

*Case No IV/M.1112 -
ADVENT
INTERNATIONAL /
EMI / WH SMITH*

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**REGULATION (EEC) No 4064/89
MERGER PROCEDURE**

Article 6(1)(b) NON-OPPOSITION
Date: 24/03/1998

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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 24.03.1998

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

to the notifying party

Dear Sirs,

Subject: Case No IV/M.1112: ADVENT INTERNATIONAL/EMI/W H SMITH

Notification of 25 February 1998 pursuant to Article 4 of Council Regulation N° 4064/89

1. On 25 February 1998 the Commission received a notification of a proposed concentration pursuant to Article 4 of Council Regulation (EEC) No 4064/89 by which the undertakings Advent International Corporation ('Advent') and EMI Group ('EMI') acquire within the meaning of Article 3(1)(b) of the Council Regulation joint control of the undertakings HMV Group ('HMV') - controlled by EMI - and Waterstones (controlled by W H Smith) by way of acquisition of interests in a newly created joint venture.
2. After examination of the notification, the Commission has concluded that the notified operation falls within the scope of Council Regulation (EEC) No 4064/89 and does not raise serious doubts as to its compatibility with the common market and with the EEA Agreement.

I. THE PARTIES' ACTIVITIES AND THE OPERATION

3. The business activities of the undertakings concerned are :
 - Advent: equity investment fund management;
 - EMI: music and recorded music publishing and retailing, retailing of books;
 - HMV: retailing of books and music;
 - Waterstones: retailing of books.

4. The operation will create a new joint venture between Advent and EMI which will combine the recorded music and book retailing businesses of EMI (operated via HMV under the HMV and Dillons/Hatchards brand names respectively) and the Waterstones book retailing business, currently owned by W H Smith.
5. The joint venture will perform on a lasting basis all the functions of an autonomous economic entity and its creation will not give rise to co-ordination of the competitive behaviour of the parents. Advent and EMI will each have some 45% of the voting securities in the joint venture, with the remainder held by the management of HMV and Waterstones. In addition, Advent and EMI will have investment protection rights, including a requirement that all strategic decisions (including budget, major investments, senior appointments etc) require the approval of both of them, which will enable them to exert decisive influence over the commercial activities of the joint venture, and accordingly give them joint control of it. The joint venture will combine all the existing assets of HMV and Waterstones. Following the completion of the operation, neither parent will have any other interest in music and book retailing apart from the joint venture.

II. COMMUNITY DIMENSION

6. EMI, Advent, and Waterstones have a combined aggregate world-wide turnover in excess of ECU 5,000 million (EMI ECU 4325 million, Waterstones ECU 250 million and Advent in excess of ECU 660 million). Each of them has a Community-wide turnover in excess of ECU 250 million (EMI, ECU 2145 million, Waterstones ECU 250 million and Advent in excess of ECU 570 million) and EMI and Advent do not achieve more than two-thirds of their aggregate Community-wide turnover within one and the same Member State. The notified operation therefore has a Community dimension. It does not constitute a co-operation case under the EEA Agreement, pursuant to Article 57 of that Agreement.

III. COMPETITIVE ASSESSMENT

A. Relevant product markets

7. The parties' activities overlap only in the retail sale of books. The notifying parties contend that there are separate relevant product markets for the retailing of books to consumers and to 'institutional' customers such as companies, libraries, schools, hospitals etc. These, and various alternative possibilities, are examined below. However, it is not necessary to reach a definitive conclusion on product markets in the present case because, in all reasonable alternative market definitions considered, effective competition would not be significantly impeded in the EEA or any substantial part of that area.

B. Relevant geographic market

8. The parties' book retailing activities overlap materially only in the United Kingdom. (Dillons has a single shop in Ireland, in which Waterstones has four shops.) The notifying parties contend that the relevant geographic market, for each of the product markets they propose, is national (ie, materially, the United Kingdom). This, and various alternative possibilities, are examined further below. However it is not necessary to reach a definitive conclusion on the relevant geographic markets in the present case

because, in all alternative geographic market definitions considered, effective competition would not be significantly impeded in the EEA or any substantial part of that area.

