significant.

¹⁹A 10-minute drive-time is equivalent to 2.4 miles; a 30-minute drive-time is equivalent to 7.1 miles (using average urban road speeds).

Summary of the competitive interaction between H&B, JG and the other retailers of NSF

- 5.52 We found that there were many types of retailer selling NSF and there were many ways in which to sell it. We found that different retailers focused on selling different forms of NSF (eg organic, mixed bags, flavoured products, etc), and in different pack sizes. We found that the NSF offerings of H&B and JG were different and the offerings of the supermarkets and other independent retailers of NSF also differed.
- 5.53 We noted comments from some third parties that H&B and JG operated in a different market to the supermarkets but we also noted comments recognizing that there might be an asymmetric constraint, ie that the supermarkets could constrain H&B and JG even though H&B and JG were unlikely to constrain the supermarkets.
- 5.54 We found that, while JG's prices appeared to be substantially lower than those of the other NSF retailers in our sample, H&B's prices were similar to the supermarket retailers. We found that, while the prices of H&B and JG appeared to move together quite closely over time, H&B's margins were more closely correlated with one of the supermarket retailers in our sample than with J&G. The results suggested that, in terms of both prices and price movements, H&B and JG did not appear to operate in a distinct market to the supermarkets.
- 5.55 We found that there were very few products stocked by H&B or JG which were not also stocked by at least one of the supermarkets in our sample, and none of these unique products accounted for a large proportion of sales. On the other hand, we found that H&B and JG (in particular, JG) stocked some larger pack sizes than the supermarkets in our sample, and these large pack sizes accounted for a greater proportion of the sales of H&B and JG compared with the supermarkets.

- 5.56 We found that H&B monitored the prices of JG and some of the supermarkets, suggesting that it perceived them to be competitors. However, we found that, when H&B recommended changing its prices on the basis of the difference between its prices and the prices of a competitor, the difference between its prices and JG's prices appeared to be more significant than the difference between its prices and any other retailer. We noted that it was not clear from the evidence submitted to us to what extent these price increase recommendations were actually implemented.
- 5.57 We found that H&B and JG did not target each other specifically in either their national pricing activity or their local promotions.
- 5.58 We found from the GfK survey that consumers perceived supermarkets as their first-choice alternative if their chosen H&B or JG store was not available. We also found from this survey that a majority of the customers who shop in either an H&B store or a JG store also shop elsewhere for their NSF. The survey suggested that, of those who do multi-source, most use a supermarket.
- 5.59 We used econometric techniques to try to estimate own-price and cross-price elasticities for H&B and JG. However, we were not satisfied with the reliability of the results and we did not draw any conclusions from this analysis.
- 5.60 We found that a JG store opening within 1 mile of an H&B store had a greater effect in reducing the incumbent store's NSF revenues than any other store opening in the same vicinity. We found that if a large or medium-sized supermarket store opened within a 10-minute drive-time of an H&B store, and to some extent if it opened within a 30-minute drive-time, there was also a negative effect on the incumbent H&B store's NSF revenues, but in both cases the effect was smaller than the effect of a new JG store opening up within 1 mile.

Product market

5.61 We concluded from this analysis that H&B and JG were close competitors for NSF but the relevant product market included supermarket stores and any other retailers, including independent health food stores,²⁰ where a sufficiently large range of NSF products were available at similar prices. We recognized that the retailing of NSF was differentiated and we did not believe that it was necessary for a retailer to offer exactly the same range of NSF as H&B and JG, or at exactly the same prices, in order to provide a competitive constraint. Indeed, we noted that there were differences in both the ranges and the prices of NSF products offered by H&B and JG. Rather, we found that some NSF retailers would be closer competitors to H&B and JG and other NSF retailers would be more distant competitors, but we concluded that we should consider all sources of competitive constraint on H&B and JG, in each geographic market, in determining whether the merger would be expected to result in an SLC.

Geographic market

5.62 We found that there were some features of the market which were local and other features of the market which were national. We recognized that both H&B and JG, and most of the supermarkets, set prices nationally. However, we also recognized that, as with most retailing markets, the ability of customers to switch between retailers of NSF was limited to a local level.

