

ANTICIPATED ACQUISITION BY TESCO PLC OF BOOKER GROUP PLC

Issues statement

9 August 2017

The reference

1. On 12 July 2017, the Competition and Markets Authority (CMA) began an in-depth investigation by a group of CMA panel members (the inquiry group) of the anticipated acquisition by Tesco plc (Tesco) of Booker Group plc (Booker) (the Merger).¹ Throughout this document we refer to Tesco and Booker collectively as the parties.
2. Our in-depth phase 2 investigation follows a first phase ('phase 1') investigation of the Merger. During the phase 1 investigation the parties requested that the CMA accelerate a reference of the investigation to the phase 2 stage under the CMA's 'fast-track' procedure.²
3. The inquiry group must decide:
 - (a) whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and
 - (b) if so, whether the creation of that situation may be expected to result in a substantial lessening of competition (SLC) within any market or markets in the UK for goods or services.
4. If a relevant merger situation may be expected to result in an SLC, then the inquiry group must also decide:

¹ The CMA referred the Merger for a phase 2 investigation in exercise of its duty under section 33(1) of the Enterprise Act 2002 (the Act).

² See CMA press release [Tesco/Booker request fast track referral](#), 29 June 2017.

- (a) whether action should be taken by the CMA for the purpose of remedying, mitigating or preventing the SLC concerned or any adverse effect which has resulted from, or may be expected to result from, the SLC;
 - (b) whether to recommend the taking of action by others for such purposes; and
 - (c) in either case, what action should be taken and what is to be remedied.
- 5. In deciding what actions should be taken, the inquiry group shall, in particular, have regard to the:
 - (a) need to achieve as comprehensive a solution as is reasonable and practicable to the SLC and any adverse effects resulting from it; and
 - (b) effect of any action on any relevant customer benefits (RCBs) in relation to the creation of the relevant merger situation concerned.
- 6. In this issues statement, we set out the main issues we are likely to consider in reaching our decisions, having had regard to the merging parties' submissions and the evidence gathered to date including evidence set out in the CMA's decision to refer the Merger for further investigation.³ This does not preclude the consideration of any other issues which may be identified during the course of our investigation.
- 7. We are publishing this issues statement to help any parties submitting evidence to focus on the issues we expect will be relevant to our inquiry and to invite interested parties to notify us if there are any additional relevant issues which they believe we should consider.

Background

The transaction

- 8. On 27 January 2017, the boards of Tesco and Booker announced that they had agreed on the terms of a recommended share and cash acquisition by Tesco of the entire issued share capital of Booker. The parties intend that the Merger will be implemented by way of a Court-sanctioned scheme of arrangement under Part 26 of the Companies Act 2006. The Merger is subject to the Takeover Code. The recommended offer values Booker's share capital at approximately £3.7 billion.

³ [Phase 1 Decision](#).

The parties

9. Tesco is a UK publicly listed company and is predominately a grocery retailer. It has operations in the UK, Europe and Asia. In the UK, its groceries operations include grocery retailing (online and through its portfolio of over 3,500 owned grocery stores, operated under the Tesco and One Stop brands) and the wholesale supply of symbol group services (through franchised One Stop stores). Tesco also owns Tesco Bank, Tesco Mobile (a mobile virtual network operator) and dunnhumby (a customer science company providing services to retailers and brands). The turnover of Tesco in 2016 was approximately £56 billion worldwide, the majority of which was generated in the UK.
10. Booker is a UK publicly listed company and is a grocery wholesaler. It has operations in the UK and India. In the UK, it operates both cash-and-carry and delivered wholesaling businesses, to the catering and retail sector. In addition, Booker provides services to over 5,500 retailers under four symbol group fascias: Premier, Londis, Budgens and Family Shopper.⁴ The worldwide turnover of Booker in 2016 was approximately £5 billion, the majority of which was generated in the UK.

Market definition

11. The purpose of market definition is to provide a framework for the analysis of the competitive effects of a merger. We will look to define what is called the relevant market. The relevant market contains the most significant alternatives available to the customers of the merger parties which act as a competitive constraint on the parties.⁵ How effective the alternatives for customers are will depend on what other products or services are available to customers and how far customers are willing to travel (or pay for the goods to travel) in order to access them. Market definition is a useful analytical tool to focus much of our analysis but it is important to note that it will not determine the outcome of our analysis of the competitive effects of the merger. Defining the market is likely to involve an element of judgement.⁶
12. In this case, the parties' activities of interest cover the retail supply of groceries to end consumers, the wholesale supply of groceries to retailers and

⁴ 'Symbol group' is a term which refers to a particular franchise model of grocery retailing. Independent retailers can trade under a brand which they do not own. In return, these retailers will commit to sourcing some products and services from the brand owner. Symbol group brands not owned by Booker include Spar, Costcutter and Nisa.

