ANTICIPATED MERGER OF TESCO AND BOOKER

Summary of interviews with third party wholesalers

Background

1. In August and September 2017, the Competition and Markets Authority (CMA) held interviews with eight third party wholesalers with different offerings in the market in order to understand the market conditions and competition in the UK grocery wholesale and retail sectors and discuss their views about the anticipated merger and its likely impact in the relevant markets.

2. The wholesalers we spoke to each provided one or more of the following wholesaler services: delivered wholesale, cash and carry wholesale, symbol group services and wholesale buying group services (which involve negotiating with suppliers and agreeing prices and volume discounts on behalf of members, which are themselves independent wholesalers). In addition, of the wholesalers we spoke to some have widespread coverage across the UK whilst others are concentrated in particular geographic areas.

3. Below is a summary of the key points made during these discussions.

Wholesale competition

4. One wholesaler said that it provides different symbol group offerings (eg through different formats of fascia) depending on store size and demographics.

5. One wholesaler said that some symbol groups have minimum spend requirements (although these are not always adhered to or enforced). Another one, said that it does not have any minimum spend requirements. Instead, this wholesaler relied on the symbol group relationship to encourage purchasing loyalty from the retailer.

6. One wholesaler noted that different symbol group offerings involved differing levels of control by the symbol group wholesaler. For example, some symbol groups were closer to a franchise model, which involved a greater degree of control by the symbol group wholesaler and typically lower margins for the retailer.

__Delivered wholesale__

7. We were told that not all wholesalers provide a delivery service, although two wholesalers agreed that it is a growth area for some wholesalers. One wholesaler said that some customers (particularly symbol group customers) will require a delivered service from their wholesaler. Another felt that not providing a delivered service was not necessarily a limiting factor, including for the symbol group customers, as for many retailers the added cost of receiving a delivered service would not be attractive.

8. One wholesaler said that delivered services are costlier to provide than cash and carry services. When asked about barriers into providing a delivery service, two wholesalers said that they had expanded into this area, a further two said that it was possible to expand, but that a certain amount of investment and infrastructure was needed before being able to launch such a service.

9. One wholesaler said that it was necessary to build up a critical mass of customers in order to make deliveries efficient: it felt that £150,000 per week of delivered sales was probably the minimum to break even. A wholesaler noted that other costs to building a delivered service include the need to purchase a delivery fleet, acquire drivers and build capability to be able to make multi-temperature deliveries (in order to provide fresh and frozen orders, as well as ambient).

10. With respect to capacity constraints, one wholesaler told us that wholesalers are only constrained by the depot/outlet size. Another wholesaler said that it has been able to expand its capacity at short notice.

11. One wholesaler explained that there are two different types of delivered service. One which is predominantly a cash and carry offering that can also deliver goods and is relatively simple to set up and one which has dedicated distribution and picking centres and requires much more planning and expertise.

12. Wholesalers have differing levels of capacity to deliver chilled, frozen and tobacco products – with three of the wholesalers we spoke to outsourcing the delivery logistics and transport of some or all of these products to a third party.

13. A wholesaler explained that for a small wholesaler trying to expand its delivery offering the use of a logistics company is not always a viable option as logistics companies require a scale of volumes that the smaller wholesalers cannot provide. These smaller wholesalers would have to undertake the deliveries themselves.

14. One of the wholesalers outsourced its buying, delivery and warehousing to a third party. Its role was working with its symbol group customers to improve and build their business through advice, guidance and the provision of technical support.

Retailer purchasing habits

15. All of the wholesalers we spoke to agreed that symbol group members would not normally purchase everything from their main supplier despite the fact that they have a main supplier.

16. All of the wholesalers that we spoke to said that they offer flexibility to their retailers, including their symbol group members, that enables them to source products from alternative suppliers and wholesalers. However, we were told that different wholesalers have different requirements and minimum spend levels. One wholesaler said that symbol group retailers were likely to have greater purchasing loyalty, although these retailers would also take advantage of particular offers available outside of their symbol group wholesaler.

17. All the wholesalers said that retailers, in particular, independent cash and carry customers, were very price sensitive and would shop around looking for the best price or promotion. Even a small increase in price would see them lose a customer to someone that was selling the product cheaper.

18. Moreover, all the wholesalers said that retailers who operate under a symbol group had an element of freedom to switch to another if they wanted to. However, one wholesaler said that this is a significant decision for the retailer as it involves disruption to its store and potentially upsetting its customers. Another wholesaler said for members of a symbol group there are mechanisms used to tie retailers in – including but not limited to: requiring promotion purchase compliance; minimum spend requirements; requiring promotional POS compliance; refit finance with conditions; and purchase rebates. This wholesaler went onto say that it is also relevant that not all symbol group wholesalers will deliver or call on shops everywhere in the UK or they may already have a nearby shop (meaning that they will not give another fascia out nearby) – so this limits choice already. One of the symbol group operators said that they charged joining fees. Two wholesalers said that it was common practice for the larger wholesalers to offer financial incentives to encourage retailers to switch.