5.63 We found, through our analysis of the effects of store entry (see paragraph 5.60), that competition between H&B and JG appeared to operate most strongly in small local areas (the effects were greatest within 1 mile), while competition between H&B

²⁰We recognized that our analysis was very limited with regard to independent health food stores and other specialist retailers of NSF. Although we could not establish what products were offered by these retailers, we found that the wholesalers from which many of them bought their NSF offered a wide range of products, including products in large pack sizes. We believed that these retailers were likely to represent further alternative sources of supply for NSF customers, in particular because they were often located on the high street in the same vicinity as H&B and JG.

and supermarket retailers appeared to operate over larger local areas (the effects were greatest within a 10-minute drive-time, but were also significant within a 30-minute drive-time). Therefore, the size of the relevant local area would appear to depend on the store providing the constraint (ie a large supermarket store located 5 miles away might provide a constraint but an independent health food store located 5 miles away might not).

- 5.64 We noted that the GfK survey found that the average journey time for customers to reach the H&B or JG store where they bought their NSF was over 18 minutes (see paragraph 5.45), though it was unclear how customers travelled to their chosen store.
- 5.65 We also noted that the size of the relevant local area might depend on the specific geographic area concerned (ie the local market was likely to be larger in rural areas).
- 5.66 We concluded that the market was likely to be local but we could not conclude on a precise geographic market definition for every local area as the size of each geographic market was likely to vary. Given our analysis of the competitive effects of the merger (see [Section 7](#)), we believed that we did not need to reach a precise geographic market definition.

Areas of local overlap

Filters for local analysis

- 5.67 We considered what filters to apply to determine the local areas where the loss of competition between H&B and JG might be of concern.

- 5.68 Consistent with the CC's recent groceries market investigation,²¹ we believed that the merger was unlikely to give rise to adverse effects in local areas where there were four competitors remaining in the market after the merger. Therefore, we considered the local areas where there were two or fewer other retailers selling a sufficient range of NSF to provide a competitive constraint on H&B and JG.
- 5.69 We considered what NSF range was sufficient for a retailer to provide a competitive constraint on H&B and JG. We noted that our analysis of the effects of entry found that a large or medium-sized supermarket stocking at least 200 NSF SKUs provided a constraint on H&B. However, we also noted that stores with a much smaller range of NSF could provide a constraint if the range overlapped sufficiently with the ranges offered by H&B and JG.
- 5.70 We noted that, for H&B, its top 20 NSF SKUs were responsible for generating [X] per cent of its NSF revenues and its top 50 NSF SKUs were responsible for generating [X] per cent of its NSF revenues; and, for JG, its top 20 NSF SKUs were responsible for generating [X] per cent of its NSF revenues and its top 50 NSF SKUs were responsible for generating [X] per cent of its NSF revenues.
- 5.71 We recognized that, as the retailing of NSF was differentiated, different retailers would provide a different competitive constraint (see paragraph 5.61). For example, a large supermarket offering 200 NSF SKUs might provide a strong constraint, while a small convenience store stocking 20 NSF SKUs might provide a limited constraint. However, alternatively, we also noted that some supermarkets selling a large number of NSF SKUs sold very few of the products which were most popular at H&B and JG, while other supermarkets selling a small number of NSF SKUs overlapped with the most popular products of H&B and JG more closely.

²¹See paragraph 11.93 of the full CC report at www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538.pdf.

5.72 We found that most retailers selling at least 50 NSF SKUs offered a large number of the most popular NSF products sold by H&B and JG. We judged that, in most cases, a retailer selling 50 or more NSF SKUs was likely to provide a reasonable competitive constraint on H&B and JG. We recognized that, in some circumstances, this filter may include a competitor offering a limited constraint, and in some circumstances it may exclude a competitor offering a strong constraint. Nevertheless, we concluded that 50 NSF SKUs was a reasonable filter for our analysis.

