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Sent via email:

Dear Peter,

We welcome the opportunity to comment on the CMA's Issues Statement published on 16th October 2018, that sets out the scope of the CMA's inquiry into the proposed Sainsbury's / Asda merger.

We are supportive of the comprehensive and detailed approach to be taken by the CMA in its investigation into the proposed merger of the UK's second and third largest grocery retailers.

Having reviewed the Issues Statement, we believe there are a number of fundamental factors that the CMA should consider in detail during its Phase 2 investigation.

Taken together, and explained further below, these key issues demonstrate that the overall effect of the proposed merger will clearly be anti-competitive as it will result in a substantial lessening of competition in the UK, both nationally and on a vast array of local markets, with clear detrimental effects for suppliers and customers and, ultimately, for competition and consumer choice.

1. Towards Big Three dominance and a powerful duopoly

It is crucial for the CMA to recognise the extent to which the 'Big Four' supermarkets continue to dominate the UK grocery sector.

The 'Big Four' currently have a combined market share of at least 68.4% (Kantar Worldpanel 12 weeks to 08/10/18) and remain the primary destination for shoppers on both a national and local level due to their store footprint and the strength of their respective national brands.

Sainsbury's and Asda have a combined market share of at least 30.7% (Kantar Worldpanel 12 weeks to 08/10/18). The proposed merger will therefore create a powerful duopoly in grocery retailing, with Tesco and the new Sainsbury's / Asda entity together controlling at least 59.3% of the UK grocery market and generating annual sales in excess of £100 billion (Kantar Worldpanel 12 weeks to 08/10/18). This duopoly would dominate the UK grocery retail landscape.

In addition, since limited range discounters such as Aldi occupy a different space and should certainly not be given equal weight in the CMA's analysis (see further below), the true market dominance of the 'Big Four' supermarkets (and other large grocery retailers) is in fact considerably higher than the Kantar metrics would suggest. Accordingly, Aldi urges the CMA to assess and recognise the real level of 'Big Three' dominance and duopolistic market power the proposed merger threatens to bring about.

Clearly, the nature of this proposed merger would also increase the likelihood of and opportunity for coordinated effects in the relevant markets. Further, it would fundamentally impact competition, reduce consumer choice both locally and nationally and have a detrimental impact on suppliers across all categories.

2. **<u>Recognition of Aldi as a limited range discounter</u>**

We note the reference in both the Issues Statement and associated CMA press release to the impact that Aldi and Lidl have had on the UK grocery market. Aldi currently has a 7.6% share of the grocery market (Kantar Worldpanel 12 weeks to 08/10/18) – a figure that is considerably smaller than the combined market share Sainsbury's / Asda will command if the proposed merger proceeds.

Aldi's market share has been achieved through a distinct and fundamentally different offering than that of the 'Big Four' supermarkets. The following factors must be considered:

- As a discount retailer, Aldi only competes with the 'Big Four' supermarkets on a limited range of circa 1,800 products. More than 90% of this range is own-label and we offer significantly fewer branded goods than any other supermarket. By comparison, a 'Big Four' supermarket will typically stock around 30,000-40,000 products.
- The average net sales area in our stores remains at just over 1,000 square metres, whereas a standard size 'Big Four' supermarket is between 3,250 square metres – 4,200 square metres.
- Aldi does not sell fresh groceries online or fuel and does not offer a year round selection of general merchandise lines as the merger parties do. The general merchandise selection we do sell is much smaller and is offered on a once it's gone it's gone basis, for example, our baby range is only on sale for four times per annum (two week in duration).

In addition to the points above, we would encourage the CMA to continue at Phase 2 to recognise the limited overall competitive constraint that Aldi is able to exert on the 'Big Four' supermarkets and on the powerful duopoly this merger would create.

Aldi fundamentally agrees with the CMA's findings at paragraph 68 of its Phase 1 decision and disputes Sainsbury's / Asda's attempts in their Initial Submission to call these CMA findings into question. For instance, Aldi considers that Sainsbury's / Asda incorrectly overstate the competitive constraint that a limited discounter such as Aldi currently exerts on their businesses and this is not borne out in the economic evidence. In line with the CMA's findings at Phase 1 (and the CMA's Phase 2 starting point), the evidence clearly demonstrates there are asymmetric constraints, including in relation to store size.

This is illustrated by an Impact Analysis, commissioned earlier this month and submitted to the CMA as part of our response to your Competitor RFI document. The results showed that the impact on a 'Big Four' supermarket is considerably greater when a similar sized supermarket opens nearby, compared to when a smaller sized supermarket like Aldi opens, a finding that contradicts the Sainsbury's / Asda's Initial Submission.

3. **<u>Competition between the parties</u>**

As indicated in section 1 above, the proposed merger would combine the UK's second and third largest grocery retailers, to create a duopoly with Tesco that would control almost 60% of the market.

We note the CMA's indication in its Phase 1 Reference Decision that the Parties refer to themselves as part of the 'Big Four' in internal documents and that the proposed merger "gives rise to a realistic prospect of a substantial lessening of competition in 463 local areas."

In addition, there are numerous examples of Sainsbury's and Asda adopting pricing strategies in direct response to the other – most notably under Sainsbury's "Brand Match" initiative two years ago and Asda's price guarantee system which it has only recently been announced they are ending. Despite the Parties' claims, this clearly demonstrates they are in direct competition, and the proposed merger would inevitably cause a significant lessening of this competition both locally and nationally.

We therefore encourage the CMA to fully assess how the Parties have directly competed in the past in its consideration of the impact of the proposed merger.

