Competition & Markets Authority

Tesco and Booker

A report on the anticipated acquisition by Tesco PLC of Booker Group plc

20 December 2017

Website: www.gov.uk/cma

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The Competition and Markets Authority 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 [✂]. Some numbers have been replaced by a range. These are shown in square brackets. Non-sensitive wording is also indicated in square brackets.

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Summary

1. The Competition and Markets Authority (CMA) has found that the anticipated acquisition by Tesco PLC (Tesco) of Booker Group plc (Booker) (the Merger) may not be expected to result in a substantial lessening of competition (SLC) within any market or markets for goods or services in the United Kingdom (UK).

Background

2. On 12 July 2017 the CMA referred the Merger for further investigation following a phase 1 review.[1] Our investigation and report has been led by a group of CMA panel members (the Inquiry Group) who 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 an SLC within any market or markets in the UK for goods or services.

3. We were required to come to, and report on, our final decision by 26 December 2017.

The Parties

4. Tesco is the UK's largest grocery retailer (it also supplies general merchandise, clothing, petrol, mobile phone and banking services). It owns approximately 3,500 supermarkets and convenience stores including some operating under the One Stop brand. Separately, Tesco owns the One Stop franchise which has approximately 160 stores which Tesco does not own.[2] In 2016/17 Tesco generated £55.9 billion of revenue worldwide, with £42.5 billion coming from the UK.

5. Booker is the UK's largest grocery wholesaler. It provides grocery wholesale services to retailers and caterers whether as delivered services or cash and carry. It is also the owner of the symbol group brands Londis, Budgens, Premier and Family Shopper. Symbol groups are collections of stores which

[1] In exercise of its duty under section 33(1) of the Enterprise Act 2002.
[2] The One Stop franchise model is one where Tesco owns the brand and provides wholesale services to the franchisees who are independent from Tesco. Franchisees agree to a large degree of central control by Tesco [✂] and to source a large proportion of their products from Tesco.

are affiliated with a wholesale symbol group provider (the symbol group wholesaler), usually operating under a common brand or 'fascia'. The retailer is independent from the wholesaler, but generally commits to minimum purchase requirements (and other conditions which vary by wholesaler and symbol group brand), in return for use of the symbol brand and other benefits such as improved promotions. Booker has around 5,500 retail stores under its symbol group brands. In addition, Booker owns and operates a very small number of Budgens stores. In 2017 Booker generated £5.3 billion of revenue worldwide, almost all of which was generated in the UK.

6. In this report we refer to Tesco and Booker collectively as the Parties.

Jurisdiction

7. We have found that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation within the meaning of the Enterprise Act 2002 (the Act) and therefore we have jurisdiction to review it.

Rationale

8. The Parties stated that the rationale for the Merger is to benefit from the growth opportunities arising from the combination of two complementary businesses, in particular, in the fast growing 'out of home' food segment. Consumer preferences have been changing in two ways in particular: (i) there is a trend for convenience shopping (where consumers buy fewer items per shop but shop more frequently) and (ii) rapid growth in eating out (which includes restaurants and also pre-prepared sandwiches and salads for lunch offered by retailers). The out of home segment is forecast to grow faster in the short term compared to 'in home' consumption of groceries. The Parties plan to grow their presence in the out of home segment by, for example, supplying restaurants with a broader range of products and by selling pre-prepared food in retail stores. To help them achieve these synergies the Parties submitted that:

   (a) Booker has expertise and knowledge in the catering and food service business to serve the out of home channel; and

   (b) Tesco has expertise in supply chain management (sourcing and distribution) and product development, with particular strength in fresh, chilled and own label categories, and well developed digital capabilities (customer insights and online ordering/delivery).

Market definition

9. We have assessed whether the Merger is likely to result in an SLC anywhere in the supply chain. In doing so, we have adopted the following frameworks for our analysis of the potential competitive effects of the Merger.

10. For our analysis of retail competition, we have differentiated by store size and distance within the categories of 'one-stop stores',[3] 'mid-size stores' and convenience stores. We have treated:

    (a) mid-size stores (280–1,400 sqm) as competitively constrained by other mid-size stores within a 5-minute drive-time in urban areas and within a 10-minute drive-time in rural areas, and by one-stop stores within a 10-minute drive-time in urban areas and within a 15-minute drive-time in rural areas; and

    (b) convenience stores (under 280 sqm) as being competitively constrained by other convenience stores, mid-size stores and one-stop stores within 1 mile.

11. For our analysis of grocery wholesale competition we have, where appropriate, treated symbol group, cash and carry and delivered grocery wholesale services separately. We have undertaken that analysis on the basis of the following differentiation, treating:

    (a) wholesalers offering delivered services to symbol group and independent retailers as competing within an area in which they derive 80% of their customers, but also taking account of a larger area in which they derive 100% of their customers;

    (b) wholesalers offering cash and carry services as competing within an area in which they derive 80% of their customers, but also taking account of a larger area in which they derive 100% of their customers.

12. For the procurement of groceries from suppliers we have assessed the Merger on the basis of product categories on a national basis.

Competitive assessment

13. Tesco is primarily a grocery retailer and Booker is primarily a grocery wholesaler. There is very little direct, head-to-head competition between

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[3] The report uses 'one-stop stores' to refer to large supermarkets (greater than 1,400 sqm) and 'One Stop stores' to refer to owned or franchised stores under the One Stop brand.

them. The Merger is therefore primarily vertical in nature. Moreover, Tesco mostly procures products directly from suppliers without using wholesalers. One Stop's expenditure on wholesale services is small relative to the UK total. It is commonly accepted that vertical mergers may lead to efficiencies which may result in benefits to customers; but some can weaken competition and may result in an SLC. Our approach to the competitive assessment reflects this.

14. We have used the following theories of harm to assess whether the Merger may be expected to result in an SLC. We have considered whether:

(a) any additional buyer power to the merged entity would weaken rival wholesalers or dampen suppliers' incentives to innovate;

(b) the merged entity would increase its wholesale prices or cut costs (that affect its quality of wholesale service) in local areas where its retailer customers overlap with Tesco's stores, in the expectation that it would be able to offset any resulting loss of wholesale sales through increased retail sales at Tesco's stores, to the advantage of the merged entity as a whole;

(c) the merged entity would increase its retail prices or cut costs (that affect its quality of retail service) in local areas where Tesco's stores overlap with the merged entity's retailer customers, in the expectation that it would be able to offset any resulting loss of retail sales through increased wholesale sales to its retailer customers, to the advantage of the merged entity as a whole;

(d) the merged entity would increase retail prices or cut costs that affect its quality of service in local areas where the Parties' owned and operated grocery stores overlap, thereby weakening local retail competition; and

(e) if Tesco were to stop using third party wholesalers post-Merger this would substantially weaken delivered wholesale competition.

15. In our inquiry we have:

(a) commissioned a survey of 463 independent and symbol group retailers about their supply options and relationships with wholesalers;[4]

(b) received submissions, internal documents and commercial data from the Parties;

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[4] The survey report is published on the Tesco/Booker merger inquiry case page.

(c) received representations including responses to written questionnaires and telephone interviews with third-party wholesalers, suppliers, retailers and trade bodies;

(d) received commercial data from some third party wholesalers about their sales, churn rates of symbol group members, depot locations and catchment areas; and

(e) received commercial data from some suppliers about their terms with the Parties.

16. In addition, we have conducted various quantitative analyses, including an analysis of the effect on Booker's sales to retailers from over 1,600 examples of entry and over 300 examples of exit by competing retailers. We have also examined via a quantitative model, local areas based on over 12,000 stores (for one theory of harm, and around 2,300 for another) in order to assess whether after the Merger the merged entity is likely to have an incentive in any of these areas to increase prices or cut costs that affect quality of service.

17. Although we have taken into account Booker's wholesale activities to caterers in some of our analysis (for example, when we consider issues of efficiencies and buyer power) in other parts of our analysis we have focussed only on the retailing segment where, unlike the catering segment, Tesco is present.

18. In order to make our assessment of whether the Merger is likely to lead to an SLC under any of the theories of harm presented in paragraph 14 above, we have first examined grocery retail and wholesale services to understand the context in which the Parties compete.

19. In grocery retailing we have found that the main factors in local competition, in addition to price, are store size, distance from other stores and the fascia of the store. We have taken these factors into account in our analysis. Regarding fascia we have found that a large number of retailers compete against Tesco including supermarket multiples, symbol group retailers, and Aldi Stores Limited (Aldi) and Lidl UK GmbH (Lidl). The strength of competition in grocery retail varies from area to area and we have taken account of that variation in our analysis.

20. In grocery wholesale, we have found that retailers generally have a range of wholesaler alternatives to choose from regardless of whether they are symbol group retailers or use delivered grocery wholesale services or cash and carry services. The strength of competition in wholesale services varies from area to area and we have taken account of that variation in our analysis. During our inquiry Palmer & Harvey McLane Limited (P&H), and most of its subsidiaries, entered administration. We have considered what this has meant for our

inquiry and for competition at the wholesale level. We have found that for each of the customer groups previously served by P&H – major multiple retailers, symbol group retailers, multi-site retailers, and other retailers including independent retailers – as well as for tobacco suppliers, sufficient options and competitive constraints will remain after the Merger.

Efficiencies and buyer power

21. We have investigated whether the Merger may be expected to result in an SLC in delivered and cash and carry grocery wholesaling as a result of the merged entity receiving more favourable terms from some suppliers or increased buyer power.

22. Some third parties raised concerns that merger-specific procurement efficiencies may lessen competition in grocery wholesale services. Specifically, third parties argued that the merged entity might pay less for its products for wholesale than others in the marketplace. This might be because of the merged entity's ability to achieve the more favourable of the supply terms currently received by either Party separately (harmonisation), or because of the merged entity's greater bargaining power. Some who expressed concern told us that supply terms to rival wholesalers may actually worsen because they would have lower sales volumes (in the event that some of their customers would have switched to the merged entity) or because suppliers would seek to recoup some of the lost profit on sales to the merged entity through raising prices to the suppliers' other customers. In any event, if the merged entity did achieve more favourable supply terms, it would receive a competitive boost in delivered and cash and carry grocery wholesaling.

23. The third parties said that, in the above scenario, eventually competition in delivered and cash and carry grocery wholesaling would be substantially lessened. Further, retailer customers, catering customers and end consumers would suffer detriment as a result of weaker competition.

24. The above concerns rely on the merged entity receiving more favourable supply terms compared to those that Booker or Tesco currently enjoy and that these will be passed on to customers so that customers of rival wholesalers would then switch to the merged entity. They therefore require us to consider the benefits to customers which could be realised in the short term and the less certain long-term impact on competition.

25. In order for this theory of harm to result in an SLC, a number of cumulative conditions would need to be met. These are that:

(a) the merged entity will be able to negotiate better supply terms from its suppliers;

(b) the resulting lower prices will be passed on to customers (ie retailers or caterers) which in turn will allow the merged entity to attract additional business away from its wholesale competitors;

(c) the competitive pressure on the merged entity from competing wholesalers will be substantially weakened as a result of rival wholesalers losing customers to the merged entity to such a degree that they either exit the market or they remain but the cost of serving their remaining customers increases (eg because suppliers increase prices to those wholesalers); and

(d) the merged entity will have the ability to increase prices or worsen its terms in the longer term as a result of substantially lessened competition in delivered and/or cash and carry wholesaling with the prospect of entry or expansion of the remaining competitors not being sufficient to prevent those price increases.

26. We have found that the merged entity would likely benefit from better terms from some suppliers with regard to some products through a degree of harmonisation of supply terms, where one of the Parties currently receives better terms than the other. The evidence indicates that this may apply to a relatively small proportion of Booker’s current total grocery procurement. However, we have not found it necessary to conclude on the magnitude of any procurement efficiencies. In any event, to the extent that the merged entity receives more favourable terms, it is likely that a proportion of these better terms would be passed on to customers, making the merged entity a more effective competitor. Apart from where one of the Parties currently receives better terms than the other, we do not consider that the merged entity would receive substantially better supply terms on any products as a result of strengthened buyer power across its retail and wholesale businesses as a whole. The overall increment to Tesco’s share of procurement as a result of the Merger is generally low. In tobacco, where we have found that the Parties have a sizeable combined share and there is a significant increment from the Merger, suppliers are likely to have a significant degree of bargaining power.

27. Based on the overall evidence that we have received, we have found that Booker’s share of grocery wholesale on any relevant measure is at a level at which we would not normally expect any firm to be in a position to substantially lessen competition across the whole marketplace. These shares indicate the very large scale of customer switching to the merged entity that

would need to occur before an SLC could be contemplated. We have also found that competition in grocery wholesale services is generally strong which the merged entity would need to overcome in order to increase its relatively low share of grocery wholesaling.

28. Recent changes in the industry indicate that some rival wholesalers might be able to offer prices competitive to the merged entity. Wm Morrison Supermarkets plc (Morrisons) has recently announced that it will supply Safeway products and national brands to some retailers. Separately, the Co-operative Group Limited (the Co-op) has recently announced a bid for Nisa Retail Limited (Nisa) (which is subject to CMA approval). Another possible response could be for wholesalers to strengthen competition on non-price aspects such as service quality differentiation. These might include quality of range, service offering to symbol group retailers and delivery logistics.

29. This analysis would be sufficient to conclude that the Merger may not be expected to result in an SLC. Even so, we have further examined the evidence on entry and expansion by rivals to investigate whether the merged entity would be able to harm competition in the longer term. Even in the hypothetical scenario that the merged entity were to increase its prices in the longer term (and there is no evidence to suggest this would be the case), we have found that rival wholesalers would be able to expand to compete for customers and defeat such a price increase.

30. Finally, we note that it would generally be against the principles of merger control to find that a merger gives rise to a likely SLC just because it made one or both parties more efficient and a stronger competitor.

31. Therefore, we have concluded that the Merger may not be expected to result in an SLC because of achieving better supply terms.

Vertical effects: wholesale to retail

32. A firm might look to increase its profits by increasing its prices or by reducing its cost base in a way that reduces the quality of the service it offers to customers. What might prevent a firm from doing this without a merger is that some customers would not tolerate the higher prices or reduced quality of service, and would look to purchase their products elsewhere. While the firm would earn additional profits on the sales to customers that stay with it, it would lose sales (and profits) from customers that switched away. The threat of customers switching away disciplines the firm from raising prices or cutting costs that would reduce the quality of its offer.

33. A merger might change a firm's incentives, however. If enough customers who would switch away from one merging party would switch to the other merging party, then what was not profitable before the merger could become profitable after it. This is because the second merging party, in recapturing some of the switching sales, is able to offset some of the losses to the first, to the benefit of the enlarged group.

34. Tesco and Booker do not generally compete at the same level of the supply chain. Therefore, they will not be able to recapture sales directly between one another. However, some of the retail stores which Booker supplies will compete in their local area with Tesco's owned stores, and others will compete in their local area with Tesco's One Stop franchised stores.

35. If the merged entity were to increase its wholesale prices, or cut costs that affected its quality of wholesale service, it might earn higher profits on each sale it made. On the other hand, it might lose retailer customers to other wholesalers. If these higher prices or lower quality of service at the wholesale level were reflected in a worsened shopping experience, the merged entity might also face reduced demand from retailer customers it retained, as shoppers at their stores switched to shop at other convenience stores instead. In local areas where these stores compete with Tesco, Tesco might gain some of these switching shoppers.

36. Post-Merger, the strategy might therefore be profitable for the merged entity overall if the profit gained by the locally competing Tesco store at the retail level (from additional shoppers it won) and from the merged entity's wholesaling activities (from larger margins on sales it retained), is greater than the profit which it lost (from customers that switched away, and lower sales to customers it retained). If this is the case, the merged entity might have the incentive to increase its wholesale prices or cut costs that affect its quality of wholesale service (ie pursue a foreclosure strategy) in those local areas.

37. We have considered in our analysis whether the Merger is likely to result in an SLC through such a vertical effect nationally. At the national level, Booker accounts for around 10-20% of grocery wholesale services overall and 18% to the retail channel, while Tesco accounts for around 28% of grocery retailing. We have found that it is not likely that the Parties could carry out a national foreclosure strategy at these levels of supply. For example, if the merged entity were to increase its wholesale prices and/or cut wholesale costs that affect its quality of service nationally, its customers (whether retailers or caterers) would be likely to switch to the other wholesalers who make up around 80% of UK wholesale supply to retailers. Likewise, in the large majority of local retail areas, Booker-supplied retailers are likely to face

sufficient competition from third-party retailers to make the necessary recoupment through Tesco unlikely.[5]

38. We have assessed whether the Merger may be expected to result in an SLC through this vertical effect locally. For there to be an incentive for the merged entity to increase wholesale prices and/or cut wholesale costs that affect its quality of service to its symbol group and independent retailer customers, the strategy would need to be profitable to the merged entity overall. There are several factors that affect whether this is likely to be the case. These are:

    (a) the degree of competition between Tesco stores and Booker-supplied retailers at a local level (ie the conditions of local retail competition). This will determine the extent to which end-customers may switch from Booker-supplied retailers to Tesco stores, rather than to other retailers' stores;

    (b) the degree of competition at the wholesale level. This will determine the extent to which retailers may switch away purchases from the merged entity and use alternative wholesalers instead if the merged entity deteriorates its offering;

    (c) the profits that the merged entity stands to gain from any consumers who switch to the locally competing Tesco store, compared to the profits that the merged entity stands to lose on lost wholesale sales (net of the higher profits it earns on higher-profit wholesale sales it retains). This will depend on the margins earned on each sale – since Tesco generally earns a much higher margin on its retail sales than Booker earns on its wholesale sales, it is plausible that forgoing a smaller (wholesale) margin in favour of a higher (retail) margin could be profitable to the merged entity overall; and

    (d) the extent to which a worsening of the wholesale offer (particularly in the form of a wholesale price rise) is likely to feed through to a similar worsening at the retail level (particularly in the form of a retail price rise). The larger the change in retail prices, the more likely that sales will divert at the retail level which may be recaptured by a locally competing Tesco store, and the greater the incentive for the merged entity to increase

[5] Since our provisional findings P&H has gone into administration and therefore we note that Booker's share of grocery wholesale services overall and grocery wholesale to retailers is likely to be higher than the 10-20% and 18% respectively that we quoted in our provisional findings report. Taking into account of P&H going into administration, even on a cautious basis we estimate that Booker's revised share will remain below 30% on either measure.

wholesale prices (for any given level of wholesale losses that would result).

39. We have examined the Parties' incentive to carry out a strategy of increasing the merged entity's wholesale prices, or cutting costs that affect its quality of wholesale service, in relation to over 12,000 stores supplied by Booker that face competition in their local area from at least one store owned or supplied by Tesco.

40. We have found that the merged entity would not have any material incentive to worsen wholesale price or service. This is because, overall, we found that competition in wholesale services was generally strong, meaning that, in most areas, many retailers would switch purchases to other wholesalers rather than suffer (or pass on to shoppers) a worsened service – defeating the merged entity's ability to carry out this strategy. Further, in many areas, the presence of other nearby retail competitors would mean that Tesco would not be able to recapture sufficient sales to make the strategy profitable, as competing retailers would capture some of the switching sales.

41. We have found that there may be, at most, some limited incentives in relation to a very small number of local areas. However, any incentives that might arise at the wholesale level would be reduced by, for example, retailers purchasing only a fraction of their products from the merged entity and the rest from other wholesalers, and by retailers not passing the full wholesale price rise through to shoppers at the retail level. Further, pursuing a targeted strategy in these areas would require coordination across the merged entity's retail and wholesale arms. We consider that the costs of implementing such a strategy would be disproportionately high relative to the very small number of areas involved. In addition, we found that wholesale competition was sufficiently strong in all of these local areas.

42. We have therefore found that the Merger may not be expected to result in an SLC with respect to this theory of harm.

Vertical effects: retail to wholesale

43. We have investigated whether the Merger could make it profitable (in a way that was not profitable prior to the Merger) for the merged entity to implement a strategy of increasing retail prices or cutting costs that affect its quality of retail service, due to the possibility of recapturing sales at Booker-supplied retail stores that overlap with Tesco stores.

44. In theory, and all other circumstances being equal, the incentives arising under this theory of harm will be lower than those discussed in the above

‘vertical effects: wholesale to retail’ theory of harm. This is because the profit which the merged entity stands to gain at the wholesale level from sales recaptured at its retailer customers’ stores are reduced in two ways. Firstly, the margins which Booker currently earns on wholesale sales are lower than the margins which Tesco currently earns on retail sales. Secondly, Booker does not supply all of its retailer customers’ wholesale requirements. Any increased demand that Booker’s retailer customers face due to shoppers switching to their stores after the Merger will therefore be spread between the wholesalers that they purchase from, only one of which may be Booker.

45. For there to be an incentive for the merged entity to increase its retail prices or cut costs that affect its quality of service (notwithstanding that this may result in some lost sales), the strategy must be profitable to it overall. There are several factors that affect whether this will be the case:

(a) First, the degree of competition between Tesco stores and Booker-supplied retailers at a local level (ie the conditions of local retail competition). This will determine the extent to which end-customers may switch from Tesco stores to Booker-supplied stores, rather than to other retailers’ stores.

(b) Second, the profits that the merged entity stands to gain from any additional wholesale sales that result from end-customers switching to Booker-supplied stores, compared to the profits that it stands to lose on lost retail sales at Tesco stores as shoppers switch away (net of the higher profits it earns on the more profitable retail sales it retains).

46. As Booker’s current wholesale margin is smaller in value compared to Tesco’s prices, the value of recaptured sales is small in relative terms (ie from Tesco’s point of view). This means that for the strategy to be profitable to the merged entity overall, the rate of diversion in any local area must be significantly higher under this theory of harm compared to the ‘vertical effects: wholesale to retail’ theory of harm.

47. We have taken into account the share of a retailer’s total wholesale supply that Booker provides. If this is a small proportion, then the value of the sales the merged entity stands to win will also likely be small, and therefore the ‘gain’ of the strategy reduced.

48. We have examined the local areas in which over 2,300 Tesco-owned stores face competition from at least one Booker-supplied store.

49. We have found that the merged entity would not be likely to have any material incentive to worsen retail price or service. This is because, if the merged entity were to raise its retail prices, it would incur losses through: other non-

Booker-supplied retailers recapturing sales, Booker-supplied retailers not purchasing all their stock from the merged entity, and Booker's current wholesale margins being lower than Tesco's retail margins.

50. We have found that there may be, at most, some limited incentives in relation to a very small number of areas, and pursuing these would require coordination across the merged entity's retail and wholesale arms. Moreover, the recaptured revenue would come via customers of the merged entity's wholesale business whose continued purchases from the merged entity are far from guaranteed. The costs and risks of implementing such a strategy would be disproportionately high relative to the very small number of areas involved.

51. We have therefore found that the Merger may not be expected to result in an SLC with respect to this theory of harm.

Horizontal effects

52. Booker owns and operates a small number of convenience and mid-sized stores, some of which are located near Tesco stores. In the CMA's phase 1 decision it identified two local areas in which a realistic prospect of an SLC arose. We have examined those two areas.

53. In the first area, within a mile of the Booker store there is a Co-op, Aldi and Lidl. The overlapping Tesco store is also within a mile but further away than the rival stores. On the basis of existing local competition we have concluded that competition concerns are not likely to arise in this local area.

54. In the second area, there are two nearby Tesco stores, both located slightly over a mile (and both under 6 minutes' drive-time) away from the Booker store. However, J Sainsbury's plc (Sainsbury's) and Asda Stores Limited (Asda) are present in the local area, and Aldi and Marks and Spencer plc (Marks and Spencer) Simply Food are both only slightly more than 5 minutes' drive-time away. On the basis of existing local competition we have concluded that competition concerns are not likely to arise in this local area.

55. We have therefore found that the Merger may not be expected to result in an SLC with respect to horizontal effects.

Conclusion

We therefore have concluded that the Merger may not be expected to result in an SLC within any market or markets for goods or services in the UK.

Findings

1. The reference

1.1 On 12 July 2017, in exercise of its duty under section 33(1) of the Act the CMA referred the Merger for further investigation and report by a group of CMA panel members (the Inquiry Group).[6] The Inquiry Group's terms of reference are set out in Appendix A. The Inquiry Group is required to publish its final report by 26 December 2017.

1.2 In our investigation we 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 an SLC within any market or markets in the United Kingdom for goods or services.[7]

1.3 This document, together with its appendices, constitutes the Inquiry Group's findings, published and notified to Tesco PLC (Tesco) and Booker Group plc (Booker) in line with the CMA's rules of procedure.[8] Further information relevant to this inquiry, including non-confidential versions of the submissions received from Tesco and Booker, as well as summaries of evidence received in oral hearings, can be found on the CMA's website.[9]

1.4 Throughout this document, we refer to Tesco and Booker collectively as the Parties.

2. The Parties

Tesco

2.1 Tesco is primarily a food retailer. It also supplies a range of non-food grocery items (eg household and health & beauty), general merchandise, clothing and petrol, and provides mobile phone and banking services. It is a UK publicly

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[6] On 30 May 2017, the Parties notified the Merger for phase 1 review by the CMA. On 27 June 2017, part way through the CMA's phase 1 investigation, the Parties requested that the CMA refer the Merger for an in-depth, phase 2 review.
[7] Section 36(1) of the Act.
[8] Rules of procedure for merger, market and special reference groups, (CMA17), Rule 11.
[9] Tesco/Booker merger inquiry case page.

listed company with operations in the UK, Europe, and Asia. In 2016/17 Tesco generated £55.9 billion of revenue worldwide, with £42.5 billion coming from the UK.[10]

UK grocery operations

2.2 Of the £42.5 billion of revenue which Tesco generates in the UK, £41.5 billion is from the supply of groceries.[11] Tesco is the largest grocery retailer in the UK with a national share of around 28%.[12] According to Mintel, Tesco accounts for 16% of UK convenience retailing.[13]

2.3 Tesco supplies groceries across the UK using a range of distribution channels, including:

(a) retail sales from around 3,500 owned and operated stores across a number of formats and sizes (including Tesco Extra, Tesco Superstore, Tesco Metro, Tesco Express and owned One Stop stores);

(b) wholesale sales to around 160 franchised One Stop stores which it does not own; and

(c) retail sales online.[14]

2.4 Tesco owns One Stop Limited (One Stop). The One Stop business owns and operates a number of One Stop stores, as well as operating a franchise business for a small number of convenience stores. The One Stop franchise model is one where Tesco owns the brand and provides wholesale services to franchisees who are independent from Tesco. Franchisees agree to a large degree of central control by Tesco [✄] and to source a large proportion of their products from Tesco.

2.5 At phase 1 the CMA examined whether any concerns might arise on the basis that the merger removed wholesale competition between Tesco as a wholesaler to its One Stop franchise and Booker as a wholesaler. No prima facie concerns were found (on a 'realistic prospect' standard) and we do not consider that issue further in this report.

2.6 A breakdown of the numbers of stores and the associated Tesco revenue is shown in Table 1 below.

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[10] Tesco Annual Report 2017, p167 (for UK groceries) and p169 (for Tesco Bank).
[11] These figures include the sales of fuel, Tesco Annual Report 2017, p167.
[12] Grocery market share data compiled by Kantar (straight average annual estimate ending October 2017).
[13] Mintel, Convenience Stores UK, April 2017.
[14] Tesco Annual Report 2017, p167.

Table 1: Number of Tesco stores, by format, and revenue (2015/16)

	Stores		*Tesco revenue*	
	Number of stores	*Share of stores (%)*	*Revenue, by store type (£bn)*	*Share of revenue, by store type (%)*
Tesco Extra	252	7	[✄]	[✄]
Tesco Superstore	478	14	[✄]	[✄]
Tesco Metro	177	5	[✄]	[✄]
Tesco Express	1,732	49	[✄]	[✄]
One Stop (owned)	768	22	[✄]	[✄]
One Stop (franchised)*	129	4	[✄]	[✄]
Online	N/A	N/A	[✄]	[✄]
Total	**3,536**	**100**	[✄]	**100**

Source: The Parties.
Note: Revenue figures exclude sales of fuel and VAT.
* Tesco revenue from franchised stores represents wholesale sales from Tesco to the franchisee. The difference in numbers for One Stop franchised stores between table 1 and paragraph 2.3, and elsewhere in the document, is because of a difference in the dates to which the two pieces of information relate. The current number of franchised stores is approximately 160.

2.7 Based on these figures, Tesco's convenience estate (which includes Tesco Metro, Tesco Express and One Stop) makes up around 80% of its store numbers, but around [✄]% of its UK grocery revenues.

Other operations

2.8 Tesco has grocery operations in a number of other countries including the Republic of Ireland, the Czech Republic, Hungary, Poland, Slovakia, Malaysia, Thailand, and joint ventures in India and China. Tesco also has a minority shareholding in Lazada Group, a south-east Asian online retailer.

2.9 Tesco also has non-grocery operations in the UK and beyond, including Tesco Bank (personal banking products), Dunnhumby (data analytics) and Tesco Mobile (a virtual network operator[15]).

Booker

2.10 Booker is primarily a wholesaler of food and non-food grocery items to businesses, particularly in the catering and retail sectors. It is a UK publicly listed company with operations in the UK and India. In 2017 Booker generated £5.3 billion of revenue worldwide,[16] almost all of which was generated in the UK.[17]

2.11 Booker is the largest grocery wholesaler in the UK. Table 2 gives an indication of Booker's size, on a national basis, across its various wholesaling activities.

[15] A mobile phone operator which does not own a communications network infrastructure, but provides mobile retail services to customers using commercially negotiated wholesale services provided by other operators.
[16] Booker Annual Report 2017, p2.
[17] 'Other than the operation in India (which is immaterial), all of the Group's revenue originates from the UK.' Booker Annual Report 2017, p69.

In this report we also refer to IGD estimates of national shares of supply of cash and carry grocery wholesaling to independent and convenience retailers and of delivered grocery wholesaling to independent and convenience retailers (Figures 3 and 4).

Table 2: Booker's UK share of supply by wholesaling activity

	CMA estimate (%)	*Parties' estimate (%)*
UK grocery wholesaling	18	11
UK grocery delivered wholesaling	13	
UK grocery cash and carry wholesaling	26	
UK symbol group wholesaling	-	15
UK grocery wholesaling to retailers	18	
UK grocery wholesaling to caterers	16	8

Source: The Parties and the CMA.
Note: CMA estimate based on revenue data from the Parties and IGD data.

2.12 Table 2 includes P&H. Since the estimated shares in Table 2 were calculated (and published in our provisional findings) P&H has gone into administration and its wholesaling businesses have ceased trading.[18] This event will not affect Booker's share of grocery cash and carry wholesaling or grocery wholesaling to caterers. However, it will affect Booker's estimated share of supply of all other wholesaling activities reported in Table 2. Nevertheless, even on the most cautious basis we have estimated that Booker's national share of supply would remain below 30% in each of the activities listed in Table 2.[19] We note that a market share of less than 30% will rarely give the CMA cause for concern with regard to vertical effects of a merger.[20]

2.13 These wholesale operations are supplied through a combination of cash and carry depots and a national wholesale delivery service. Booker also owns the symbol brand for four symbol groups: Premier, Londis, Budgens and Family Shopper.[21] Symbol groups are collections of stores which are affiliated with, but not owned by, a wholesale symbol group provider (the symbol group wholesaler), usually operating under a common brand or 'fascia'. The retailer

[18] The entities in administration are Palmer & Harvey (Holdings) PLC; Palmer & Harvey McLane Limited; Palmer & Harvey McLane (Holdings) Limited; P&H (1925) Limited; P&H Direct Van Sales Limited; P&H Sweetdirect Limited; P&H Direct Limited; and P&H Snacksdirect Limited. Where in this report we refer to P&H being in administration we mean these companies. WS Retail Limited has not been placed into administration and continues to trade as normal.
[19] This is based on the assumption that Tesco and Sainsbury's purchases from P&H would be taken in-house, and that Booker would capture all of P&H's remaining sales except for those from two major customers who have publicly announced that they have moved to an alternative supplier, namely Costcutter (moved to Co-op) and McColls (already due to transfer to Morrisons in 2018, with Nisa providing a short-term contract in the meantime). Even in this extreme scenario, there would be less than a five percentage point increase in Booker's estimated shares of UK grocery wholesaling, UK grocery delivered wholesaling and UK grocery wholesaling to retailers.
[20] Merger Assessment Guidelines, paragraph 5.3.5.
[21] The Parties submitted that there was also another, smaller category of Booker symbol group stores, labelled in the data provided by the Parties as 'BRP non-fascia' symbol group stores. The Parties submitted that these were stores where there was a supply agreement between Booker and the independent retailer, but the store did not operate under one of the four Booker brands. [✂] In our assessment, we have therefore treated these stores in the same way as Booker's other symbol group fascia.

is independent from the wholesaler, but generally commits to minimum purchase requirements (and other conditions which vary by wholesaler and symbol group brand), in return for use of the symbol group brand and other benefits such as improved promotions. Booker has around 5,500 retail stores under its symbol group brands. It also owns and operates a very small number of retail stores.

2.14 Booker serves three main types of customer:[22]

(a) Retailers (£3.36 billion of revenues, around 63% of total revenues): This consists of 117,000 retailer customers. Many of these customers are members of Booker's symbol groups, with 5,500 Booker symbol group stores. The remainder are customers which are not affiliated with Booker's symbol groups (referred to in this report as 'independent customers'). Independent customers can use Booker's delivered grocery wholesale service or its cash and carry service. Booker also serves some national retail chains, including Marks and Spencer and WH Smith (referred to as national account customers).