Local analysis

5.73 We found that, in all but 18 locations where an H&B store overlapped with a JG store, there were at least three retailers stocking 50 or more NSF SKUs within a 10-minute drive-time of the H&B store (using a conservative geographic market definition—see paragraphs 5.66 to 5.70). In these locations, the merger represented, at worst, a reduction from five NSF retailers to four NSF retailers, and we did not believe that the merger would result in an SLC.

5.74 Of the 18 locations where there were two or fewer other retailers selling 50 or more NSF SKUs, we noted that the JG store in one location had already been identified as loss-making over a long period and was likely to close in the near future. In this location, the merger would not result in any loss of competition.

5.75 We noted that the remaining 17 locations where there were two or fewer other retailers selling 50 or more NSF SKUs were predominantly rural market towns. We noted that, in these areas, it might be appropriate to consider a wider geographic market (see paragraph 5.65). Therefore, we expanded the geographic market in these 17 locations to a 20-minute drive-time, and found that in six locations there were at least three retailers selling 50 or more NSF SKUs. We also expanded the

geographic market to a 30-minute drive-time, and found that in a further four locations there were at least three retailers selling 50 or more NSF SKUs.

5.76 In [Section 7](#) we set out our evaluation of the competitive effects of the merger overall and in particular in the overlap locations where we found a small number of alternative retailers selling a wide range of NSF.

6. Barriers to entry and expansion

6.1 We considered the ability, incentives and effects of different retailers starting to sell NSF or expanding their existing supply of NSF. We noted that entry and expansion could take several forms, including:

- existing stores already selling NSF expanding to sell a wider range of NSF products so as to overlap more closely with the ranges offered by H&B and JG;
- existing stores not currently selling NSF starting to sell NSF;
- new stores opening up to sell NSF (possibly alongside other products); and
- online stores starting to sell NSF or expanding their existing supply of NSF.

6.2 We recognized that each of these different forms of entry and expansion could take a different scope, ranging from entry or expansion in one location with a limited NSF offering to entry or expansion over many different locations with a wide NSF offering. We noted that the strength of the competitive impact would depend on the scope of the entry/expansion strategy.

6.3 We found that, because most other retailers of NSF (even those retailers selling a wide range) did not monitor the prices or ranges of NSF at H&B and JG, it was unlikely that they would expand their range of NSF to become closer competitors following the merger. Most of the NSF retailers which spoke to us told us that they had no ambitions to expand significantly their range of NSF in the near future.

- 6.4 We considered whether existing retailers selling other products might begin to sell NSF, in particular if NSF was complementary to their existing products, for example for other confectionary retailers or home entertainment retailers. However, we concluded that there was no reason to believe that these retailers had any ambitions to expand into NSF, particular given the lack of growth in consumer demand for NSF and the availability of NSF in all large supermarkets.
- 6.5 We also considered whether new retailers might sell NSF. We noted that NSF was not particularly suitable for sale on the Internet given the significant weight of the product, and thus a high postage cost, compared with its relatively low value. However, we found that the barriers to entry for a small dedicated retailer of NSF were low. An independent retailer could easily source small quantities of NSF, either packaged from a wholesaler, or loose directly from a commodity broker, and on terms which were not dissimilar to the terms offered to H&B and JG. Although it would be costly to establish a national chain of stores, we found that it would not be costly to establish a few small stores or market stalls in a select number of locations. We noted that JG began and operated successfully in this way. We also noted there had been a couple of recent new entrants which had established businesses selling NSF through small retail outlets, for example Cranberry.²² We concluded that it would be relatively easy for these recent new entrants to expand their businesses into new locations, or for other new entrants to begin selling NSF on a similar basis in different locations.

7. Competitive effects of the merger

- 7.1 In this section we set out the expected effects of the merger in the retail supply of NSF. We compare the structure of the market and the options for JG's customers between the post-merger situation and the counterfactual.

²²www.cranberryuk.com.