C. Assessment

9. The notifying parties have provided data, based on publicly-available information, for sales of books to consumers and to 'institutional' customers, in the UK. On this basis, the parties would have (1996, by value) a combined share of approximately 16.4% (Waterstones, 9.4%) in a market for sales to consumers (value c. £1800m), and less than 3% of the 'institutional' market (valued at c. £900m). It is difficult to delineate the boundaries of these possible product markets precisely. The parties estimate that perhaps 25% of sales in the 'institutional' category are in fact made to individuals. On that basis, if such sales were considered as part of the 'consumer' market, the parties' shares in that market would decrease slightly, and their shares of a narrower 'institutional' market would increase by one or two percentage points. In general, only larger bookshops supply 'institutional' customers, who may receive credit terms and quantity discounts not available to ordinary consumers. Institutional customers are also likely to buy direct from the publisher, however, or from wholesalers. The parties' figures do not include such sales, and their inclusion would further decrease the parties' shares of an 'institutional' market. Accordingly it is unnecessary to consider further the existence or otherwise of an 'institutional' market, since the operation would not significantly affect competition there.
10. The parties' shares (separately or together) of a market for all retail consumer book sales in the UK are not of a level likely to give rise to competition concerns. Indeed, by this measure, the merger could be seen as improving the competitive structure of the market. W H Smith also sells books (and will continue to do so) through its large chain of newsagent/stationery/bookseller outlets. If Waterstones were to remain part of the W H Smith group, W H Smith's share on the above basis would be 23.2%; Dillons would be the next largest, but with only 7%. Post-merger, Smith's share would reduce to 14%.
11. Various plausible alternative market definitions can also be devised, however, and these, and the merger's likely impact under them, are examined further below.
12. It is arguable that a 'consumer' market should be further subdivided into sales through shops and sales by mail order, Internet, book clubs etc. Book clubs effectively 'tie' the purchaser by requiring them to buy a minimum number of titles from the club each year. Mail order specialists, who provide customers with a catalogue listing the range of titles for which orders can be placed, do not, as a rule, have this requirement, but they usually add a charge for postage and packing to the basic selling price, although the latter is often discounted. Internet purchases (which are made from a 'virtual catalogue' displayed on the sellers web-site) are available only to the relatively small (if fast-growing) proportion of the book-buying population which has access to a personal computer with an Internet connection, and operate in broadly similar fashion to other mail-order businesses.
13. Neither party operates book clubs. The parties' activities do not overlap in (non-electronic) mail order, as only Dillons is present there. Excluding sales through book clubs and traditional mail-order would raise the parties' combined share of a 'consumer bookstore' market to 18.5%. Both parties have an Internet purchasing service. No reliable figures are available for the overall size of the Internet sector, so individual market shares cannot be estimated; it is unlikely to account for more than a few

percentage points' worth of total sales, however. Moreover since, according to information supplied by the parties, around 25% of all book retailers, including most of the larger ones as well as a number of smaller ones (and over 80% of the publishers) are connected to the Internet, the parties do not appear likely to have, separately or together, a dominant position in that sector.

14. From the demand side, books in different subject categories - eg, adult fiction, children's books, cookery, travel, history, biography, scientific/technical etc - and, perhaps, even different titles within a category, are not likely to be substitutes for each other. But from the supply side, nearly all booksellers sell a range of books in different categories, albeit some may specialise to a greater or lesser extent. Retailers wishing to vary the 'mix' of titles and categories they offer do not appear to face any significant barriers to doing so more or less immediately and at little if any cost; they simply change their ordering pattern (most books are sold by publishers on a 'sale or return' basis so there is not even a need to dispose cheaply of unwanted stock). An analysis by category may not be relevant to the question of market power, therefore. In any event, the parties' shares in any particular category do not seem likely to be high enough to create dominance. There are inevitable difficulties in defining relevant subject categories, but on the basis of categories adopted in a survey undertaken for the parties, which appears to be more comprehensive than publicly available ones, their highest share by category - in 'business/economics/finance' - is estimated at 31% by value (research by BML, survey period January - November 1997). This category is relatively unimportant to the parties' sales, representing around 5% (and a similar proportion of total book sales). In the more important categories, their shares are considerably smaller (eg 21% in all adult fiction; 19% in non-fiction).
15. A further alternative possible product market would distinguish 'specialist' bookshops (ie those which sell only, or mainly, books) from other shops, such as supermarkets, department stores, garages, newsagents and general stores, which sell books as part of a wider range of other goods. Such a subdivision might be based on the importance of the service offered - knowledgeable assistants, willingness to order a title not stocked etc - and/or the range of titles carried; the latter on the grounds that some consumers, at least, prefer to 'browse', and see before them a wide range of books before they make their choice. (A typical specialist shop carries around 10-25,000 titles, though some carry up to 50,000, and the largest over 100,000; those of the parties and other chains average 25-50,000). To the extent that some customers may not buy (either at all or in the same quantity) from outlets without one, possession by a retailer of a large range may confer some competitive advantage which might create market power.
16. Estimates of market share by type of retailer vary, partly because of definitional differences and partly also as a result of the large number of businesses and outlets involved. On the basis of information provided by the parties in Form CO, their share of a market for sales through 'specialist' shops amounts to about 22% by value if W H Smith's non-Waterstones stores (which account for nearly 14% by value of all books sold) are included. Smith's, like larger branches of supermarkets and department stores, will typically stock the 3-5,000 or so most popular titles which account for about 45% of all book sales by value. (The parties' shares by category on this basis would be similar to those for all outlets, since non-specialists will have few sales in the less popular categories.) The parties' share would rise (to about 27%, on the basis of the parties' information) if W H Smith's, and other 'non-specialists', were excluded. Smith's typical range is substantially smaller than that of typical 'specialists', although it has a few stores which stock around 15,000 titles. But like independent specialists