(b) Caterers (£1.68 billion of revenues, around 32% of total revenues): This consists of 441,000 catering customers including restaurants, pubs and fast food outlets. Customers include a mix of single-sites ([✂]% of catering revenue), multi-sites ([✂]% of catering revenue), and national chains ([✂]% of catering revenue, referred to as national account customers). The majority of catering sales are collected, with only around [✂]% of catering revenue from delivery. Catering customers generate higher margins for Booker, with approximately [✂]% of Booker's overall profit coming from catering.

(c) Small business users[23] (£290 million of revenues, around 5% of total revenues): This consists of 641,000 small business customers who generally purchase non-food products such as stationery and cleaning materials.

2.15 Given that Tesco's and Booker's activities predominantly overlap in relation to services to retailer customers (rather than caterers or small business users), the primary focus of our investigation is on Booker's services to retailer customers. Booker's wholesale services to retailers are handled through two

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[22] Revenue figures and customer numbers from Booker Annual Report 2017, p2.
[23] Also referred to by Booker as personal business users, or PBUs.

divisions, which differ in the extent to which they make sales through cash and carry versus delivered wholesale services:[24]

(a) Booker Wholesale, which serves Premier and Family Shopper retailers, as well as national account customers[25] and independent retailers, from [✂] wholesale depots. These are predominantly cash and carry depots, but do also offer some delivered wholesale services; and

(b) Booker Retail Partners (BRP), which serves Londis and Budgens retailers (as well as a smaller number of symbol group stores that do not operate under any particular symbol group fascia), from [✂] wholesale depots which offer a delivered wholesale service only.

2.16 Booker's four symbol groups span a range of different propositions with supporting characteristics, as shown in Figure 1 below.

Figure 1: Booker symbol group propositions

	Premier	Londis	Budgens	FAMILY SHOPPER Bargains everyday
Number of stores:	[3,300 – 3,400]	[1,800 – 1,900]	[100 – 200]	[50 – 100]
Size of store	[500 - 1,000] sq ft	[1,000 – 1,500] sq ft	[2,000 – 2,500] sq ft	Min 1,600 sq ft
Customer affluence (% ABC1)	36%	49%	71%	N/A

Source: The Parties (except for Family Shopper store size, taken from Family Shopper website).

2.17 In addition to its wholesale operations, Booker has a small retail operation through [✂] retail stores under the Budgens brand which it owns or operates.[26] These were originally acquired as part of Booker's acquisition of Musgrave in 2015, [✂].

[24] Booker refers to the cash and carry depots operated by Booker Wholesale as 'business centres', and the delivery depots operated by BRP as 'distribution centres'. For simplicity, and consistency with references to cash and carry and delivery depots operated by other wholesalers, we refer in this report both to Booker's business centres and to its distribution centres as 'depots'.
[25] See paragraphs 2.14(a) and 2.14(b). [✂].
[26] [✂] stores owned and operated by Booker, and [✂] that it does not own but currently operates.

3. The Merger and its rationale

The Merger

3.1 On 27 January 2017, the Parties formally announced their intention to merge.[27] The Merger is intended to be implemented by means of a Court-sanctioned scheme of arrangement under section 26 of the Companies Act 2006.[28] The details of the Merger are publicly available on the Tesco and Booker websites.[29]

3.2 The Merger is subject to the Takeover Code and is conditional, among other things, on merger clearance by the CMA.[30]

The rationale for the Merger

3.3 The Parties stated that the rationale for the Merger is to benefit from the growth opportunities arising from the combination of two complementary businesses, in particular in the 'out of home' food segment. The Parties stated that consumer preferences have been changing in two ways in particular: (i) there is a trend for convenience shopping (where consumers buy fewer items per shop but shop more frequently) and (ii) rapid growth in eating out (which includes restaurants and also pre-prepared sandwiches and salads for lunch offered by retailers). The out of home segment was forecasted to grow at 3.8% per annum between 2015 and 2018, compared with an expected growth of 2.4% for in home consumption of groceries. The Parties stated that they plan to grow their presence in the out of home segment by, for example, supplying a greater range of higher quality products to restaurants and by selling more pre-prepared food in retail stores. In addition, the Parties could increase efficiency and reduce waste by, for example, combining their routes to market to increase the proportion of the crop they are able to use (since the standards required differ between channels). The Parties submitted that combining their businesses would bring together:

(a) Booker's expertise and knowledge in the catering and food service business to serve the out of home segment; and

(b) Tesco's expertise in supply chain management (sourcing and distribution) and product development, with particular strength in fresh and own label

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[27] Tesco press release.
[28] Although Tesco also reserves the right to implement the Merger by way of a Takeover Offer: Rule 2.7 announcement of proposed transaction, p4.
[29] Tesco website and Booker website.
[30] Rule 2.7 announcement of proposed transaction, Appendix 1 (CMA approval) and Appendix 2 (shareholder approval).

categories, and well developed digital capabilities (customer insights and online ordering/delivery).

3.4 Beyond the stated overarching aim of improving the existing offerings of each business discussed above, the Parties' statements and internal documents indicate that they are exploring a number of additional specific initiatives arising from the Merger within both the in home and out of home segments, in particular:

(a) [✂]

(b) [✂]

(c) [✂]

(d) offering an improved online proposition to customers through an expanded network of nearly 8,000 locations to pick up click and collect orders; and

(e) [✂]

3.5 The Parties stated that the proposed Merger would have a range of benefits across different stakeholders including for:[31]

(a) consumers: the proposed Merger will allow improved choice, range and availability of high quality food across a range of outlets including retail and eating out establishments, as well as the improved online proposition through an expanded network of click and collect locations;

(b) business customers: enhancement to the range of food available including fresh and own brand, a better value equation through better sourcing, improved and more efficient delivery services, sharing of knowledge, skills and innovation and access to other Tesco services such as banking and mobile;

(c) suppliers: access to a wider range of channels and outlets (ie via both retail and catering), allowing for fuller crop utilisation resulting in more efficiency and less waste (since the standards applied to fresh food differ across the Parties' different channels) and helping reduce carbon emissions; and

[31] Rule 2.7 announcement of proposed transaction, pp18–19.

(d) the Parties' staff: greater opportunities within a larger and more diverse business.

3.6 Of particular note in the context of our assessment is the potential to offer a more compelling service to wholesale customers, eg providing a better fresh and own label proposition.

3.7 In their public announcement, the Parties included an estimate of the qualified financial synergies of £200 million per annum by the end of the third year following the Merger.[32] This estimate consisted of:

(a) around £25 million of revenue synergies, through additional revenue generated from an extended catering offering within Tesco's stores, as well as Booker's symbol group stores being able to offer an enhanced product range and customer proposition;

(b) around £96 million of cost synergies associated with procurement, by reducing waste and optimising/harmonising supply terms between the Parties;

(c) around £61 million of cost synergies associated with distribution and fulfilment, by combining and optimising the national distribution networks of the Parties; and

(d) around £18 million of cost synergies associated with central functions and other efficiencies, by reducing duplicated costs (eg in head office) and improving purchasing of goods not for resale (eg store fixtures, and utilities spend).

3.8 The Parties also indicated that further synergies may be realised, noting at the time of announcement of the Merger that Tesco anticipated 'significant revenue growth opportunities, many of which have not been fully quantified for reporting under the Code at this stage'.[33]

4. Jurisdiction

4.1 In accordance with section 36(1) of the Act and pursuant to our terms of reference (see Appendix A), we are required to decide first whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

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[32] Rule 2.7 announcement of proposed transaction, p20; investor presentation from 27 January 2017, available on the Booker Group website, slide 12.
[33] Rule 2.7 announcement of proposed transaction, p21.

4.2 A relevant merger situation is created if:

(a) two or more enterprises cease to be distinct; and

(b) the value of the turnover in the UK of the enterprise being taken over exceeds £70 million (the turnover test) or 'the share of supply test' is satisfied.[34]

4.3 The Act defines an 'enterprise' as 'the activities, or part of the activities, of a business'. A 'business' is defined as including 'a professional practice and includes any other undertaking which is carried on for gain or reward or which is an undertaking in the course of which goods or services are supplied otherwise than free of charge'.[35] Tesco is a grocery retailer and Booker is a grocery wholesaler. We are therefore satisfied that both Tesco and Booker are businesses and, in turn, enterprises for the purpose of the Act.

4.4 We are satisfied that arrangements are in progress or in contemplation for the purposes of the Act.[36] We note that the boards of Tesco and Booker have announced their agreement on the terms of the share and cash offer which they are recommending to shareholders.

4.5 The Act provides that two enterprises 'cease to be distinct' if they are brought under common ownership or common control.[37] As a result of the Merger, the enterprise presently carried on by Tesco and the enterprise presently carried on by Booker would be brought under common ownership or common control. Accordingly, we are satisfied that they would cease to be distinct enterprises for the purpose of the Act.

4.6 In the accounting year ending 24 March 2017, Booker generated £5.3 billion of revenue worldwide,[38] almost all of which was generated in the UK.[39] We are therefore satisfied that the value of the annual UK turnover of Booker exceeds £70 million and that the turnover test is met.[40]

4.7 We have also considered whether the Merger falls within the jurisdiction of the European Commission rather than the CMA. The Parties submitted that as they both achieve at least two-thirds of their EU turnover in the UK, jurisdiction

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[34] Sections 23 of the Act.
[35] Section 129(1) of the Act.
[36] Section 36 of the Act.
[37] Section 26 of the Act.
[38] Booker Annual Report 2017, p2.
[39] 'Other than the operation in India (which is immaterial), all of the Group's revenue originates from the UK.' Booker Annual Report 2017, p69.
[40] As the turnover test in section 23(1)(b) of the Act is satisfied in this case, it is not necessary to consider the application of the share of supply test in section 23(2) to (4) of the Act.

to review the Merger lies with the CMA.[41] The Merger has not been notified in any other jurisdiction.

4.8 In light of the above, we have found that the Merger, if carried into effect, will result in the creation of a relevant merger situation. As a result, we must consider whether the creation of that relevant merger situation may be expected to result in an SLC within any market or markets in the United Kingdom for goods or services.[42]

5. The counterfactual

5.1 The assessment as to whether the creation of the relevant merger situation may be expected to result in an SLC involves a comparison of the prospects for competition with the proposed merger against the competitive situation that would exist in the absence of it.[43] This situation, referred to as the 'counterfactual', is the benchmark against which we assess the competitive effects of the merger.

5.2 We select the counterfactual that is most likely to have existed absent the merger, based on the facts available to us and the extent of foreseeable events.[44] Given that the counterfactual incorporates only those elements of those scenarios that are foreseeable, it will not in general be necessary to make finely balanced judgements about what is and what is not in the counterfactual. However, even if an event or its consequences are not sufficiently certain to include in the counterfactual, they may be considered in the context of the competitive assessment.[45]

5.3 We may examine several possible scenarios to inform our judgement on the likely future situation in the absence of the merger, one of which may be the continuation of the prevailing conditions of competition. The most notable examples of situations where the CMA may use a counterfactual different from the prevailing conditions of competition are:

(a) the exiting firm scenario;

(b) the loss of potential entrant scenario; and

(c) where there are competing bids and parallel transactions.[46]

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[41] Article 1(2) of the EU Merger Regulation, Council Regulation 139/2004/EC.
[42] Section 36(1)(b) of the Act.
[43] Merger Assessment Guidelines, paragraph 4.3.6.
[44] Merger Assessment Guidelines, paragraph 4.3.2.
[45] Merger Assessment Guidelines, paragraph 4.3.2.
[46] Merger Assessment Guidelines, paragraph 4.3.7.

Parties' submissions

5.4 The Parties submitted generally that, in their view, the Merger should be assessed against a counterfactual of the prevailing conditions of competition. [✄]

5.5 [✄]

Our assessment

5.6 As noted above, the CMA will not necessarily opt for the prevailing conditions of competition, in particular where the situation involves a failing firm, the loss of a potential entrant or parallel transactions.[47] In those circumstances, however, a clear evidential basis is needed to depart from the prevailing conditions. If there is a material difference in the assessment because of the choice between two counterfactuals, the CMA will carry out additional detailed investigation before reaching a conclusion.[48] While based on evidence obtained by the CMA in its investigation, the counterfactual is generally not comparable in detail to its analysis of the competitive effects of the merger.[49]

5.7 In this case, there are a number of specific factors which may affect the conditions of competition in one or more of the markets and therefore, may be relevant when assessing the competitive effects of the Merger. These factors and the extent to which they may affect the counterfactual analysis are discussed below.

Parallel transactions

5.8 The CMA may be required to consider a merger at a time when there is the prospect of another merger in the same market (a parallel transaction).[50]

5.9 We cannot ignore a parallel transaction on the grounds that it has not been notified, or was notified after the merger under review.[51] In these circumstances, when determining the relevant counterfactual for one of the mergers, we will take into account whether or not it expects the other transaction to proceed.[52]

[47] Merger Assessment Guidelines, paragraph 4.3.7.
[48] Merger Assessment Guidelines, paragraph 4.3.6.
[49] Merger Assessment Guidelines, paragraph 4.3.1.
[50] Merger Assessment Guidelines, paragraph 4.3.25.
[51] Merger Assessment Guidelines, paragraph 4.3.26.
[52] Merger Assessment Guidelines, paragraph 4.3.27.

5.10 The Co-op has announced that it has agreed with the board of Nisa terms for the acquisition by the Co-op of Nisa.[53] These terms have been approved by shareholders. We note that the transaction is conditional on CMA approval (and any approval may include remedial action to address any SLCs found at the time).[54] Both the Co-op retailing and the Nisa wholesaling functions are expected to continue.

5.11 We note that if the Co-op/Nisa transaction were to go ahead it is not likely that it would affect the SLC assessment of the Merger. Any approval by the CMA would include remedial action to address any competition concerns found at that time.[55]

Status of P&H

5.12 In our provisional findings, we noted reports in the press that the wholesaler P&H had been facing financial difficulties.

5.13 We provisionally concluded that P&H should not be excluded from the counterfactual on the basis that it would have exited the market(s) (absent the Merger). P&H's weak financial situation had persisted for a number of years,[56] yet it continued to operate.

5.14 Subsequently, on 28 November 2017, P&H and other entities which constituted the majority of the P&H Group entered administration.[57] Those entities in administration ceased trading from that date. At this stage, it is too early to predict what will happen to P&H's business and assets and what will emerge from the process of administration. For example, it is foreseeable that P&H's business or elements of it, may be subsumed within other grocery wholesalers or brought in-house by former customers. Some former customers of P&H have announced new supply arrangements with other wholesalers.[58]

5.15 For the purposes of providing a framework for our competitive assessment, we consider that the counterfactual should be based on prevailing conditions of competition (ie P&H's wholesale activities have ceased trading). We have taken this into account in relevant sections of our competition assessment.

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[53] Co-op press release, 10 October 2017.
[54] Co-op press release, 10 October 2017.
[55] Merger Assessment Guidelines, paragraphs 4.3.25–4.3.27.
[56] For example, P&H's annual account filings have not shown a positive profit after tax (after exceptionals) since 2013.
[57] PwC: Palmer & Harvey McLane Limited and other entities – in administration.
[58] For example, Costcutter announced on 29 November 2017 that following P&H's announcement, it had agreed an exclusive wholesale supply agreement with the Co-op.

Conclusion on the counterfactual

5.16 Therefore, we have concluded that the counterfactual in this case is the prevailing conditions of competition.

6. Market definition

6.1 The purpose of market definition in a merger inquiry is to provide a framework for the analysis of the competitive effects of a merger. Market definition is a useful analytical tool, but not an end in itself, and identifying the relevant market involves an element of judgement.[59] In this case we use market definition to, for example, define the set of primary competitive constraints which might act to weaken post-merger incentives to increase prices or cut costs that affect quality of service for particular wholesale customers or at particular retail stores.

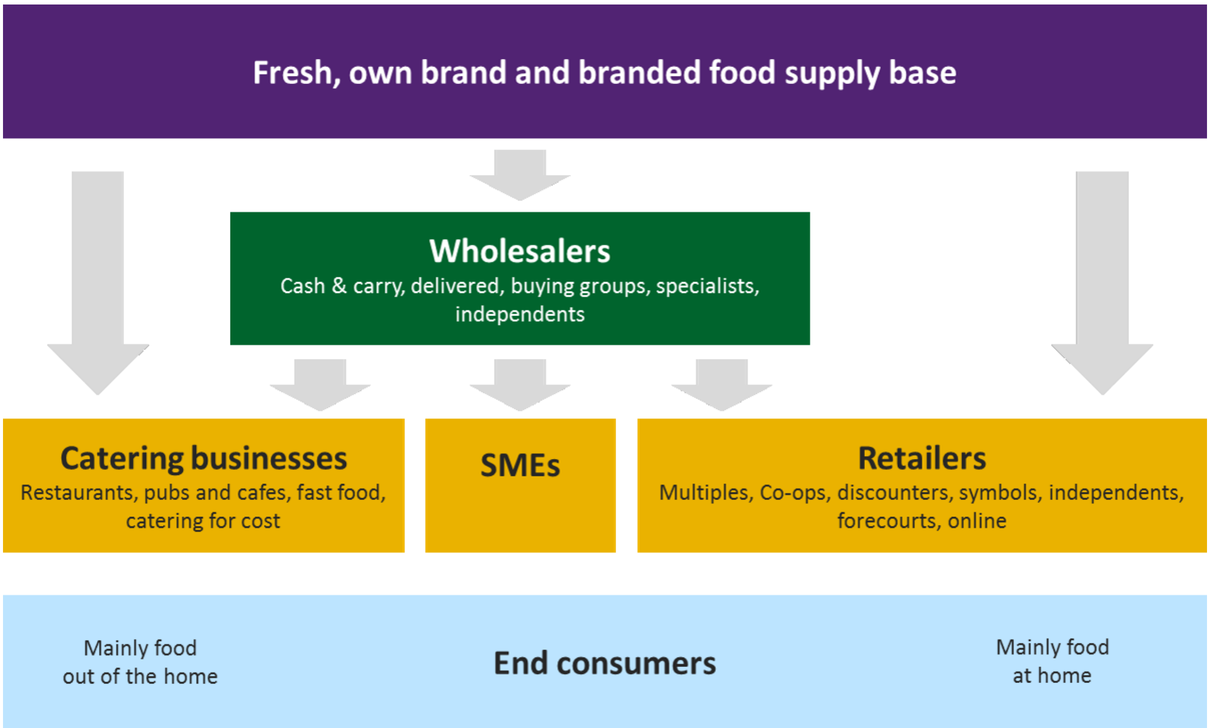
6.2 The boundaries of the market do not determine the outcome of our analysis of the competitive effects of a merger in a mechanistic way. In assessing whether a merger may give rise to an SLC, we may take into account constraints outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others.[60]

6.3 In practice, the analysis underpinning the identification of the market or markets and the assessment of the competitive effects of a merger overlap, with many of the factors affecting market definition being relevant to the assessment of competitive effects and vice versa. Therefore, market definition and the assessment of competitive effects should not be viewed as distinct analyses.[61]

6.4 This case concerns the supply of groceries (and related non-groceries) at the retail and wholesale levels. It also concerns how grocery wholesalers and grocery retailers purchase those groceries from manufacturers and suppliers. The different routes through which groceries are supplied to end-consumers are shown in Figure 2 below.

[59] Merger Assessment Guidelines, paragraphs 5.2.1 and 5.2.2.
[60] Merger Assessment Guidelines, paragraph 5.2.2.
[61] Merger Assessment Guidelines, paragraph 5.1.1.

Figure 2: Diagram of groceries routes to market



Source: CMA, adapted from Parties' submissions.

6.5 In the remainder of this chapter, we consider the definition of the relevant markets in which the effects of the Merger should be assessed. This looks at three levels of the supply chain: grocery retailing, grocery wholesaling and grocery supply. For each, we have concluded on the appropriate product market and the appropriate geographic market.

Grocery retail services

Product scope

6.6 Tesco is a grocery retailer, across a range of store sizes. Booker is a grocery wholesaler, providing services to a large number of grocery retailers who are themselves active in grocery retailing. Booker is also a grocery retailer to a limited degree through its ownership or operation of [✂] Budgens stores.

6.7 The CMA (and its predecessor bodies) have conducted a number of investigations into mergers involving grocery retailing in recent years. In these cases, the definition of the relevant market has been used primarily to determine the framework (typically described as a filtering methodology) which is used to identify relevant local overlaps and to exclude from further analysis local areas where competition concerns are unlikely to arise.

6.8 The CMA has previously analysed mergers involving grocery stores according to the size of their net sales area and found that the competitive constraint faced by such stores is asymmetric (so that larger stores constrain smaller ones but not vice versa). This approach was adopted by the Competition Commission in its Groceries Market Investigation, and has been adopted in subsequent phase 1 merger investigations.[62] These cases have concluded that:

(a) one-stop stores (1,400 square metres (sqm) and larger) are constrained only by other one-stop stores;

(b) mid-sized stores (280–1,400 sqm) are constrained by other mid-sized stores and by one-stop stores; and

(c) convenience stores (under 280 sqm) are constrained by other convenience stores, mid-sized stores and one-stop stores.

6.9 With respect to convenience stores, the CMA has sometimes distinguished between large convenience stores (100-280 sqm) and small convenience stores (under 100 sqm):

(a) In some cases where the CMA has considered possible worsening of services at large convenience stores (100-280 sqm), it has taken a cautious approach and excluded small convenience stores from its analysis – meaning that for large convenience stores it considered constraints only from other large convenience stores, mid-sized stores and one-stop stores, but not smaller convenience stores (under 100 sqm).[63]

(b) The CMA has also noted that there is no clear threshold between smaller and larger convenience stores,[64] and has sometimes taken account of

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[62] The Competition Commission's Report, *The supply of groceries in the UK market investigation*, 30 April 2008 (Groceries Market Investigation); and for example, *Anticipated acquisition by Asda Stores Limited of five grocery stores and three petrol filling stations from Co-operative Group Limited. (ME/6466/14)*, CMA, decision dated 28 November 2014.

[63] The exclusion of convenience stores under 100sqm was first introduced in *Anticipated acquisition by Co-operative Foodstores Limited of 15 Budgens grocery stores from Booker Retail Partners (GB) Limited (ME/6588/16)*, CMA, decision dated 6 June 2016 and then applied in *Completed acquisition by Co-operative Foodstores Limited of eight My Local grocery stores from ML Convenience Limited and MLCG Limited (ME/6625/16)*, CMA, decision dated 19 October 2016. The OFT also previously considered that smaller convenience stores (including kiosks attached to petrol stations) may not be in the same frame of reference as larger convenience stores due to factors such as their small size and more limited range: *Anticipated acquisition by Co-operative Group Limited of David Sands Limited (ME/5317/12)*, OFT, decision dated 16 April 2012, paragraph 20.

[64] The CMA recognised in CFL/Booker that there was no clear threshold between smaller and larger convenience stores. However, the CMA considered that, in that case, using a threshold of 100 sqm provided a useful starting point for segmenting between different sizes of convenience store: *Anticipated acquisition by Co-operative Foodstores Limited of 15 Budgens grocery stores from Booker Retail Partners (GB) Limited (ME/6588/16)*, footnote 16.

competition between small and large convenience stores, albeit noting that the strength of constraint may differ by size of store.[65]

6.10 The Parties in their submissions followed the store size framework adopted by the CMA in previous cases. They also submitted that size is relevant for assessing competition within the convenience size category – pointing out that convenience stores supplied by Booker are typically smaller than Tesco convenience stores.

6.11 The stores which Booker supplies (and the few it owns) include a small number of mid-sized stores, as well as many large convenience stores and small convenience stores. We do not have data on the size of every store supplied by Booker.

6.12 Tesco owns one-stop stores, mid-sized stores and convenience stores and supplies convenience stores as part of its One Stop franchise business. The large majority of the local overlaps of potential concern (as set out below) relate to overlaps between Booker-supplied convenience stores and Tesco owned or franchised convenience stores.

Conclusion on product market definition

6.13 Regarding the product market for grocery retail services, we have concluded that:

(a) in line with evidence from past cases, it remains appropriate to conclude that one-stop stores (1,400 sqm and larger) are constrained only by other one-stop stores. This means that, although Tesco currently has 697[66] such stores in the UK, these stores do not face competition from any Booker owned or supplied stores. The effect of the Merger on one-stop stores is therefore not considered further in these findings;

(b) mid-sized stores (280–1,400 sqm) are constrained by other mid-sized stores and by one-stop stores;

(c) we should consider small and large convenience stores together, because of the limitations of our data on store size and the lack of evidence on an appropriate size threshold at which competition ceases between smaller and larger convenience stores. We have found that convenience stores are constrained by convenience, mid-size and one-stop stores. However, within our competitive assessment we take account of the likely variation

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[65] *Anticipated acquisition by Martin McColl Ltd of 298 groceries stores from Co-Operative Group Ltd (ME/6632/16),* CMA, decision dated 20 December 2016, paragraph 43.
[66] Independent Store List Spending Over 20k – Update.xlsx", submission dated 8th September 2017.

in the strength of the constraint provided by different fascia, and this is based in part on evidence about the average sizes of these fascia.

6.14 For a discussion of the importance of fascia in local retail competition, and the extent to which different fascia compete more or less strongly with the Parties, see paragraph 7.18 to 7.53.

Geographic scope

6.15 At a local level, the CMA has previously adopted a geographic scope whereby mid-sized stores are constrained by other mid-sized stores within a 5-minute drive-time in urban areas and within a 10-minute drive-time within rural areas, with additional constraint from one-stop stores within a 10-minute drive-time within urban areas and within a 15-minute drive-time within rural areas.[67] We have not received any submissions from the Parties, or any other strong evidence that supports moving away from this approach regarding mid-sized stores, and adopt it again in this case.

6.16 In response to our provisional findings, we received a submission commenting that drive times vary considerably during the day and that the measure we had used in our provisional report would tend to discriminate against those that need to shop at busier times by considering as good options for them some more distant stores which are time consuming to reach during rush hour. Our drive time measure is a 7-day average (excluding the early hours of the morning); at busy times, the relevant stores will take longer to reach than assumed in our analysis. However, we consider that retailers in setting their prices and the quality of service that they provide are likely to respond to the strength of competition that they face on average during the week, for which our drive time estimates are a better measure.

6.17 For convenience stores, our own analysis of the Parties' internal documents, survey evidence from market research companies and third party submissions, and our entry-exit analysis showed that distance is particularly important in convenience grocery retailing. We therefore assessed whether using the geographic scope adopted in some previous cases of a 5-minute drive-time or 1-mile radius remained appropriate, or whether a narrower catchment should be adopted. While this evidence is used in this section for

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[67] For example, *Anticipated acquisition by Martin McColl Ltd of 298 groceries stores from Co-operative Group Ltd (ME/6632/16)*, paragraph 32, *Completed acquisition by Co-operative Foodstores Limited of eight My Local grocery stores from ML Convenience Limited and MLCG Limited (ME/6625/16)*, paragraph 43, *Anticipated acquisition by Co-operative Foodstores Limited of 15 Budgens grocery stores from Booker Retail Partners (GB) Limited (ME/6588/16),* paragraph 37.

the purposes of determining the appropriate geographic scope, it also feeds into our assessment of the competitive effects of the merger.[68]

Evidence from the Parties

6.18 To test the geographic scope of the market, we asked the Parties whether and over what distance they take account of competition between proposed new owned or supplied stores and their existing stores:

(a) Booker submitted that it does not define a catchment by either time or distance metrics. When a new store is seeking to join a Booker symbol group, a Booker [✂]. In the past Booker has used as part of this process [✂].

(b) Tesco submitted that before opening a new store or accepting a franchisee, One Stop assesses local competition within [✂] metres and [✂] metres. It submitted that this did not reflect an assessment of how far customers were willing to travel, but instead were conservative thresholds designed to minimise the risk of new franchisees opening in areas where they would fail to generate sufficient profits or significantly cannibalise sales from existing One Stop or Tesco stores. That said, one internal document noted that One Stop customers live within [✂] metres of the store, while others (in the context of new store openings) noted the presence of competitors up to [✂] away;

(c) As for Tesco Express openings, Tesco's internal documents show that Tesco also primarily looks at competitors within [✂] and [✂] metres bands. The competitive situation from [✂] metres to [✂] is also looked at occasionally. Again, Tesco submitted that this did not reflect an assessment of how far customers were willing to travel, but rather whether the new store would generate sufficient sales to recoup the investment cost of opening a new store.

6.19 Tesco also submitted analysis of the effects on sales at its Tesco stores of the opening of new local stores belonging to large competitors.[69] It told us that, broadly, it monitors the effect of competitor entries within [✂] of a Tesco Express. Our analysis of this data indicates that on average store entries have

[68] In the local competition assessments in Chapters 9, 10 and 11.
[69] Competitors include [✂]. The effect is computed on [✂] Tesco stores, [✂] of which are Tesco Express stores. In the analysis, each new competitor store is matched to a Tesco store. A control group is then internally created by Tesco to estimate the impact of the new store on the Tesco store's sales.

a stronger effect the closer they are to the Tesco Express store, particularly when entry occurs within [✂] metres.[70]

Third party survey evidence

6.20 Survey evidence from the Association of Convenience Stores (ACS) and market research firm him! states that 78% of shoppers surveyed travel less than a mile to a convenience store, 53% less than a quarter of a mile and 19% less than 100 yards.[71] Of those surveyed, 56% of convenience store customers travelled on foot to reach the store, while 21% of customers visited the store in question every day. In the same survey, the top two reasons for choosing a particular store were that it was close to where the shopper lives, or works. We have considered this to be strong evidence that when choosing a convenience store, proximity is the most important factor.

Evidence from third parties

6.21 We asked a number of larger retailers the distance over which they considered their convenience stores competed for customers. While they indicated that catchment areas varied by store, these retailers generally confirmed that competition for convenience stores tends to be very local, particularly in urban areas.[72] Almost all respondents indicated that they considered that the primary catchment area of a convenience store did not exceed 1 mile in urban areas, with three retailers indicating that it may be as small as 250 to 500 metres in some locations. Some retailers indicated that the catchment area may be larger in rural areas, however this was not consistently the case, and one retailer suggested that the difference may be only very small (500 metres as opposed to 250 metres).

Evidence from our entry-exit analysis

6.22 We investigated how Booker's sales to individual retailer stores are affected by the entry or exit of other stores in the retailer's local area[73] and how this effect varies depending on how far away the entry or exit occurs (referred to as our entry-exit analysis).[74] We used this analysis as evidence of the

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[70] This is also true for stores of larger size (Tesco Extra, Metro, and Superstore).
[71] ACS 2017 Local Shop Report; based on him! Convenience Tracker Programme 2017 (link to 2016 version). Sample size is 20,000 interviews with shoppers in UK as they enter/exit stores.
[72] These responses are also consistent with past cases. For example, in *McColls/Co-operative*, several third parties told the CMA that they consider convenience store competition in urban areas over a narrow area of 0.25 to 0.5 miles: *Anticipated acquisition by Martin McColl Ltd of 298 groceries stores from Co-operative Group Ltd (ME/6632/16)*, paragraph 31.
[73] [✂]
[74] See further Appendix B.

distance over which the Booker-supplied convenience stores competes for customers. This is because a dip in sales at the Booker-supplied store (and a resulting dip in purchases from Booker) following the entry of a new store is likely to indicate customers diverting to the store that had just opened, while an increase in sales following an exit is likely to indicate customers diverting away from the store that has just closed.

6.23 For practical reasons this distance was measured in terms of straight line distance (rather than drive-time or walking distance).[75] There are a number of important caveats in interpreting this analysis, in particular our results for rural areas were not sufficiently precise to allow firm inferences to be drawn separately from the urban results.[76] However, the analysis indicated that entry or exit of another store had:

(a) a significant effect on Booker's sales to the Booker-supplied convenience store when it took place within 1 mile; and

(b) a much stronger effect within the first quarter of a mile.

Conclusion on geographic scope

6.24 In light of the evidence set out above, we have adopted the following geographic scope for grocery retail services, which is used to define the set of nearby retailers that we consider to compete with the stores owned or supplied by the Parties:

(a) for mid-sized stores, a 5-minute drive-time in urban areas and within a 10-minute drive-time within rural areas, with additional constraint from one-stop stores within a 10-minute drive-time within urban areas and within a 15-minute drive-time within rural areas; and

(b) for convenience stores, a 1-mile catchment in both rural and urban areas, noting that the constraint is likely to be stronger the closer another retailer is to the store in question.

6.25 In reaching our conclusion in relation to the relevant geographic market for convenience stores, we have taken into account a range of evidence including:

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[75] Straight line distances are easily computed using coordinates of the stores. While these distances do not account for physical hurdles and streets configuration, we avoid additional assumptions on speed and traffic, and reduce the complexity of our analysis.
[76] See further Appendix B.

(a) the Parties' internal documents showing that when a new store opens, they review competition within a short distance;

(b) submissions from retailers, together with third party survey evidence that many people walk to convenience stores, that point to a very narrow geographic scope of competition up to a few hundred metres;

(c) third party survey evidence that although the majority of people do not travel more than a mile for their convenience shopping, around 20% of people travel further than a mile to a convenience store; and

(d) our entry-exit analysis which shows some effects on a Booker-supplied store from rival retailers up to 1 mile away and similar analysis undertaken by Tesco which shows effects based on entries within around 2 miles, with both showing much stronger effects within a few hundred metres.

6.26 For market definition purposes, the relevant geographic scope includes all the nearest constraints that a hypothetical monopolist would need to control in order to be able to raise prices above the competitive level, rather than only the strongest constraints.[77] On this basis, and reflecting the evidence above, we have chosen to adopt a geographic scope of 1 mile but, as set out in more detail in Appendix C, our competitive assessment explicitly takes account of the fact that nearby stores are likely to exert a stronger constraint than those which are more distant, even with a mile. Our assessment also takes into account that some constraint is likely to come from stores outside a 1-mile radius.