⁵ [Merger Assessment Guidelines](#), paragraph 5.2.1.

⁶ [Merger Assessment Guidelines](#), paragraph 5.2.2.

the procurement of groceries from suppliers. We give some more information on these below.

Retail supply of groceries

13. Consistent with previous decisions of the CMA, the phase 1 investigation in this case defined grocery stores according to the size of their net sales area and stated that the competitive constraint faced by such stores is asymmetric (so that a large store constrains a smaller one but not vice versa). So that:
 - (a) one-stop stores (OSS) (1,400 sq metres and larger) are constrained only by other OSS;
 - (b) mid-size stores (MSS) (280–1,400 sq metres) are constrained by other MSS and by OSS; and
 - (c) large convenience stores (280–100 sq metres) are constrained by other large convenience stores, MSS and OSS.⁷
14. For the geographic scope of the market, the CMA's phase 1 decision adopted the following approach:
 - (a) a 10/15 minute drive-time in urban/rural areas for OSS;
 - (b) a 5/10 minute drive-time in urban/rural areas for MSS, which are also constrained by OSS within a 10/15 minute drive-time (in urban/rural areas); and
 - (c) a 5-minute drive-time or 1-mile radius for convenience stores, which are only constrained by other groceries stores (including other convenience stores, MSS and OSS) within that area.⁸
15. We plan to use this product and geographic scope as defined in the phase 1 decision as the starting point for our analysis, but will review evidence submitted to us on whether this definition is appropriate.

Wholesale supply of groceries

16. The CMA's phase 1 decision framed the market for the wholesale supply of groceries as:
 - (a) the wholesale supply of symbol group services on a regional basis, focusing its assessment on those catchment areas centred on symbol

⁷ [Phase 1 Decision](#), paragraphs 41–45.

⁸ [Phase 1 Decision](#), paragraphs 46–48.

group wholesaler delivery depots, in which 80% of those depots' customers are found;

(b) cash-and-carry wholesale on a regional basis, using a 30-minute drive-time catchment area centred on cash-and-carry depots; and

(c) delivered wholesale on a regional basis (the precise geographic scope of the frame of reference was left open).⁹

17. We plan to use this product and geographic scope as defined in the phase 1 decision as the starting point for our analysis, but will review evidence submitted to us on whether this definition is appropriate

Procurement of groceries

18. Although the CMA's phase 1 decision did not conclude on the market definition for the procurement of groceries, it based its assessment on the procurement of groceries by product category on a national basis.

19. We plan to use this approach as the starting point for our analysis, but will review evidence submitted to us on whether this definition is appropriate.

Assessment of the competitive effects of the merger

Counterfactual

20. We will assess the potential effects of the Merger on competition compared with the competitive conditions in the counterfactual situation (ie the competitive situation that would be likely to prevail absent the Merger). In making our assessment, we will consider possible alternative scenarios of competitive conditions and decide upon the appropriate counterfactual based on the facts available to us and the extent to which events or circumstances and their consequences are foreseeable.¹⁰

21. In the phase 1 decision the CMA found that the pre-Merger situation was the appropriate counterfactual apart from the exit of one store.¹¹ We will examine whether this is still the appropriate counterfactual.

⁹ [Phase 1 Decision](#), paragraphs 61–64.

¹⁰ [Merger Assessment Guidelines](#), paragraph 4.3.2.

¹¹ [Phase 1 Decision](#), paragraphs 38 & 39.