and the bookshop chains, Smith's also operates an ordering service, which enables its branches to obtain the majority of titles from the publisher (or one of several wholesalers) within 24 hours, at no extra charge. The third party enquiries conducted by the Commission and the various trade surveys, market research studies and other information available to it did not, overall, support the view that the market should be further sub-divided on the basis of the size of the range stocked. In any event, the ready availability of books on order would provide an additional safeguard against attempts by a retailer to exploit possession of a large range anticompetitively. For example, an attempt to raise prices above the competitive level, even for the less popular titles not stocked by shops with a smaller range, would be likely to provoke 'free-riding' by customers, who could see the books on offer in the larger shop, but order their choice, at a lower price, from elsewhere.

17. A final alternative possibility is that there are local geographic markets within the United Kingdom in which the parties are, or may become, dominant. This does not appear likely from the information available. The parties' networks of branches appear to be generally complementary, with relatively few overlaps, and they have not indicated that rationalisation of the branch network is a main reason for the merger or a likely consequence of it. Publishers' discounts to retailers, and retail prices to consumers do not, from the information available to the Commission, vary significantly across the UK, suggesting that the relevant geographic market may be either national, or else to consist of a series of overlapping local or regional markets, so that they could be considered as a single market. There appears to be a selection of bookshops of varying sizes and types in most localities. Consequently there appears to be little if any scope for retailers with a strong position in one area to exploit that position by raising prices (or reducing the level of discount or service to consumers) in that area, without losing substantial sales to competitors slightly further away. The ability of consumers to order books (either direct or from a bookshop) further reduces the scope for such exploitation.
18. On this basis, the merger would not create or strengthen a dominant position by any plausible market definition, even if barriers to entry into the relevant market(s) were substantial. There are moreover indications that entry, even on quite a large scale, does not face significant barriers.. At the smaller end of the spectrum, a specialist bookshop requires little in the way of assets; a shop lease in a suitable location and a catalogue/ordering system (preferably, but not essentially, computerised) being the main physical requirements. Working capital can be quite small, given the trade practice of supplying on 'sale or return'. Moving upscale, prime city-centre shop space of the relevant size can be expensive and hard to find. But the cost of acquiring such sites is likely to be largely or fully recoverable on exit, making 'sunk' costs - generally regarded as the most important physical entry factor - relatively low. Several firms have announced entry or expansion plans. Borders Inc (a large US-based bookselling company which also owns the Books Etc chain) has begun a major UK expansion with very large stores in London and Leeds. Ottokars has announced plans to double its number of branches (from 50 to 120) in the next two years. Another US firm, Barnes & Noble (said to be the world's largest bookseller) has announced plans to enter the UK, initially via the Internet - a sector which seems likely to grow rapidly as more of the population become connected. W H Smith has announced that it intends to expand substantially the range of books it carries. Expansion (or extension) by existing retailers in other sectors - eg supermarkets, department stores, could be accomplished with little difficulty; essentially they would need only to reallocate shelf/display space.

V. **CONCLUSION**

19. For the above reasons, the Commission has decided not to oppose the notified operation and to declare it compatible with the common market and with the EEA Agreement. This decision is adopted in application of Article 6(1)(b) of Council Regulation (EEC) No 4064/89.

For the Commission,