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Submission [✂]

on the anticipated acquisition by

Tesco plc of Booker Group plc

12 August 2017

Market changes likely if Tesco plc acquires Booker Group plc

Apparent pro-consumer and pro-retailer benefits brought about by the Tesco-Booker merger are illusory. The possibility that the merger might result in reduced prices, *if* passed on to consumers (which Tesco can only guarantee in its owned stores) may give the merger the appearance that it is pro-competitive or competition-neutral. In reality, a substantial lessening of competition will still result because the acquisition of Booker will enhance Tesco's ability to act across several markets with a view to raising prices and eliminating competition. It will be in the unique position of being able to manipulate the parameters of competition in:

- All grocery procurement markets, irrespective of the size of the supplier;
- Delivered wholesaling;
- The markets for grocery retailing in convenience stores; and
- The market for symbol operator services.

We urge the CMA not simply to look at these markets in isolation but to consider the effect of Tesco's increased power in all these markets in combination and through their inter-relationship with one another.

It is in this context that we disagree fundamentally with the provisional conclusion in the Phase 1 Decision that the merger will not harm competition in the market for symbol operator services. [✂]

We urge the CMA not simply to look at this merger in terms of compartmentalised "theories of harm" and to broaden its review to encompass the bigger picture. [✂]

That all grocery market participants, even the multiples, are afraid of what the future now holds is apparent from the deals and alliances that have been announced, and collapses rumoured, since the Tesco-Booker deal was itself announced. All result from the realisation that survival in their current form of all market participants is threatened by the sheer scale of Tesco-Booker and the power the merged group will hold.

To assist the CMA in understanding why we fear for the future of our sector, we have set out below what we believe will be Tesco's incentives going forward and how the merger enhances its power to achieve its objectives across markets, not just within them. In traditional "dominance" terminology, the enlarged Tesco will be able to act independently of its competitors, customers and suppliers.

We also see this as a vicious circle, in which Tesco's actions in one market will have repercussions, in competition terms, in a neighbouring market and this, in turn, will harm competition in another neighbouring market, and so on.

We are convinced that the merger will result in a substantial lessening of competition and urge the CMA to block the transaction outright.

1. Tesco's Procurement Objectives

First objective: Extract better prices from suppliers through better volume discounts and, in particular, through its ability to offer unparalleled logistical benefits within the supply chain.

These savings will not necessarily be passed on to consumers by Tesco. Options for use of monetary savings in procurement include:

- paying dividends to shareholders
- reducing retail prices across all owned stores
- reducing retail prices in supermarkets only
- reducing retail prices in Tesco-owned convenience stores only
- reducing prices in all owned stores and wholesale prices to the Tesco symbols/franchises. With respect to the latter, it is far from certain that these savings would then be passed on to the consumer; retailers are likely to retain some or all of the benefit.

We believe that Tesco will be under considerable pressure from investors to restore profitability and dividends to former levels. Tesco's results for the last few years can be viewed at: https://www.tescoplc.com/investors/reports-results-and-presentations/financial-performance/five-year-record/. Profitability has fallen away and the dividend payment, which remained steady at 14.76p per share in 2012, 2013 and 2014, dropped to just 1.16p in 2015. Shareholders will want to see the benefit of the Booker acquisition play out in improved terms for them.

Second objective: Lock-in suppliers, reducing choice and availability for competitors and raising the latter's costs.

Tesco will have the incentive to improve its position further vis-à-vis competitor purchasers through:

- Use of exclusive contracts requiring suppliers only to supply Tesco;
- Where possible, purchasing all or most of suppliers' output, especially small suppliers, whether or not using exclusive contracts;
- Use of long-term contracts;
- Use of punitive termination provision;
- Threatening not to deal with the supplier;
- Requiring "most-favoured-nation" (MFN) terms, i.e., that a supplier must not offer more favourable terms, including as to price, range and delivery times, to any other buyer (this is only relevant to multiples as no symbol operator can achieve equivalent prices to Tesco as it is);
- Requiring that any new or innovative products from its suppliers are only supplied to Tesco or only to Tesco for an introductory period, so that Tesco benefits from the first mover advantage.

Result of Tesco's power in procurement:

a) Tesco will have access to significantly better prices and terms from suppliers than all its competitors, including other multiples.

b) Tesco will enhance its already strong bargaining power with respect to suppliers of groceries as it will become (insofar as it is not already) a "must deal with" buyer across almost all product categories, including "must have" branded products.

c) Tesco's extraction of higher prices from suppliers will result in suppliers raising costs to Tesco's competitors, especially the non-multiples, as they seek to recoup their lost income. According to the CMAs Phase 1 Decision, certain suppliers have already confirmed to the CMA that they will do this. [✂] The price "gap" between what the multiples pay and what other purchasers pay would increase if the merger were allowed to proceed.

d) Increased prices charged by suppliers to third party wholesalers and symbol operators are likely to be passed on ultimately to the consumer. This will make those wholesalers and retailers less competitive. This in turn reduces any incentive on the part of Tesco to reduce the wholesale prices to those its supplies or its retail prices. Rivals' costs are increased leaving it scope to increase its prices.

e) Reduced costs to retailers supplied by Tesco (if Tesco chose to lower wholesale prices rather than retain the advantage) may not be passed on to consumers anyway. Retailers will likely prefer to retain the benefit for themselves.