Assessment of the impact of the merger on competition

22. Tesco is a grocery retailer (see above at paragraph 9) and Booker is a grocery wholesaler (above at paragraph 10). The parties mostly operate at different points in the supply chain. The Merger, therefore, is largely vertical in nature. Most vertical mergers are benign and do not raise competition concerns.¹² Indeed, vertical mergers can lead to efficiencies and this may result in the merged firm having increased incentives to compete to take business from rivals.¹³
23. However, under certain conditions, vertical mergers can weaken rivalry. The merged firm might harm the ability of its rivals to compete post-merger, for example by raising effective prices to its rivals, or by refusing to supply them completely. Such actions may harm the ability of the merged firm's rivals to provide a competitive constraint into the future.¹⁴ We will assess whether the vertical aspects of the Merger (described in more detail below) will result in substantial harm to competition.
24. The Merger is not completely vertical, however. The parties both operate grocery retail stores (albeit with Booker on a very small scale) and both procure groceries from upstream suppliers and manufacturers. Therefore, in addition to the vertical aspects of the Merger we will also consider whether any horizontal aspect is likely to substantially lessen competition.
25. We have considered the ways in which an SLC may result from the Merger. These provide the initial framework for our analysis. We have set out below the issues that we are currently minded to investigate. However, we may revise these as our inquiry progresses. Identifying an issue to investigate in this issues statement does not preclude an SLC being found on another basis following further work by us, or the receipt of additional evidence.
26. We have identified three principal ways in which the Merger might harm competition and on which we intend to focus our assessment (we call these hypotheses 'theories of harm'). These are listed below.
- (a) Theory of harm 1: competition may be lessened between stores currently owned by Tesco and Booker, or as a result of reduced incentives to open or retain competing stores. The CMA's phase 1 decision found that only two Booker stores are relevant for this theory of harm. This is a

¹² [Merger Assessment Guidelines](#), paragraph 5.6.1.

¹³ [Merger Assessment Guidelines](#), paragraph 5.6.4.

¹⁴ [Merger Assessment Guidelines](#), paragraph 5.6.5.

straightforward horizontal effect hypothesis involving a loss of head-to-head competition.

- (b) Theory of harm 2: competition may be lessened between either Booker symbol group stores or Booker's independent convenience store customers on the one hand and Tesco stores on the other hand as a result of Booker worsening its wholesale services.
- (c) Theory of harm 3: competition may be lessened between Tesco stores and stores supplied by Booker as a result of Tesco increasing the prices or worsening the quality of its retail services, or as a result of reduced incentives to open or retain competing stores.

27. More details on these theories of harm are set out below. We have also identified two further ways in which the Merger has the potential to harm competition, which we list below. Although we will investigate these two theories of harm (set out below), on the basis of the information that we currently have, we consider that the above three theories of harm will be the main focus of our investigation:

- (a) Theory of harm 4: competition may be substantially lessened in the supply of delivered wholesale services; this could occur if the merged entity moved some or all of its purchasing away from Tesco's existing wholesalers to Booker;
- (b) Theory of harm 5: the merged entity may have increased buyer power which may result in a loss of competition to the detriment of consumers.

28. In its phase 1 decision the CMA found that the Merger does not raise a realistic prospect of an SLC as a result of horizontal unilateral effects in the supply of symbol group services.¹⁵ We are not currently minded to investigate this issue any further.

29. In investigating the likelihood of all of these theories of harm we will be examining information provided by the parties. We will also take into account the views of and information provided by third parties, whether they are suppliers or rivals to, or customers of, the parties.

¹⁵ [Phase 1 Decision](#), paragraph 208.

Theory of harm 1: a lessening of competition between stores owned by Tesco and Booker

30. Booker currently owns and/or operates a small number of Budgens stores, some of which are in the same local area as a Tesco grocery store. The CMA's phase 1 decision found that in two of these overlap areas, the Merger gives rise to a realistic prospect of an SLC. We will investigate whether the Merger is likely to lead to an SLC in these two local areas as a result of a loss of direct, head-to-head competition between the two merger parties.
31. We will examine whether the closeness of competition between the parties in these two local areas is such that Booker's or Tesco's retail quality of service is likely to be worsened after the Merger. That is, whether the merged entity will be likely to raise prices or otherwise allow quality of service levels to diminish (to save money on costs) on the basis that customers would either pay the higher prices or switch to another shop also owned by the merged entity. This is called a horizontal unilateral effect.
32. For completeness, we will also examine whether either party has plans to open stores in the future in local areas where the other party is present, but would not do so as a result of the Merger. This might result in a loss of future competition between the parties.
33. In assessing these we will also look at quantitative information, including on sales and pricing, and the parties' plans for store openings.