6.27 Although some retailers indicated that catchment areas for their convenience stores may be wider in rural areas, these comments did not paint a consistent picture of the relevant catchment size. The Parties submitted that in relation to convenience stores a 1-mile catchment area is likely to understate the actual distance that customers travel in many rural and urban areas to reach their preferred shop. We have found that there is insufficient evidence to conclude that catchment areas are systematically wider than 1 mile in rural areas.

6.28 For convenience stores, in past cases the CMA has sometimes also used a 5-minute drive-time catchment (which on average is a similar size to a 1-mile catchment). In this case, we have found that a distance rather than drive-time catchment is more appropriate on the basis of the survey evidence discussed in paragraph 6.20 above that a high proportion of customers walk to convenience stores and travel no more than 1 mile to do so.

[77] Merger Assessment Guidelines, paragraphs 5.2.9–5.2.20.

Grocery wholesale services

Product scope

6.29 Wholesalers sell products, often in large quantities, to business customers. Grocery wholesalers supply groceries to retailers, caterers and other traders who usually then:

(a) sell these products directly to the end-customer (grocery retailing);

(b) use the products to produce goods which are sold to the end-customer (such as caterers using groceries to produce finished meals); or

(c) consume the products within their business (such as caterers or small business using products such as cleaning materials).

6.30 Grocery wholesale services are more likely to be used by smaller grocery retailers than larger retailers, as larger retailers are more likely to purchase groceries directly from suppliers and manufacturers.

6.31 Grocery wholesale services are generally provided through cash and carry depots or via delivery, and are used by both grocery retailers and caterers.

6.32 Grocery retailers that buy from wholesalers sometimes do so through symbol group arrangements. As explained at paragraph 2.12, symbol groups are collections of stores which are affiliated with a wholesale symbol group provider (the symbol group wholesaler), usually operating under a common brand or 'fascia'. The retailer is independent from the wholesaler, but generally commits to minimum purchase requirements (and other conditions which vary by wholesaler and symbol group brand), in return for use of the symbol brand and other benefits such as improved promotions.

6.33 In the remainder of this report we use the term 'independent retailers' to mean grocery retailers that are not part of a national or regional retail chain and are not part of a symbol group.

6.34 Booker is active in grocery wholesaling through its delivered and cash and carry wholesale services to independent retailers[78] and through its wholesale supply of symbol group services under four symbol group fascia: Premier, Londis, Budgens and Family Shopper.

[78] In addition to supplying independent retailers, Booker also supplies large retail accounts (with customers such as Odeon, Cineworld and Marks and Spencer). At phase 1, the CMA did not find any concerns in relation to wholesale services to large retail accounts, and we have not received any further evidence to depart from this position.

6.35 While Booker also supplies caterers and small businesses, our inquiry has primarily focused on wholesale supply to retailers. This is because Tesco does not generally supply catering customers.

6.36 The Parties submitted that there is a broad market for grocery wholesale services to retailers, caterers and other small businesses, which comprises all channels, customer types and business.

6.37 In *Booker/Makro*,[79] the Competition Commission identified five wholesale supply channels for grocery retailers, in addition to retailers purchasing directly from suppliers: (i) cash and carry wholesale; (ii) delivered wholesale; (iii) specialist wholesale; (iv) symbol groups; and (v) buying groups.[80] We have not found it necessary to consider the appropriate market for buying groups or specialist wholesale, as neither of the Parties is active in these channels. However, we note below that these are likely to act as an additional constraint on Booker, to the extent that wholesalers that are part of a buying group or specialise in particular product ranges, are present in the relevant local areas that we have considered in our analysis.

6.38 We considered whether it is appropriate to treat the remaining channels (cash and carry grocery wholesale, delivered grocery wholesale and symbol groups) as separate markets, or to combine some or all of them. The implication of treating them as separate markets would be that the starting point for our competitive assessment would be that Booker competes more closely with other wholesalers in the same channel, than with wholesalers that only operate in one or more of the other channels. We also acknowledge that there is some overlap between the channels according to how customers use them. For example, a symbol group retailer may use both delivered and cash and carry grocery wholesale services.

Supply of symbol group services

6.39 As noted above, some wholesalers offer a symbol group service.[81] Although there is a variety of symbol group models which vary in the obligations placed on retailers, symbol group retailers are typically obliged to acquire a certain proportion of their groceries from the symbol owner, the wholesaler (in the case of Booker, the symbol groups are Premier, Londis, Budgens and Family Shopper). However, they are typically not obliged to acquire all of their groceries from the symbol owner and are free to use other wholesalers to

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[79] *A report on the completed acquisition by Booker Group PLC of Makro Holding Limited,* Competition Commission, report dated 19 April 2013, paragraph 2.4.
[80] Buying groups are an affiliation of several grocery wholesalers established to obtain more favourable terms from suppliers than each wholesaler could achieve individually.
[81] Examples of symbol groups not owned by Booker include Spar, Costcutter and Nisa.

some extent. Therefore, the range of products available is, to some degree, at the discretion of the retailer. Retailers are also free to set minimum prices and will have some flexibility regarding the general quality of their stores. In this way, stores operating under a symbol group tend to be less uniform than stores operating under a franchise arrangement.

6.40 On the demand side, we have considered whether the supply of symbol group services is constrained by other wholesale supply options of the retailer outside a symbol group relationship (and therefore including wholesalers that do not offer symbol group services). This may be the case if, in response to a price rise,[82] symbol group retailers would be likely to:

(a) switch to become an independent retailer; or

(b) switch sufficient volumes of purchases to non-symbol group wholesalers, such that a price rise by a symbol group wholesaler would be unprofitable.

Switching to become an independent retailer

6.41 Our survey of Booker-supplied retailers[83] indicated that symbol group retailers had a low propensity to switch to independent retailing. Only 15% of symbol group retailers surveyed had previously considered switching to operate as an independent retailer.[84] Further, data on customers who had switched wholesaler (leaver data) provided by Booker and competing wholesalers for the period 2016-17 indicated a low rate of actual switching by symbol group retailers to independent retailing, with only 6 to 7% of leavers recorded in this data leaving to become independent retailers.[85] The vast majority left to join another symbol group.

6.42 One wholesaler also told us that a common reason for symbol group retailers switching to become an independent retailer is failure to meet symbol group membership criteria, such as minimum spend requirements, which may in part

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[82] Specifically a 'small but significant non-transitory increase in price', or 'SNNIP'. Assessing the likely reaction of customers to a SNNIP is a tool used for defining economic markets. The CMA typically uses 5% as its measure of a small price rise, as do many other competition authorities, and reflected this is in the design of our survey of retailers. In response, a number of third parties noted that in a sector such as the wholesale supply of groceries, where margins are very low, a 5% price increase may not be considered a 'small' price rise. We therefore acknowledge that responses received may overstate the response that customers would have if faced with what they would consider a 'small' price rise.

[83] The survey covered a small subset of Booker's retailer customers, representing around 3% of its symbol group customers and around 0.2% of its independent customers. In total 463 telephone interviews were completed – 153 with symbol group retailers, and 310 with independent retailers. The survey sample was not randomly selected; it focused on retailers in areas perceived to have potentially fewer wholesale competitors. The respondents also typically spent a significantly higher than average amount with Booker.

[84] Survey of retailers question 21.

[85] Based on observed switching in 2016 and 2017 by customers of Nisa, Spar, Bestway, Musgrave, Conviviality and Booker (Budgens, Family Shopper, Premier and Londis). This estimate excludes leavers for which a destination was not provided.

by driven by low revenues. This, together with the results of our survey and fascia switching analysis (described above but discussed in more detail in Chapter 7), indicates that symbol group retailers are much less likely to make an active choice to switch to independent retailing than they are to switch to another symbol group.

6.43 The Parties submitted that our survey of Booker-supplied retailers is likely to underestimate the proportion of retailers willing to switch to become an independent retailer, because according to the Parties respondents are significantly bigger in value terms and of longer standing than Booker's typical customers. However, we have found that the actual switching rates observed in the data submitted by Booker and other wholesalers supports the view that symbol group wholesalers are likely, in relation to fascia switching, to face a greater constraint from other wholesalers with a symbol group offering.

Switching volumes to another wholesaler

6.44 In addition to the possibility of switching to become an independent retailer, symbol group retailers may switch some of their volumes away from their symbol group wholesaler to purchase from wholesalers that do not offer symbol group services. Symbol group wholesalers may therefore be constrained by the threat of symbol group retailers switching a significant volume of purchases to another wholesaler (without switching away from the symbol group entirely).

6.45 The Parties submitted that Booker's symbol group customers source a significant proportion of their supplies from alternative wholesalers and frequently switch supply between wholesalers for the most competitive offer.

6.46 We discuss the evidence received during the inquiry regarding symbol group retailers switching purchase volumes as part of our competitive assessment at paragraphs 7.86 to 7.957.86 below. This evidence shows that, while purchasing loyalty amongst Booker symbol group retailers is generally high (the evidence regarding other symbol groups is more mixed), multi-sourcing and switching of purchase volumes by retailers is common. It also shows that switching costs are generally low and that other potential barriers (such as contractual minimum purchasing requirements) may not prove significant in practice.

6.47 On the basis of the above evidence, we have concluded that it is appropriate, as a starting point, to consider the offering of symbol group services and other wholesale services separately, whilst acknowledging that symbol group wholesalers are likely to be constrained to some extent by the threat of symbol group retailers switching to other (non-symbol) wholesalers, at least for a proportion of symbol group retailers' purchases.

Delivered wholesale vs cash and carry grocery wholesale

6.48 We have considered the competitive constraints between delivered grocery wholesalers and cash and carry grocery wholesalers.

6.49 The Parties submitted that it is appropriate to consider the delivered and cash and carry grocery wholesale channels together as part of one and the same relevant product market. The Parties said that [✂] of Booker's Premier customers rely on either deliveries only or cash and carry only for 90% or more of their grocery requirements, with the majority of customers multi-sourcing between the two channels.[86] In addition, the Parties submitted that the survey of retailers commissioned by the CMA supports this.[87] The Parties highlighted that when asked which other wholesale suppliers they could use to buy the items that they currently purchase from Booker, 27% of independent retailers said they would use cash and carry only and 15% said that they would use delivered services only.[88] The Parties also submitted that minimum order quantities and/or spend requirements do not prevent switching between the two channels for either retailer or catering customers.[89]

6.50 On the demand side, from the retailer's perspective, we found that different types of customers rely on these channels to differing extents, and that one channel may be more important (or more suited) to some retailers than to others. In particular, we found that symbol group retailers rely more heavily on delivered services than smaller independent retailers, who may face barriers to switching to delivered services:

(a) Almost two-thirds of independent retailers who responded to our survey of Booker-supplied retailers[90] had less than 10% of the volumes they purchase from Booker delivered to the store. Meanwhile, 76% of the symbol group retailers surveyed received more than half of their purchases from Booker by delivery to store.

[86] Parties phase 2 submission, paragraph 2.30 annex 3.
[87] The survey results were published with our provisional findings.
[88] Parties response to provisional findings.
[89] Parties response to provisional findings.
[90] The survey covered a small subset of Booker's retailer customers, representing circa 3% of its symbol group customers and circa 0.2% of its independent customers. The survey sample was not randomly selected; it focused on retailers in areas perceived to have potentially fewer wholesale competitors. The respondents also typically spent a significantly higher than average amount with Booker.

(b) One wholesaler stated that symbol group retailers will require a delivered service from their symbol group wholesaler.

(c) According to the ACS, independent retailers tend to multi-source between cash and carry grocery wholesalers, delivered grocery wholesalers and direct purchases from suppliers, while symbol group retailers (although also likely to multi-source to a degree) rely more heavily on delivered services.[91]

(d) Several wholesalers, including Costco Wholesale UK Limited (Costco), Dhamecha Foods Limited (Dhamecha) and United Wholesale (Scotland) Limited (United Wholesale Scotland), also said that retailers are very price conscious and are willing to switch channels to secure the lowest prices. For example, retailers may switch some volumes to cash and carry grocery wholesalers, or even large multiples, to take advantage of time-limited promotions or discounts.

(e) In addition, several wholesalers, including Costcutter Supermarkets Group Limited (Costcutter), United Wholesale Scotland and Bestway Cash & Carry Limited (Bestway), indicated that minimum order quantities and/or spend requirements generally apply to delivered grocery wholesale. This may mean that for some smaller retailers, delivered grocery wholesale is not a viable option.

6.51 Some wholesalers currently offer both cash and carry and delivered grocery wholesale services, while others offer only one or the other.

6.52 We received evidence that there is, in general, growing demand for delivered grocery wholesale services. One wholesaler told us that footfall has reduced in its cash and carry stores, and two wholesalers referred to current plans, or future expectations, to expand their delivered offering to meet demand. Notwithstanding these expansion plans, we were told by one wholesaler that building a delivered service is significantly more complex and costly than a cash and carry service. Further, while we note that some wholesalers (particularly Costcutter and Nisa) outsource the delivered function to a third party logistics provider, two other wholesalers said that they considered this would be too costly.

6.53 On the supply-side, the Parties submitted that wholesalers are increasingly developing a multi-channel presence. They also submitted that barriers to entry and expansion are low for both cash and carry and delivered wholesale. Wholesalers can easily adapt existing warehouse facilities to provide

[91] ACS phase 1 submission.

wholesale operations of another type. Booker uses some cash and carry depots for a dual purpose: (i) to support collect sales to wholesale customers; and (ii) to load and operate vehicles that deliver goods to wholesale customers. Dedicated distribution and picking centres are not necessary for delivered wholesaling and outsourcing of delivery is also an option (as evidenced by recent symbol group distribution partnerships).[92]

6.54 We note that there is some differentiation in the industry. For example, Costco and Dhamecha operate cash and carry grocery wholesale service only whereas Nisa offers only a delivered grocery wholesale service.

6.55 From both a retailer and wholesaler perspective (that is, from both the demand- and supply-sides), there therefore appears to be some overlap between delivered grocery wholesale and cash and carry grocery wholesale (with our survey of Booker-supplied retailers confirming that many of Booker's retailer customers use a combination of delivered and cash and carry wholesale), but also a degree of differentiation between the two channels. As a result, we have assessed delivered and cash and carry grocery wholesaling separately in our analysis, but recognise that:

(a) delivered grocery wholesalers may face a constraint from cash and carry grocery wholesalers, particularly for some of a retailer's volumes (for example, in response to a time-limited promotion); and

(b) cash and carry grocery wholesalers may increasingly face a constraint from delivered grocery wholesalers as retailers' preferences move towards delivered services. However, this constraint is likely to be more limited for smaller independent retailers for which deliveries may remain a less viable option (due to minimum purchase requirements and cost).

Additional constraints

6.56 We have found that specialist wholesalers (whether in delivered or cash and carry wholesaling) as well as wholesalers who supply catering customers are likely to impose some constraint on Booker's wholesaling activities to grocery retailers, to the extent that the products and localities they supply overlap with Booker's (or can be considered as sufficiently close substitutes by retailers and consumers).

6.57 We have found that while large retail multiples and the discounters Aldi and Lidl may also provide a limited constraint on delivered and cash and carry

[92] Parties response to provisional findings.

grocery wholesalers, this is likely to be the case only or primarily for smaller retailers and for a limited proportion of goods. In *Booker/Makro*,[93] the Competition Commission's analysis of supermarket prices indexed against Booker indicated that the multiples are generally not an effective alternative to cash and carry wholesalers across the majority of product groups.

Conclusion on product market definition

6.58 For the reasons set out above, we have concluded that it is appropriate, as a starting point, to consider symbol group, cash and carry and delivered grocery wholesale services separately, whilst acknowledging that each of these services provides an important constraint on each of the others. In particular, the trend toward delivered wholesaling may strengthen the constraint of delivered services on cash and carry wholesalers. There is also evidence of cash and carry services constraining delivered grocery wholesalers, particularly in relation to partial switching in response to fixed-term promotions or top-up purchases.

6.59 Further, we note that grocery wholesalers are likely to face some (albeit more limited) constraint from wholesalers who supply catering customers and from specialist wholesalers.

Geographic scope

Delivered grocery wholesale

6.60 This section discusses the geographic scope of delivered grocery wholesale services and encompasses delivered services to independent and symbol group retailers (and therefore we do not consider the geographic scope of symbol group services separately).

6.61 Submissions to us from wholesalers indicated that competition for delivered grocery wholesale services is likely to be regional. There are few truly national wholesalers (although Booker is one). Further, as discussed further below in paragraphs 9.25 and 9.26, while the vast majority of wholesalers told us that prices and service factors are typically set nationally, some told us that they may be overridden locally, for example to respond to local competition. [✂]

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[93] See *A report on the completed acquisition by Booker Group PLC of Makro Holding Limited,* p28.

6.62 The Parties submitted that, while a number of competitors offer nationwide delivery services,[94] they consider a 4-hour drive-time to best reflect the catchment area for delivered grocery wholesale services.

6.63 Based on the evidence received, we have found that constraints on Booker for delivered grocery wholesale services are likely to vary across the country. While we do not consider it necessary to conclude on the precise geographic market for delivered grocery wholesale services, what matters for our competitive assessment is the strength of competition for the custom of individual retailers. One way in which to measure this is to count the number of competing wholesale fascia from which each Booker-supplied retailer can choose to purchase. To do this, we have used 80% catchment areas provided to us by third-party wholesalers.[95] As shown in Table 3 below, on average, 80% of wholesalers' delivered customers are within a 128-minute (just over 2-hour) drive-time of their depot, but this can be as much as 390 minutes (6.5 hours).[96]

Table 3: Delivered grocery wholesale catchment areas (minutes)

Minutes	*80%*	*100%*
Average	128	363
Median	105	270
Minimum	25	90
Maximum	390	720

Source: CMA analysis of information submitted by nine third party wholesalers. Each wholesaler provided the average catchment area across all of its delivered depots (where multiple depots are operated). We present the average, median (ie middle value), maximum and minimum catchment area across these wholesalers.

6.64 The Parties submitted that an 80% catchment area is too narrow as it excludes 20% of wholesalers' customers that are served at greater distances. The Parties submitted that in a business-to-business context, where the wholesaler (rather than the customer) is undertaking the travel, the concept of the 80% cut-off is not appropriate, and indeed it is in the interests of the wholesaler to gain more custom at the outer reaches of their existing delivery network, in order to maximise the efficiency of existing deliveries to those areas. The Parties submitted that the quality of a delivered wholesaler's delivery service does not vary with distance from a delivery depot (eg there was no correlation between the distance from BRP's depots and the number of deliveries to customers in the last financial year) and that delivered wholesalers' business models allow them to flex their delivery catchment to supply new customers. On this basis, the Parties submitted that using a 100%

[94] P&H, Nisa and Blakemore (Spar). [✂].
[95] The CMA often uses catchment areas that capture 80% of a store's sales or customers. Retail mergers commentary (CMA62), paragraph 2.20.
[96] For the purposes of our subsequent analysis, the two wholesalers that did not submit a catchment area were assigned the median value.

catchment area is more appropriate because wholesalers will also compete strongly for customers in the outer part of their delivery catchment.

6.65 Our approach accounts for the possibility that wholesalers compete more weakly at greater distances by considering 80% catchment areas; however we also take into account information on 100% catchment areas.

6.66 The analysis of competition, using these catchment areas, is set out in our competitive assessment at paragraph 7.106 onwards.

Cash and carry grocery wholesale

6.67 This section discusses the geographic scope of cash and carry grocery wholesale services, which applies to both independent and symbol group retailers. Unlike delivered grocery wholesale, for which the catchment area is determined by the distance that the wholesaler is willing to send its delivery vehicles (which itself will depend on several factors, including drop density), the geographic scope of cash and carry is likely to depend largely on how far individual retailers are willing to travel to purchase their supplies.

6.68 In *Booker/Makro*, the CMA used a 30-minute drive-time catchment area for assessing competition in cash and carry wholesale.[97]

6.69 The local nature of cash and carry wholesaling is confirmed by what third party wholesalers have told us. For example, Bestway and Today's (Holdings) Limited (Today's) noted that having a cash and carry nearby is very important for recruiting new stores in a particular area; Bestway explained that this allows quicker local service and enables top-up purchasing.

6.70 However, the Parties submitted that the geographic catchment for Booker's cash and carry customers extends significantly beyond 30 minutes, noting that customers can and do travel further than 30 minutes to obtain the best wholesale terms.

6.71 Information provided by third party wholesalers indicated that, on average, 80% of wholesalers' cash and carry customers travel 34 minutes to get to a store (Table 4).

[97] *A report on the completed acquisition by Booker Group PLC of Makro Holding Limited,* paragraph 12.

Table 4: Cash and carry grocery wholesale catchment areas (minutes)

Minutes	*80%*	*100%*
Average	34	86
Median	30	60
Minimum	20	30
Maximum	60	300

Source: CMA analysis of information submitted by eight third party wholesalers. Each wholesaler provided the average catchment area across all of its cash and carry sites (where multiple sites are operated). We present the average, median, maximum and minimum catchment area across wholesalers.

6.72 As described above in relation to delivered grocery wholesale, while we do not consider it necessary to conclude in this case on the precise geographic market for cash and carry grocery wholesale, we have taken into account the indicative catchment areas provided by third parties in our competitive assessment of local wholesale competition. In particular, to estimate a fascia count variable for cash and carry grocery wholesale alternatives available to retail stores, we employ each wholesaler's 80% cash and carry catchment area.[98] Again, when assessing individual local areas, where relevant, we consider wholesalers in whose 100% catchment area the retailer falls.

6.73 The analysis of competition, using these catchment areas, is set out in our competitive assessment at paragraph 7.106 onwards.

Conclusion on geographic market definition

6.74 We have not found it necessary to conclude on the geographic scope of the markets for delivered and cash and carry grocery wholesale services (including those offered to symbol group and independent retailers). However, we have concluded that the appropriate starting point for our analysis is the 80% catchment areas around each wholesaler's cash and carry or delivery depot, with 100% catchment areas also being relevant to our competitive assessment.

Procurement of groceries

Product scope

6.75 The Parties overlap in the purchase of groceries from suppliers. The Parties submitted that the relevant product market for the procurement of groceries should be segmented by product categories (eg soft drinks, confectionery, fruit and vegetables), because suppliers producing one category of products may not be able to switch readily to produce other products. The Parties also

[98] For the purposes of our analysis, the two wholesalers that did not submit a catchment area were assigned the median value.

submitted that there are separate procurement markets for different sales channels (for example retail or catering) because producers may not be able to switch readily to produce products used in another channel. However, the Parties submitted that channel segmentation may not be appropriate for some procurement categories because product requirements between sales channels do not differ meaningfully and therefore the frame of reference for those categories should include multiple or all sales channels.

6.76 We have found that from the point of view of producers, different sales channels (eg retailing and catering) may not be readily interchangeable because of investment in different product specifications or different sales strategies. The ability of producers to serve both channels may vary by procurement category, which suggests that an assessment by category is appropriate.

Geographic scope

6.77 The Parties submitted that the appropriate geographic scope is at least national. The Parties procure products on a national basis. They submitted that end-customer preferences are broadly consistent across the country, large retailers predominantly purchase nationally and suppliers usually negotiate at the national level. Third party suppliers who we spoke to confirmed this.

Conclusion on product and geographic scope

6.78 We have concluded that it is appropriate to undertake our assessment on the basis of individual product categories and on a national basis.

7. Introduction to our competitive assessment and existing competition

Introduction to our competitive assessment

7.1 Central to the rationale for the Merger is the Parties' stated strategy to increase their presence and product availability in the 'out of home' food segment. As discussed in paragraph 3.3, this includes pre-prepared food sold in retail outlets and food prepared via the catering segment. Although we do take into account Booker's presence in the catering channel when we consider merger efficiencies and buyer power, we do not take into account this part of Booker's activities in other parts of our analysis of the competitive effects of the Merger. This is because Tesco does not generally serve catering customers at present.

7.2 In our inquiry we have used a broad range of information and evidence. We have:

(a) commissioned a survey of 463 independent and symbol group retailers supplied by Booker about their options and relationships with wholesalers. The survey focused on those local areas identified by the CMA's phase 1 investigation in which Booker-supplied symbol group retailers overlap with at least one Tesco store, with relatively few other retail competitors and national symbol group wholesalers nearby;

(b) received submissions, internal documents and commercial data from the Parties;

(c) received representations including responses to written questionnaires and telephone interviews with third party wholesalers, suppliers, retailers and trade bodies. We received responses to our questionnaire from 15 wholesalers, 32 suppliers and 19 retailers;[99]

(d) received commercial data from seven third party wholesalers about their sales and churn rates of symbol group members. We also received depot locations and catchment areas from 13 wholesalers;

(e) received commercial data from some suppliers regarding their terms with the Parties; and

(f) received commercial information from P&H regarding its relationship with Tesco.

7.3 In addition, we have conducted various quantitative analyses. These are discussed in further detail below and in Appendices B and C, and include a large-scale analysis of the effect on Booker's sales to retailers from over 1,600 examples of entry by competing retailers and over 300 examples of retailer exit. We have also examined via a quantitative model, local areas based on over 12,000 stores (for one of the theories of harm, and around 2,300 for another) to assess whether after the Merger the merged entity is likely to have incentives to increase prices or cut costs that affect quality of service in any of these local areas.

7.4 In response to our provisional findings we received several representations, including some which raised concerns of some third parties but which were either not directly related to the Merger or did not relate to competition. We considered all responses and, where relevant to our analysis of the

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[99] Responses to the issues statement and summaries of the oral hearings can be found on the Tesco/Booker merger inquiry case page.

competitive effects of the Merger, these have been addressed within the discussion of the analysis to which they relate.

7.5 The framework for our analysis has been to assess whether the Parties' horizontal and vertical overlaps could give rise to competition concerns in one of a number of ways ('theories of harm'). We have used the following theories of harm to assess whether the Merger may be expected to result in an SLC. We considered whether:

(a) any additional buyer power provided to the merged entity would weaken rival wholesalers or dampen suppliers' incentives to innovate;

(b) the merged entity would increase its wholesale prices or cut costs (that affect its quality of wholesale service) in local areas where its retailer customers overlap with Tesco, in the expectation that it would be able to offset any resulting loss of wholesale sales through increased retail sales at Tesco stores, to the advantage of the merged entity as a whole;

(c) the merged entity would increase its retail prices or cut costs (that affect its quality of retail service) in local areas where Tesco's stores overlap with the merged entity's retailer customers, in the expectation that it would be able to offset any resulting loss of retail sales through increased wholesale sales to its retailer customers, to the advantage of the merged entity as a whole;

(d) the merged entity would increase retail prices or cut costs that affect its quality of retail service in local areas where the Parties' owned and operated grocery stores overlap, thereby weakening local grocery retail competition; and

(e) if Tesco were to stop using third party wholesalers post-Merger, this would substantially weaken delivered wholesale competition.[100]

7.6 Before moving to the individual theories of harm, we set out in the following sections our findings on the current state of competition in grocery retail and wholesale services, which inform our assessment of these theories of harm.

[100] This final theory of harm was set out in our issues statement and discussed in our provisional findings report. However, since our provisional findings the only third party wholesaler that Tesco was using, P&H, has gone into administration and the Parties told us that Booker is performing that service for Tesco instead. Therefore, we do not consider this theory of harm any further.

Competition in grocery retail services

Introduction

7.7 Grocery retailing in the UK encompasses a broad spectrum of formats, store sizes, price points, and range of products and service levels. There are large national grocery retailers (including Tesco, Sainsbury's, Morrisons, Asda, Waitrose, the Co-op and Marks and Spencer); the discounters Aldi and Lidl; Iceland Foods Ltd (Iceland); and a very large number of smaller grocery retailers, including those operating as part of a symbol group and those operating as unaffiliated independent retailers. The grocery retail marketplace is fragmented along these and other lines. Moreover, a grocery retailer may operate at more than one of the points on this spectrum. For example, Tesco itself has stores ranging from convenience outlets to large supermarkets (or one-stop stores). It has both its own brand of stores and the One Stop franchise of convenience stores.

7.8 IGD estimates UK grocery retailing to be worth £180 billion in 2016.[101] Tesco is the UK's largest grocery retailer, accounting for approximately 28% of grocery sales in the UK. Sainsbury's is the next largest, accounting for approximately 16% of UK grocery sales followed by Asda (15%), Morrisons (10%), Aldi (7%), the Co-op (6%) and Lidl and Waitrose (each 5%).[102]

7.9 For large retailers, and for the sector generally, the largest share of sales is generated by large stores, such as hypermarkets and supermarkets (£103 billion of grocery sales in the UK in 2016), although this has been shrinking in recent years. The next largest share of sales comes from convenience stores.

7.10 The largest growth in UK grocery sales in recent years has been in online sales (both from online offerings of traditional 'bricks and mortar' retailers and new online-only offerings such as Amazon Fresh), and in discount retail (predominantly by Lidl and Aldi, whose offerings focus on a more limited range of products with low prices).[103]

Convenience grocery retailing

7.11 Convenience grocery retailing is a subset of grocery retailing. It is particularly important to this case as both Tesco and Booker are involved in this sector –

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[101] IGD data, as updated by IGD in submissions to the CMA.
[102] Grocery market share data compiled by Kantar (straight average annual estimate ending October 2017).
[103] IGD data shows that online grocery sales had a cumulative annual growth rate of 7% between 2014 and 2016 (to £9.7 billion) and discounter sales had a cumulative annual growth rate of 14% in the same period (to £18.2 billion).

Tesco primarily through operating convenience grocery stores, and Booker primarily through supplying convenience grocery stores.

7.12 Convenience grocery retailing is even more fragmented than grocery retailing as a whole. In its latest Local Shop Report, the ACS estimated that there are almost 50,000 convenience stores operating in the UK, 74% of which are operated by independent retailers, whether on their own or as part of a symbol group.[104]

7.13 IGD estimates that convenience grocery retailing was worth £38 billion in 2016 (equivalent to 21% of the total).[105] These convenience sales have also seen growth recently,[106] with substantial discussion in the industry of a change in consumer purchasing behaviour away from a single, big weekly shop, towards shopping 'little and often'.[107]

7.14 Most of the sales growth in convenience grocery retailing has come from an increase in the sales from (i) the convenience estate of the major supermarkets, and (ii) symbol groups. The sales of these two segments grew by 45% between 2011 and 2016.[108] Much of this growth, at least for the major supermarkets, has been as a result of new store openings.[109]

7.15 Some multiple supermarkets have significant convenience store estates. Mintel estimated that the Co-op accounts for approximately 17% of UK convenience grocery retailing, Tesco accounts for around 16%, Marks and Spencer 14% and Sainsbury's 7%.[110] Of the symbol groups, Mintel estimated that together Booker's symbol group retailers account for around 8% of convenience grocery retailing, Spar 6%, Costcutter 3% and Nisa around 2%.[111]

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[104] ACS 2017 Local Shop Report, p7.
[105] The specific definition of a 'convenience grocery retailer' (or convenience stores) sometimes differs between sources. However, it commonly requires stores to be below a certain size and not be subject to restricted opening hours under the Sunday Trading Act 1994. The Sunday Trading Act definition is of stores with a maximum sales area of 280 sq m (approximately 3,000 sq ft) The IGD definition also requires a store to be a non-specialist by stocking at least seven of the following categories: alcohol, bakery, canned and packaged grocery, chilled food, confectionery, frozen food, fruit and vegetables, health & beauty, hot food-to-go, National Lottery, milk, newspapers/magazines, non-food items, sandwiches, savoury snacks, soft drinks, and tobacco; IGD convenience retailing 2015.
[106] IGD data shows that convenience sales had a cumulative annual growth rate of around 3% between 2014 and 2016, compared with large store sales decline of 2%.
[107] See for example: UK Grocery Market Update: BFFF and BBC news story (5 October 2014), 'The death of the weekly supermarket shop'.
[108] IGD data.
[109] IGD data indicates the number of convenience stores owned by supermarket multiples increased from 3,054 in 2011 (ACS 2012 Local Shop Report) to 4,280 in 2017 (IGD press release), equivalent to a 40% increase.
[110] Mintel, Convenience Stores UK, April 2017.
[111] Mintel, Convenience Stores UK, April 2017.

Retail competition

7.16 At the local level, the main observable store characteristics that are likely to affect competition are size of stores, location, and brand/operator (or 'fascia'). Understanding these factors is central to several of the theories of harm that we are assessing. This is because, for each local area in which Booker's and Tesco's owned or supplied stores overlap, the profitability of a strategy which involves one Party increasing prices or cutting costs (that affect its quality of service) will depend on whether sufficient numbers of those end-consumers who would switch retailers as a result, would switch to stores owned or supplied by the other Party, rather than to other retailers' stores. This will depend on how closely the Parties' overlapping stores compete with each other and how closely they compete with other local stores.

7.17 We discussed the way we treat competition between different sizes of stores in paragraphs 6.8 to 6.13, above, and the distance over which stores compete in paragraphs 6.15 to 6.28 (this is also discussed further in Appendix C). In the remainder of this section, we focus on how competition varies between different fascia.

The role of fascia in retail competition

7.18 Not all supermarket and convenience store fascia compete against each other equally strongly. To reflect this the CMA has previously used a list of effective competitors. The list itself has varied according to the focus of the investigation (eg the size or type of stores involved). The CMA has used this list as a starting point for its analysis, ruling out competition concerns in local areas where a sufficient number of these effective competitors are present within the relevant catchment area.