19. One wholesaler said that from a cash and carry perspective, pricing is important, however, other criteria can be more important, such as stock availability. The same wholesaler said that for a retailer that has made a special trip to a cash and carry it is very frustrating not to be able to find a particular product, especially if it is part of a promotion.

20. One wholesaler noted that, although not typical, multiple retailers may act as an alternative source of wholesale supply for some independent customers.

Flexing wholesale services

21. All of the wholesalers we spoke to have a national pricing structure. However two wholesalers also negotiate at regional [and local] level for some products. Another wholesaler said that local cash and carry managers will have some (although fairly limited) discretion to offer one-off promotions to particular customers.

22. One wholesaler said that in its view the merged entity would not vary pricing across its estate, as this would quickly become apparent to customers (who are savvy, price conscious and shop around). This would be very detrimental to its business.

Role of Palmer & Harvey (P&H) in the wholesale market

23. One wholesaler said that due to P&H's specialism in high density, small drop deliveries, it did not feel that there was any wholesaler that could immediately offer the services which P&H provides, particularly for its large multiple retailer accounts. For smaller, independent retailers, however, two wholesalers said that there was a range of alternatives, and that the service P&H offered was not unique (although P&H was able to leverage its business with large multiples to serve these independents at lower cost).

24. A different wholesaler said that it thought that there were currently more alternatives to P&H than in the past, which included Booker, Spar and Bestway as well as some of the bigger grocers. This was the case especially because grocers were looking to grow their activities in wholesaling. Another wholesaler included Nisa within this list.

25. One wholesaler said that P&H's multi-site operator customers (typically operators of petrol forecourt retail sites eg Shell, Rontec) may have few alternatives to P&H. However, this wholesaler also said that many of the smaller multi-site operators partner with a number of wholesalers and retailers to supply their petrol forecourts across different sites, which provide them with a range of supply options.

26. With respect to P&H's role in delivery tobacco, all of the wholesalers we spoke to sold tobacco products, but did not deliver them on the same scale as P&H. One wholesaler said that most retailers (other than the large multiples) would buy tobacco through a wholesaler rather than direct from tobacco suppliers. No wholesaler said that it had any current intentions to supply tobacco to large

multiple retailers. One wholesaler indicated that this would be unattractive due to: the investment in infrastructure and secure systems that this would require, the very low margins available on tobacco, and the fact that delivery of tobacco alone (rather than in combination with other, higher margin products) would be very costly. In addition, the same wholesaler said that the payment terms that multiple retailers may require would also not be attractive.

Retail competition

Consumer shopping habits

27. A wholesaler said that there has been an increase in convenience shopping, with consumers expecting higher quality products, including fresh produce.

Competition between retailers

28. Regarding competition between symbol group stores and multiple convenience stores, three wholesalers agreed that symbol groups faced increased competition from the convenience offerings from the larger multiples, including Tesco Express and Sainsbury's Local. One wholesaler said that the impact of a Tesco Express opening near one of its symbol stores could see the store's turnover drop by 20-40%.

29. Regarding competition between convenience stores and discount retailers, only one wholesaler said that discount stores such as Aldi and Lidl do not compete directly with independent convenience retailers. It said that discount stores were attractive to the customers of the big multiple superstores, rather than convenience stores, although it acknowledged that this could change in the future. The other wholesalers we spoke to thought that, as customer shopping habits were changing to more frequent shopping missions, the overlap between discount stores and convenience stores had increased. One wholesaler noted that the more limited range that discounters offered was not considered a limiting factor for a convenience store customer shopper. This was the case because these customer shoppers did not generally require a large amount of choice when carrying out small convenience shopping trips. The fact that discount retailers did not sell tobacco was not limiting their ability to compete for convenience shoppers according to two wholesalers.

Price marked packs

30. Three wholesalers said that they placed a great deal of importance on price marked packs. They felt that they gave the consumer confidence that they were getting a fair price for the product. They noted that this was particularly important in the convenience sector in the absence of the brand trust that is

usually enjoyed by the large multiple supermarkets. One wholesaler said that 60-70% of the products they sold (excluding tobacco) were price marked packs, another said they sold 80% price marked packs and this area has seen a real increase in popularity over the last few years.