2. Tesco's Objectives in the Convenience Sector

First Objective: To promote the expansion and success of its network of Tesco-owned stores.

Tesco will want to achieve as great a share as possible of the retail spend in the convenience sector for its Tesco-owned stores, so that Tesco, rather than even its own independent symbol retailers, take the profit from sales to consumers. It can achieve this by **"managing" competition to its owned stores from its own (former Booker) symbol stores**; where there is local competition between the two, Tesco will want its owned-stores to make the sale to the consumer so that the retail profit is retained in the Tesco Group; this can be achieved by:

- manipulating wholesale prices to, and the retail prices in, its symbol stores (e.g., lowering its own store prices and/or raising wholesale prices, RRPs and maximum prices in its symbol stores);

- raising wholesale input costs to its symbol retailers over time and/or selectively, through Tesco's knowledge of its symbol's retail prices and retail margin (facilitated where EPOS data is available from its symbol retailers);

- dropping service levels and choice in its symbol stores where this would not risk a competitor gaining the trade;

- not appointing any new "Booker" symbol retailers in close proximity to any Tesco-owned stores (unless it is worth it to keep the store from falling into the hands of a symbol competitor, assuming any would want to be close to a Tesco Express given its price advantage);

- not appointing any new "Booker" symbol retailers at all, i.e., only operating owned and franchised stores in the future;

- failing to continue to support its symbols to the same degree as they have been in the past, leading to a loss of innovation and stagnation.

As stated, many of the above actions will be facilitated by Tesco's access to the EPOS data of all its stores, including those of its symbol retailers. No competitor should have access to its competitors' real-time pricing information. This access will enable it to change prices in nearby Tesco Express stores in response. **As they will know both the wholesale and the**

retail price of all products they have supplied, Tesco will also be able to work out the retail margins chosen by their symbol operators, potentially allowing Tesco to increase their wholesale prices on a customer-by-customer basis.

Second Objective: Eliminate competition from third party symbols/convenience retailers

Tesco's overwhelming wholesale price advantage will enable it to attract retailers to its symbol(s) by offering them prices that will be unmatchable by any competitor, even with the most competitive will in the world. Tesco will only be able to do this because it can leverage its buying power from its supermarkets into the wholesaling and convenience sectors. We have already demonstrated, in our response to the Phase 1 RFI, the *huge* differential between the discounts Tesco supermarkets receive compared to all other non-multiple buyers.

Tesco will not just take business away but it will also raise its symbol operator and wholesaler competitors' costs. [✂]

Their most likely switch is to a Tesco symbol as price is the key consideration for a retailer when deciding on a symbol under which to operate. [✂]

[✂]

Third Objective: Reduce/eliminate potential competition

In addition to eliminating competition in the symbol operator services and wholesaling markets, the merger will raise barriers to entry to these markets. Retailers looking to join a symbol or switch are always most concerned about the wholesale prices on offer. A new entrant would have no ability to match Tesco in this regard and would have no chance of attracting retailers. Tesco would have no incentive itself to supply a new entrant

Depending on the location, Tesco could also introduce lower retail prices at a targeted, local level so as to undermine the ability of the new entrant's symbol retailers to compete. The mere threat that this might happen can be expected to deter new symbol operator entry.

Further, no one will want to open a store near a Tesco-owned store given its price advantage and ability to target lower prices at consumers on a local basis.

3. Conclusion

This merger gives Tesco the **incentive and ability** to achieve all the above objectives. We ask the CMA to analyse the merger in the context of the chain reaction across markets that will result.

Tesco's power will derive from:

- **Its unassailable position in purchasing markets and its ability to enhance this position by attracting customers from competitors who have no ability to compete on price.** This can only be prevented by not allowing the parties to combine in the first place. This unassailable position will also enable it to **raise its rivals' costs**.

- **Its ability to control or influence the input costs and key parameters of competition in its downstream competitors operating under its own symbols.** "Releasing" individual symbol stores at a local level would be insufficient to remove the national concern in this regard. Even if some stores or symbols were sold, Tesco would probably remain their wholesale supplier, thereby still retaining the ability to manipulate or increase the input costs of its downstream competitors. The CMA does not have the power to impose remedies on third parties, i.e., independent symbol retailers or the symbol operators if sold, and any remedy would be behavioural, e.g., not to make wholesale purchases from Tesco.

- **Its control of the input costs of all downstream convenience retailer competitors that are supplied today, in whole or in part, by Booker**, i.e., in addition to its own symbol retailer competitors. This would not change if Tesco sold off some stores or symbols.

- **Its access to real time retail price information from its own symbols' EPOS systems.** Any remedy in this regard would involve Tesco giving behavioural undertakings, which the CMA would be reluctant to monitor.

- **The raising of barriers to entry brought about by the merger itself,** in addition to the strategies Tesco will have the power to implement to prevent new entry in wholesaling, symbol operation and independent retailing.

This merger creates too many options and third-party decision points within the supply chain for Tesco to be able to claim that any efficiencies derived negate the substantial lessening of competition.

We urge the CMA to block this merger outright.