7.19 In this inquiry, we have used as a starting point for our analysis the effective competitor set defined in past cases involving convenience stores.[112] However, we have also assessed in further detail two aspects of particular relevance to this case:

(a) The closeness of competition between Tesco's stores and Booker's owned and supplied stores (both symbol group and independent retailers); and

[112] Eg, *Anticipated acquisition by Martin McColl Ltd of 298 grocery stores from Co-operative Group Limited (ME/6632/16)*, *Completed acquisition by Co-operative Foodstores Limited of eight My Local Grocery stores from ML Convenience Limited and MLCG Limited (ME/6625/16)*.

(b) The closeness of competition between those stores and other fascia – in particular, the retailers Aldi, Lidl and Iceland, and independent retailers not supplied by Booker.

7.20 Our conclusions on these points feed into our competitive assessments in Chapters 9, 10, and 11 where we assess the effect of the Merger on retail competition in each local area by reference to the number, location and fascia of competing stores present.

Closeness of competition between Tesco and Booker-supplied stores

Parties' submissions

7.21 The Parties submitted that Booker-supplied symbol group and independent retailers are not close competitors to Tesco stores. They submitted that Tesco's main competitors are the multiple retailers and discounters, and that stores operated by these retailers exert a much greater competitive constraint on Tesco than do Booker-supplied stores. The Parties submitted that this is illustrated, for example, by the substantial difference in product range between Tesco Express and Premier stores and the substantial price difference between them. Tesco submitted that while it monitors some [✄] when assessing the competitiveness of its convenience store pricing (as a secondary measure to monitoring certain other key competitors, namely [✄]), it does not monitor Booker's symbol groups.

Our assessment

7.22 We assessed the degree of competition between Tesco and Booker-supplied retailers using evidence from the Parties' internal documents (especially competitor monitoring documents), our survey of Booker-supplied retailers, the results of our entry-exit analysis (see Appendix B), and data on the range and services available at the stores in question. We are conscious that competition between these retailers might be asymmetric. That is, one retailer may exert a stronger competitive constraint on the other than the other way round.

- *Internal documents*

7.23 The Parties provided a range of internal documents that discussed competitor monitoring. These documents indicated that Tesco monitors a range of retail competitors, [✄]. Booker's internal documents meanwhile indicated that Booker monitors [✄]. In particular:

(a) From the Tesco perspective, its internal documents showed that Tesco monitors a range of retail competitors, including [✂]. Its competitor monitoring documents focusing on convenience grocery retailing in particular benchmarked Tesco Express and One Stop on a range of factors against [✂]. With respect to promotions specifically, these documents compared Tesco Express' offering against [✂].

(b) From the Booker perspective, [✂]) show that the retail competitors most frequently cited [✂].

- *Survey of Booker-supplied retailers*

7.24 In our survey, we asked a sample of Booker-supplied retailers, that overlapped with a Tesco store in areas of potential concern, who they considered to be their main competitors.[113] The results showed that around a quarter of independent retailer respondents, and half of symbol group retailer respondents, considered Tesco to be one of their main competitors.[114] This was the most common response, followed by the Co-op (29% of symbol group and 20% of independent retailers) and other multiple retailers (around a quarter for both independent and symbol group retailers). Discounters were seen as main competitors by around 10% of symbol group and independent retailers, as were other competing independent retailers. Symbol group retailers were among the main competitors for 36% of symbol group retailers and 25% of independent retailers surveyed.[115]

7.25 The Parties submitted that the prevalence of Tesco as a competitor in these responses is likely to be heavily influenced by the fact that our survey focused on areas where the CMA's phase 1 investigation found there to be an overlap between Tesco and Booker-supplied stores, with relatively few other retail competitors and national symbol group wholesalers nearby. We note that for this reason our survey results are likely to reflect well the conditions of competition in the areas where it is most important to assess the possible effects of the Merger, and is therefore the correct measure of Tesco's prevalence as a competitor. Moreover, among a sub-sample of retailers (whose survey responses could be matched to our database of stores in the UK, even when controlling for whether the competitor is in the area), Tesco was slightly more likely to be mentioned than other large supermarkets.

113 Multiple responses were possible.
114 Survey of retailers question 47.
115 Note that in the percentages for mentions of symbol groups, mentions of Bargain Booze (franchise) and One Stop (franchise or owned) are included.

- *Entry-exit analysis*

7.26 We undertook an econometric exercise examining the effect on Booker's sales from a large retailer entering or exiting the same local area as a Booker-supplied retailer (referred to as an 'entry-exit analysis'). This analysis is discussed further in Appendix B. It focused on the effect of entry by large retailers because we did not have access to comprehensive data on entries and exits by symbol group stores or independent retailers. With respect to the effect that entry or exit of Tesco had on Booker's sales, we found that:

(a) on average an entry of a Tesco store reduces the sales that Booker makes to nearby retailers up to 1 mile away, with much stronger effects within the first half mile; and

(b) among multiples, Tesco has a relatively large effect. For example, our analysis estimates that the opening of a Tesco store would decrease Booker's sales to retailers less than ¼ mile away by 11% compared to 9% when other competing multiples enter.

7.27 While Tesco provided complementary analysis showing the effect on Tesco stores from nearby entries, this included very few occasions of Tesco monitoring the impact of the entry of a Booker-supplied store (only [✄] out of a total of approximately [✄] instances over the past three years in relation to Tesco Express stores). Tesco submitted that this is evidence that Tesco does not see such stores as a competitive constraint.

- *Data on the range and services available*

7.28 We received data indicating that, compared to a Tesco Express, symbol group retailers, and even more so independent retailers, tend to have:

(a) a smaller range;

(b) shorter opening hours;[116]

(c) less refrigeration[117] and much lower sales of fresh food;

(d) less frequent provision of services such as the National Lottery or cash machines;[118] and

(e) smaller average customer baskets.

[116] ACS Survey Data.
[117] ACS Survey Data.
[118] ACS Survey Data.

7.29 In respect of each of these aspects, the gap between Tesco Express and independent convenience retailers is even larger than between Tesco Express and symbol group retailers.

7.30 This evidence therefore suggests that Tesco stores are likely to exert a stronger constraint on symbol group stores and (especially) independent stores, than vice versa.

Competition from Aldi, Lidl and Iceland

7.31 In some previous grocery retailing cases the CMA has taken into account the constraints provided by discounters when assessing competition in particular local areas.[119]

7.32 The market position of Aldi and Lidl has significantly increased in recent years. For overall grocery retailing, their combined share of national retailing has more than doubled since 2010. Iceland has had a stable market share in recent years.[120] However, for convenience retailing specifically, we note that the offering which Aldi, Lidl and Iceland provide to customers differs from that provided by Tesco and Booker-supplied convenience stores in at least two key respects. First, the retailers themselves indicate that they do not, in the design of their stores or range, aim specifically to compete strongly for convenience customers.[121] Second, they do not supply tobacco, a product which, as discussed further below, several third parties stated was a key component of their convenience offering.

7.33 Bearing in mind these differences, we assessed the extent to which Aldi, Lidl and Iceland compete with Tesco and Booker-supplied convenience stores.

Parties' submissions

7.34 The Parties submitted that there is strong evidence that Aldi, Lidl and Iceland provide a strong and effective competitive constraint in convenience retail. They submitted evidence showing that:

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[119] *Anticipated acquisition by Martin McColl Ltd of 298 groceries stores from Co-operative Group Ltd (ME/6632/16)*, paragraphs 121 and 127; *Completed acquisition by Co-operative Foodstores Limited of eight My Local grocery stores from ML Convenience Limited and MLCG Limited (ME/6625/16),* paragraph 67; *Anticipated acquisition by One Stop Stores Limited of 33 stores from Alfred Jones (Warrington) Limited, trading as Spar (ME/6131/13)*, OFT, decision dated 18 September 2013, paragraph 27; *Anticipated acquisition by Co-operative Group Limited of David Sands Limited (ME/5317/12)*, paragraph 44.
[120] Grocery market share data compiled by Kantar.
[121] With respect to the design of stores, we note that some large supermarket formats from Tesco or Sainsbury's, for example, may have a counter at the front of the store dedicated to quick sales of convenience items such as confectionery, tobacco, impulse products and newspapers.

(a) all three retailers cater to a similar proportion of convenience-type missions as other retailers;[122] and

(b) Aldi and Lidl are winning a very significant proportion of shoppers from both symbol group and independent retailers (Aldi and Lidl together accounting for the largest proportion of recent switching losses from these types of retailers seen in a repeated survey of consumers), and from Tesco Express (which lost more (net) customers to Aldi and Lidl than any other competitors between June 2016 and June 2017).

7.35 The Parties submitted that analysis conducted both by Tesco and by us (discussed further below) also showed that entry by these retailers had an important impact on Tesco's and Booker's sales, comparable to that of entry by other retailers included in the effective competitor set. The Parties submitted that evidence from third parties (also discussed further below) corroborates the view that Aldi and Lidl compete directly with independent convenience retailers.

7.36 Regarding the importance in convenience retail of tobacco, which is not sold by Aldi, Lidl or Iceland (or Marks and Spencer), the Parties submitted that although tobacco makes up a sizeable proportion of revenue at Tesco and Booker-owned and supplied convenience stores ([✂]% at Tesco Express, [✂]% at One Stop, and around [✂]% of Londis and Premier revenue), this overstates tobacco's importance. This is because tobacco sales are in decline, retailers make very low margins on tobacco (with duty accounting for the large majority of the selling price) and tobacco has limited importance as a 'footfall driver' (ie in drawing in customers to make other purchases instore, alongside their tobacco purchases). As evidence of the limited importance of tobacco as a footfall driver, the Parties submitted that research shows that half of consumers that purchase tobacco products at convenience stores have only one item in their basket, while at One Stop, [✂] of baskets containing tobacco do not contain anything else.

Our assessment

- *Internal documents and survey of Booker-supplied retailers*

7.37 As noted in paragraph 7.23, Tesco's internal documents indicated that [✂]. Booker's internal documents [✂]. However, there is also some evidence from Tesco's internal documents that the competition it faces from Aldi, Lidl and

[122] Based on the Parties' analysis of Kantar data. Figure 7, Annex 7 to Parties' Initial Submission for the CMA's Phase 2 Review. Which shows the mission mix by customer trips for various retailers. Percentage of trips not in Main Shop category: [✂]

Iceland is stronger for customers seeking to undertake larger shopping trips, and these retailers are less strong (but still relevant) competitors for convenience shopping missions. For example, in one internal document, Tesco states that ‘The majority of our switching to Aldi and Lidl over the last year has been [✂]. [✂]% fewer families are doing [✂] at Tesco compared to two years ago.’

- *Survey of Booker-supplied retailers*

7.38 In our survey of Booker-supplied retailers, 12% of symbol group respondents and 11% of independent retailer respondents counted Aldi or Lidl amongst their main competitors.[123] These figures are significantly lower than the corresponding percentages of retailers who regarded Tesco as one of their main competitors (50% of symbol group retailers and 26% of independent retailers). The figures are also lower than the equivalent responses relating to the Co-op (29% of symbol group retailers and 20% of independent retailers).[124] Sainsbury’s, Asda and Morrisons were also ahead of the discounters (in aggregate), accounting for 27% of symbol group responses and 25% of independent retailer responses. Iceland, meanwhile, did not account for any response from either symbol group retailers or independent retailers.

7.39 Based on a sub-sample of retailers (whose survey responses could be matched to our database of UK stores, when controlling for whether the competitor is in the area), Aldi and Lidl remain relatively less likely to be mentioned than Tesco or other supermarkets.

- *Entry-exit analyses*

7.40 Tesco submitted an analysis of the impact on Tesco store sales of entry by other large retailers in the period 2014 to 2017. This analysis indicated that nearby entry by other large retailers tends to reduce sales at the affected Tesco; [✂].[125] Focusing on Tesco Express stores, the average estimated impact on sales at those stores from a new Aldi or a new Lidl is [✂]% and [✂]% respectively. The average estimated effect of a new Sainsbury is [✂]%,

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[123] Survey of retailers question 47.
[124] Our survey was focused on local areas which the CMA’s phase 1 decision found raised a realistic prospect of an SLC. In other words, in all these local areas Tesco overlaps with a Booker-supplied retailer. Therefore, we would expect that Tesco would frequently be cited as a main competitor by those Booker customers.
[125] Tesco told us that, broadly, it monitors the effect of competitor entries within [✂] of a Tesco Express.

of a new Asda is [✂]% and of a new Morrisons is [✂]%. The estimated effect of a new Iceland is [✂]%.[126]

7.41 Our own entry-exit analysis (set out in Appendix B) indicated that the effects on Booker's sales to nearby retailers from entry by [✂] are similar to that by others including [✂]. The average effect of an entry or exit by [✂] found in the data was negligible (although we note that the entry analysis included very few entry events by [✂]).[127]

- *Third party submissions*

7.42 We asked Aldi, Lidl and Iceland about the extent to which they considered themselves to compete in the convenience segment.

(a) One told us that it competes with the independent retailers to a degree, certainly in terms of the customers that use their stores. It said that the product range will differ in certain respects, as independent retailers will likely offer more in terms of general grocery items and newspapers, magazines and tobacco products, but that competition was likely on more generic grocery items such as bread, milk, cheese and other general household items.

(b) Another told us that in areas where it is located close to convenience stores there is an element of competition. However its operating model as well as the shopping habits of its average customer are different from that typically observed in convenience retailing. [✂]

(c) The third told us that it competes with all retailers, including independent retail stores, however with no particular focus on convenience stores. It considers the other nine biggest UK grocery retailers to be its main competitors and emphasised that it does not consider that it faces significant competition from convenience stores as it targets full shop customers.

7.43 These representations indicate that competition between these retailers and convenience store retailers might be asymmetric, ie discounters exert a stronger constraint on convenience stores than convenience stores do on discounters.

7.44 Many of the wholesalers and larger retailers we spoke to told us that tobacco is an important part of their convenience range. A number of these told us that

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[126] CMA analysis of Tesco data.
[127] See Appendix B for details.

tobacco is an important product that drives footfall and that they could potentially lose footfall to other retailers if they did not have a tobacco offer. However, in general, these retailers said that they see Aldi, Lidl and to a lesser extent Iceland as strong competitors in convenience retailing. Aldi and Lidl often received the highest ratings when we asked large retailers to rank their main competitors, though less often than was the case for Tesco and Sainsbury's. Regarding Aldi and Lidl, three respondents specifically mentioned their lack of a tobacco offering as a weakness.

Competition from symbol groups and independent retailers

7.45 In past cases, the CMA has concluded that retailers operating under certain specific symbol groups provide effective competition to large retailers, provided that the stores in question are within the same or larger size band and fall within the relevant geographic market. The largest symbol groups in the UK, by store numbers, are Costcutter (over 2,600 stores), Spar (over 2,400 stores)[128] and Booker's symbol group Premier (approximately 3,300 stores).[129] The Parties submitted that Tesco and Booker-supplied symbol group and independent stores also face competition from:

(a) additional symbol group stores operating under the Bargain Booze fascia operated by wholesaler Conviviality,[130] and the Lifestyle Express fascia operated by buying group Landmark Wholesale Limited (Landmark); and

(b) independent retailers not supplied by Booker.

7.46 In relation to Bargain Booze and Lifestyle Express, we received some limited responses from wholesalers that these symbol groups provide effective wholesale competition and that stores operating under these symbol groups would provide relevant retail competition. While only two respondents (1%) to our survey of Booker-supplied retailers identified Bargain Booze as a competitor, A G Parfett & Sons (Parfetts) told us that Bargain Booze is a strong retail competitor and would pose a significant constraint on any independent or symbol group retailer in close proximity, and other wholesalers also mentioned Landmark and Conviviality as wholesale competitors.

7.47 In relation to the constraint on Tesco from non-Booker-supplied independent retailers, we note that almost all the larger retailers we spoke to indicated that they compete in some way with independent retailers. Several respondents

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128 IGD/William Reed Grocery Retail Structure 2016.
129 Parties phase 2 submission, paragraph 3.8(b).
130 Bargain Booze is a franchise rather than a symbol group but operates in a similar way and has therefore been considered as a competitor.

indicated that this was mainly due to the location/proximity of the independent retailer.

7.48 In relation to the constraint on Booker-supplied retailers from non-Booker-supplied symbol group and independent retailers, 10% of the symbol group retailers we surveyed view independent retailers as their main competitor; likewise 12% of independent retailers surveyed view other independent retailers as being part of their main competitors.[131] Symbol group retailers were among the main competitors for 36% of symbol group retailers and 25% of independent retailers.[132]

7.49 As set out in paragraph 7.28, when compared to Tesco, and to symbol group retailers, independent retailers have on average a smaller range, shorter opening hours, less refrigeration and less fresh food, less frequent provision of services such as the National Lottery or cash machines, and smaller average customer baskets.

Conclusion on fascia

7.50 In light of the above evidence, we have concluded that it is appropriate in our assessment to take account of:

(a) competition between Tesco and symbol group stores, but we also have taken into account that Tesco will exert a stronger constraint on the symbol group store than vice versa. We take account of this through a reduced 'weighting' for symbol group stores in our analysis when assessing their constraint on Tesco stores (see Appendix C for more detail);

(b) competition between Tesco and symbol group stores on the one hand and independent stores on the other, but we have also taken into account that Tesco and the symbol group stores will exert a stronger constraint on the independent stores than vice versa. We take account of this through a reduced 'weighting' for independent stores in our analysis (Appendix C);

(c) competition from Aldi and Lidl. In doing so we include some allowance for the fact that when competing with convenience stores in particular (as opposed to mid-size stores), these retailers may be slightly disadvantaged by not selling tobacco and their stated lack of focus on convenience missions. We have taken this into account through a reduced 'weighting'

[131] Survey of retailers question 47.
[132] Note that in the percentages for mentions of symbol groups, mentions of Bargain Booze (Franchise) and One Stop (Franchise or owned) are included.

for Aldi and Lidl stores in our analysis. We have also applied a reduced 'weighting' for Marks and Spencer stores, for the same reason that Marks and Spencer does not sell tobacco products (Appendix C);

(d) competition from other retailers previously confirmed as effective competitors by the CMA.

7.51 In relation to competition from Iceland, Bargain Booze and Lifestyle Express specifically, we have not found it necessary to conclude on the extent of the constraint they provide. In our competitive assessment, we have conducted sensitivity testing which shows that the inclusion of these fascia does not materially affect our results.

7.52 Our analysis set out in Chapters 9, 10 and 11 therefore takes into account data on the locations of stores of the following fascia, as well as the locations of independent retailers supplied by Booker, and some additional competing independent stores,[133] wherever the store size of these fascia falls within the relevant product frame of reference.

Table 5: Retail fascia incorporated into our incentives analysis

Retailers	*Symbol groups/fascia operated by wholesalers*
Aldi	Bargain Booze*
Asda	Best-One
Booths	Budgens
The Co-op	Centra
Dunnes	Key Store/Key Shop
Iceland*	Lifestyle Express*
Lidl	Londis
Marks and Spencer	Mace
	Nisa
McColls	P&H Retail†
Morrisons	Premier
Sainsbury's	Spar
Tesco	Supervalu
Waitrose	Today's
Whole Foods	VG/Vivo

Source: CMA analysis; information on store locations is based on store data provided by the Parties updated with information from certain third parties.
* These stores were included in a sensitivity test only.
† P&H Retail (via its operating company, WS Retail Limited) has not been placed in administration.

7.53 The Parties also told us that barriers to entry and expansion in the convenience retail segment are very low, particularly for symbol groups and independent retailers. However, we have not found it necessary to conclude

133 We do not have comprehensive data on independent store locations, other than for Booker customers. We consider that retailer purchases of less than £20,000 a year are likely to account for a very small proportion of a retailer's total spend. If a retailer is buying this little from one wholesaler, we have assumed that it is buying the very large majority of its supplies from elsewhere. Therefore, we have excluded in our analysis any Booker-supplied independent retailer with such a low spend as a Booker customer since they would not be materially affected by a price rise by Booker. Therefore, we have treated these independent retailers as competitors to Booker-supplied retailers.

in this case that such entry or expansion would be timely, likely, and sufficient[134] within local catchments in the absence of any evidence supporting that the opening of a particular store is in contemplation.[135]

Competition in grocery wholesale services

Introduction

7.54 According to IGD estimates, the total value of sales by grocery wholesalers is around £30 billion, spilt between sales to retailers (£18.2 billion), caterers (£10.2 billion) and others such as small and medium sized businesses and professional business users (£1.6 billion).[136] Within sales to retailer customers, the vast majority of grocery wholesale sales are to independent and convenience retail (£15.2 billion of the £18.2 billion).[137]

7.55 The focus of this section is on wholesale services provided to retailer customers, on the basis that, as noted in paragraph 7.1, Tesco does not generally serve catering customers at present. As discussed above in market definition, we have concluded that a significant component of wholesale competition is likely to take place at a local level. Nevertheless, given that Booker operates on a national scale and the overlap between Tesco's and Booker's activities extends across the country, we start by describing the national wholesale landscape, and the characteristics that will affect competition across local areas, before considering the level of competition in each local area.

7.56 In the paragraphs which follow, drawing on evidence received from our survey of Booker-supplied retailers, Booker's internal documents, information and data provided by wholesalers and industry and market reports, we explore:

(a) the variety of grocery wholesale services available to retailers;

(b) the key competitors to Booker in the supply of cash and carry grocery wholesale, delivered grocery wholesale and symbol group services;

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134 Merger Assessment Guidelines, section 5.8.
135 Regarding the treatment of pipeline stores, see footnote 18 of Appendix C.
136 IGD UK grocery & foodservice wholesaling 2017.
137 These estimates differ from the Parties' estimates of the total size of the grocery wholesale sector. The Parties submitted that discrepancies between estimates from different sources are in part a result of the fragmented and differentiated nature of the UK wholesale market and the blurred lines between the various different segments it encompasses (Phase 2 submissions, p5). Based on a combination of Horizons, IGD and Booker management estimates, the Parties estimated that the total value of sales by grocery wholesalers is around £45 billion, split between sales to caterers (£22.5 billion), retailers (£18.3 billion), and others such as SMEs and professional business users (£4.0 billion).

(c) expansion within wholesale services;

(d) the purchasing habits of Booker's retailer customers, including the type and range of wholesalers they use;

(e) the degree to which these retailers switch, both between different symbol group fascia and between different wholesalers for some proportion of their purchases, including how often retailers switch and what would prompt them to do so; and

(f) local conditions of wholesale competition.

Variety of grocery wholesale services

7.57 As discussed in relation to product market definition, there is a significant degree of variety in the services which different wholesalers offer to retailers. We distinguish in that section between three wholesale services which Booker provides: symbol group services, cash and carry grocery wholesale and delivered grocery wholesale. However, even within these markets, different wholesalers adopt very different wholesale models.

7.58 Some wholesalers, such as Booker, Spar, Nisa and Costcutter, operate symbol group services. The degree of independence which the symbol group retailer has from the symbol group wholesaler will depend on the contracts and business model adopted, and it can vary between different fascia operated by the same wholesaler. For example, the contracts signed between Booker and its symbol group retailers across all Booker symbol group fascia require [✂].[138]

7.59 Similar to other symbol group providers, Booker offers its symbol group retailers a range of services including provision of the shop front/signage, advice about merchandising and equipment, and access to promotions/discounts.

7.60 Booker's contracts [✂]

7.61 Booker's contracts require that retailers adhere to a number of conditions, including:[139]

(a) [✂]

[138] [✂]
[139] [✂]

(b) [✂][140]

(c) [✂]

7.62 Some wholesalers (such as Dhamecha) only offer cash and carry grocery wholesale services, while others (such as Nisa) only deliver; and others (like Booker) offer both. Some operate independently, while others offer their services in partnership with one or more other wholesalers. Costcutter, for instance, offers symbol group services, but outsources the purchasing of a large percentage of the stock that it supplies to those symbol group retailers. In the past this was carried out by P&H, which was largely responsible for negotiations with suppliers as well as warehousing and delivery. Nisa also has a distribution partner – DHL – but retains responsibility for supplier negotiations itself. Spar offers a single symbol group and largely leads supplier negotiations centrally. However, its individual wholesaler owners may also engage in a second level of supplier negotiations. These members are, further, responsible for distribution of goods to Spar symbol group retailers in their respective regions.

7.63 Some wholesalers are also members of buying groups. A buying group is an affiliation of several grocery wholesalers established to obtain more favourable terms from suppliers than each wholesaler could achieve individually. Buying groups may also offer their member wholesalers other services, such as access to common own-label products. There are a number of buying groups in the UK, the two largest being Today's (£5.5 billion turnover, 145 members[141]) and Landmark (£2.7 billion turnover, 38 members).[142]

7.64 Though buying groups are responsible for central negotiations with suppliers, some secondary negotiations take place between individual member wholesalers and suppliers. Customers also purchase from individual members, rather than from buying groups as a whole. For this reason, in our assessment, we do not consider buying groups as posing a constraint on Booker, separate from their individual member wholesalers. We note that this is consistent with *Booker/Makro*,[143] and is also the basis on which Booker monitors competitors' prices. [✂] We have, however, found that regional wholesalers that are part of a buying group are likely to impose a stronger

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140 [✂]
141 Of these wholesale members, Today's classifies 40 as a distinct group that participate in most of the services it offers as a buying group.
142 Submissions by Landmark and Today's. Spar operates in a similar way to a buying group, but, unlike a buying group, Spar is owned by its five wholesalers and other wholesalers cannot become a 'member'.
143 *A report on the completed acquisition by Booker Group PLC of Makro Holding Limited,* p24. In this case the Competition Commission considered, in each local overlap failing the initial filtering exercise, whether wholesale competitors active in the area were part of a buying group.

constraint on Booker compared to regional wholesalers that are not part of a buying group, as a result of having access to lower supplier prices and own-brand products.

Key competitors

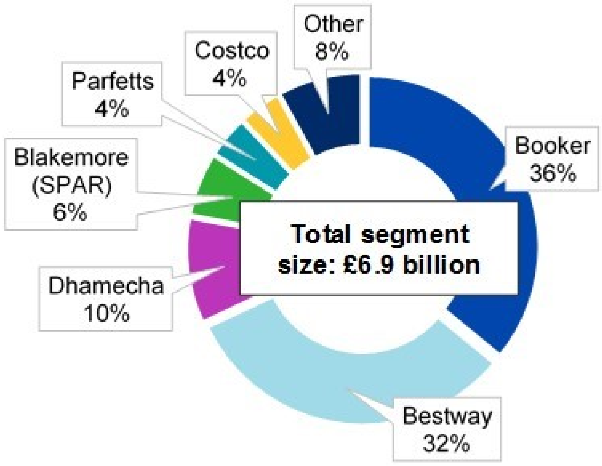
Cash and carry grocery wholesale and delivered grocery wholesale

7.65 As noted in paragraph 6.58 above, while we treat cash and carry grocery wholesale and delivered grocery wholesale separately in our analysis, we acknowledge that an important degree of constraint exists between them, and we discuss these two channels together below.

7.66 While some wholesalers offer both cash and carry and delivered grocery wholesale services, a firm may have a more extensive offering in one or the other. For example, as shown in Figures 3 and 4 below, in cash and carry grocery wholesale, Booker and Bestway are the largest wholesalers in the UK, followed by Dhamecha, Blakemore, Parfetts and Costco. In delivered grocery wholesale, before going into administration, P&H[144] was the largest, followed by Spar, Nisa, Booker and Conviviality. Based on Booker's sales data, we consider that Figure 3 is likely to overstate Booker's share of cash and carry sales to retailers, but it is still useful for showing the relative size of the various wholesalers operating in this segment.[145]

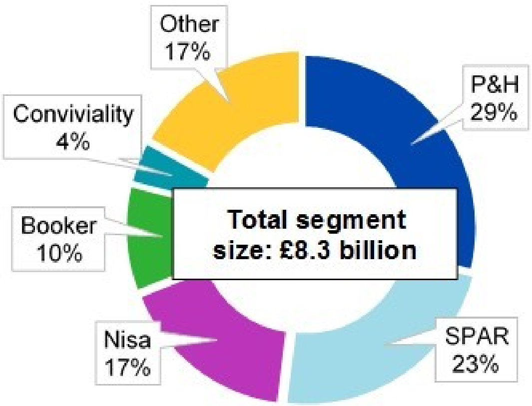
[144] We think that the overall size of P&H – whether in terms of its revenue or in terms of its national share of wholesale services, as indicated in Figure 4 – was not a good indicator of the strength of P&H as a competitor to Booker. [✂]
[145] See Table 2 for the CMA's estimates of Booker's share of supply in the UK by wholesaling activity.

Figure 3: Cash and carry grocery wholesaler shares to independent and convenience retailers, 2016



Source: IGD UK grocery wholesaling sector performance statistics 2016.
Notes:
1. IGD has calculated these shares on the basis of independent trading companies and has excluded joint entities such as buying groups.
2. Information relates to sales to independent and convenience retailers only (ie excludes larger format stores).

Figure 4: Delivered grocery wholesaler shares to independent and convenience retailers, 2016[146]



Source: IGD UK grocery wholesaling sector performance statistics 2016.
Notes:
1. IGD has calculated these shares on the basis of independent trading companies and has excluded joint entities such as buying groups.
2. Information relates to sales to independent and convenience retailers only (ie excludes larger format stores).

The approach in past cases

7.67 The Competition Commission assessed the merger between Booker and Makro in 2013 in the context of the overlap in the provision of cash and carry wholesale to retail and catering customers. In that case, the Competition Commission identified an 'effective competitor set' for cash and carry wholesale, which was adopted in the phase 1 decision in the present case

[146] Figure 4 includes P&H. P&H and most of its subsidiaries are currently in administration.

(updated only to reflect consolidation in the market since the *Booker/Makro* decision). This effective competitor set is shown in Table 6. However, in *Booker/Makro*, the Competition Commission noted that delivered grocery wholesalers were also effective alternatives to cash and carry wholesalers for both retailers and caterers; it considered the delivered wholesalers set out in Table 7, which include some specialist catering wholesalers, as effective competitors.

7.68 The Parties submitted that the list of effective competitors considered by the CMA at phase 1 was unduly narrow and omitted a number of important cash and carry and delivered grocery wholesale alternatives. In particular, the Parties submitted that three large members of the Landmark and Today's buying groups that have symbol group offerings should be considered a constraint. The Parties also submitted that in each local area Booker faces competition from a range of local and specialist wholesalers.

Table 6: Phase 1 effective competitor set, cash and carry grocery wholesale

Wholesaler	*National/Regional operator*	*Belongs to buying group?*	*Also has delivered offering?*
Booker	National	×	✓
Bestway	National	×	✓
Costco	National	×	×
Blakemore	Regional	✓	✓
Dhamecha	Regional	✓	×
Hyperama	Regional	✓	✓
Parfetts	Regional	✓	✓
United Wholesale Scotland	Regional	✓	✓

Source: Tesco/Booker: phase 1 Decision, based on Booker/Makro.

Table 7: *Booker/Makro* effective competitor set, delivered grocery wholesale

Wholesaler	*National/Regional operator*	*Belongs to buying group?*	*Catering wholesale specialist?*
Brake Bros	National	×	✓
3663 (Bidfood)	National	×	✓
JJ Foodservice	National	✓	✓
P&H	National	×	×
Nisa	National	×	×
Musgrave	Regional	✓	×

Source: Booker/Makro: Final report.

Our assessment of effective competitors

7.69 In relation to wholesale services to retailers, we do not in this case consider Brake Bros Limited (Brake Bros), Bidfood (formerly 3663) and JJ Food Service as direct competitors for Booker's retailer customers since these wholesalers specialise in the catering sector.

7.70 Our survey of Booker-supplied retailers and Booker's internal documents confirmed that Booker faces constraints from the competitors that the CMA has previously considered to be effective - Bestway, Costco, Blakemore, Dhamecha, Hyperama, Parfetts, United Wholesale Scotland, P&H, Nisa, and Musgrave.[147]

(a) Our survey of Booker's retailer customers showed that, alongside Booker, Bestway, P&H and Dhamecha were cited most frequently by symbol group retailers and independent retailers alike as the alternatives they used.[148] This was followed by Blakemore, United Wholesale Scotland, Nisa and Parfetts.

(b) We have analysed Booker's [✂] documents for the same 11-week period in 2017 and 2018.[149] This analysis shows that when [✂] were indexed against Booker (ie with Booker's pricing being fixed at 100) across a range of over 200 product lines on average, the index value of the prices of these products ranged between [✂] and [✂] in 2017 and between [✂] and [✂] in 2018.[150] The data indicates that over this period Booker competed most closely with [✂]. We note that Booker also produces [✂].

7.71 We also found evidence which suggested that Booker faces strong constraints from a range of other wholesale competitors.

(a) In addition to the larger wholesale competitors included in the CMA's phase 1 competitor set, a long tail of other wholesalers was listed by a very significant number of respondents to our survey of Booker-supplied retailers (collectively accounting for over 40% of the alternatives listed by symbol group retailers, and over 50% of those listed by independent retailers).

(b) We assessed evidence from the Parties' internal documents regarding the competitors which Booker monitors. This showed that Booker monitored a range of different wholesalers, including [✂].

7.72 The Parties also submitted evidence on a number of local areas that we identified as facing potentially weaker wholesale competition (discussed below at 7.106 onwards). This indicated that there exist a broad range of local and regional wholesale options, some of which are full-range operators while others focus on, for example, baked or fresh goods.

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[147] Since the survey P&H has gone into administration.
[148] Survey of retailers question 39b. Since the survey P&H has gone into administration.
[149] [✂]
[150] The CMA has removed Hyperama's observation for week 15 in 2018, which is deemed an outlier.