Theory of harm 2: a lessening of competition between Booker supplied stores and Tesco stores and as a result of Booker worsening its wholesale services

34. Some Booker symbol group retailers and some independent convenience store operators who are customers of Booker will compete with Tesco (whether Tesco branded or One Stop stores and franchised One Stop stores) in their local area. These Booker symbol group retailers and independent retailers will source a proportion of their grocery products from Booker via Booker's delivered wholesale and/or Booker's cash-and-carry services.
35. The scenario for this hypothesis is that Booker worsens its quality of service to those customers who compete directly with a Tesco store in their local area (whether by degrading its delivered wholesale or its cash-and-carry services). Booker would do so on the basis that some end-customers of those retailers may switch to shop at Tesco's stores instead. This is a vertical effect.
36. We will assess whether the merged entity would have the ability to harm competition in this way; whether it would have the incentive to do so (ie whether it would be profitable); and whether the overall effect would be likely

to result in an SLC. These conditions are cumulative. Therefore, if we find that one of the conditions is not met we may not find it necessary to assess the other conditions.

37. In our assessment, we will look at whether the merged entity would have the ability to target its relevant symbol group retailer customers or its relevant independent convenience store customers without harming its other customers. This is expected to include an examination of:
 - (a) what factors of its delivered wholesale and cash-and-carry services Booker can flex (for example, by raising prices, making deliveries unreliable or reducing the range of products available);
 - (b) how important those factors are to its customers; and
 - (c) the services which Booker provides to symbol group retailers including its contractual relationships with those retailers.
38. We will also investigate what other options symbol group retailers and independent convenience store operators have in the event that Booker's service levels deteriorate, for instance purchasing from another wholesaler/cash-and-carry provider. For symbol group retailers, they may have the option of switching to another symbol group brand which is not owned by Booker. We intend to use evidence from a survey of retailers which we shall undertake, in addition to data provided by the parties and any other evidence, to consider the importance of Booker to them.
39. We will then consider whether the relevant retailers are likely to pass on higher prices or a lower grade of service to their customers and, if so, whether sufficient numbers of their customers are likely to switch to Tesco.
40. If we consider that Booker does have the ability to embark on this strategy, we will assess whether it is likely to be profitable for the merged entity (in other words, whether it would have the incentive to do so). To do this we expect to consider Booker's relevant delivered wholesale and cash-and-carry profit margins, Tesco's relevant retail profit margins and the level of sales likely to be affected. We will examine whether the loss of some Booker wholesale profits is likely to be outweighed by larger retail profits at the Tesco stores to which customers may be diverted.
41. Finally, we will consider whether the overall effect would be likely to result in an SLC.

Theory of harm 3: a lessening of competition between Tesco stores and Booker supplied stores as a result of Tesco worsening its offer

42. The theory that we will be investigating in this scenario is very similar to theory of harm 2 except that it would arise from Tesco, not Booker, degrading its quality of service. In this scenario, in those local areas where a Tesco grocery store (ie Tesco and One Stop stores) overlap with Booker symbol group retailer stores, Tesco might increase prices or worsen its level of service so that some Tesco customers will pay the higher prices or accept lower levels of service and others will switch their shopping to the Booker symbol group retailer. In this event, Tesco will lose some retail sales but the merged entity will gain some wholesale sales (and therefore profits). This is because Booker will be supplying more products to those symbol group stores who have gained some Tesco customers. This is also a vertical effect.
43. We will assess whether the merged entity would have the ability to harm competition in this way; whether it would have the incentive to do so (ie would it be profitable); and whether the overall effect would be likely to result in an SLC. These conditions are cumulative. Therefore, if we find that one of the conditions is not met we may not find it necessary to assess the other conditions.
44. In our assessment, we will look at whether Tesco would have the ability to target its relevant customers without harming its other customers. This is expected to include an examination of:
 - (a) how Tesco might do so by assessing what local factors of its retail service it can flex; and
 - (b) whether sufficient customers are likely to switch from the relevant Tesco stores to the relevant Booker symbol group retailer stores.
45. If we consider that Tesco does have the ability to embark on this strategy, we will assess whether it is likely to be profitable for the merged entity (in other words, whether it would have the incentive to do so). To do this we expect to consider Tesco's relevant retail profit margins, Booker's relevant delivered wholesale and cash-and-carry profit margins, and the level of sales likely to be affected. We will examine whether the loss of some profits at those Tesco stores is likely to be outweighed by larger wholesale profits at the Booker outlets.
46. Finally, we will consider whether the overall effect would be likely to result in an SLC.

47. As noted in paragraph 27, in addition to the three theories of harm listed above, which we consider are likely to be the main focus of our investigation, we have also identified two further ways in which the Merger has the potential to harm competition. These are discussed below.