31. Regarding pricing on price marked packs, one wholesaler noted that while it was very unlikely that a supplier would make a bespoke price marked pack for a particular wholesaler, pricing of these packs were likely to be decided through conversations with wholesale customers.

Impact of the merger

32. Seven of the wholesalers that we spoke to expressed concerns over the increased buying power of the merged company as a result of the anticipated merger. These seven wholesalers thought it likely that, once merged, Booker would benefit from the lower prices currently available to Tesco, (which are not available to other wholesalers), making it very challenging for wholesalers to compete.

33. Three wholesalers explained that multiple retailers generally have access to much lower supplier prices than wholesalers. This is due to the scale of their purchases, which lead to volume discounts. In addition, this is due to the benefit suppliers get from the greater exposure and access to end-consumers that multiple retailers provide for their products and the fact that these retailers tend to have multiple depots, which makes it more efficient, and therefore cheaper, for suppliers to serve them.

34. One wholesaler was of the view that these lower supply prices would also give Booker an advantage in wholesale to catering customers.

35. Four wholesalers said that if Booker lowered its prices which resulted in an increase in its market share it would then be in a position to increase its prices to the detriment of retailers and consumers. A wholesaler explained that if Booker, the largest wholesale operator, leverages the buying power of Tesco, the largest grocery retailer, this has the potential to wipe out wholesale competition. Another said that it would be disastrous to its business, if Booker were to get similar terms from suppliers, as Tesco currently does. In that case the wholesaler would be left at the mercy of suppliers lowering the cost of their goods.

36. Five of the wholesalers noted that the merger would have an impact on suppliers. One wholesaler explained that the size of Tesco/Booker merger would mean that suppliers might have to make a choice to supply Tesco/Booker only due to capacity issues or because the merged entity might require that

suppliers supply them exclusively. This would mean that the choice of suppliers would reduce.

37. There was also concern that post-merger Tesco/Booker may become the preferential customer for suppliers; meaning that they will have preferential access to stock that is seasonal or in limited supply from time to time.

38. Two wholesalers said that there is a risk that suppliers would increase their prices to wholesalers, in order to maintain supplier profitability, for example if they have to give Booker the cheaper prices currently enjoyed by Tesco. However, another wholesaler disagreed with this. It noted that its own suppliers would not necessarily increase their prices as a result of the merger. It was more concerned about the increasing differential between its prices and multiples' pricing. Another wholesaler believed that as the rate of real inflation hardens prices will go up for all, but not necessarily equally to all wholesalers. Two wholesalers expressed concern about whether price marked packs would continue after the merger. They felt that a company the size of Tesco/Booker would be able to influence the supply chain by switching to exclusively plain packs for supply chain synergies; meaning that it would not be viable for manufacturers to continue to produce price marked packs. Alternatively, they argued that suppliers could increase the prices of price marked packs which are available in the wholesale channel to recoup margin lost in selling more cheaply to Tesco/Booker.

39. Two wholesalers expressed concern over the amount of information that Tesco/Booker would have access to post merger, namely information which is collected through sales figures and Tesco club card data. They felt that the merged company would have knowledge of how Tesco Express stores and competing Booker supplied symbol group stores were performing, which could influence their strategy in a particular area.

40. One wholesaler also raised concerns that the merged entity may seek to move Booker's symbol group retailers to a stricter symbol group arrangement (with greater control for the merged entity over retail terms eg pricing) and may reduce the number of different own-branded ranges across Tesco and Booker's estate, which may reduce choice for consumers.

41. In response to the merger, one wholesaler said that it would push hard to negotiate better prices from its suppliers so that it could compete. However, it noted that it would be very challenging to stop customers from switching to Booker, if it was up against a significant price advantage.

42. Another wholesaler said that if the merger went ahead then it would have to absorb any additional costs to remain price competitive for customers, which

would have a detrimental impact on its profit. It said that ultimately it may have to restructure and focus on ensuring it remained cost effective, but that this might impact its delivery frequency and availability. One wholesaler said that it would focus on product availability and customer service and it would try to be price competitive on certain products, even if this meant losing money. It would also reconsider whether to continue with its planned expansion plans.

43. One wholesaler said that the merger was more likely to impact independent retailers and as a result the merger could impact it. Another wholesaler said that it would have to reconsider its profit levels and potentially drop its prices, which could mean that it would be unable to continue to provide that same quality of service. It may have to stop its delivery service and revert to just providing a cash and carry offering.

44. One wholesaler said that the only way for it to compete with lower prices was to consolidate. It noted that there was not much more it could do on improving efficiency, but it would have to either source products more cheaply, lower its distribution costs, or lower its overheads. It noted that the only way it could do this was by working with others in the market.