7.73 In relation to the Parties' specific submission that we should take into account the constraint from buying groups, we note (as we did in our product frame of reference), that both national and regional wholesalers may be members of buying groups. For example, as indicated in Table 6, Blakemore, Parfetts and Hyperama are each members of Landmark and Dhamecha and United Wholesale Scotland are members of Today's.[151] We have found that smaller wholesalers are likely to benefit from greater negotiating power as part of a buying group. However, we have also found that the offering of individual wholesalers within buying groups can vary significantly. We have found that it is inappropriate to treat all members of these buying groups as equally strong competitors. However, where we have evidence that a particular member has a strong offering in a particular region, this is taken into account in our local assessment of competition (which in part draws on local shares of supply).

7.74 In summary, the evidence we have reviewed showed that Booker faces a variety of constraints, both in delivered and cash and carry wholesaling. Some of these wholesalers are national in scope while others are focused in particular regions. The Parties have also made us aware of a significant number of wholesalers who operate on a very local basis. Some of these will belong to buying groups, which we would expect to increase the competitive constraint they impose on Booker. To the extent applicable, we took into account the individual and combined constraint from these different wholesalers in our local assessment of competition.

Symbol groups

7.75 Wholesalers not only compete against each other to supply goods and services to retailers, but some will also compete to recruit retailers to their symbol group in order to increase their sales.

7.76 As described in Chapter 2, symbol group services may be offered under a single symbol group fascia (brand), or under several different fascia, which may allow the symbol group wholesaler (and the symbol group retailer) to distinguish between different customer or product offerings. For example, according to a him! report, Booker's Budgens fascia tends to appeal to a higher socio-economic demographic than its Premier or Londis fascia, while its Family Shopper fascia offers a discount convenience format.[152] Table 8 lists the brands operated by the major symbol group wholesalers.

[151] Member's lists found on Landmark Wholesale and Today's websites.
[152] See Figure 1.

Table 8: List of symbol group providers in the UK and their respective brands

Symbol group providers	*Brands operated*
Booker	Premier, Londis, Budgens, Family Shopper
Costcutter	Costcutter, Mace (not NI), Supershop (NI), Kwiksave
Filshill	Key Store
Nisa	Nisa Local/Extra, Loco
Select & Save	Select & Save
Bestway	Best One, Xtra Local
Spar	Spar
Landmark	Lifestyle Express
Today's	Today's, Day-Today
Parfetts	Go-Local, Go Local Extra
Musgrave (RoI and NI only)	Day-Today, Mace, Centra, Supervalu
Conviviality	Bargain Booze, BB Select Convenience, Wine Rack

Source: CMA, compiled from third party submissions.

7.77 The Parties submitted that we should also take into account the symbol group operations of Lifestyle Express (operated by members of Landmark), Today's, Key Store (Filshill) and Bargain Booze (Conviviality). We assessed evidence on each of these symbol group wholesalers, including their share of shops (by postcode area), size of stores, and sales data (where provided). We found that:

(a) **Landmark**, which runs the Lifestyle Express symbol group, is a buying group made up of individual wholesalers. Together its 38 wholesalers have around 1,200 symbol group stores using the Lifestyle Express fascia, though these are falling in number. The average size of these stores is comparable to Premier. Lifestyle Express was not mentioned as a competitor by many wholesalers in response to our questionnaire. However, while our share of shops analysis shows that Lifestyle Express does not have UK-wide coverage, in some of the regions in which it operates, it has a significant share of shops.

(b) **Today's**, which runs the Today's symbol group, is also a buying group, consisting of 145 members.[153] Today's has 488 stores operating under its symbol fascia in the UK (which are supplied by three of Today's wholesale members) and has been growing. Today's told us that it considers itself a strong competitor to Booker in Scotland and Northern England, although only one other wholesaler highlighted it as a key competitor.

(c) **Filshill** which runs the Key Store symbol group has 170 stores in Scotland using its symbol fascia, compared to around 400 Booker symbol group stores. Key Store is only present in 20 UK postcode areas but in those areas it appears to provide a relatively strong constraint, with

[153] Of these wholesale members, Today's classifies 40 as a distinct group that participate in most of the services it offers as a buying group.

average shares of shops of 10% and a maximum of 27% in one area. One wholesaler highlighted them as a key competitor.

(d) **Conviviality** runs the Bargain Booze franchise and has a significant number of these stores, focused in the Midlands.[154] One wholesaler highlighted them as a key competitor. Conviviality sells a range of products but its primary category is beers, wine and spirits. It told us that it has agreements in place with Nisa and Kerry foods for its stores to access fresh and chilled ranges and it also uses a number of small suppliers, for bread and dairy products, for example. Bargain Booze is present in around two-thirds of UK postcode areas and has a very significant share of shops in some areas. It also has an average of 5% share of wholesale sales across all UK postcode areas.

7.78 Based on the above, we have found that the larger symbol group providers – Costcutter, Nisa, Spar and Best-One – are likely to impose the greatest constraint on Booker. However, other symbol groups (in particular Lifestyle Express, which has around 1,200 stores under its fascia) are also likely to impose a constraint on Booker, and this constraint will be stronger in certain regions in which they have a more significant presence. These additional symbol group wholesalers are taken into account in our local assessment of competition.

Expansion within grocery wholesale services

7.79 We considered what barriers wholesalers might face in expanding their existing wholesale services, or moving into new wholesale services, such as symbol group services.

7.80 The Parties submitted that wholesaling is a largely variable cost business that can be scaled up or down in response to volume changes which means barriers to expansion are low. They submitted that there are no sunk costs of entry or expansion since all major assets (including depots and delivery vehicles) can be leased; there is no shortage of necessary assets such as land on which to build depots, since they can be outside prime retail locations; and the short-run fixed costs of operation are a small proportion of total costs. Booker pointed to its own success in scaling its delivered grocery wholesale business as evidence of scalability of wholesale services. It submitted that its own delivered operation accounted for around [✂]% of its total sales in 2017, up from just around [✂]% in 2012. The Parties also submitted that the range

[154] Bargain Booze is a franchise rather than a symbol group but operates in a similar way to symbol groups and has therefore been considered as a possible competitor.

of national, regional and local wholesaling competitors is consistent with what one would expect in an industry with low barriers to entry and expansion.

7.81 We found examples of wholesalers expanding the scale of their existing services. In delivered grocery wholesale services, one wholesaler told us that it was able to accommodate around 300 new customers in a matter of weeks, following the award of a new contract. In cash and carry grocery wholesale services, London-based Dhamecha has very recently expanded – it opened a cash and carry depot in Leicester in 2015 and opened a further one in Birmingham in October 2017.

7.82 We have also seen entry by new players not previously active in wholesale: Morrisons (a supermarket chain and supplier) has recently won an exclusive contract to supply McColls on a delivered-to-outlet basis.

7.83 The Parties submitted other examples of entry and expansion, notably Costco's plans to open new cash and carry depots in Stevenage and High Wycombe and AF Blakemore opening a new cash and carry depot in Bangor.

7.84 While the evidence indicates that substantial expansion is possible in a timely manner, entry may be more difficult. For delivered grocery wholesale services, we found that there will be costs to setting up a delivery network where one does not exist, since a denser network of deliveries will allow for more efficient delivery routes. For example, Bestway told us that a number of regulatory requirements and practical considerations apply to delivery services but which are not relevant to cash and carry.[155] For a symbol group wholesale services, there will be costs in establishing a brand.

7.85 Although there is evidence of entry by existing wholesalers into new wholesale services (for example, Parfetts' entry into symbol group services in 2012) there is also evidence that developing such a new service can take time (Parfetts told us that it took seven to eight years to develop this offering). While we are not aware of any other current plans by wholesalers to expand their wholesale services, we note that the developments discussed in paragraph 5.10 above indicate potential interest in the market to find new ways of entering into wholesale services and, in any case, expansion is feasible.

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[155] Some of these include: obtaining an operator's licence, purchasing appropriate vehicles, recruiting licensed drivers, setting up security systems, establishing distribution centres which are laid for picking orders (rather than for customers), purchasing routing and picking software, setting up systems for taking delivery orders, creating and maintaining a delivered pricing strategy (if different from cash and carry pricing) and collecting and storing additional SKU information to facilitate this.

Purchasing habits of retailers and volume switching

7.86 Several of the theories of harm that we considered in this inquiry depend on the extent to which retailers could and would switch away from Booker if Booker worsened its prices or quality of services; that is, the strength of wholesale competition. To assess how retailers may respond if faced with a price increase by Booker, we looked at evidence from our survey of Booker-supplied retailers, Booker's own sales data and submissions from competing wholesalers.

7.87 Our survey of Booker-supplied retailers indicated that Booker's retailer customers tend to rely on Booker for a significant proportion of their purchases, especially in the case of symbol group retailers. On average, the symbol group retailers surveyed relied on Booker for 78% of their purchases compared to 60% of independent retailers' purchases.[156] This was a little higher than indicated by the Parties' own estimates.[157] Further, only 10% of symbol group retailers surveyed used Booker for less than 50% of their purchases compared to 40% of independent retailers.[158]

7.88 However, our survey also indicated that both multi-sourcing between different wholesalers, and switching volumes between them, was common. Almost three quarters of symbol group retailers surveyed, and four fifths of independent retailers surveyed, stated that they purchase from another wholesaler in addition to Booker. While respondents were not asked to list all alternatives exhaustively, the responses indicated that one quarter of independent retailers and 16% of symbol group retailers surveyed purchased from two or more alternative wholesalers.[159]

7.89 Both symbol group retailers and independent retailers indicated that they move volumes between different wholesalers on a relatively frequent basis: of those surveyed, [✂]% of symbol group retailers and [✂]% of independent retailers switched at least once a month, and a further [✂]% of symbol group retailers and [✂]% of independent retailers switched every six months.[160] Retailers were also found to keep a close eye on their alternatives: of those surveyed, [✂]% of symbol group retailers and [✂]% of independent retailers

[156] Survey of retailers question 17.
[157] The Parties submitted that, across a sample of 38 Premier and 11 Londis stores, retailers sourced on average approximately [✂]% of purchases from Booker, with [✂] of the sample sourcing [✂] of their estimated purchase requirements from Booker.
[158] Survey of retailers question 17. The survey covered a small subset of Booker's retailer customers, representing circa 3% of its symbol group customers and circa 0.2% of its independent customers. The survey sample was not randomly selected; it focused on retailers in areas perceived to have potentially fewer wholesale competitors. The respondents also typically spent a significantly higher than average amount with Booker.
[159] Survey of retailers question 30.
[160] Survey of retailers question 43.

stated that they track one or more elements of competing wholesalers' offerings.[161] From our survey of retailers, when independent retailers were asked what they would do if Booker raised wholesale prices by 5%, over a third said that they would consider switching all of their purchases to another wholesaler and 41% said that they would consider switching some of their volumes to another wholesaler. Only 18% said that they would consider staying with Booker and purchasing the same volumes.[162]

7.90 We note that the sample of retailers chosen for our survey was focused on retailers who the CMA's phase 1 investigation found to (i) overlap with at least one Tesco store (and have in their local area three or fewer other retail competitors) and (ii) be located in areas with fewer national symbol group wholesalers nearby. The sample is therefore weighted towards those retailers that we would expect to have the fewest wholesale options. We consider it informative that these retailers nevertheless indicated that they use several wholesalers.

7.91 Further, while we might expect minimum contractual spend requirements to limit the extent to which retailers switch volumes, only 6% of respondents to our survey mentioned this as a barrier to switching.[163] This supports what Booker and other wholesalers told us, that [✂].

7.92 We also analysed Booker's sales data to examine actual switching rates. We inferred 'switching' where a retailer's purchases from Booker fell below 25% of their average monthly purchases for at least two or three months of the year. This indicated that [✂]% of retailers switched at least [✂] times in a year, and [✂]% switched at least twice in a year. The data also indicated that [✂].

7.93 While we have tried to control for seasonality in purchasing patterns (resulting in the removal of product categories wine, spirits and confectionery from the data), we note that this analysis still has a number of caveats. Importantly, switching is not observed directly in this analysis and a fall in purchases may be explained by other factors. We thus interpreted these data with caution but note that, in line with responses to our survey and submissions from third party wholesalers, this analysis is consistent with there being some constraint on Booker from volume switching.

7.94 Wholesalers who responded to our questionnaires generally supported the finding that multi-sourcing and switching of purchase volumes by retailers

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[161] Survey of retailers question 32. Both symbol group and independent retailers most commonly tracked other wholesalers' price, promotions and product ranges.
[162] Survey of retailers question 35.
[163] Survey of retailers question 24.

were common.[164] While different wholesalers indicated quite different levels of estimated purchasing loyalty from customers, the vast majority of wholesalers confirmed that multi-sourcing was commonplace. All wholesalers except one also agreed that customers were highly price sensitive, and that switching of purchase volumes was common.

7.95 A number of wholesale competitors submitted to us that there may be certain costs to switching volumes, arising from lost opportunities to benefit from rebates, or due to challenges with meeting minimum delivery quantities. However, the evidence of multi-sourcing and of switching set out above indicates that for most retailers these barriers are not likely to be significant and would not be sufficient to prevent retailers from switching away at least some of their purchases in response to a price rise by Booker.

Switching symbol groups by retailers

7.96 We assessed responses from our survey of Booker-supplied retailers regarding the degree of switching between symbol group fascia and the barriers to doing so. We reviewed this alongside data on switching rates submitted by Booker and other symbol group wholesalers, as well as qualitative submissions from competing wholesalers.

7.97 Overall, our survey indicated that a significant proportion of symbol group retailers (just under half of respondents) had considered switching away from their existing symbol group. A similar proportion indicated in our survey that they were likely to switch in the face of a 5% price rise by Booker. Only 20% said that they would consider staying with Booker and purchasing the same volumes.[165] Of those who indicated that they would switch, 46% said they would most likely switch symbol group and 45% said that they would most likely switch some of their purchase volumes.

7.98 We also analysed actual switching rates in 2016 and 2017 from Booker and other wholesalers' data. This analysis indicates that, on average, 4% of symbol group retailers (as a proportion of the total stock of symbol group retailers in that year) switched to another symbol group or to independent retailing in 2016 (3% in 2017). In addition, symbol groups acquired, on average, 9% more stores in 2016 (5% in 2017) from a competing symbol group or from the independent retail sector.[166] Most of this switching, in both

[164] At phase 2 we received responses to our questionnaire from 13 wholesalers and two buying groups.
[165] Survey of retailers question 35.
[166] Joiner and leaver switching rates based on data submitted by Nisa, Spar, Bestway, Musgrave NI, Conviviality and Booker for 2016 and 2017. Parfetts and Costcutter are also included in leaver data. Londis and Costcutter have been removed from the 2016 joiner and leaver analysis respectively due to a large transfer of MFG stores from Costcutter to Londis in this year which skews the data.

directions, took place between symbol groups, with limited movement to and from independent retailing.

7.99 From this, we note that the indication of a high propensity to switch from our survey was generally not borne out in the rates of actual switching observed in data submitted by Booker and other wholesalers. The Parties submitted that the low rate of actual switching indicates high levels of customer satisfaction and loyalty and that this data cannot be used to predict what level of switching would occur if Booker were to degrade its wholesale offering. Indeed, a significant proportion of respondents to our survey were long-standing customers of Booker, with 53% of symbol group stores having been affiliated with their Booker symbol group for over six years and over 20% for more than ten years.[167] While this may explain some of the differential, it is nevertheless always important to interpret survey questions about a hypothetical price rise with caution.

7.100 Despite lower levels of observed fascia switching, we received evidence that symbol group wholesalers actively compete for customers, and that barriers to switching are generally thought to be low.

7.101 In our survey, 67% of symbol group retailers surveyed said that they had been contacted by another symbol group seeking to promote their offer in the previous year.[168] Symbol group wholesalers confirmed that it was common for competing symbol groups to actively seek to recruit retailers through various channels, including advertising, direct mail and cold-calling, as well as more targeted methods, such as reviewing planning applications.

7.102 When considering the barriers to switching symbol group, over 60% of symbol group retailers in our survey considered that it would be 'very easy' or 'fairly easy' to switch. Of the approximately one quarter of respondents who said that it would not be easy to switch, the most common reasons cited were: complications of moving to a new ordering system; the expense of switching; and the restrictions of a long-term contract.[169]

7.103 The first two of these reasons were confirmed by some wholesalers as potential costs/deterrence factors to switching, although one wholesaler noted that the costs of changing fascia, branding and store format were likely to be at least partly funded by the destination symbol group. As for the third reason – restrictions of long-term contracts – this was confirmed as a potential cost to switching by two wholesalers. It was also raised as a potential concern by the

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[167] Survey of retailers question 8.
[168] Survey of retailers question 26.
[169] Survey of retailers question 24.

CMA during the phase 1 investigation, which found that Booker symbol group retailers in the [✂].

7.104 We requested further information from Booker on the degree to which they had pursued repayment of investment by retailers that left within the minimum contract period. This showed that [✂].

7.105 The specific situation of a very small number of retailers for whom Booker holds the head-lease on properties leased by the retailers, and how this affects their ability to renew their leases, is considered in Chapter 11.

Local conditions of grocery wholesale competition

7.106 As well as looking at the overall level of competition in grocery wholesale (whether in symbol group wholesale, delivered grocery wholesale or in cash and carry grocery wholesale), we considered the level of wholesale competition at a local level. This analysis consists of three parts:

(a) An analysis of competition in grocery wholesale at the postcode area level, assessed on the basis of:

(i) Booker's share of symbol group stores (based on data submitted by the Parties and ten other symbol group providers); and

(ii) Booker's share of delivered and cash and carry grocery wholesale sales to retailers (based on data submitted by Booker and seven other wholesalers).

(b) A review of local wholesale competition in relation to specific retailers who indicated in our survey that they have few options, drawing on information about the number delivered and cash and carry grocery wholesalers whose 80% and 100% catchment areas the retailer falls within.

(c) A similar analysis of local conditions of delivered and cash and carry grocery wholesale competition in those areas that were identified as being potentially problematic in Chapter 9 (which considers the merged entity's incentives to increase wholesale prices or reduce quality of wholesale services to specific retailers).

Parties' submissions

7.107 Booker submitted that our calculations of Booker's local shares of both symbol group stores and wholesale sales are likely to be overstated, given that they only reflect data provided by a limited number of key players and exclude a number of regional/local operators with which Booker competes.

Booker also submitted that postcode areas are not likely to accurately reflect the boundaries of the competitive frame of reference. Specifically in relation to its share of symbol group stores, Booker noted that its stores typically (i) are smaller than competing symbol group stores; and (ii) [✂], meaning that its importance is, again, overstated.

7.108 Based on Booker's own internal estimates of total wholesale sales to retailers in the UK, Booker submitted that its share of sales was significantly lower than that estimated by us, and did not exceed 40% in any of the postcode areas identified as potentially having weaker wholesale competition. Booker also supplied qualitative evidence relating to wholesale conditions in each of the areas identified. This showed that retailers in these areas had a wide range of wholesale alternatives (around 20 in each area) from which to choose. It also indicated that retailers in these areas tend to purchase goods from multiple wholesalers.

Our assessment

7.109 Based on our postcode area analysis described in paragraph 7.106*(a)*, we identified five postcode areas (out of a total 123 areas) in which Booker had a share of shops and share of sales of greater than 50%, and an additional 29 areas in which these two metrics exceed 40%. On average, Booker's share of sales across all postcode areas is [30-40%] and its share of shops is [40-50%].

7.110 While this represents a relatively large number of postcode areas where Booker appears to have a relatively large share of sales and of shops, we acknowledge that the data we used to compile these shares is incomplete. We agree with the Parties that the figures are therefore likely to overstate Booker's shares because they exclude a number of regional and local wholesalers.

7.111 Further, the evidence submitted by the Parties in response to the areas in which we identified Booker as having a relatively high share showed that, in each area, a range of national, local and specialist wholesalers were present. The Parties also submitted that retailers used a large number of wholesalers concurrently. The evidence showed that some multi-site retailers even use multiple symbol groups across their store portfolio (eg operating one Premier-branded store and one Nisa-branded store).

7.112 Regarding the analysis described in paragraph 7.106*(b)*, in our survey of Booker-supplied retailers, 18% of independent retailers responded that they shop with Booker because it is the only wholesaler nearby and they have no other options available to them.[170] However, when asked what they would do in response to a 5% price rise by Booker, one quarter of these retailers said they would switch all of their purchases to another wholesaler, and one third said they would switch some of their purchases to another wholesaler (the final third said they would purchase the same amount from Booker). We identified what options were available to these retailers, and found that all of them fell within the 80% catchment area of at least one competing delivered grocery wholesaler (ie in addition to Booker) and within the 100% catchment area of between 6 and 12 additional delivered grocery wholesalers.[171] We found that these retailers had fewer cash and carry options, with only one half falling within the 80% catchment area of one or more alternative cash and carry grocery wholesalers. Nevertheless, the vast majority had cash and carry grocery wholesale options when the 100% catchment areas of those wholesalers were considered.

7.113 Evidence submitted by the Parties also indicated that there are a number of local cash and carry wholesalers that were not included in our assessment but which are used by Booker retailers in these areas. For example, in Norwich, the location of one of the respondents to our survey that was identified as falling outside the 100% catchment area of all cash and carry grocery wholesalers included in our effective competitor set list, the Parties identified a range of wholesalers including Select cash and carry, Bobby's cash and carry and SOS wholesale (a discount cash and carry which is part of two buying groups, including Today's).

7.114 On the basis of the analysis above, we have concluded that at a local level wholesale competition is strong in most areas. Notwithstanding this, there are a small number of local areas where retailers have limited options to switch away from Booker. Our analysis presented in Chapter 9 indicates that retailers generally face a wide choice of wholesalers, though there are differences between cash and carry and delivered grocery wholesale (with there being relatively fewer options for those that have a strong preference for cash and carry, based on the catchment areas submitted by third party wholesalers).

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[170] Survey of retailers question 31. The survey covered a small subset of Booker's retailer customers, representing circa 3% of its symbol group customers and circa 0.2% of its independent customers. In total 463 telephone interviews were completed – 153 with symbol group stores, and 310 with independent retailers. The survey sample was not randomly selected; it focused on retailers in areas perceived to have potentially fewer wholesale competitors. The respondents also typically spent a significantly higher than average amount with Booker.

[171] Without P&H we have found that all of these retailers fell within the 80% catchment area of at least one competing delivered grocery wholesaler (ie in addition to Booker) and within the 100% catchment area of between 5 and 11 additional delivered grocery wholesalers.

Effect of P&H entering administration

7.115 In our provisional findings we provisionally concluded that the Merger was not expected to result in an SLC in the supply of delivered wholesale services as a result of Tesco choosing not to buy from third-party wholesalers post-Merger. This included an assessment of whether the Parties had the ability and incentive to shift wholesale purchases away from P&H (Tesco's only wholesale supplier). Since then, P&H has entered into administration.[172] Its entities are no longer trading and we have been told by the Parties that Tesco is no longer a customer of P&H. Further, there is no evidence that indicates that these events are directly related to the Merger.

7.116 Given these recent developments we no longer consider it necessary to assess the implications for competition of Tesco choosing not to buy from third-party wholesalers post-Merger. However, as stated in our counterfactual (Chapter 5 above), we have considered the impact of P&H entering administration on the competitive environment.

Effect on wholesale competition of P&H entering administration

7.117 We have considered the alternatives available to the following groups that were served by P&H: major multiple retailers, symbol group retailers, multi-site retailers and other retailers including independent retailers. In addition, we have considered alternatives to P&H in the wholesale supply of tobacco, given P&H had a particular strength in this product category.

7.118 Since P&H did not provide wholesale services to catering customers, we have found that there is no effect on the catering segment.[173] Likewise, P&H did not provide cash and carry grocery wholesale services and we have found that there was no effect on these services. We therefore focused our assessment within the supply of delivered wholesale services to retailers.

Parties' views

7.119 [✂]

[172] PwC: Palmer & Harvey McLane Limited and other entities – in administration.
[173] As P&H's distribution services for manufacturers are limited (less than [✂]% of revenues) and concern only two manufacturers (which suggests that all other manufacturers adopt other methods of distribution, which these customers could also adopt), in the absence of any concerns raised by these customers, the effect on direct distribution services for manufacturers is also not considered further in this report, and their sales are excluded.

7.120 The Parties stated that the wholesale market would remain very competitive irrespective of P&H's activity, noting that there are several credible alternatives to P&H for all customer segments.

7.121 The Parties also highlighted multiple recent examples of entry and expansion in wholesaling (such as the Morrisons/DHL partnership to deliver to McColls), stating that this confirmed that barriers to entry or expansion in wholesale services are low and capacity can be added quickly (as the wholesale business model relies on leased assets, is scalable and is not constrained by a lack of sufficient available space).

7.122 In addition, the Parties noted that for customers of P&H (some of whom may be rivals of the Parties) there exist alternatives to purchasing through a wholesaler, such as large multiple retailers being able to in-source distribution services (as Asda and Morrisons currently do). With respect to wholesale supply of tobacco, the Parties submitted that tobacco manufacturers would be very motivated to find an alternative route to reach retailers, if P&H's services were not available.

Wholesale supply to major multiple retailers

7.123 Approximately [✂]% of P&H's revenue was derived from multiple retailers, principally from Tesco ([✂]% of P&H revenue, as previously stated) and Sainsbury's ([✂]% of P&H revenue). In addition, P&H served McColls ([✂]% of P&H revenue, although this contract was lost prior to it entering administration [✂]), [✂] ([✂]% of P&H revenue), and [✂] ([✂]% of P&H revenue).[174]

7.124 The services which P&H supplied to the larger multiple retailers were generally closer to a pure distribution service (albeit that in all cases P&H took title to the products), and for most of these customers did not include substantial 'value added' services. This was due to the scale and general sophistication of the customers themselves.

7.125 The evidence from multiple retailers shows that they are generally able to arrange supply directly from suppliers/manufacturers, without the need to use a wholesaler, for either all or the large majority of their needs. For example:

(a) Asda, Waitrose, [✂], Iceland and Booths all currently arrange supply directly with suppliers, manufacturers or importers, rather than through grocery wholesalers; and

[174] [✂]

(b) Sainsbury's [✂] stated that [✂];

7.126 Based on this evidence, we have found that major multiple retailers have sufficient alternative options to purchasing through P&H and that these alternative supply options would be sufficient to maintain the degree of rivalry in delivered grocery wholesale services for these customers.

Wholesale supply to symbol groups

7.127 Approximately [✂]% of P&H's revenue was derived from its supply arrangements with symbol groups, primarily through its full supply relationship with Costcutter.[175]

7.128 Costcutter submitted that there were a potential range of alternative wholesale supply options available to it, including Spar, Nisa, Booker and Bestway. It submitted that in-sourcing and partnering with a third-party logistics firm for delivery to stores was also a possible option, while Morrisons' entry into wholesaling could indicate additional options in the future. Prior to P&H entering into administration we note that Costcutter and the Co-op had agreed that the Co-op would become the exclusive wholesale supplier to Costcutter.

7.129 We also considered the approaches and views of other symbol group wholesalers:

(a) Nisa arranges its own wholesale supply, but delivers to stores via its distribution partner DHL;

(b) Bestway provides almost all of its procurement and distribution in-house; and

(c) Spar generally arranges its wholesale supply through its five wholesaler shareholders, who also provide delivery.

7.130 The responses received from third parties therefore indicated that there is a range of wholesale and distribution models available to symbol group wholesalers, including in-sourcing all or some of these arrangements. Further, for those symbol group wholesalers that require a full wholesale and distribution offering, there are a number of wholesaler alternatives to P&H (see eg paragraphs 7.65 to 7.78).

7.131 Based on the evidence above, we have found that symbol groups have sufficient alternative options to purchasing through P&H and that these

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175 [✂]

alternative supply options would be sufficient to maintain the degree of rivalry in delivered grocery wholesale services for these customers.

Wholesale supply to multi-site retailers

7.132 Approximately [✂]% of P&H's revenue was derived from 'multi-site operators': operators of petrol forecourts and other service station retail outlets, which may operate the sites directly or in partnership with a symbol group wholesaler or large retailer. Customers in this segment include [✂] ([✂]% of P&H's turnover), [✂] ([✂]% of P&H's turnover) and [✂] (each [✂]% of P&H's turnover).[176]

7.133 No major multi-site operators raised concerns regarding the Merger. Some of these operators provided information on their approach to wholesale supply, for example:

(a) Shell tenders for wholesale services to its Shell-branded petrol forecourt stores [✂]. In addition, Shell has arrangements with two wholesale/retail partners, with Budgens stores (supplied by Booker) on [✂] sites ([✂]) and Waitrose stores (supplied and operated by Waitrose) on [✂] sites ([✂]). The Parties submitted that Shell has now moved to Booker those wholesaling requirements formerly provided by P&H;

(b) MRH tenders for wholesale services to the majority of its petrol forecourt stores[177] [✂]. In addition, MRH has arrangements with Spar on [✂] sites, and has a pilot arrangement with Coop for [✂] franchised sites. The Parties submitted that MRH has now moved to Booker those wholesaling requirements formerly provided by P&H

(c) The majority of MFG's petrol forecourt sites are operated as Budgens and Londis stores (supplied by Booker). A smaller number of sites have Costcutter branded retail stores, [✂]. MFG submitted that it would consider [✂] viable and competitive alternatives, and it has also considered [✂].

(d) BP's stores are supplied by a combination of BP products (purchased directly from manufacturers and, to a lesser degree Blakemore, and delivered by DHL) and Marks and Spencer Simply Food.

7.134 Based on the evidence above, we have found that multi-site retailers have sufficient alternative options to purchasing through P&H and that these

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[176] [✂]
[177] Including those operated under MRH's Hursts brand or under the incumbent oil company brand.

alternative supply options would be sufficient to maintain the degree of rivalry in delivered grocery wholesale services for these customers.

Wholesale supply to other retailers, including independent stores

7.135 The remaining [✂]% of P&H’s wholesale revenue was generated by other customer types, including independent retailers (which generated around [✂]% of P&H’s wholesale revenue) and very small multi-site operators.[178]

7.136 For independent stores, P&H's internal documents identified the following wholesalers as its closest competitors: Booker, Bestway, Spar/Blakemore and Nisa. In its response to our questions, P&H considered that Booker, Bestway, Nisa, Blakemore and Dhamecha (in London) had a competitive offering to independent retailers [✂], whilst it saw James Hall (a Spar wholesaler) as marginally weaker than P&H. The responses that we received from other wholesalers were also generally consistent with these views around competitive alternatives.

7.137 We note that the alternatives discussed above may not be equally available for all customers, as supply options will vary across geographic regions. Therefore, we have considered the evidence regarding the availability of wholesaler alternatives for independent customers. This analysis indicated that the vast majority of P&H’s independent customers were within the geographic catchment of alternative delivered grocery wholesalers. In particular, [✂]% of these stores are within an 80% catchment of at least three alternative delivered grocery wholesalers, and almost [✂]% of these stores were within a 100% catchment of at least three alternative delivered wholesalers to P&H.

7.138 P&H's internal documents also noted that cash and carry grocery wholesalers were a particularly strong competitor for these types of customer who, P&H also noted, tend to be very promotion-orientated and often seek out the best deals. This is consistent with our understanding that independent retailers are generally particularly heavy users of cash and carry grocery wholesalers. We therefore found that these are likely to provide an alternative to P&H for some customers.

7.139 Furthermore, based on the evidence from our survey of Booker-supplied retailers at the time of the survey:

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[178] [✂]

(a) 12% of Booker's independent customers surveyed were also using P&H for some of their purchases. This was substantially below the level of those using the most common alternative provider, Bestway (33%);

(b) 38% of Booker's independent customers surveyed considered that they could use Bestway as an alternative to Booker; and

(c) 20% of Booker's independent customers surveyed, who stated that they would switch as a result of Booker raising prices, considered P&H to be the most likely alternative, compared with 39% who said they would use Bestway.[179]

7.140 Based on the evidence above, we have found that independent retailers have sufficient alternative options to purchasing through P&H and that these alternative supply options would be sufficient to maintain the degree of rivalry in delivered grocery wholesale services for these customers.

Wholesale supply of tobacco

7.141 In addition to customer groups we have also considered the wholesale of tobacco specifically. Delivery of tobacco was a major component of P&H's business, representing nearly [✂]% of its wholesale revenue (albeit only [✂]% of gross profit due to the lower margins earned on tobacco). P&H stated that it was the largest customer of tobacco companies in the UK, and estimated that it supplied around [✂]% of all delivered tobacco in the UK.[180] [✂]

7.142 Most of P&H's tobacco sales ([✂]%) were to Tesco and Sainsbury's.[181] For these customers P&H primarily provided distribution with limited additional services and, as discussed above, these customers have alternative options available to them, including for the supply of tobacco.

7.143 Before P&H entered administration, we spoke to the major tobacco suppliers in the UK who provided numerous examples of possible alternative routes to market for their products (including direct supply to customers, and alternative wholesalers, including cash and carry wholesalers). However, some noted that these substitutes may not be available to all customers in all geographic areas, and that a closer analysis may be required to ascertain whether these are feasible substitutes in practice in the long term. In addition, they submitted

179 Survey of retailers question 14.
180 [✂]
181 [✂]

that alternative wholesalers may require additional investment in order to scale up or take steps to act as a substitute to P&H.

7.144 Since P&H entered administration, a number of the major tobacco suppliers have publicly stated that they have implemented alternative supply arrangements which would prevent any significant interruption.[182]

7.145 The evidence of the existence of alternative options for the wholesale supply of tobacco is consistent with our findings in the customer-segment analysis discussed above.

7.146 Based on the evidence above, we have found that retailers have sufficient alternative options to purchasing through P&H for the wholesale supply of tobacco and that these alternative supply options would be sufficient to maintain the degree of rivalry in wholesale services for tobacco products irrespective of any changes in P&H's competitiveness.