- 7.2 In the counterfactual, JG would have continued to compete against H&B, and both parties would have continued to compete against all the other diverse retailers of NSF. We concluded that, although JG may have operated through a smaller number of stores than prior to the merger, its customers would have faced a similar choice for their NSF (see paragraph 4.13).
- 7.3 As a result of the merger, H&B and JG will come under common ownership but they will continue to face competition from other retailers of NSF, including from supermarkets, other independent health stores and other specialist retailers.
- 7.4 We considered the effects of the merger due to the loss of a competitor in local markets around the UK. In almost all local markets where both H&B and JG operate there are at least three other retailers selling a wide range of NSF products. We have provisionally concluded that, in these areas, the competition from other retailers, which has constrained H&B and JG prior to the merger, will continue to be sufficient to constrain their activities after the merger (see paragraph 5.72).
- 7.5 However, there are between seven and 17 local areas (see paragraph 5.75) where there are two or fewer other retailers selling a wide range of NSF products. We considered the aggregate effect of the loss of competition in each of these local markets on the retail supply of NSF nationally. We also considered the effect of the loss of competition in each of these local markets on the retail supply of NSF locally.

National effects of the merger due to the loss of a local competitor

- 7.6 We found that a reduction in the number of retailers selling 50 or more NSF SKUs to three or fewer in a maximum of 17 locations (approximately 3 per cent of H&B's store portfolio and less than 5 per cent of JG's store portfolio) would not be sufficient for it

to be profitable for the merged entity to increase substantially its prices of NSF, or to reduce its range (or any other feature of its NSF offering), on a national basis.

Local effects of the merger due to the loss of a local competitor

Constraint from small competitors

7.7 We recognized that in each of the 7 to 17 locations where there were two or fewer other retailers selling a wide range of NSF there were many other retailers selling a smaller range of NSF (below 50 SKUs), including, for example, convenience stores, market stalls, etc. Although we did not believe that any of these other retailers stocking a small range of NSF imposed a substantial constraint on H&B and JG on its own, we believed that there could be a cumulative constraining effect when considered together, particularly if they had slightly differentiated NSF offerings. This effect was hard to quantify as it was not possible for us to gather comprehensive data on all the retailers offering a small range of NSF in each location.

Sufficient constraint from one supermarket

7.8 NBTY told us that one supermarket stocking a wide range of NSF would provide a sufficient competitive constraint on H&B and JG in any local area. NBTY noted that customers of H&B and JG considered a supermarket to be their first-choice alternative option (see paragraph 5.43), and, for most customers, this switching was likely to take place during their weekly supermarket shop. Therefore, in an area where there was only one supermarket, most of the switching away from H&B and JG would be to this supermarket, whereas in areas where there were many supermarkets the switching would be split between them.

7.9 NBTY continued that, as the supermarkets did not monitor the activities of H&B and JG, a supermarket which experienced a growth in the sales of its NSF would not increase its prices but would respond by restocking its shelves more regularly and

possibly, over time, devoting more shelf space to the category. As the supermarkets competed with other supermarkets across a much wider set of products, they would not respond by deviating from their national pricing policies to increase the prices of NSF in one store on a local level, even if there were no other supermarkets in the local area.

7.10 NBTY submitted that, due to customers' regular supermarket shop being the primary alternative for buying NSF, and due to supermarkets operating very differently to H&B and JG, with NSF representing a small part of their customers' typical basket, even just one supermarket could provide a sufficient constraint to the merged entity to make any post-merger price rise or other reduction in its NSF offering unprofitable.

7.11 We believed that there was some merit in these arguments. We noted that there were approximately 24 locations where an H&B or JG store was situated in a non-overlap area and currently faced competition from just one large or medium-sized supermarket competitor (using a 10-minute drive-time to define the local market). We compared the prices of NSF stocked by the supermarket competitor in a couple of these locations with the prices of the same NSF products stocked by the same supermarket in other locations around the UK. We found no evidence that the supermarkets currently deviated from their national pricing strategies in locations where they faced limited competition for the retailing of NSF, so we concluded that there was no reason to believe they would do so in the future as a result of the merger.