Theory of harm 4: competition may be lessened in the supply of delivered wholesale services

48. In some vertical mergers, the merged firm might increase retail prices when selling rivals' products, or stop stocking rivals' products altogether, thereby diverting customers to its own products.¹⁶ In this inquiry we will examine whether Tesco would have the ability and incentive to stop stocking products supplied by its existing wholesalers and diverting those sales to Booker instead. The result of this might be to weaken its existing wholesalers to such an extent that competition in the supply of wholesale services is substantially lessened.
49. An SLC might arise in such a scenario if the merged entity has the ability and incentive to carry out this strategy and, if so, the overall effect on the market amounts to an SLC. These conditions are cumulative. Therefore, if we find that one of the conditions is not met we may not find it necessary to assess the other conditions.
50. The information that we currently have in this inquiry indicates that Tesco acquires many grocery products directly from the suppliers of those products. However, it also sources some products from delivered wholesalers. It has a commercial relationship with only one wholesaler, Palmer and Harvey (P&H).¹⁷
51. We will examine whether the merged entity has the ability to weaken P&H by shifting some or all of its existing purchases to Booker and, if so, whether it would be profitable for it to do so. If these conditions are met, we will consider whether competition overall will be substantially lessened. This will depend on P&H's position in the wholesale marketplace and its customers' alternatives to P&H.

Theory of harm 5: a lessening of competition as a result of buyer power

52. Where the merger firms purchase the same products, the merged firm may enjoy greater buyer power than the merger firms could previously exert individually. In many instances, an increase in buyer power is not likely to give

¹⁶ [Merger Assessment Guidelines](#), paragraph 5.6.13.

¹⁷ [Phase 1 Decision](#), paragraph 210.

rise to competition concerns, and may be pro-competitive insofar as some of the benefits to the firm from its greater buyer power may be passed on to consumers in the form of lower prices.¹⁸ However, in some specific circumstances, an increase in buyer power may have a negative effect on competition and we will examine whether this may be the case here.

53. We will assess the extent to which, as a result of the Merger, the parties may benefit from greater buyer power than the parties could previously exert individually in purchasing groceries (or particular categories of groceries) which would be of such a significant change that it could result in a substantial loss of competition in the supply chain, whether at the supplier or retail level.

Countervailing factors

54. Any analysis of a possible SLC involves considering the responses of others (eg rivals, potential rivals and customers).¹⁹ For the purposes of this inquiry, for all of the theories of harm described above we will assess whether barriers to entry or expansion are high, which would facilitate an SLC. Conversely, it might be the case that entry or expansion by a wholesale or retail rival will prevent an SLC from arising. This is discussed below. We may also consider whether there are other countervailing factors that are likely to prevent or mitigate any SLC that we may find.

Entry and expansion

55. We will consider whether entry or expansion by competitors could prevent any SLC that might otherwise arise. To do this, we may assess evidence relating to:
- (a) whether entry or expansion by rivals is likely to occur in a timely manner, which may include an assessment of the costs and time necessary to enter and/or expand;
 - (b) whether entry or expansion by rivals is likely, including any plans and the certainty of those plans; and
 - (c) whether entry or expansion is likely to be sufficient to prevent an SLC from arising.

¹⁸ [Merger Assessment Guidelines](#), paragraph 5.4.19.

¹⁹ [Merger Assessment Guidelines](#), paragraph 5.8.1.

Countervailing buyer power

56. In some circumstances, customers may be able to use their negotiating strength to limit the ability of the merged firms to raise prices.²⁰ For the purposes of the theories of harm under consideration, customers of Tesco are end-consumers and customers of Booker are symbol stores and independent retailers. Our preliminary view is that such customers are unlikely to hold countervailing buyer power to an extent to prevent an SLC from arising.

Efficiencies

57. We will examine any submissions made in relation to efficiencies arising from the Merger. In particular, we will examine whether any potential efficiencies are rivalry-enhancing and could be expected to offset any loss of competition.

Possible remedies and relevant customer benefits

58. Should we provisionally conclude that the Merger may be expected to result in an SLC in one or more markets, we will consider whether, and if so what, remedies might be appropriate, and will issue a further statement.
59. In any consideration of possible remedies, we will take into account whether any relevant customer benefits might be expected to arise as a result of the Merger and, if so, what these benefits are likely to be and which customers would benefit.

Responses to the issues statement

60. Any party wishing to respond to this statement of issues should do so in writing, by no later than 23 August 2017. Please email tesco.booker@cma.gsi.gov.uk or write to:

Project Manager
Tesco/Booker merger inquiry
Competition and Markets Authority
Victoria House
Southampton Row
London
WC1B 4AD

²⁰ [Merger Assessment Guidelines](#), paragraph 5.9.1.