Conclusion on conditions of wholesale competition

7.147 Given the recent developments and P&H entering administration, it was no longer necessary to assess the implications for competition of Tesco choosing not to buy from third-party wholesalers post-Merger. However, we have considered the impact on the competitive environment of P&H entering administration. Based on the evidence set out above, we have concluded that competition for wholesale services is generally strong and that retailers overall have a range of wholesale options to choose from. This is true of symbol group alternatives, but is even more significant for delivered and cash and carry grocery wholesale alternatives. While there appears to be relatively limited switching of symbol group by Booker symbol group retailers (or those belonging to other symbol groups), our analysis of Booker's sales data indicated relatively strong volume switching. Our survey also indicated a high propensity for retailers to switch symbol group in the face of a price rise and a high proportion of retailers multi-sourcing from other wholesalers in addition to Booker. Barriers to switching wholesaler were also considered low by most retailers.

7.148 We note that conditions of wholesale competition will vary between local areas, and that the general picture may overstate the level of competition in particular local areas where Booker is present. As such, we have analysed whether there are particular areas in which wholesale competition appears

[182] For example, see JTI's announcement of 29 November 2017 and Imperial Brands' announcement of 28 November 2017.

weaker and found evidence of additional constraints that Booker faces in those areas (eg from local and specialist wholesalers).

7.149 We have considered the impact of P&H's recent entry into administration. However, we have found that for each of its customer groups, as well as for tobacco suppliers, sufficient competition will remain after the Merger.

7.150 To the extent necessary, we have also taken account of local conditions of wholesale competition in our local assessment of competition, discussed in more detail in Chapter 10. However, before we discuss these, we examine the impact of the Merger on the efficiency of the Parties and on their buyer power.

8. Efficiencies and buyer power

Introduction

8.1 It is generally accepted that most vertical mergers are benign and do not raise competition concerns.[183] Indeed, vertical mergers can lead to efficiencies and this may result in the merged entity having increased incentives to compete.[184]

8.2 In general, the exercise of buyer power by wholesalers or retailers is not likely to raise competition concerns and might even be beneficial to customers, although as noted in our guidelines, there are circumstances under which it may lead to harm.[185] Where competition is effective, wholesalers or retailers are expected to pass on to customers a substantial portion of any better supply terms received.

8.3 The Merger may result in the merged entity being a more efficient and effective competitor at one or both of the wholesale and retail levels. The merged entity may receive more favourable terms from some suppliers than Booker and/or Tesco currently receive across some products. This might occur through either the harmonisation of supply terms or an increase in the buyer power of the Parties overall.

8.4 By 'harmonisation of supply terms', we mean for those products which Tesco and Booker both currently purchase and for which one Party currently negotiates better supply terms, after the Merger the merged entity's wholesaling or retailing arm (as the case may be) might negotiate suppy

[183] Merger Assessment Guidelines, paragraph 5.6.1.
[184] Merger Assessment Guidelines, paragraph 5.6.4.
[185] Merger Assessment Guidelines, paragraph 5.4.19. See also paragraphs 5.4.20 and 5.4.21 regarding suppliers' incentives to innovate and invest.

terms in line with or close to those more favourable terms (or otherwise negotiate better terms than it currently receives).

8.5 Some third parties raised concerns that merger-specific procurement efficiencies may lessen competition in grocery wholesale services.[186] These have predominately been raised by third party wholesalers (mostly grocery wholesalers serving the retail channel, although some wholesalers to the catering channel also raised some concerns). In addition, some suppliers have also raised concerns. Specifically, third parties argued that the merged entity might pay less for its products for wholesale than others in the marketplace. This might be because of the merged entity's ability to achieve the more favourable of the supply terms currently received by either Party separately (harmonisation), or because of the merged entity's greater bargaining power. Some, who expressed concern told us that supply terms to rival wholesalers may worsen because they would have lower sales volumes (in the event that some of their customers would have switched to the merged entity) or because suppliers would seek to recoup some of the lost profit on sales to the merged entity through raising prices to the suppliers' other customers. In any event, if the merged entity did achieve more favourable supply terms, it would receive a competitive boost in delivered and cash and carry grocery wholesale.

8.6 The third parties said that, in the above scenario, eventually competition in delivered and cash and carry grocery wholesaling would be substantially lessened. Further, retailer customers, catering customers and end consumers would suffer detriment as a result of weaker competition.

8.7 In addition, a number of rival wholesalers and retailers raised concerns that the merged entity may receive other non-price advantages from suppliers as a result of the merged entity's increased buyer power. These were that the merged entity may get preferential access to suppliers' goods (eg during periods of peak demand) or access to exclusive products or product formats (eg price-marked packs) to the detriment of other customers. Our findings as set out below regarding price rises apply equally to these concerns.

8.8 Additional concerns were raised by third parties that argued that as a result of the Merger:

(a) supplier innovation would be reduced as a consequence of the merged entity favouring sales of own-branded goods;

[186] Summary of wholesaler interviews, Letter from wholesalers and Summary of supplier interviews.

(b) the range of branded products stocked by the merged entity would be reduced; and

(c) the merged entity might abuse its buyer power in contravention of the Groceries Supply Code of Practice (GSCOP).

8.9 We discuss each of the concerns in turn below.

Efficiencies

Introduction

8.10 We have examined the potential financial benefits of the Merger, as estimated by the Parties, and what this might mean for competition in grocery wholesaling. Generally, we consider the possibility that the merged entity could obtain lower prices as an efficiency that could arise from the Merger.[187] If the Parties are able to achieve better supply terms so that some prices are reduced, this is likely to be rivalry-enhancing.

8.11 We have examined whether the Merger may be expected to result in an SLC in delivered and/or cash and carry grocery wholesale as a result of the merged entity receiving improved supply terms.[188] In order for this theory of harm to result in an SLC, a number of cumulative conditions would need to be met. Many of those conditions would only arise in the longer term. These are the following:

(a) the merged entity would be able to negotiate better supply terms from its suppliers;

(b) the resulting lower prices would be passed on to customers (ie retailers or caterers) which in turn would allow the merged entity to attract additional business away from its wholesale competitors;

(c) the competitive pressure on the merged entity from competing wholesalers would be substantially weakened as a result of rival wholesalers losing customers to the merged entity to such a degree that they either exit the market or they remain but the cost of serving their remaining customers increases (eg because suppliers increase prices to those wholesalers – also known as the 'waterbed effect'); and

[187] Merger Assessment Guidelines, paragraphs 5.7.7 and 5.7.8. See also *Asda/Netto*, where the Office of Fair Trading took into account supply term harmonisation as an efficiency from that merger: *Anticipated acquisition by Asda Stores Limited of Netto Foodstores Limited (ME/4551/10)*, OFT, decision dated 23 September 2010.
[188] Merger Assessment Guidelines, paragraph 5.4.20.

(d) the merged entity would have the ability to increase prices or worsen its terms in the longer term as a result of substantially lessened competition in delivered and/or cash and carry grocery wholesale with the prospect of entry or expansion of the remaining competitors not being sufficient to prevent those price increases.

8.12 We have examined whether the conditions listed in paragraph 8.11 are satisfied in the circumstances of this case. In particular, as is evident from the above cumulative conditions, this theory of competitive harm requires that any cost savings accruing to the merged entity would be passed on to and benefit customers that buy from the merged entity in short term, while any potential harm to competition would only occur in the less foreseeable, longer term.

Parties' submissions

8.13 The Parties stated that the rationale for the Merger is to increase the Parties' presence and product availability in the 'out of home' food segment. In this regard, the Parties said that the Merger will result in a broader range of foods being offered across retail and in the out of home segment, a reduction of end-to-end costs, increased efficiencies throughout the supply chain (including reducing waste) and increased innovation.[189] While the Parties have not submitted evidence on the likely value of these anticipated efficiencies, we have examined cost synergies.

8.14 The Parties told us that the estimated procurement synergies arising from the Merger are relatively small. They said that approximately a third of Booker's sales are to the catering channel and that due to Booker's focus on catering customers,[190] the Parties generally do not buy the same products from the same suppliers. As a result, there will be little increment as a result of the Merger in respect of specific products.

8.15 The Parties also submitted that any existing overlap is mostly in branded products for retailer customers. Even within branded products, the Parties told us that the extent of that overlap may be misleading as in some instances the Parties are buying different pack sizes.[191] We asked the Parties for corroborating evidence. Given the many thousands of products involved, the Parties were not able to perform a stock-keeping unit (SKU) level comparison across their ranges to indicate how prevalent the different pack sizes issue might be. Instead, they performed a 'product clusters' analysis across their top

189 Tesco announcement dated 27 January 2017.
190 Phase 2 submission, Figure 2.
191 [✂]

five to ten suppliers, the results of which are in Table 9.[192] Regarding how a product cluster differs from a SKU, the Parties told us that a hypothetical product cluster might be 'Smirnoff Red vodka' whereas a SKU is Smirnoff Red 700ml. Smirnoff Red 1 litre would fall within the same product cluster but is a different SKU to Smirnoff Red 700ml.

8.16 Table 9 shows the proportion of the Parties' SKUs that lie within a product cluster where the Parties overlap (for those selected suppliers). The cost of goods sold (COGS) column in Table 9 shows the proportion of Booker's procurement from those selected suppliers that the overlapping product clusters account for. We assess these results in paragraph 8.39.

Table 9: Product overlap between the Parties

		%
Category	*SKUs in overlapping clusters*	*COGS of overlapping SKUs within a product category*
Beer, wine, spirits	[✂]	[✂]
Confectionery	[✂]	[✂]
Dairy & bakery	[✂]	[✂]
Frozen	[✂]	[✂]
Grocery	[✂]	[✂]
Meat	[✂]	[✂]
Non-food	[✂]	[✂]
Produce	[✂]	[✂]
Tobacco	[✂]	[✂]

Source: The Parties.

8.17 The Parties' public announcement of the Merger estimated that pre-tax cost synergies arising from the Merger would be at least £175 million per year by the end of the third year after completion of the Merger. This, in broad terms, is composed of procurement savings (55% of the total), distribution and fulfilment savings (35% of the total) and central functions and other savings (less than 10% of the total).[193] These estimates were calculated by a management consultancy and independently audited (by a different firm) for the purpose of the announcement to the stock market.[194]

8.18 The Parties submitted that the procurement synergies of approximately £100 million per year would account for around [✂]% of the merged entity's sales and, if all the procurement synergies were to accrue to Booker, they would account for approximately [✂]% of Booker's sales (or [✂]% of its COGS). According to the Parties this does not represent a significant change in buying terms. The Parties have also stated that increased scale is not a key factor in obtaining better buying terms and that realising any procurement

[192] A SKU is a single, distinct product including its pack size.
[193] Tesco announcement dated 27 January 2017, the £175 million figure is based on cost synergies and excludes £25 million of quantified revenue synergies.
[194] The announcement was made in accordance with the UK City Code on Takeovers and Mergers.

synergies will depend on negotiations with suppliers, which will only agree to offer better terms if the merged entity shows supply chain efficiencies that can benefit both sides of the negotiation. The Parties submitted a breakdown of expected procurement synergies by product category (Table 10). [✄] The Parties told us that [✄].

Table 10: Estimated procurement synergies

%

Category	*Proportion of Booker's COGS*	*Proportion of combined COGS*
Beer, wine, spirits	[✄]	[✄]
Confectionery	[✄]	[✄]
Dairy & bakery	[✄]	[✄]
Frozen	[✄]	[✄]
Grocery	[✄]	[✄]
Meat	[✄]	[✄]
Non-food	[✄]	[✄]
Produce	[✄]	[✄]
Total	[✄]	[✄]

Source: The Parties.

8.19 Further, the Parties estimated that they will be able to achieve around £60 million a year in distribution and fulfilment savings. The Parties said that combining and optimising the Tesco and Booker national distribution systems including sharing part of their fleets and expanding Click & Collect points would realise benefits.

8.20 The Parties submitted that the combination of Tesco's and Booker's purchases will not lead to a significant increase in negotiating power.[195] The Parties submitted that they have a combined share of 24% of UK grocery procurement representing an increase of just 3.5% to Tesco's existing share.[196]

8.21 The Parties told us that the Merger's impact on their buyer power should be analysed on a product category basis. On this basis, the Parties submitted that their combined procurement shares exceed 30% in relation to tobacco only.[197] This is discussed in detail in our competitive assessment below.

[195] Phase 2 submission, annex 6.
[196] Phase 2 submission, annex 6.
[197] Phase 2 submission, annex 6.

Third party submissions

Views of wholesalers

8.22 As a part of our inquiry we sent written questionnaires to 40 third party wholesalers and received responses from 15. We interviewed eight third party wholesalers.[198] Seven of these expressed concerns over the increased buyer power of the merged entity, as did the majority of wholesalers who replied to our questionnaires. These wholesalers thought it likely that the merged entity would benefit from the lower prices at the wholesale level currently available to Tesco (and which are not available to other wholesalers), making it very challenging for wholesalers to compete. One wholesaler was of the view that these lower supply prices would also give Booker an advantage in wholesale to catering customers.

8.23 Bestway, a rival wholesaler, submitted that the Merger would substantially reduce Booker's current cost prices both in absolute terms and relative to those of its wholesale rivals, as the merged firm leveraged its enhanced buying power across its supplier base in both wholesale and retail channels.[199] This would give the merged firm a substantial advantage at the wholesale level over its rivals which was not ultimately justified by the operational or purchasing efficiency of the legacy Booker business compared to that of its rivals. This would prevent Booker's rivals from being able to compete on the merits against the leading supplier in grocery wholesaling. Bestway submitted that this would distort competition at the wholesale level and would have significant adverse price and non-price effects over time.

8.24 One symbol group wholesaler submitted that Tesco's wholesale price advantage would enable the merged entity to attract retailers to its symbol groups by offering them prices that would be unmatchable by any competitor, even with the most competitive will in the world. This third party said that the merged entity would not just take business away from rivals but it would also raise symbol group wholesalers' and wholesale competitors' costs.[200]

8.25 We received a letter on behalf of seven wholesalers who wrote that the Merger threatens competition in the sale of groceries in the UK. The letter said that with lower wholesale prices, the merged entity would be able to drive its competitors out of business, be they delivered grocery wholesalers, cash and carry grocery wholesalers or symbol group wholesalers.[201]

[198] Summary of third party wholesaler interviews.
[199] Bestway Wholesale Limited response to the issues statement.
[200] Symbol group operator response to the issues statement.
[201] Letter from wholesalers submitted to the CMA.

8.26 However, some wholesalers, despite being concerned about the Merger, were of the view that they could respond to additional competitive pressure from the merged entity or that the Merger might not affect them substantially. For example, one told us that the Merger would not impact its business as much as a cash and carry wholesaler who did not have the breadth of product that it has. Another wholesaler told us that it would compete as best it could and perhaps focus more on availability, ensuring that the customer service experience was improved. It also said that it would ensure that its prices were competitive, and that stock availability and service levels were improved. But this particular third party also told us that it would have to decide whether to curtail its expansion programme in light of the Merger. A further wholesaler told us that it would continue to survive although it might not prosper immediately. This wholesaler considered that it would push suppliers for an equivalent price advantage to the merged entity, although it also considered that this might be difficult.

Views of suppliers

8.27 We also sent written questionnaires to 75 suppliers of groceries (both food and non-food) and received over 30 responses. We also conducted interviews with four suppliers.[202]

8.28 The British Brands Group consulted its members about the Merger. It received responses from [✂] of its members and the implications of harmonisation of trade terms between Tesco and Booker was considered as a risk to brand owners by a total of [✂] of the [✂] members. For those members who supplied both Tesco and Booker ([✂] in total), [✂] considered that the impact of harmonisation would be 'significant', [✂] thought it would be 'marginal' and [✂] thought it would be 'negligible'.[203] When asked about the current scale of the differences in terms between the Parties, [✂] stated a differential of less than 5%, [✂] said 5 to 10%, and [✂] of respondents said it is 20 to 30%.[204]

8.29 Many suppliers who responded to our questionnaire expected to concede price cuts to the merged entity because of harmonisation of terms. Some suppliers explained that after the *Booker/Musgrave* merger substantial price cuts had been secured by the merged entity. One larger supplier said that there is a possibility that prices to the merged entity could be lower, but subject to negotiation. Bacardi-Martini Limited trading as Bacardi Brown-Forman Brands ('Bacardi' rum, 'Jack Daniels' Tennessee whiskey) expected

[202] Summary of third party supplier interviews.
[203] [✂]
[204] British Brands Group response to issues statement.

the merged entity to seek to move to a single price as did Carlsberg UK Limited (beer), [✄] and Mondelez Europe Services GmbH (confectionery, biscuits). [✄] said that moving Booker to the lowest price level on all products would mean that, overall, it might receive a price reduction of around [✄]%. [✄] told us that it expected harmonisation in terms after the Merger but in return it would seek greater promotional support for its brands.

8.30 Likewise, Britvic Soft Drinks Limited (which sells a range of carbonated soft drinks, fruit juices and other non-alcoholic drinks) expected some movement towards price harmonisation between the Parties, [✄]. Booker receives the lower price from [✄]. Nestlé UK Limited (Nestlé) told us that customers are able to earn discounts based on objective criteria (including volumes). Nestlé said that whether Tesco or Booker were to receive a greater discount in a product category post-Merger would depend on whether the Merger resulted in any change which would impact their ability to achieve any of these criteria.

8.31 Müller (milk) did not anticipate any material changes to pricing.

Our assessment

Whether the merged entity may negotiate better supply terms and will pass them on

8.32 To assess the first condition and part of the second, we have examined whether the merged entity would be likely to negotiate better supply terms. We have focused on procurement and distribution savings since these are variable/operational costs and savings in these areas are more likely to be passed on to customers than savings in overheads.[205]

8.33 Whether the merged entity would be able to achieve better supply terms would depend on the deal it is able to negotiate with suppliers. Suppliers have told us that they have various criteria for their pricing and it is far from certain that both the retail and wholesale operations of the merged entity would be able to satisfy those criteria in the same way, so as to achieve the lower prices overall. For example, one supplier told us that the prices prescribed in its price list vary depending on the volumes purchased and in some instances logistic and delivery efficiencies.[206] Another supplier agreed and said that discounts from the published price list depend on business or logistical efficiencies.[207] A further supplier said that for its wholesale and convenience customers, other than the top six grocers, there is effectively one standard

[205] Merger Assessment Guidelines, paragraph 5.7.9.
[206] Summary of third party supplier interviews.
[207] Summary of third party supplier interviews.

price list (from which customers can get better prices based on volume, range, distribution efficiencies and other factors).[208] Moreover, three wholesalers explained that multiple retailers generally have access to much lower supplier prices than wholesalers. This is because of the volume of their purchases and the fact that suppliers benefit from the greater exposure and access to end-consumers that multiple retailers provide. In addition, they said that these retailers tend to have multiple depots, which makes it more efficient, and therefore cheaper, for suppliers to serve them.[209]

8.34 We also note, however, that, although in many instances Tesco may be currently receiving better supply terms than Booker, in some instances Booker may be receiving better supply terms.

8.35 Whether the Parties will be able to achieve better supply terms post-Merger will depend on negotiations with suppliers, which are often complex, and take into account efficiencies to the supplier regarding distribution and logistics. Those negotiations are further affected by the negotiating skills of the parties concerned (either suppliers or buyers).

8.36 Some suppliers indicated that they expected the merged entity to receive harmonised terms on some products but not on all, or perhaps even most, products. We have found that this evidence may be consistent with the Parties' estimated procurement synergies of around [✂]% of Booker's COGS.

8.37 Although we have not been able to verify the Parties' estimates of procurement or distribution and fulfilment savings, we note that these have been audited and found to be properly compiled.[210] We are conscious that it is difficult for the Parties to estimate, pre-Merger, which procurement synergies will be realised since they depend on the terms they are able to negotiate with suppliers.[211] However, irrespective of whether the procurement synergies as estimated will be realised we nevertheless have concluded that they demonstrate the Parties' expectation that they would be able to improve some supply terms after the Merger.

8.38 The Parties have submitted that cost synergies from the Merger would be at least £175 million per year by the end of the third year after completion, with procurement efficiencies accounting for approximately £100 million of this

[208] Summary of third party supplier interviews.
[209] Summary of third party wholesaler interviews.
[210] Tesco announcement dated 27 January 2017.
[211] Therefore, the estimated procurement synergies may in practice be an under or over estimate of any actual synergies.

(paragraphs 8.17 and 8.18). We note that some third party investment banking analysts have estimated that the cost savings might be higher.[212]

8.39 With respect to the procurement efficiencies component of these savings, Table 9 shows that for some product categories the overlapping product clusters account for a large proportion of the Parties' procurement in that category. For example, in the beer, wine and spirits cluster [✂]% of SKUs in the category cluster are common to both Parties, but those SKUs within that cluster account for [✂]% of the Parties' purchasing from their top suppliers. Likewise, common category clusters account for [✂]% of the Parties' purchases in both dairy and bakery, [✂]% in general groceries and [✂]% on confectionery. It seems reasonable to expect some procurement synergies in these product categories.

8.40 The nature of the possible efficiencies – procurement of groceries and logistical efficiencies – means that it is likely that if any efficiencies were to be realised from the Merger, they would be shared between the retail and catering channels. We note that some of the Parties' overlap categories have materially larger sales in one of the catering or retailing sectors. For example, a [✂][213] [✂]

8.41 We think that it is likely that the merged entity will achieve better supply terms because of harmonisation. We have gone on to consider in the event that it does, what that could mean for competition in grocery wholesaling. However, we have also considered whether the merged entity is likely to achieve better supply terms across the whole entity (not just in wholesaling) as a result of being a stronger buyer in specific product categories. This is discussed immediately below.

8.42 Overall, we note the increment to Tesco's share of procurement as a result of the Merger is generally low. As noted in paragraph 8.20, the Parties submitted their current combined share of grocery procurement is 24% with an increment from the Merger of 3.5%. We note this increment is similar to the decline in Tesco's market share since 2007 (of approximately four percentage points) (Figure 5).[214] In other words, in overall buyer power terms the Merger returns Tesco to where it was around a decade ago.

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[212] HSBC Global Research (12 May 2017) thought that the synergies could be as high as £500 million a year. Macquarie Research (April 2017): 'Installing Booker's catering offer in TSCO's 180 largest stores of >60k could drive further synergies, adding £50-£100mn to the £200mn synergies announced' UBS (April 2017): 'Tesco has acquired a high-performing wholesaler in Booker and we think the £200m synergy target will ultimately be exceeded'.

[213] [✂]

[214] Note that Figure 5 is Tesco's share of grocery sales, not procurement, but it is reasonable to expect the overall trend in sales will be reflected in procurement.

Figure 5: Tesco's share of grocery retailing in the UK, May 2007 to May 2017 (per cent)

Source: The Parties based on Kantar data.

8.43 The Parties provided a range of estimates of their UK procurement shares by product category, and the increment to those shares that would be caused by the Merger. We reviewed the underlying data and have calculated estimates of procurement shares by product category (Table 11).

Table 11: Parties' share of procurement and increment by product category

		%
Product category	*Combined share of procurement*	*Increment*
Total procurement	**24.0**	**3.5**
Tobacco total	[30-40]	[10-20]
Drinks & Impulse:		
Spirits	[20-30]	[5-10]
Beer & Cider	[10-20]	[5-10]
Wine	[20-30]	[0-5]
Confectionery	[20-30]	[5-10]
Crisps and Snacks	[20-30]	[5-10]
Soft Drinks	[20-30]	[5-10]
Fresh:		
Meat	[20-30]	[0-5]
Produce	[20-30]	[0-5]
Bread and Cakes	[20-30]	[0-5]
Chilled	[20-30]	[0-5]
Frozen	[10-20]	[0-5]
Grocery:		
Grocery - food	[20-30]	[0-5]
Grocery - non-food	[20-30]	[0-5]

Source: CMA based on the Parties' submission.

8.44 The only product category in which Tesco and Booker have a sizeable combined share and a significant increment is in tobacco where their share is [30-40%] and the incremental is [10-20%]. Based on the above, we have found that it is unlikely that the merged entity would be in a stronger bargaining position relative to Tesco pre-Merger in any product category with the possible exception of tobacco, which we have explored further.

- *Views of the Parties on tobacco*

8.45 The Parties said that the tobacco supply base is very concentrated (JTI, Imperial Tobacco, British American Tobacco and Philip Morris make up more than 90% of UK tobacco sales) and as such suppliers themselves have substantial bargaining power. The Parties submitted that [✂]. Booker told us that all major tobacco suppliers have a price list which is provided to all sectors of the trade. Price lists set out the different price tiers, which reflect the volume of the order placed and the efficiencies gained by suppliers in delivering different volumes of tobacco to a single site. Price tiers apply to specific orders and not to the organisation placing the orders. Accordingly, [✂].

8.46 Tesco submitted that its buyer power in relation to tobacco is not strong. It [✂]

8.47 Tesco told us [✂].

8.48 [✂]

- *Views of tobacco suppliers*

8.49 Two tobacco suppliers raised concerns with respect to the effect the Merger might have on the prices those suppliers receive from the Parties:

(a) [✂]

(b) JTI told us that the effect of the Merger may be that the merged entity will pay less for its products, as a result of the merged entity potentially being able to benefit from an increase in sales volumes or greater logistic efficiencies (rather than a price reduction). JTI said that Booker currently receives higher volume discounts than [✂]. JTI explained to us that [✂].

8.50 Large tobacco suppliers submitted, [✂], that pre-Merger, Tesco and Booker are already buying high volumes and often obtain the highest volume discounts on orders and, therefore, increasing volumes would not necessarily cause the merged entity to achieve a higher discount tier. In addition, one supplier suggested that it is not clear why other rebates would increase post-Merger.

- *Our assessment*

8.51 The evidence indicates that the merged entity will not have materially stronger bargaining power in tobacco or any other products following the Merger. This is because the increment in procurement shares as a result of the Merger is low. With regard to tobacco, tobacco suppliers are likely to retain a significant degree of bargaining power post-Merger due to the high concentration of the UK tobacco industry. Tobacco suppliers' bargaining power would therefore constrain any ability of the merged entity to exercise increased buyer power.

8.52 Having found that the Merger will not strengthen the merged entity's buyer power overall, we continue in the next section to examine how any harmonisation of supply terms in wholesaling is likely to affect competition.

Will competition become weaker?

8.53 Assuming that the merged entity were to achieve some harmonisation of supply terms for its wholesaling activities, it is likely that this would only affect a relatively small proportion of Booker's current procurement of groceries. The evidence in paragraph 8.18 indicates that these might be approximately [✄]% of Booker's sales. Whilst noting that this represents a low proportion of its sales, we have examined the effect on competition in wholesaling in case the merged entity were to negotiate better supply terms and in turn offer better terms to its own customers.

8.54 We first note that within grocery wholesaling, Booker's share is generally low. For all grocery wholesaling, we estimated, based on IGD data, that Booker's share was approximately 18% nationally, although we note that the Parties submitted that it is 11%.[215] Although supply terms are reflected in all of Booker's activities, we nonetheless note that within all grocery wholesaling:

(a) For the catering (foodservice) channel, on a national basis (comprising delivered and cash and carry services) we estimated, based on IGD data, that Booker's share is around 16%, although we note that the Parties submitted that it is 8%. In catering, according to market research firm, IGD, both Brakes and Bidfood (formerly 3663), who together with Booker

[215] Our estimate and the Parties' estimate includes P&H. Taking into account of P&H going into administration, on a cautious basis we estimate that Booker's revised share will remain below 30%.

are the market leaders on a national scale, have similar shares of supply to Booker.

(b) For the retail channel, we estimated that Booker's share in grocery wholesaling is 18%.[216]

(c) For cash and carry grocery wholesale services we have estimated that Booker's share is 26% nationally, and for delivered grocery wholesale we estimated that it is around 13%.[217]

8.55 We would not normally expect any firm with these levels of shares of supply to be in a position to substantially lessen competition across the whole marketplace.[218] These low shares indicate the very large scale of customer switching to the merged entity that would need to occur before an SLC could be contemplated.

8.56 For catering customers, we note that before the Merger Tesco was not active in this segment and the Merger does not reduce competition in wholesale services to these customers or Booker's incentives within it.

8.57 We also note that we have found that competition in grocery wholesale services to retailers is generally strong and retailers have a range of wholesale options to choose from (paragraph 7.147). While this is true for symbol group retailers, it is even more significant for delivered and cash and carry grocery wholesale services. Existing strong competition is a factor that the merged entity would need to overcome in order to increase its relatively low share of grocery wholesaling.

8.58 Furthermore, there are a range of competitive responses available to rival wholesalers.

8.59 Recent changes in the industry indicate that one possible response could be for other large retailers to leverage advantageous supply terms into the wholesale sector. This might come from, for example, Morrisons who has recently announced that it will supply Safeway products and national brands to 1,300 McColls convenience shops and 350 newsagents.[219] Separately, it

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[216] Since our provisional findings P&H has gone into administration and therefore we note that Booker's share of grocery wholesale to retailers is likely to be higher than the 18% that we quoted in our provisional findings report. Taking into account of P&H going into administration, on a cautious basis we estimate that Booker's revised share will remain below 30%.
[217] Since our provisional findings P&H has gone into administration and therefore we note that Booker's share of delivered grocery wholesale to retailers is likely to be higher than the 13% that we quoted in our provisional findings report. Taking into account of P&H going into administration, on a cautious basis we estimate that Booker's revised share will remain below 30%.
[218] Merger Assessment Guidelines, paragraph 5.3.5. See also OFT863, The Competitive Effects of Buyer Groups, a report prepared for the OFT by RBB Economics, January 2007, paragraph 1.86.
[219] As reported in a McColl's press release, 1 August 2017.

might come from the Co-op which has recently announced a bid for Nisa which has been recommended by the board of Nisa (and would be subject to CMA approval) (paragraph 5.10). Although in the counterfactual to our analysis in this inquiry we have not taken into account the potential acquisition of Nisa by the Co-op, we nevertheless view the possibility of such a merger as an example of how the type of buying terms enjoyed by large retailers could be available to a rival wholesaler and therefore retailer customers in the future. It also demonstrates the level of uncertainty that exists in assuming that the merged entity would have materially better prices than all other rival wholesalers. Some third party wholesalers who we spoke to said that they expect further vertical integration in wholesaling.

8.60 Another possible response could be for wholesalers to strengthen competition on non-price aspects such as service quality differentiation. These might include quality of range, service offering to symbol group retailers or delivery logistics. Third party wholesalers have told us about the type of initiatives that they might try in response to Booker being very price competitive (paragraph 8.26).

8.61 Although we expect some retailers to switch their wholesaler as a result of relative wholesale price changes (which may include altering the proportion of products that they buy from several different wholesalers) it appears unlikely that retailers would switch to the merged entity in such large numbers as to diminish competition across wholesale services as a whole. In this respect, we note that our survey of Booker-supplied retailers shows that non-price factors are also important to retailers. When symbol group retailers were asked what would make them consider moving to another symbol group, our survey found that 28% said wholesale price but 38% said 'other' factors.[220] On the factors as to why symbol group retailers chose to become symbol group retailers in the first place, a quarter (net) said it was because of wholesale prices but over 30% said it was because of 'other' factors (eg support from a local manager, reliability, quality of own label products, free delivery and financial support).[221]

8.62 With regard to whether rival wholesalers would receive worse supply terms in the event that the merged entity were to receive better terms (ie the waterbed effect), a small number of suppliers told us that they might seek to recoup from other wholesalers profits lost as a result of selling their products at reduced prices to the merged entity.[222] In this regard, we note that if a supplier could profitably charge 'weak buyers' higher prices, one would expect it

[220] Survey of retailers question 25.
[221] Survey of retailers question 10.
[222] See, for example, Summary of third party supplier interviews.

already to be doing so. Moreover, if the merged entity were to obtain lower prices from a supplier, it would become more competitive in the downstream market. As a result, it would win sales from rivals. As demand from rivals declined, the supplier would often have an incentive to reduce, rather than increase, the prices that it charged to such buyers in order to retain purchases.[223]

8.63 Based on this analysis, we have concluded that it is unlikely that competition would be weakened following the Merger and we expect competitors would continue to act as a competitive constraint to the merged entity. This is based on the overall competitive conditions in grocery wholesale and the competitive options available to wholesalers after the Merger to prevent any harm to competition. This would suffice to conclude that the Merger may not be expected to result in an SLC. In any event, we have further examined the evidence on entry and expansion by rivals to investigate whether the merged entity would be able to harm competition in the longer term in the unlikely event all other conditions set out in paragraph 8.11 were to hold.[224]

Entry and expansion by wholesalers

8.64 In the unlikely event that the merged entity were to attempt to increase its prices, we expect that the overall competitive conditions observed would allow remaining wholesale competitors to act as a competitive constraint on the market to defeat those attempts.

8.65 We have set out recent examples of entry and expansion in paragraphs 7.81 to 7.82, including one wholesaler accommodating around 300 new customers in a matter of weeks, following the award of a new contract, in delivered grocery wholesale services. Any attempted price increase in the longer term would therefore be likely to be defeated by the expansion of rival wholesalers.

8.66 Finally, in the event that the merged entity attempted to increase its prices, wholesalers in the retail channel are likely to face an indirect constraint from downstream retailers. That is, wholesalers cannot increase prices to such an extent as to make their retailer customers uncompetitive against their retailer competitors including multiple retailers.

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[223] See OFT863, The Competitive Effects of Buyer Groups, a report prepared for the OFT by RBB Economics, January 2007.
[224] Condition (d) in paragraph 8.11 above.

Conclusion on efficiencies and buyer power

8.67 We have investigated whether the Merger may be expected to result in an SLC in delivered and cash and carry grocery wholesaling as a result of the merged entity receiving more favourable terms from some suppliers or increased buyer power.