4. Methodology

We note that the CMA will consider the use of a 'weighted share of shops' (WSS) methodology, alongside other methodologies such as a fascia counting exercise. This must be considered within the market context outlined above. The CMA's methodology must not incorrectly overstate the competitive constraint that a smaller, limited range discounter like Aldi can exert on the 'Big Four' supermarkets in general, and on the powerful duopoly this merger will create if it goes ahead.

Furthermore, whilst the CMA has not given specific detail of how it will calculate pricing pressures within this investigation, we note that the merger parties have stated in their initial submission that the GUPPI model used previously by the CMA would be appropriate in this instance. If the CMA does intend to use this model, the threshold applied should be appropriately low given the low margins in retail grocery. A 5% threshold would provide too high a benchmark in this market. We would welcome the opportunity to comment further on the CMA's intended methodology.

5. Interdependencies

We welcome the indication in the Issues Statement that the CMA will consider the interdependencies between the Parties in relation to a number of product areas. It is of critical importance that these are fully and adequately scrutinised by the CMA in its investigation. This proposed merger would:

i. Combine the UK's second and third largest grocery retailers.
ii. Combine the UK's second and third largest suppliers of online delivered groceries.
iii. Create the largest retailer of fuel in the UK by volume of fuel sold.

The combined effects of this on competition must be thoroughly analysed as part of the Phase 2 process.

This must include significant analysis into how the interdependencies between the merger parties' various and wide-ranging product markets affect consumer behaviour. For instance, the CMA should fully consider how the ability for consumers to combine shopping for general merchandise, fuel and groceries in one overall shopping mission, influences their behaviour.

6. Customer Data

In addition to significant analysis regarding consumer behaviour, it is important the CMA considers in detail the associated data that can be harvested from the merger parties' activities across multiple markets. We note Sainsbury's 2018 acquisition of Nectar, which is referred to as the country's biggest loyalty programme. The CMA should consider the impact of potential network effects as a result of this merger which could lead to consumer lock-in and raise barriers to entry for competitors. The potential for consumer detriment as a result of this should be closely examined by the CMA in its investigation.

We also note that the CMA indicates that beyond grocery sales the initial focus of its investigation will be on three general merchandise categories (toys, electricals and clothing) in addition to fuel as "the currently available evidence indicates that there will remain a sufficient degree of competition in relation to the other categories of general merchandise." However, it is essential that when considering interdependencies and how these affect consumer behaviour, the full range of product offerings between the merger parties are considered in their entirety.

7. Suppliers

We note from the Issues Statement that the CMA will consider how the increase in the buyer power of the merged entity may distort competition in the groceries market and, in turn, have an adverse impact on consumers.

The merger parties are direct competitors who compete very closely with each other on a number of different markets. As this horizontal merger would combine the UK's second and third largest supermarkets, who currently compete head-to-head, the scope for increased buyer power is significant.

Given that Sainsbury's and Asda have claimed that the proposed merger will not result in store closures or in-store staff reductions, it is reasonable to conclude that a significant proportion of the forecast cost-savings will be borne by suppliers.

Therefore, the CMA must investigate the potential impact on suppliers in granular detail across all categories and geographies. Consideration should be given to the following factors:

- The proposed merger will increase the pressure on suppliers to reduce their margins further, with local suppliers likely to feel this pressure most acutely. This pressure for lower supplier costs will create a 'waterbed effect', forcing suppliers to increase prices for other purchasers to secure sustainable margins.
- Raising the purchasing cost for other retailers may then lead to higher costs for consumers in these other stores.
- In addition, the increased purchasing power of the merged entity may also lead to pressure for exclusivity deals, prohibiting retailers from accessing key suppliers and limiting the range and choice available to consumers.
- The potential consolidation may restrict trading conditions for suppliers across a vast range of categories, as some suppliers that currently work with both merger parties would lose one customer.
- It could stagnate innovation in the marketplace by forcing more suppliers to be overly reliant on individual retailers and therefore reduce the incentive to develop new products and propositions.
- Whilst Sainsbury's and Asda have indicated that they would be seeking to negotiate more favourable contracts from the largest brands, these global organisations will be more capable of resisting price pressures than smaller suppliers. Both merger parties are focusing on their own brand offering which suggests smaller suppliers are likely to face significant pricing pressures.

Clearly any increase in prices or limiting of access to our key suppliers could have a detrimental impact on our competitiveness. Access to innovation and trialling, exclusivity deals, and indirect economies of scale (e.g. on packaging) can all have an impact and we encourage the CMA to consider these factors to understand the complexity of the grocery retail supply chain.

The CMA must also consider in detail the procurement synergies as a result of the merger parties harmonising their respective purchasing terms. The substantial buyer power that would result is likely to make new entry considerably more difficult and may drive further consolidation, reduce competition overall and limit consumer choice. Ultimately this buyer power could distort competition and result in adverse effects on end customers.

We note the merger parties assert in their Initial Submission that all effects from the proposed merger can be considered at the local level, but this fails to address the potential impact on suppliers as outlined above. We therefore encourage the CMA to ensure these are fully investigated as part of the Phase 2 process.

8. <u>The retail property market</u>

The CMA recognises in the Issues Statement that there is the potential for this merger to require remedies, and indeed the merger parties' own Initial Submission states that national competition concerns could be "resolved by an appropriate local remedy package."

Yet there is no indication within the Issues Statement that the CMA will consider the retail property market in the UK and which retailers would consider purchasing divested stores if such remedies are required.

It is vital that, if the CMA concludes that competition can only be adequately preserved through divestments of stores to credible competitors, the merger is blocked if such credible buyers cannot be found. As this is so fundamental to the potential outcomes of the investigation, we urge the CMA to address issues such as these as early as possible in its inquiry.

We remain keen to fully engage with the CMA throughout this process and look forward to the opportunity you have provided to discuss these matters further in a hearing in November.

Yours sincerely,

Giles Hurley
CEO - UK and IRE