7.12 However, although this analysis confirmed NBTY's argument that the supermarkets provided an asymmetric constraint on H&B and JG (see paragraph 7.9), we could not find a way to assess whether, in a local area, one alternative supermarket would provide the same constraint as several alternative supermarkets (see paragraph 7.8). We recognized that most customers of H&B and JG make regular visits to their local

supermarket but we could not assess whether, in the event of a price rise by H&B or JG, the proportion of customers who would switch to buying their NSF from the one alternative supermarket in an area where there are no other options would be the same as the aggregate proportion of customers who would switch to one of several supermarkets in a different area.

Costs of deviating from a national pricing policy

- 7.13 H&B told us that it priced nationally, with very few promotions on a local basis (see paragraph 5.32). JG also told us that it priced nationally, although we noted that, over the last few years, there had been many local promotions (see paragraph 5.36). However, we found that JG's promotions were usually very short (typically lasting between one and seven days), and took place in selected stores at different times across all areas of the UK, including both overlap areas and non-overlap areas. We concluded that the choice of location for JG's local promotions did not appear to be affected by the strength or weakness of local competition.
- 7.14 NBTY told us that it would be costly for H&B and JG to deviate from their national pricing policies. NBTY told us that it would result in a loss of national brand identity, resulting in reduced revenue, and in additional costs, such as for local in-store advertising and new staff to manage local promotions and local stock management. We accepted that there would be costs for H&B and JG associated with deviating from their national pricing policies but we could not quantify the extent of these costs.
- 7.15 NBTY also pointed out that both H&B and JG currently operated in many non-overlap areas where they faced limited competition from large and medium-sized supermarkets (see paragraph 7.11). NBTY told us that, if it was profitable for H&B or JG to deviate from their national pricing policies in local areas where there was a limited competitive constraint, they would have done so already.

7.16 We believed that there was some merit in these arguments but we did not have any evidence to show whether the increase in the number of areas where the merged entity would face limited competition would be sufficient for it to become profitable to deviate from a national pricing strategy.

Costs of reducing the attractiveness of non-price features of the NSF offering

7.17 We considered whether the loss of competition in some local markets would enable the merged entity to increase its profits by limiting its range of NSF products or by reducing the quality or service it offered.

7.18 We found that, although there were variations in the extent of competition between different local areas, we did not find any relationship between the range of NSF offered by either H&B or JG and the extent of competition in the local area. Also, we did not find any evidence of significant differences in the quality or service offered by different stores in their store portfolios.

7.19 We also noted that, for both H&B and JG, NSF represented only a part of their total offering. We concluded that it was unlikely that the merged entity would vary non-price features as a result of the merger, such as quality and service, as to do so would have a detrimental effect on all parts of its business.

Small-scale new entry

7.20 We noted that entry by a dedicated retailer of NSF on a small level, whether in small stores or using market stalls, was relatively easy (see paragraph 6.5). We noted that there had been some recent entry on this basis and it would not be difficult for these existing businesses to expand or for other new entrants to begin operating in some local markets.

Conclusions on local effects of the merger due to the loss of a local competitor

7.21 We considered all these arguments together. We recognized the continuing competitive constraint from existing NSF retailers in each location; we accepted that there would be costs for H&B and JG if they deviated from their national pricing policies, and that they had not done so prior to the merger in areas where they faced a small number of competitors; we accepted that any deterioration in the non-price features of the merged entity's NSF offering would affect other parts of its business, and that H&B and JG had not varied these features prior to the merger in areas where they faced limited competition; and we also believed that the threat of new entry, in particular on a small scale in some local areas, would constrain the activities of H&B and JG to some extent. We concluded that it was unlikely that the merged entity would find it profitable to raise its prices substantially, or to reduce the range or quality of its NSF offering, in any local market.

8. Provisional findings

- 8.1 We found that the completed acquisition of JG by NBTY constitutes a relevant merger situation (see paragraph 3.4).
- 8.2 We have provisionally concluded that we do not expect the completed acquisition of JG by NBTY to result in an SLC in the retail supply of NSF in the UK (see paragraph 7.6) or in any local market in the UK (see paragraph 7.21).