8.68 This theory of competitive harm requires that any potential cost savings accruing to the merged entity would be passed on to and benefit customers in the foreseeable future. For any SLC to arise the cumulative and interrelated conditions (set out in paragraph 8.11) would need to be satisfied.

8.69 We have found that the merged entity would likely benefit from better terms from some suppliers with regard to some products in grocery wholesaling through a degree of harmonisation of supply terms, where one of the Parties currently receives better terms than the other. The evidence indicates that this may apply to a relatively small proportion of Booker’s current total grocery procurement (ie around [✂]% of its COGS or [✂]% of its sales). However, we have not found it necessary to conclude on the magnitude of any procurement efficiencies. In any event, to the extent that the merged entity were to receive more favourable terms, it is likely that a proportion of these better terms would be passed on to customers, making the merged entity a more effective competitor. Apart from some harmonisation of supply terms where one of the Parties currently receives better terms than the other, we do not consider that the merged entity would receive substantially better supply terms on any products as a result of strengthened buyer power across its retail and wholesale businesses as a whole. The overall increment to Tesco’s share of procurement as a result of the Merger is generally low. In tobacco, where we have found that the Parties have a combined share of over [✂]% and there is a significant increment from the Merger, suppliers are likely to have a significant degree of bargaining power.

8.70 Based on the overall evidence that we have received, we have found that Booker’s share of grocery wholesaling is less than 30% on any relevant measure and we would not normally expect any firm with these levels of shares of supply to be in a position to substantially lessen competition across the whole marketplace. These shares indicate that very large scale customer switching to the merged entity would need to occur before an SLC could be contemplated. We have also found that competition in grocery wholesaling is generally strong. The merged entity would need to overcome this strong competition in order to increase its relatively low shares of grocery wholesaling.

8.71 Recent changes in the industry indicate that some rival wholesalers might be able to offer prices competitive to the merged entity. Morrisons has recently announced that it will supply Safeway products and national brands to some retailers. Separately, the Co-op has recently announced a bid for Nisa (which is subject to CMA approval). Another possible response could be for wholesalers to strengthen competition on non-price aspects such as service quality differentiation. These might include quality of range, service offering to symbol group retailers or delivery logistics.

8.72 This analysis would be sufficient to conclude that the Merger may not be expected to result in an SLC as a result of the merged entity achieving better supply terms.

8.73 Even so, we have further examined the evidence on entry and expansion by rivals to investigate whether the merged entity would be able to harm competition in the longer term. Even in the hypothetical scenario that the merged entity were to increase its prices in the longer term (and there is no evidence to suggest this would be the case), we have found that rival wholesalers would be able to expand to compete for customers and defeat such a price increase.

8.74 Finally, we note that it would generally be against the principles of merger control to find that a merger gives rise to a likely SLC just because it made one or both parties more efficient and a stronger competitor.

8.75 Therefore, we have concluded that the Merger may not be expected to result in an SLC as a result of the merged entity achieving better supply terms.

Innovation and own-branded goods

8.76 The concern raised in relation to innovation and own-branded goods is that, through the merged entity's position as purchaser of new products, it will gain access to advance information about product innovations. In turn, the merged entity would be able to copy innovations and use them in its own-branded goods. This spreading of innovation, while of benefit to consumers, may discourage supplier innovation since suppliers, as a result of competition from own-brand goods, may see their profits from innovation diminished.[225]

[225] Merger Assessment Guidelines, paragraph 5.4.21.

8.77 A similar concern that buyer power may reduce innovation has been previously considered by the CMA in the Groceries Market Investigation.[226] For this to hold, the following must apply:

(a) As a result of the Merger the merged entity has:

(i) improved access to advance information about supplier product innovation; and/or

(ii) improved ability to use this information in the development of own-branded goods; and/or

(iii) improved ability for the resulting own-branded goods to compete against the branded innovations, eg through wider distribution.

(b) The aforementioned improvements lead to a reduction in demand for or prices of the branded innovations.

(c) The reduced profitability reduces investment in innovation, and as a result less innovation arises.

(d) The balance of the lower prices offered by the Parties and suppliers as a result of increased competition, and the reduced innovation, is such that customers and consumers lose out overall.

8.78 We received a submission by the British Brands Group, raising a concern about the use of commercially sensitive information by retailers in developing 'private label' products, as described above.[227]

8.79 In the Groceries Market Investigation the Competition Commission found no evidence that such a behaviour had a negative impact on innovation expenditures and we note that Tesco's share of grocery retail activity has declined since then (see Figure 5, above).[228]

8.80 In the context of the Merger, the initial condition for harm – that the merged entity has improved access to relevant information, ability to use it, or to market their own resulting products – could arise if the Merger provides a substantial increment in the merged entity's ability to market own-branded goods, relative to each Party separately.

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[226] Groceries Market Investigation, Appendix 9.10.
[227] British Brands Group response to issues statement.
[228] Groceries Market Investigation, Appendix 9.10.

8.81 As set out in the previous section, as a result of the Merger, the increment in the merged entity's purchases as a proportion of total UK groceries is low, at 3.5%, which includes branded and own-label purchases, as well as tobacco.[229] We assessed the prevalence of branded products in Tesco's COGS in key convenience categories to understand which categories would be affected. We noted that in those categories the share of branded COGS is above [✂]%, except for [✂] (Table 12). For Booker [✂]. Comparing Tesco's share of proportion of branded sales to Booker's share suggests that there is limited scope for Tesco to substantially expand sales of own-branded goods at Booker-supplied stores and force out branded suppliers' innovations.

Table 12: Proportion of the Parties' sales from branded suppliers (impulse)

	[✂]	[✂]
Tobacco	[✂]	[✂]
Spirits	[✂]	[✂]
Beer and cider	[✂]	[✂]
Wine	[✂]	[✂]
Confectionery	[✂]	[✂]
Crisps and snacks	[✂]	[✂]
Soft drinks	[✂]	[✂]

Source: The Parties.

8.82 We therefore have concluded that the Merger may not be expected to result in an SLC through negative effects on innovation.

Range effects

8.83 A further concern raised was that the Merger could lead to a reduction in the range of branded products stocked by Booker, either because the merged entity would choose to reduce the number of branded lines it carried (in line with previous range reductions undertaken by Tesco) or would stock (particularly Tesco's) own-branded goods in preference to branded lines, and that this would lead to harm to consumers as they would have less choice.

8.84 We have concluded that this is unlikely to be a concern if, overall, the downstream market is competitive, as the competitive pressure on the merged entity will remain to supply customers an appropriate range of branded products. Otherwise it would be reasonable to expect that retailers would switch away from Booker and/or consumers would switch away from Booker-supplied stores. We have found that competition at the wholesale and retail levels is sufficient to protect against this occurring.[230]

[229] [✂]
[230] See paragraphs 7.114 and 10.17.

8.85 We therefore have concluded that the Merger may not be expected to result in an SLC as a result of range effects.

Application of the Groceries Code of Practice

8.86 A small number of concerns were also raised by third parties about the possibility that Booker, as a wholesaler, post-Merger might not be covered by the GSCOP.[231] The concern, as put to us, is that the merged entity might use the Booker purchasing arm to obtain supplies on behalf of the merged entity as a whole (including for grocery retailing). The concern is that, by doing so, it could circumvent the protection otherwise created for suppliers by the GSCOP in relation the supply to grocery retailers.

8.87 Tesco submitted that GSCOP will continue to apply to groceries procurement for Tesco's retail business post-Merger. It submitted that it has had preliminary discussions with the Groceries Code Adjudicator (GCA)[232] to inform her about the Merger.

8.88 The GSCOP provides detail on how grocery retailers should manage their relationship with suppliers. The GSCOP is contained within schedule 1 of The Groceries (Supply Chain Practices) Market Investigation Order 2009 (the Order). Designated retailers are required to comply with the Order, and therefore the GSCOP.

8.89 Tesco is a Designated Retailer.[233] Each Designated Retailer must ensure that its subsidiaries comply with the Order as if they were themselves bound by its terms.[234] Under the Order, any person who carries on the whole, or a substantial part, of the business of Tesco will also be a Designated Retailer for the purposes of the Order.[235] Further, if the GCA considers it appropriate for any changes to be made to the Groceries Code, he or she would recommend them to the CMA.[236]

[231] Groceries Supply Code of Practice. Designated retailers are required to comply with the GSCOP, see The Groceries (Supply Chain Practices) Market Investigation Order 2009 (the Order) which was made by the Competition Commission under section 161 of the Act following the Grocery Market Investigation. It is intended to remedy adverse effects on competition found by the Competition Commission to arise from grocery supply chain practices which transferred excessive risks and unexpected costs to suppliers and which prevented, restricted or distorted competition in connection with the acquisition of groceries by the larger grocery retailers.
[232] The role of the Groceries Code Adjudicator, conferred upon it by the Groceries Code Adjudicator Act 2013, is to enforce the GSCOP and to encourage and monitor compliance with it.
[233] Schedule 2 of the Order.
[234] Article 4(4) of the Order.
[235] Article 1(c) of the Order.
[236] Section 13 of the Groceries Code Adjudicator Act 2013.

8.90 For these reasons, we have concluded it unlikely that the merged entity would be able to circumvent the existing application of the GSCOP to supply terms pertaining to purchases made for the purpose of grocery retailing.

Conclusion on efficiencies and buyer power

8.91 For the reasons given above, we have concluded that the Merger may not be expected to result in an SLC as result of efficiencies or buyer power.

9. Vertical effects: wholesale to retail

Introduction

The theory of harm

9.1 A firm might look to increase its profits by increasing its prices or by reducing its cost base in a way that reduces the quality of the service it offers customers. What might prevent a firm from doing either of these without a merger is that some customers will not tolerate the higher prices or reduced quality, and will look to purchase their products elsewhere. While the firm will earn additional profits on the sales to customers that stay with it, it will lose sales (and profits) from customers that switch away. The threat of customers switching away disciplines the firm from raising prices or cutting costs that would reduce the quality of its offer.

9.2 A merger might change a firm's incentives however. If enough customers who would switch away from one merging party would switch to the other merging party, then what was not profitable before the merger could become profitable after it. This is because the second merging party, in recapturing some of the switching sales, is able to offset some of the losses to the first, to the benefit of the enlarged group.

9.3 Tesco and Booker do not generally compete at the same level of the supply chain. Therefore, they will not be able to recapture sales directly between one another. However, some of the retail stores which Booker supplies will compete in their local area with Tesco's owned stores, and others will compete in their local area with Tesco's One Stop franchised stores.[237]

[237] The remainder of this chapter focuses on the merged entity pursuing a strategy of increasing its wholesale prices or cutting costs that affect the quality of its wholesale service. Tesco is also a wholesaler to a small number of One Stop franchised stores; these stores were also included in our assessment (for example of incentives – see Appendix C for more detail), and no concerns were found.

9.4 If the merged entity were to increase its wholesale prices, or cut costs that affected its quality of wholesale service, it may earn higher profits on each sale it makes. On the other hand, it may lose retailer customers to other wholesalers. If these higher prices or lower quality of service at the wholesale level are reflected in a worsened shopping experience, the merged entity may also face reduced demand from the retailer customers it retains, as shoppers at their stores switch to shop at other convenience stores instead. In local areas where these stores compete with a Tesco store, the merged entity may gain some of these switching shoppers.

9.5 Post-Merger, the strategy might therefore be profitable for the merged entity overall if the profit gained by the locally competing Tesco store at the retail level (from additional shoppers it won) and the merged entity's wholesaling activities (from larger margins on sales it retained), is greater than the profit which it lost (from customers that switched away, and lower sales to customers it retained). If this is the case, the merged entity might have the incentive to increase its wholesale prices or cut costs that affect its quality of wholesale service (ie pursue a foreclosure strategy) in those local areas.

9.6 The Parties submitted that implementing the strategy envisaged in this theory of harm would not only be operationally impractical, but would also run counter to the commercial ethos of either Party and the rationale for the Merger. They submitted that the unpredictability of shoppers' purchasing habits meant that driving, in a targeted way, sales from one Party's stores to the other Party's stores would be impossible to achieve. They also submitted that any strategy to deteriorate one Party's offer to favour the other Party was inconsistent with the principle of growth that drives the rationale for the Merger, and would be seriously reputationally damaging to the merged entity's businesses.

9.7 We note that the theory of harm does not require the merged entity to have the specific intent to drive customers from Booker's retailer customers to Tesco. It also does not require the merged entity to control the flow of customers in that direction. Instead, it requires that the merged entity pursue a strategy of seeking to increase the merged entity's profits (through increasing wholesale prices or cutting costs that affect its quality of wholesale service) on the understanding that it will be able to offset some of the resulting losses (from customers switching away) by recapturing those sales at a competing Tesco store. This understanding would come from the merged entity's knowledge that, in the local area in question, shoppers have limited alternative options but to shop at a Tesco store, and, on that basis, the merged entity is likely to pick up sufficient sales to make the strategy profitable overall.

The framework for assessment

9.8 The balance of gains and losses will depend on the conditions of competition at both the wholesale and retail level. If the merged entity faces strong wholesale competition for the retailers it supplies, and many retailers respond to a price rise by switching away to other wholesalers, then the overall strategy is likely to come at a significant cost. Similarly, if the retailers that the merged entity supplies face strong retail competition from retailers other than Tesco, Tesco may be unlikely to pick up a sufficient number of switching customers to balance any losses suffered.

9.9 Given that the gains and losses accrue at different levels of the supply chain, this is a vertical effect. Vertical mergers may be competitively benign or even improve efficiency. However, in certain circumstances, they can weaken rivalry.[238]

9.10 Our approach to assessing vertical theories of harm is to analyse:

(a) whether the merged entity would have the **ability** to carry out the strategy;

(b) whether it would find it profitable to do so (ie the **incentive**), and

(c) whether the **effect** of any action by the merged firm would be sufficient to reduce competition in the affected market to the extent that it may give rise to an SLC.[239]

9.11 These conditions are cumulative: if we find that one condition is not met, we may not find it necessary to assess the other conditions. They may also overlap. For example, at the extreme end, with sufficient resources a firm is likely to be **able** to pursue almost any strategy, but if it is exceedingly costly to do, the firm is very unlikely to have the **incentive** to do so.

9.12 We discuss below how we assessed the conditions of wholesale and retail competition at a local level in each of the local areas where Tesco and Booker-supplied retailers overlap. As a part of this analysis we discuss whether the merged entity would have the ability to target its strategy on those local areas where both the wholesale and retail conditions of competition favoured its success. However, first we discuss whether the Merger is likely to have an impact on national competition.

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[238] Merger Assessment Guidelines, paragraph 5.6.1.
[239] Merger Assessment Guidelines, paragraph 5.6.6.

National foreclosure strategies

9.13 We have considered in our analysis whether the Merger could result in a vertical effect nationally. Nationally, Booker accounts for around 10-20% of grocery wholesale services overall and 18% to the retail channel, and Tesco accounts for around 28% of grocery retailing.[240] We do not consider it likely that the Parties could carry out a national foreclosure strategy at these levels of supply. For example, if the merged entity were to increase its wholesale prices and/or cut wholesale costs that affect its quality of service nationally, its customers (whether retailers or caterers) would be likely to switch to the other wholesalers who make up around 70-80% of UK wholesale supply. Likewise, in the large majority of local retail areas, Booker-supplied retailers are likely to face sufficient competition from third-party retailers to make the necessary recoupment through Tesco unlikely.

9.14 We note that if Booker had a sufficiently strong incentive to pursue a local foreclosure strategy in respect of a very large number of local areas, this could in turn lead it to make national changes in response, increasing prices to all of its customers, or to large subsets of them, such as to all its retailer customers. However, as set out further below, we have found this not to be the case.[241]

9.15 We therefore have concluded that it is not likely that the Parties would be able to embark on a foreclosure strategy nationally. Consequently, we have concluded that the Merger may not be expected to result in an SLC as a result of a national vertical foreclosure effect.[242]

Local foreclosure strategies

9.16 Our assessment in the remainder of this chapter is focused on the possibility that the merged entity may have the ability and incentive to increase the wholesale price or reduce the quality of wholesale service it offers to specific individual retail stores that overlap with a Tesco store – that is, to follow a

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[240] Booker's national share of wholesale services overall submitted by Parties based on Frontier's analysis of IGD estimates and annual reports for Costco and Brake Brothers. Estimated share of grocery wholesaling to the retail channel in 2016, IGD report, UK grocery & foodservice wholesaling. Tesco's grocery market share data compiled by Kantar (straight average annual estimate ending October 2017). Since our provisional findings P&H has gone into administration and therefore we note that Booker's share of grocery wholesale services overall and grocery wholesale to retailers is likely to be higher than the 10-20% and 18% respectively that we quoted in our provisional findings report. Taking into account of P&H going into administration, even on a cautious basis as explained at footnote 19 we estimate that Booker's revised share will remain below 30% on either measure.
[241] By way of context, in this inquiry we analysed over 12,000 local retail market overlaps between Booker-supplied retailers and Tesco and have found competition in local retail areas and local wholesale competition to be weak on a prima facie basis in around 0.2% of the overlap areas.
[242] For the same reasons of national wholesale and retail shares of supply, we do not consider national foreclosure strategies in Chapter 10.

local foreclosure strategy. This is the scenario in which the merged entity would have the greatest incentive to increase wholesale prices (since, compared to a situation where it raised prices nationally, there is less incidental loss of volumes through increasing prices to Booker-supplied retailers that do not overlap with a Tesco store).

9.17 A significant number of third parties raised concerns about the Merger under this theory of harm. Some third parties suggested further that the merged entity may seek to close Booker symbol group stores where they overlap with Tesco stores, or convert Booker symbol group stores into Tesco stores including One Stop franchises. We have found that as Booker does not own the vast majority of stores (and its contractual arrangements with symbol group retailers do not give Booker any right to acquire such stores), this option would not be available to the merged entity. The possible exception to this is where Booker owns the head-lease for the symbol group store. This is discussed further in Chapter 11.

9.18 Other third parties suggested that the merged entity may alternatively refuse to accept new symbol group members in local areas where a Tesco (or One Stop) store is already located, to avoid drawing business away from that store. We note that this would be less profitable to the merged entity than continuing to serve those customers but charging a higher price or offering a lower quality of service, as envisaged in the theory of harm discussed in this chapter. In any event, as we have found that wholesale competition is strong, and that retailers have a range of alternatives for symbol group services, we do not consider that the Merger would create competition concerns on this basis. Conversely, one third party suggested that Tesco could purposely target new openings in local areas where Booker symbol group stores are performing well (to draw business away from those stores). As this strategy would already be open to Tesco at present (and would, arguably, in any event increase local competition), we do not consider there to be any Merger-specific element to this concern.

Ability

9.19 The merged entity's ability to pursue a local foreclosure strategy through its wholesale offer will depend on the merged entity being able to target any wholesale price increases or cutting of wholesale costs to specific retailers, according to local competitive conditions. This is because the merged entity must be able to target these actions to symbol group or independent retailers in local areas where:

(a) those retailers would find it difficult to avoid a worsening of their retail offering, because of their limited wholesale alternatives; and

(b) the local conditions of retail competition mean that sufficient customers leaving the Booker-supplied retailer's store would shop at a Tesco store instead.

9.20 In other words, the merged entity must be able to flex its wholesale offer at a local and/or individual-retailer level, and do so in response to conditions of competition at both the wholesale and retail level.

9.21 The merged entity's ability to pursue a local foreclosure strategy through its wholesale offer will also depend on what actions retailers may take in response. If retailers can avoid a significant deterioration of their own retail offering through switching to an alternative wholesaler, or by not passing on the price increase to its own customers, then the merged entity's strategy will be defeated. As noted in paragraphs 7.88 to 7.89, overall we found that Booker-supplied symbol group and independent retailers multi-source, regularly monitor their competitive alternatives, and have a strong propensity to switch in the face of a price rise (even if actual rates of fascia switching are generally low). The ability of individual customers to switch will, however, depend on the alternatives available to them in their local area. We therefore return to the local conditions of wholesale competition at the end of our assessment (paragraph 9.53 below), by looking at wholesale alternatives in those particular areas where – provided the merged entity had the ability to do so – our analysis suggests that the merged entity might have higher incentives to pursue such a strategy.[243]

Parties' submissions

9.22 Booker submitted that the competitive parameters of its wholesale offering to retailers are set almost exclusively on a national basis, with very limited local variation in pricing and promotions. Booker submitted that any variation, for example in range, between cash and carry depots is driven by customer demand (ie customers asking that a certain product be stocked in their local business centre), and not by local conditions of competition. Booker submitted that implementing any degree of local variation that did not improve customer choice or quality of experience would be very poorly received by customers, who would easily detect any local variation, given the high occurrence of multi-store ownership and close personal networks between Booker's retailer

[243] As noted in paragraph 9.11, our assessment of 'ability' and 'incentive' may overlap, and some factors may be assessed under either heading. We might consider, for example, that Booker's **ability** to pursue this strategy would also depend on what other actions retailers take in response, such as whether they would absorb (rather than pass on) a price rise. This is because if all retailers took this response, then the strategy would be defeated as no sales could be recaptured by Tesco. As different retailers are likely to take different responses, however, and the effect is likely to be one of degrees, we instead treat these factors as affecting the overall profitability of the strategy. They are therefore addressed in our assessment of **incentive** below.

customers. Booker submitted that it would also cause retailers to switch away from Booker to the many alternative wholesalers available to them. Even if Booker was minded to vary its pricing locally (which it stated it would not be), Booker submitted it was partly constrained from doing so by pricing that was imposed by suppliers and manufacturers, such as through price-marked packs and promotions (which are generally applied across the entire wholesale channel and not specifically for Booker's customers).

9.23 To support this, Booker presented the results of an analysis which sought to measure the effect that the presence of other cash and carry depots within a 30-minute catchment (and delivered wholesale depots within four hours) of its own depots had on different measures of its offering, [✄].

9.24 We have considered Booker's submissions in the round with other pieces of evidence, set out below, to conclude on the merged entity's ability to target any wholesale price increases or cutting of wholesale costs that affect the quality of its service, to specific retailers, according to local competitive conditions.

Third party submissions

9.25 We asked other wholesalers about the level of their businesses at which they set their wholesale offering. The responses received indicated that different wholesalers take different approaches, with some tending to apply a nationally-consistent offering and others allowing more local variation. One wholesaler noted that the barriers to varying prices and other parameters at a depot level are the costs and complexity of managing multiple selling prices across a large number of products, and of monitoring competition at the local level.

9.26 Nevertheless, a significant number of wholesalers told us that at least some aspects of their pricing are varied at a sub-national level, whether regionally, locally (eg at the depot level) or at an individual retailer level.[244] One wholesaler noted explicitly that this was in response to competitive conditions.[245]

[244] Bestway, Musgrave NI, Brake Brothers, Spar, Today's, Conviviality, Filshill, Sugro.
[245] Costco, which submitted that it responds to price competition on a regional basis.

Our assessment

Evidence of current depot/retailer level variation

9.27 We note Booker's analysis of the relationship between performance and competition around its cash and carry depots (discussed in paragraph 9.23). While our review of this analysis also did not find a statistically significant relationship between these factors, we consider that failure to find a statistically significant effect is not, in and of itself, evidence of the non-existence of an economic relationship. We therefore rely in this section on other relevant evidence.

9.28 We reviewed submissions and internal documents provided by Booker to assess the level at which Booker varies its wholesale offering to retailers.

9.29 We found that Booker's wholesale offering to retailers is largely set nationally. We found that pricing is almost exclusively national across the UK, with the exception of some limited variation in Scotland, which is due to alcohol licensing restrictions. We found some evidence of variation at a depot or individual-retailer level on some other parameters, although there was no evidence that this was in response to local competitive conditions. This related to:

(a) promotions, [✄];

(b) discount schemes, [✄];[246,]

(c) delivery terms, [✄];

(d) advice [✄]; and

(e) (for symbol group retailers only) contractual terms, [✄].

9.30 We also found that individual business centres monitored local wholesale competitors, although Booker submitted that [✄]. We did not find any evidence to the contrary.

Evidence of potential for depot/retailer level flexing

9.31 We found that Booker may have the technical ability to target flexing at a customer or local level, if it had the incentive to do so. For example, Booker's IT systems [✄]. We note that this system appears to give Booker the technical ability to target its pricing and promotions in a very specific way, and

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[246] [✄]

plausibly at a more localised level (for example, based on the postcode of the retailer's store) than is currently the case.

9.32 As set out above, other wholesalers indicated that it is possible to flex price and service locally.

Costs or barriers to flexing in response to competitive conditions

9.33 We note that any strategy to target its offer in this way is likely to come at a cost to the merged entity, albeit that measuring such cost is difficult.

9.34 As regards the ability of the merged entity to vary its wholesale offer at a local (depot) level, we note that any single Booker depot is likely to serve some customers that compete with Tesco in their local retail area, and some customers that do not (including catering customers, who do not compete with Tesco at all). We consider that to discriminate between retailer customers that do or do not compete with Tesco is likely to require a focused, retailer-level strategy, unless such customers constitute a significant proportion of a particular depot's customers.

9.35 We also note that this strategy, in order to be effective, is likely to require a significant degree of central coordination by the merged entity. This is because it would require the merged entity to monitor (and respond to) both the local conditions of wholesale competition, and also the local conditions of retail competition faced by its retailer customers and by Tesco stores. We note that this is likely to involve greater complexity (and cost) than in a horizontal merger situation, where we assess whether a firm may flex its offering in response to conditions of competition in its own market, rather than in a market which is upstream or downstream to it.

9.36 We have also considered whether, after the Merger, the retail arm of the merged entity would receive information about some of its retail rivals (ie Booker-supplied retailers) which would help the merged entity facilitate this strategy.[247] [✄] We do not consider that the information that the merged entity will receive from some retailers will enable, in any practical way, the merged entity to facilitate this strategy.[248]

[247] Merger Assessment Guidelines, paragraph 5.6.13 says 'vertical mergers may allow the merged firm to gain access to commercially sensitive information about the activities of non-integrated rivals in the input market or the market for the final product, allowing it unilaterally to compete less aggressively in the market for the final product or otherwise to put rivals at a competitive disadvantage'.

[248] Regarding information access, one third party additionally raised the concern that the Merger would give Tesco access to pricing and sales information regarding Booker's national account customers, some of whom are retail chains that compete with Tesco. We did not receive any concerns from such customers regarding the

Conclusion on Booker's ability to flex parameters of competition locally

9.37 We found that Booker sets all key aspects of its wholesale offering at a national level. We also found that Booker does vary some elements of its offering at a depot and/or individual-customer level on a small scale. Further, it may have the technical ability to effect more local/retailer-level variation if it had the incentive to do so. We did not find any evidence that the current (limited) variation in Booker's offer at a local/retailer level is driven by local conditions of competition. However, we did find that at least one other wholesaler flexes its offer in response to local competition. That being the case, in the context of the vertical nature of this merger, we acknowledge that for the merged entity to flex its wholesale offering to respond to local competitive conditions at both the wholesale and retail level is likely to involve greater operational complexity, and central oversight, than in a horizontal merger context.

9.38 In any event, as noted in paragraph 9.21, the merged entity's ability to pursue a local foreclosure strategy at the wholesale level will also depend on what actions retailers may take in response to any targeting (such as wholesale switching or not passing on the price rise to its own customers). These actions are also central to the merged entity's incentives to follow a foreclosure strategy and are therefore discussed under incentives, below.

9.39 However, as discussed further in the next section, we have found that the merged entity is not likely to have both the ability and incentive to increase wholesale prices and/or cut costs that affects its quality of wholesale service, in any local areas (given the combination of local conditions of retail and wholesale competition). Given this, we have not found it necessary to conclude on whether the merged entity would have the ability to flex its wholesale offering at a local/retailer level.

Incentive

Factors relevant to incentives assessment

9.40 For there to be an incentive for the merged entity to increase wholesale prices and/or cut costs that affect its quality of wholesale service to its symbol group and independent retailer customers, the strategy must be profitable to the

Merger. Further, as discussed in Chapter 7, we consider that such customers (who are likely to be either large retail multiples, or 'multi-site operators') are likely to have sufficient wholesale alternatives such that competition concerns are not likely to arise.

merged entity overall. There are several factors that affect whether this is likely to be the case. These are:

(a) First, the degree of competition between Tesco stores and Booker-supplied retailers at a local level (ie the conditions of local retail competition). This will determine the extent to which end-customers may switch from Booker-supplied retailers to Tesco stores, rather than to other retailers' stores. This will depend on which other retailers are present in the local area and where they are situated relative to the Tesco and Booker-supplied stores.

(b) Second, the degree of competition at the wholesale level. This will determine the extent to which retailers may switch away purchases from the merged entity and use alternative wholesalers instead if the merged entity deteriorates its wholesale offering.

(c) Third, the profits that the merged entity stands to gain from any consumers who switch to the locally competing Tesco store, compared to the profits that the merged entity stands to lose on lost wholesale sales (net of the higher profits its earns on higher-profit wholesale sales it retains). This will depend on the margins earned on each sale – since Tesco generally earns a much higher margin on its retail sales than Booker earns on its wholesale sales, it is plausible that forgoing a smaller (wholesale) margin in favour of a higher (retail) margin could be profitable to the merged entity overall.

(d) Fourth, the extent to which a worsening of the wholesale offer (particularly in the form of a wholesale price rise) is likely to feed through to a similar worsening at the retail level (particularly in the form of a retail price rise). The larger the change in retail prices, the more likely that sales will divert at the retail level which may be recaptured by a locally competing Tesco store, and the greater the incentive for the merged entity to increase wholesale prices (for any given level of wholesale losses that would result). The extent to which wholesale price rises feed through to the retailer's average retail prices depends on:

   (i) Booker's share of the retailer's total purchases (its 'share of wallet'), as only those goods that are purchased from Booker will be affected by the merged entity's actions; and

   (ii) the extent to which the retailer passes on the wholesale price increase (or deteriorates quality) on individual products to customers, in the form of a retail price increase (or deterioration in quality).

9.41 The first two factors – the conditions of local retail competition and of local wholesale competition – are likely to be highly determinative. A local foreclosure strategy will only be profitable to the merged entity if the amount of business gained by a Tesco store through retailer customers diverting away from Booker-supplied retailers is large; large enough to compensate for any losses of wholesale business as some retailers switch purchases to other wholesalers. Given that the wholesale market is generally competitive, this means that diversion to the Tesco store will need to be high for the strategy to be profitable in any local market. As discussed in Chapter 7 above, the market for convenience retail is highly fragmented. This suggests that, in many areas, the merged entity would not find it profitable (and would therefore not have the incentive) to engage in a local foreclosure strategy, as shoppers may be more likely to switch to any number of competing retailers rather than to a Tesco store. In other words, a profitable local foreclosure strategy would only be plausible in 'marginal cases' where the local retail conditions of competition mean that Tesco stores and Booker-supplied stores are close competitors, and face little competition from other retailers.

9.42 The incentives in any given local area will vary. Given the thousands of overlaps between Tesco's stores and the retail stores which Booker supplies, it is necessary to apply a systematic method for combining the factors outlined above in any given local area. This allows us to identify those marginal cases where the retail conditions of competition may make the overall strategy profitable.

Framework for incentives assessment

9.43 As regards such a systematic framework, the Parties proposed an assessment based on a 'gross upward pricing pressure index' (GUPPI). GUPPI is an economic tool which uses diversion ratios, margins and prices to 'score' the post-merger incentives of merging parties to increase prices.

9.44 GUPPI has previously been applied by the CMA in assessments of horizontal mergers. Given the vertical nature of the theory of harm in this case, the Parties proposed a modified GUPPI framework (a vertical GUPPI framework or vGUPPI) to take account of additional factors relevant in this situation where Booker does not control the retail stores that compete with Tesco (such as wholesale competition, Booker's share of the retailer's wallet and the extent to which retailers may pass on any price rise).

9.45 The method of calculation used for the vGUPPI framework, and in particular the level of inputs used in reflecting each of the factors discussed above, is explained further in Appendix C. We note that determining the appropriate level of some of these inputs has required an element of judgement. Where it has not been possible, on the evidence available, to measure or calculate a particular input with sufficient certainty, we have taken a cautious yet realistic approach and applied the more conservative position (ie that which would tend to suggest the Parties had more, rather than less, incentive to pursue an anti-competitive strategy). We have also conducted sensitivity testing to understand how the results vary with less cautious assumptions.

9.46 In the past, for some (but not all) horizontal mergers, the CMA has taken the approach that a GUPPI of less than 5% indicates that concerns could be ruled out.[249] Typically, this has been followed by closer examination of markets where the GUPPI was 5% or higher. In other cases, the CMA has signalled that a higher threshold may be appropriate.[250]

9.47 The Parties submitted that to adopt a threshold for concern of 5% would be unduly conservative given that some previous phase 2 horizontal merger cases have identified concerns using a GUPPI threshold of more than 5%. They submitted that even a 10% threshold in a vertical merger would be conservative. They argue that this is because the threshold relates to the purported incentive on Booker to increase its wholesale prices. Once any such price increase is translated into a retail price increase at the Booker-supplied retailer's store, the effect is much smaller (having been diluted, for example, by Booker not supplying all of the retailer's wholesale requirements, and retailers not passing on all of the price increase to customers).

9.48 We discuss the results of our vGUPPI analysis and other evidence in the following section.

Results of incentives assessment

9.49 We have used our vGUPPI analysis to examine over 12,000 overlaps between the Parties at the local level and analyse whether the merged entity would have an incentive to increase wholesale prices (or to cut costs in a manner that affects its quality of wholesale service) in each overlap area. Using cautious inputs as described in Appendix C, we have found that a

[249] For example, in *A report on the completed acquisition by Cineworld Group plc of City Screen Limited*, Competition Commission, report dated 20 August 2013, paragraphs 6.82, 6.79 and 6.107 and Appendices, Table 6. See further, *Anticipated acquisition by The Original Bowling Company Ltd of Bowlplex Ltd (ME/6528/15)*, CMA, decision dated 17 August 2015, paragraphs 91 and 112. By contrast, see *Anticipated acquisition by MRH (GB) Limited of 78 service stations from Esso Petroleum Company Limited (ME/6563/15)*, CMA, 26 November 2015, paragraph 54 and *Anticipated acquisition by Shell UK Limited of 253 petrol stations from Consortium Rontec Investments LLP (ME/5191/11)*, OFT, decision dated 3 February 2012, paragraphs 92–106.
[250] For example, *A report on the anticipated merger between Ladbrokes plc and certain businesses of Gala Coral Group Limited*, CMA, report dated 26 July 2016.

vGUPPI of 5% or greater is produced in 10 local areas, and that there are no areas where we find a vGUPPI of 10% or more.[251]

9.50 We consider that, in this case, a 5% threshold for concern, which is sometimes used in horizontal cases, is conservative. This is because the Merger is vertical in nature: the vGUPPI results presented above relate to pricing pressure experienced by Booker, so that a 5% vGUPPI would be equivalent to an increase in Booker's costs equal to 5% of wholesale prices. Before feeding through into pricing pressure for an individual retailer supplied by Booker, this effect could firstly be diluted by Booker not passing through all of the pricing pressure into a price increase (ie if there is less than 100% wholesale pass through). It would then be diluted by the fact that most Booker-supplied retailers do not buy all their stock from Booker (ie the proportion of its wallet that the retailer spends with Booker is less than 100%). Finally, the effect may also be lessened by any efficiencies as a result of the Merger that place counterbalancing downward pressure on Booker's costs and therefore prices.

9.51 In addition, the vGUPPI analysis assumes that there are no costs to the merged entity of implementing a targeted strategy of focusing any wholesale price increases, or cost-cutting that affected quality of wholesale service, in any local areas where the conditions of competition may favour it. As noted in paragraph 9.35, we acknowledge that there are likely to be costs to doing this. This is likely to reduce the overall profitability of the strategy, and therefore the incentive for the merged entity to pursue it, particularly where the affected number of areas is extremely small relative to the Parties' overall estate – which our vGUPPI analysis indicates is likely to be the case.

9.52 For these reasons, we consider that a vGUPPI 5% threshold for concern, in respect of this theory of harm, is conservative. In light of the factors discussed in paragraphs 9.50 and 9.51 and given that in no area did we find a vGUPPI of over 10%, we have found that there are no areas where the merged entity is likely to have an incentive to follow the foreclosure strategy identified under this theory of harm.[252]

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[251] As explained in footnote 13 of Appendix C, our analysis was conducted on a dataset which included the Parties' and third parties' pipeline stores, although we also carried out a sensitivity analysis where we excluded these third party pipeline stores. As shown in tables 5 and 6 of Appendix C, when these pipeline stores were excluded, a vGUPPI of 5% or greater was produced in 11 local areas. There remained no local areas where a vGUPPI of 10% or greater was produced.

[252] As explained in Appendix C, the constraint from wholesale competition is taken into account in the vGUPPI calculation, represented by variable wholesale margins (which under linear pricing are the inverse of demand elasticity). A higher margin therefore assumes a weaker constraint from wholesale competition. We received some submissions that wholesale competition is weaker for Budgens fascia, especially the larger stores. This is represented in our vGUPPI analysis and the results presented here, by the fact that Booker's [✂]. We also

9.53 Even so, we reviewed wholesale competition in the 10 local areas attracting a 5% vGUPPI result, as highlighted above. In line with the overall picture of strong wholesale competition in the UK, we found that all of the 10 stores identified by the vGUPPI analysis faced a range of wholesale options. All of the stores were within an 80% catchment area of two or more competing delivered grocery wholesalers (ie in addition to Booker) and nine fell within an 80% catchment area of at least five delivered alternatives (in addition to Booker).[253] Seven of the 10 stores also fell within the 80% catchment of at least two alternative cash and carry depots (in addition to Booker). Even the three areas with fewer cash and carry alternatives all had at least one alternative from which to choose when the 100% catchment area of those wholesalers was considered. We note that even on this relatively conservative basis (including only those wholesalers with a national or significant regional presence,[254] and using 80% catchment areas) retailers face a sufficient amount of choice. Retailers would therefore be likely to have the ability to defeat such a foreclosure strategy in these areas by switching to other wholesalers.

Conclusion on vertical effects: wholesale to retail

9.54 We have found that the merged entity would not have the ability or incentive to worsen wholesale price or service at a national level, as a result of the Parties' national shares of supply in retail and wholesale services.

9.55 We also have found that the merged entity would not have any material incentive to worsen wholesale price or service at a local level. This is because, overall, we have found that competition in wholesaling services was generally strong, meaning that, in most areas, many retailers would switch purchases to other wholesalers rather than suffer (or pass on to shoppers) a worsened service – defeating the merged entity's ability to carry out this strategy. Further, in many areas, the presence of other nearby retail competitors means that Tesco would not be able to recapture sufficient sales to make the strategy profitable, as competing retailers would capture some of the switching sales.

conducted an even more conservative sensitivity analysis using gross margins for these stores. Under that scenario only one store faces a vGUPPI of over 10%; in that case ([✂]) there are a large number of additional retail constraints just outside the relevant catchment area which will tend to reduce the likelihood of profitable levels of recapture at Tesco but are not reflected in the vGUPPI figures. This store also falls within the 80% catchment area of 10 delivered wholesalers.

[253] Without P&H we have found that all of the stores were within an 80% catchment area of two or more competing delivered grocery wholesalers (ie in addition to Booker) and eight fell within an 80% catchment area of at least five delivered alternatives (in addition to Booker).

[254] Spar wholesalers, Bestway, Conviviality, Costco, Dhamecha, Filshill, Landmark, Musgrave, Nisa, Parfetts, Today's, United wholesale.

9.56 We have found that there may be, at most, some limited incentives in relation to a very small number of local areas. However, any incentives that might arise at the wholesale level would be reduced by, for example, retailers purchasing only a fraction of their products from the merged entity and the rest from other wholesalers, and by retailers not passing the full wholesale price rise through to shoppers at the retail level. Further, pursuing a targeted strategy in these areas would require coordination across the merged entity's retail and wholesale arms. We consider that the costs of implementing such a strategy would be disproportionately high relative to the very small number of areas involved. In addition, we found that wholesale competition was sufficiently strong in all of these local areas.

9.57 On this basis, we have concluded that the Merger may not be expected to result in an SLC under this theory of harm on a national basis or in any local areas.

10. Vertical effects: retail to wholesale

Introduction

The theory of harm and the framework for assessment

10.1 In the previous chapter, we assessed whether the Merger could make it profitable (in a way that was not profitable prior to the Merger) for the merged entity to implement a strategy of increasing wholesale prices or cutting costs that affect its quality of wholesale service to retailer customers, due to the possibility of recapturing sales at Tesco stores that overlap with the stores it supplies as a wholesaler.

10.2 This chapter deals with an analogous assessment, namely whether the Merger could make it profitable (in a way that was not profitable prior to the Merger) for the merged entity to implement a strategy of increasing retail prices or cutting costs that affect its quality of retail service, due to the possibility of recapturing sales at Booker-supplied retail stores that overlap with Tesco stores.[255]

10.3 In theory, and all other circumstances being equal, the incentives arising under this theory of harm will be lower than those discussed in the previous chapter. This is because the profit which the merged entity stands to gain

[255] The remainder of this chapter focuses on the merged entity pursuing a strategy of increasing its retail prices or cutting costs that affect the quality of its retail service at Tesco stores. Booker is also a retailer via a small number of Budgens stores that it owns; these stores were also included in our assessment (for example of incentives – see Appendix C for more detail), and no concerns were found.

from sales recaptured at its retailer customers' stores are reduced in two ways. Firstly, the margins which Booker currently earns on wholesale sales are lower than the margins which Tesco currently earns on retail sales. Secondly, Booker does not supply all of its retailer customers' wholesale requirements. Any increased demand that Booker's retailer customers face due to shoppers switching to their stores after the Merger will therefore be spread between the wholesalers that they purchase from, only one of which may be Booker.

10.4 However, it is still possible for the strategy to be profitable, since any recapture will tend to decrease the costs of a price rise or deterioration of service. Below we set out our assessment of this theory of harm, taking into account the combination of circumstances that arise in practice.

10.5 As with the assessment in Chapter 9, our approach to assessing vertical theories of harm is to analyse:

(a) whether the merged entity would have the **ability** to carry out the strategy;

(b) whether it would find it profitable to do so (ie the **incentive**); and

(c) whether the **effect** of any action by the merged firm would be sufficient to reduce competition in the affected market to the extent that it gives rise to an SLC.[256]

Ability

10.6 We assessed whether the merged entity could vary some aspects of its retail offering by local area, to respond to local retail conditions of competition. If so, the merged entity could adjust its retail offering at Tesco stores in local areas where conditions of retail competition meant that sufficient customers leaving the Tesco store would shop at Booker-supplied stores instead, thereby increasing the profits of the merged entity overall.

Parties' submissions

10.7 Tesco submitted that its prices are set at a national level, with variation only between different store formats/brands.[257] It submitted that promotions also operate on a national basis, and that it does not knowingly flex any other parameters of its offer in response to local competition (including where it currently faces limited retail competition at the local level). Tesco submitted

[256] Merger Assessment Guidelines, paragraph 5.6.6.
[257] [✄]

that the operational costs of implementing any store-level variation would be significant, as would be the reputational effects. It said that customers expected consistency of pricing, as shown by the negative reaction to public reporting of price disparities between Tesco Metro and larger format stores, and responses to a survey of Tesco's customers (which showed that simple and stable prices, and openness and transparency, were key drivers of customer trust). In any event, it found that [✂]. Finally, Tesco submitted that the lack of close competition between Tesco and Booker-supplied retailers (indicated amongst other things by their difference in product range and substantial price difference) meant that any hypothetical attempts to use local flexing to push customers to Booker-supplied stores would be ineffective, as shoppers were significantly more likely to switch to other retailers instead.[258]

Our assessment of local targeting

Evidence of current local variation

10.8 Based on a review of submissions and internal documents provided by Tesco, we found that Tesco's competitive offering is largely set nationally. This includes pricing and promotions. However, we found some limited evidence of variation on some competitive parameters at a local level. This included in relation to:

(a) trade driving and local marketing activity, [✂];

(b) range, with different product ranges [✂];

(c) refurbishment, [✂]; and

(d) opening hours, [✂].

Evidence of potential for local flexing

10.9 We also noted that Tesco may have the means available to it to implement further local variation, if it had incentive to do so. For example:

(a) [✂]

(b) [✂]

(c) [✂]

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[258] Phase 2 Initial Submission, Annex 2.

Costs or barriers to flexing

10.10 Despite the evidence of some local variation, and the potential for Tesco to do more, we note that there would be costs to this strategy. As we have identified there is very limited evidence that Tesco currently alters its local offering in response to local competition (or monitors Booker-supplied retailers – see paragraph 7.23*(a)*), it would need to put in place systems to do so. Based on Tesco's submissions, and those provided by other retailers, this would involve some level of operating cost, although to estimate these costs would be challenging.

10.11 There is an additional 'cost' which comes as a feature of this being a vertical relationship. The strategy envisaged in this theory of harm is that the merged entity would find it profitable to degrade its Tesco store offer because it would recapture sufficient sales through customers switching to stores which are currently supplied by Booker. As Booker does not own these stores, there is less certainty that Booker will continue to supply these stores in future, or continue supplying them to the same extent. This is particularly true in light of our findings on wholesale competition which show healthy numbers of wholesale competitors and frequent volume switching by retailers. Any costs which the merged entity would incur to set up systems, or otherwise take steps, in the expectation of recapturing sales via Booker-supplied stores would come at a zero return to the merged entity if those stores subsequently stopped being supplied by Booker. The strategy is therefore inherently riskier than in a horizontal merger context.

Conclusion on local targeting

10.12 We found that Tesco sets several aspects of its retail offering at a national level. We also found that Tesco varies some elements of its retail offering according to certain local conditions (eg [✄]). While we found only limited evidence (specifically with respect to [✄]) of Tesco varying its offer locally to respond to local competition, we did find that Tesco may have the means to introduce more local flexing if it had the incentive to do so. We acknowledge that for Tesco to flex its offering to respond to local competitive conditions would involve some operational costs, although these are difficult to quantify.

10.13 In any event, as discussed further in the next section, we have found that the merged entity would not have the incentive to pursue a foreclosure strategy in any local areas. We have therefore not found it necessary to conclude on whether the merged entity would have the ability to flex Tesco's offering at a local/store level.

Incentive

10.14 For there to be an incentive for the merged entity to increase its retail prices or cut costs that affect its quality of retail service (notwithstanding that this may result in some lost sales), the strategy must be profitable to the merged entity overall. There are several factors that affect whether this will be the case, some of which are the same as those applied in Chapter 9. These are:

(a) first, the degree of competition between Tesco stores and Booker-supplied retailers at a local level (ie the conditions of local retail competition). This will determine the extent to which end-customers may switch from Tesco stores to Booker-supplied stores, rather than to other retailers' stores.

(b) second, the profits that the merged entity stands to gain from any additional wholesale sales that result from end-customers switching to Booker-supplied retail stores, compared to the profits that it stands to lose on lost retail sales at Tesco stores (net of the higher profits it earns on the more profitable retail sales it retains). This will depend on:

(i) Booker's share of the retailer's total purchases (its 'share of wallet'): if it is only a small proportion, then the value of the wholesale sales the merged entity stands to win will also likely be small, and therefore the 'gain' of the strategy reduced;[259] and

(ii) the margins earned on each sale. Since Booker generally earns a much lower margin on wholesale sales than Tesco earns on its retail sales, this tends to reduce the chances of this strategy being profitable in any given local area.

10.15 Unlike in the previous chapter, pass-through rates are not relevant, as Tesco controls its own stores. Any deterioration will therefore be passed through, fully, to shoppers.

10.16 As in the previous chapter, given that the market for convenience retail is highly fragmented, we would expect the incentive to pursue this strategy to exist in relatively few areas (ie where the local retail conditions of competition mean that Tesco stores and Booker-supplied stores are close competitors, and face little competition from other retailers). This is all the more so given

[259] Although this may also reduce Booker's ability to meaningfully worsen the retailer's offer at all: this is reflected in our analysis by down-weighting the incentive that the merged entity may have where the Booker's share of the retailer's 'wallet') is small. See Appendix C.

that, under this theory of harm, any margin recaptured by the merged entity's wholesale business would be small relative to Tesco's retail prices.

10.17 Once again, vGUPPI provides a useful economic tool for combining the factors described above, across local areas, in a systematic way. We have examined the Parties' incentive to carry out a strategy of increasing the merged entity's retail prices, or cutting costs that affect its quality of service, in relation to over 2,300 stores owned by one of the parties that face competition in their local area from at least one store owned or supplied by the other party.

10.18 Using cautious inputs as described in Appendix C, a vGUPPI of 5% or greater is produced in 11 local areas. For 10 of these 11 affected stores, the vGUPPI is less than 7.5%. The remaining store has a vGUPPI of 9.4% - ie there are no areas where we find a vGUPPI of 10% or more. Therefore, there is a very small number of areas in which we have found a possible, albeit very small, incentive to increase prices to some extent.[260]

10.19 However, there are several reasons why, in this case, concerns can be ruled out in all local areas. As discussed in Appendix C, some of the assumptions used in the calculation are likely to overstate Tesco's incentives to raise prices. In particular, we have adopted a relatively cautious approach to the degree to which shoppers may switch from Tesco to Booker-supplied retailers, for two reasons. First, we have assumed that current Booker-supplied stores exert a strong constraint on Tesco where they are present (equivalent to an Aldi or Lidl). Second, we have assumed only 10% diversion to stores outside the catchment area (1 mile in the case of convenience stores) or to other options (such as not purchasing). Flexing these cautious assumptions reduces or eliminates the number of areas highlighted.

10.20 Importantly, the vGUPPI analysis, while it incorporates an estimate of the expected gains to Tesco of the strategy, does not take account of the associated risk. Under this theory of harm, Tesco would be seeking to recapture sales via a store that the merged entity does not own – and which could therefore choose to move volumes away from the merged entity's wholesale arm and towards other wholesalers. This will tend to reduce the attractiveness of the strategy, in this vertical case. As stated in paragraph 10.12, there are also likely to be some costs of implementing a targeted

[260] As explained in footnote 15 of Appendix C, our analysis was conducted on a dataset which included the Parties' and third parties' pipeline stores, although we also carried out a sensitivity analysis where we excluded these third party pipeline stores. As shown in tables 5 and 6 of Appendix C, when these pipeline stores were excluded, a vGUPPI of 5% or greater was produced in 12 local areas. There remained no local areas where a vGUPPI of 10% or greater was produced.

strategy, which will reduce its profitability, particularly when very few areas are involved.

10.21 We consider that, together, these factors mean that the merged entity could only be expected to engage in such a strategy if the expected gains were high, given the costs and risks associated with the strategy in this vertical setting. Given the very small number of areas and relatively low vGUPPI values found (none of which exceeded 10%), we are therefore confident that the merged entity would not be likely to have the incentive to increase its retail prices or cut costs that affect its quality of retail service in any local areas.

Conclusion on vertical effects: retail to wholesale

10.22 We have found that the merged entity would not be likely to have any material incentive to worsen retail price or service. This is because, if the merged entity were to raise its retail prices or cut costs that affect its quality of retail service, it would incur losses through: retailers supplied by other wholesalers capturing sales, Booker-supplied retailers not purchasing all their stock from the merged entity and Booker's current wholesale margins being lower than Tesco's retail margins.

10.23 We have found that there may be, at most, some limited incentives in relation to a very small number of areas. However, pursuing these would require coordination across the merged entity's retail and wholesale arms. Moreover, the recaptured revenue would come via customers of the merged entity's wholesale business whose continued purchases from the merged entity are far from guaranteed. The costs and risks of implementing such a strategy would be disproportionately high relative to the very small number of areas involved.

10.24 On this basis, we have concluded that the Merger may not be expected to result in an SLC under this theory of harm in any local areas.

11. Horizontal and related effects

11.1 In this chapter, we consider two related scenarios. The first is that in which Booker owns and operates a retail store in a local area where Tesco is present, raising the prospect of price rises by Booker and/or Tesco as a result of expected recapture at the overlapping store. This is a standard horizontal effect.[261]

[261] Merger Assessment Guidelines, paragraph 5.4.1.

11.2 The second scenario is that in which Booker holds the head-lease for the property in which its retailer customer's store is based, and sublets the property to the retailer. Although this second scenario involves a vertical relationship, as Booker does not own or operate the symbol group store to whom it sublets the premises, these stores have been assessed through the horizontal assessment framework in the first instance. As further explained below, this is because under the [✂] and may therefore provide the merged entity a greater degree of influence over the symbol group store's offering than over other symbol group customers. Further, the expiry or early termination of the under-lease may result in the merged entity gaining operational control over the store.

11.3 We set out our assessment of these two scenarios in turn below.

Horizontal effects

11.4 Booker owns and/or operates [✂] convenience and mid-sized Budgens stores, some of which are located nearby to Tesco stores.[262] The premise under this theory of harm is that prior to the Merger one or both of Booker and Tesco may be disciplined by the other party from raising prices, or otherwise cutting costs that affect quality of services at these stores, on the basis that doing so may cause some shoppers to switch away. If, after the Merger, enough of those customers who would have switched away from one Party would switch to the other Party, then what was not profitable before the Merger may become profitable after the Merger.

11.5 This is a horizontal theory of harm. At phase 1, the CMA found that there was a realistic prospect of an SLC on this basis in two local areas where Booker's owned stores overlap with Tesco owned stores: in [✂] (where the Budgens store is a convenience store) and in [✂] (where the Budgens store is a mid-sized store in an urban area). We have built on the CMA's phase 1 decision.

11.6 In our assessment of these stores, we have adopted the geographic framework set out in paragraph 6.24 above, namely:

(a) For [✂], as a mid-sized store, a 5/10-minute catchment area (urban/rural), with additional constraint from one-stop stores within a 10/15-minute catchment area (urban/rural);

[262] See footnote 26.

(b) For [✂], as a convenience store, a 1-mile catchment, noting that the constraint is likely to be stronger the closer another retailer is to the store in question.

11.7 We have applied a GUPPI framework in our assessment and used a 5% GUPPI as the benchmark for identifying stores which may give rise to potential concerns.[263]

11.8 With regard to [✂], the GUPPI analysis did not indicate that the merged entity was likely to have sufficient incentive to increase prices, or otherwise degrade services, at either Party's store. In this local area there is a Co-op store near to the Budgens and, within a mile of the Budgens store, there is an Aldi and a Lidl store. The overlapping Tesco store is also within a mile although further away than the rival stores. On the basis that there is likely to be insufficient diversion between the Parties' stores to make such a strategy profitable we have found that the Merger may not be expected to result in an SLC as a result of horizontal unilateral effects in [✂].

11.9 With regard to [✂], we calculated a GUPPI of a little over 5% for the Budgens store, using the same assumptions as for the theories of harm discussed in Chapters 9 and 10 (as set out in Appendix C). We therefore looked at this local area in further detail.

11.10 In this local area, the Budgens store and the nearest Tesco store (a one-stop store) are located slightly over a mile or just under 6 minutes' drive-time apart. Another Tesco store (also a one-stop store) is located almost one-and-a-half miles or just over five-and-a-half minutes' drive-time away from the Budgens store.

11.11 Within the geographic catchment for mid-sized stores, and as reflected in the GUPPI analysis, the Budgens store faces competition from two other retailers in addition to Tesco: Sainsbury's (which has three one-stop stores within a 10 minute drive-time) and Asda (which has a one-stop store within a 10 minute drive-time).

11.12 However, there are also two other retailers within our effective competitor set with mid-sized stores located just outside the 5-minute drive-time catchment for mid-sized stores:

(a) Aldi, just under five-and-a-half minutes drive-time and less than a mile away; and

[263] See footnote 249 regarding the CMA's use of 5% as a threshold for concern in past cases.

(b) Marks and Spencer Simply Food, just under five-and-a-half minutes drive-time and just under one-and-a-half miles away.

11.13 These stores only narrowly miss the 5-minute drive-time catchment. Although we assume that competition from rivals is likely to be stronger if they are located within a 5 minute drive-time of the Budgens store, we do not consider that rivals do not exert any competitive constraint as soon as consumers have driven 5 minutes to get to one of these rivals.

11.14 In our GUPPI analysis we have assumed that 10% of shoppers will divert outside of the area if prices were to rise. We note that some of the assumptions used in the GUPPI analysis are cautious. In this local area, given the presence of additional mid-size stores just outside the 5-minute drive-time, it may be appropriate to consider a slightly higher level of out-of-market diversion. If the assumption of out-of-market diversion is increased to 14%, the GUPPI would fall below 5%. Given Aldi and Marks and Spencer are only slightly more than a 5 minute drive-time away, and are a slightly shorter drive from the Budgens store than the nearest Tesco, we consider that it is likely that the out of market diversion would be at least 14%.

11.15 When these additional competitors are considered, we consider that the constraints faced by the merged entity will be sufficient to remove any incentive by the merged entity to increase prices or cut costs that affect its quality of service, as it is not likely to recapture sufficient sales at the Tesco store to make the strategy profitable overall.

Conclusion on horizontal effects

11.16 For the reasons set out above, we have concluded that the Merger may not be expected to result in an SLC in relation to horizontal overlaps.

Stores for which Booker holds the head-lease

11.17 Booker holds the head-lease, and is therefore the sub-landlord, for [✂] premises used by symbol group retailers supplied by Booker ([✂] Budgens stores and [✂] Londis stores). This is as a result of [✂].

11.18 We have considered whether an SLC may be expected to arise as a result of:

(a) the merged entity increasing the wholesale price or worsening the quality of the wholesale service that Booker offers to these retailers; or

(b) the merged entity replacing the existing store with a Tesco store, either by refusing an extension of the under-lease or by exercising contractual rights to purchase the business under specific terms of Booker's current contracts with the retailers.

Third party submissions

11.19 We received submissions from two retailers whose head-lease is held by Booker. Although one noted that the Merger had the potential to be good for both its business and for customers, both submitted that they were concerned that the merged entity may harm their businesses by either:

(a) increasing the price or worsening the quality of service that they receive from Booker – actions to which these retailers would be more susceptible than other Booker customers, because [✄],[264] or

(b) refusing renewal of the under-lease (at the time of renewal) in order to use the property for its own business, such as a Tesco store.

11.20 In response to our provisional findings, we received a further submission from a retailer, relating to its store for which Booker holds the head-lease. The retailer submitted that:

(a) those stores for which Booker holds the head-lease that are over 3,000 sq feet (approximately 280 sq metres) in size are better suited to conversion into a Tesco store meaning that these stores are at greater risk of such conversion;

(b) the merged entity will be able to offer landlords a covenant which is of a better quality than that which the affected retailers can themselves provide; and

(c) the merged entity may choose to use the head-lease renewal process with the freeholder to extend its head-lease for a longer period of time than the under-lease in order to allow the merged entity to be able to occupy the premises at the expiration of the under-lease.

Parties' submissions

11.21 The Parties submitted that all of the head-leases that Booker currently holds were inherited as a part of its acquisition of Musgrave Retail Partners GB Limited and that [✄]. They told us that the merged entity has no plans or incentives to switch these head-lease stores to Tesco fascia, saying that this

[264] [✄].

does not form any part of the deal rationale. The Parties' detailed submissions are discussed below.

Increasing the price or worsening quality of service during the lease term

11.22 In relation to possible deteriorations in the price or service provided to these retailers post-Merger, the Parties submitted that:

- *(a)* [✂];
- *(b)* Were Booker to deteriorate its wholesale offering to these retailers they would be able to switch volumes to other wholesalers and Booker would be unable to prevent such switching without facing significant reputational damage, which would be untenable;
- *(c)* [✂]. Booker submitted that this is true for all of its stores, including those for which it owns the head-lease;
- *(d)* In all those local areas where Booker holds the head-lease and there are fewer than three large retail competitors and a Tesco in the area, there are at least five competing delivered grocery wholesalers, and in all but two areas, at least one competing cash and carry wholesaler;[265]
- *(e)* Booker is entitled to enforce its contracts with retailers. [✂]; and
- *(f)* Any attempt by Booker to impose unfair terms on retailers would carry considerable reputational risk and would be particularly damaging where the symbol group retailer is a multi-site customer.

Refusal to renew a lease

11.23 In relation to the potential refusal to renew an under-lease, the Parties submitted that:

- *(a)* [✂];
- *(b)* Where an extension of the head-lease would be required in order to be able to serve an eviction notice on the sub-tenant retailer, Booker ([✂]) invited affected retailers [✂]. Further Booker followed up its offer [✂];[266]

[265] To assess this, Booker has applied a 20-mile catchment area for cash and carry depots and a 160-mile catchment area for delivered grocery wholesalers.
[266] [✂] Booker has also made a similar offer to provide comfort for retailers in circumstances where service of an eviction notice is possible without extending the head-lease. [✂]

(c) The merged entity, moreover, does not have the incentive to switch these head-lease stores to Tesco stores because:

   (i) to determine whether any potential site location is a suitable location to invest the capital required, Tesco undertakes a detailed assessment of site characteristics including: [✂];

   (ii) [✂];

(d) Even if the merged entity were able to and had the incentive to replace the head-lease stores with Tesco stores, (which the Parties do not accept), an SLC would not arise, since in most areas there is substantial retail competition within the geographic catchment areas and relevant store size categories based on the relevant market definition, and in other areas there are substantial numbers of out of market constraints from smaller stores and from stores just outside the geographic market; and

(e) Overall, in all cases where there are fewer than three large competitors inside the product and geographic market, the under-lease is not due to expire for at least five years, such that an assessment of hypothetical scenarios that may occur beyond that time-frame would be too remote and speculative, given the possibility of intervening events and changes, to be included in the assessment of whether the Merger may give rise to an SLC.

Our assessment

Increasing price or worsening quality of service during the lease term

11.24 We consider that Booker potentially has some additional ability (relative to its other customers) to impose higher prices or worsened service quality on those retailers who sublet premises from it. This is because of Booker's right to purchase the businesses in the event of fascia switching (ie, upon termination of the relevant retailer agreement) which may discourage the retailer from switching. However, such a purchase would itself involve costs to Booker. Moreover, in relation to volume switching we note Booker's statement that it treats head-lease retailers the same as other retailers.

11.25 In relation to incentives to pursue such a vertical effects strategy, we have set out our analysis in Chapter 9. As discussed in Chapter 9, we calculated vGUPPI values in respect of the leased stores. Under our central assumptions (that together overstate the merged entity's incentives to increase price or worsen service), we did not find a vGUPPI of over 5% for any of the leased stores. This was also the case under the sensitivity test where we used gross margins (as opposed to the smaller variable margins) to represent the extent of wholesale competition – and we did this to take account of the possibility that switching may be more difficult for these head-lease stores.[267]

11.26 We therefore have concluded that the merged entity would not have the incentive to increase prices or worsen terms to these retailers during the term of the lease.

Refusal to renew a lease

11.27 To assess whether an SLC may be expected to arise as a result of the merged entity refusing to renew an under-lease we have considered whether:

(a) the merged entity, if it had both the ability and incentive to refuse renewal of the under-lease and instead occupy the premises with a Tesco store, would also, based on conditions of local competition, have the incentive to increase prices or worsen service such that an SLC could in theory arise;

(b) the merged entity would in fact have the ability to refuse renewal of the under-lease and instead occupy the premises with a Tesco store within a 5 year period.

11.28 We assessed competition in the 39 local areas in which Booker holds a head-lease for one of the stores that it supplies. In 5 areas there is no overlap between the Booker-supplied store and a Tesco store. In 34 areas, the head-lease store either constrains or is constrained by a Tesco store.

11.29 In those 34 areas, we found that:

(a) In 17 cases, even if we take a very cautious approach of treating these stores as directly owned, none have GUPPI results of 5% or more. This is because sufficient competition would exist in the local market to prevent a competition concern from arising even if the Booker-supplied store were to exit or be converted into a Tesco store.

(b) in 13 of the remaining 17 cases, a significant period of time remains on the under-lease, at least five years in all cases.[268] In all but one of those 13 cases, the head-lease and under-lease expire at the same time.

11.30 One other store among the 17, in [✂]. This mid-size store, as well as facing competition from one-stop stores of Sainsbury's and Morrisons, is likely to

[267] Appendix C.
[268] Including one in which there is a reversionary lease in place which means that, in effect, the term of the sublease expires in October 2027. The reversionary lease grants the tenant a future property right, exercisable at the point of lease expiry.

face constraints from several mid-size stores (including Co-op, Asda and Aldi) just outside the five-minute drive-time catchment, as well a large number of convenience stores that are very nearby.

11.31 This leaves [✂] stores: Budgens stores in [✂]. For one of these, at [✂], we note that our GUPPI analysis shows that it is only slightly above 5%. We consider that using a 5% threshold is cautious given that the merged entity will not control the Budgens retailer after the Merger (for example, unlike in a standard unilateral horizontal effects theory of harm, in this case we cannot rule out the possibility that even if the retailer did not have its under-lease renewed it could nonetheless still compete in the local area from other premises).

11.32 For all [✂] stores, the under-lease expires within five years. However, we note that in all [✂] cases the head-leases and the under-leases are coterminous (ie they expire at the same time). In practice this means that, in the absence of any extension to the head-lease and under-lease agreed between Booker and its superior landlord, the sub-tenant retailer in each case has the statutory protection of the Landlord and Tenant Act 1954 (LTA) regarding security of tenure.[269]

11.33 If, however, the merged entity were to attempt to extend its head-lease (outside the framework of the LTA) without providing an under-lease extension, and on the assumption that it would have the commercial incentive to do so, it would require Booker's landlord (eg the freeholder) to agree to such an extension. We cannot be certain that Booker's landlord would agree to this. Nevertheless, if an extension were agreed, it could potentially render the merged entity the competent landlord under the LTA for the purposes of any renewal of the under-lease. Under these circumstances the merged entity could potentially refuse to renew the under-lease (for example, because of its future intention to use the premises for its own business). However, there is considerable uncertainty around whether such an outcome would occur.

11.34 [✂]

11.35 We consider that this action gives some assurance that the relevant retailers in the [✂] stores discussed above could themselves take steps to ensure that their protection under the LTA for security of tenure would continue after the Merger.

[269] For example, Booker could potentially qualify as the 'competent landlord' under the provisions of the Landlord and Tenant Act 1954, for the purposes of an extension of the under-lease if the remaining term of its head-lease is more than 14 months at that time. Otherwise, the competent landlord is likely to be the superior landlord to the sub-tenant (ie not Booker as the immediate landlord).

11.36 Based on the above, we consider that a number of events would need to occur before an SLC could be contemplated. Considering these factors in the round we have found that an SLC may not be expected to arise in respect to these three stores.

Conclusion on stores for which Booker holds the head-lease

11.37 On the basis of the above evidence, we have concluded that the Merger may not be expected to result in an SLC in respect of any of the leased stores.

12. Conclusions

12.1 As a result of our assessment, we have concluded that the anticipated acquisition by Tesco of Booker:

(a) if carried into effect, will result in the creation of a relevant merger situation; and

(b) may not be expected to result in an SLC within any market or markets in the UK for goods or services.