CASE ME/6752/18

PARTIES' RESPONSE TO ISSUES STATEMENT

Sainsbury's

J Sainsbury plc

ASDA

ASDA Group Limited

06 November 2018

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PART I – EXECUTIVE SUMMARY

I. Introduction

(1) The Parties welcome the opportunity to respond to the CMA's Issues Statement. This Response addresses the main issues raised[1] and makes two principal points that are relevant across the Issues Statement's various themes and theories of harm.

(2) First, the UK grocery sector is highly competitive and dynamic – across local grocery markets, channels and store formats. The Parties are significant players but are not particularly close competitors relative to an array of traditional, disruptive and newer rivals.

(3) Second, the Proposed Merger will enhance competition. It will:

- substantially lower the Parties' combined costs, especially in purchasing, narrowing the gap to many competitors, including Aldi, Lidl, Tesco and the bargain stores;
- enable the Parties to convert these lower purchasing costs directly into reduced retail prices, and to invest other cost savings into further price reductions and an improved retail offer to the benefit of their customers;
- be "rivalry-enhancing" (in CMA guidance terms) – given the need to remain competitive, rivals will respond to this enhanced offer, thus benefitting their customers too; and
- give the Parties' shareholders a stake in a more resilient, more cost-competitive and de-leveraged grocery business that is more attractive to customers, and better able to invest ahead of the retail disruptions of the next five to 10 years.

(4) Sections A and B below address these two key points, and the Proposed Merger rationale and efficiencies are addressed at the outset of the Response (Part II of the Response). The remainder of this Executive Summary summarizes the arguments addressed in Parts III to V of the Response, covering Grocery, General Merchandise and Fuel, respectively.

A. Drivers of competition in the retail grocery sector

(5) The dynamism of today's UK grocery sector is driven by the fact that customers are increasingly shopping across multiple brands, shopping more often, and buying smaller baskets. They can and do choose from a diverse range of competitors, from traditional names (including Asda, the Co-op, M&S, Morrisons, Sainsbury's, Tesco and Waitrose), through to industry disrupters (Aldi and Lidl) and newer players such as Ocado and Amazon, as well as Iceland, B&M, Home Bargains and other bargain retailers. In addition, there are large numbers of regional, local and independent operators.

(6) As there are no subscriptions or contracts that tie consumers to a grocery retailer, competition plays out on a dynamic basis between this large number of retailers, as households continuously split expenditure across brands, formats, and channels.

(7) Within this overall context, three points are particularly important for the evaluation of the Proposed Merger:

[1] This draws on the evidence already provided to the CMA in the Parties' Merger Notice and subsequent responses to requests for information. Cross reference is made to these more detailed submissions where relevant, but this Response does not seek comprehensively to restate the evidence already provided to the CMA. The Parties also refer the CMA to their Initial Submission, which addressed points raised in the CMA's Phase 1 Decision.

(8) First, Aldi and Lidl are mainstream competitors who have disrupted the UK market and continue to do so:

- Their reinvented retail offer combines convenient locations, high quality (including fresh and premium) products, with the lowest prices in the industry.
- Their product range serves customers' "main shop" needs and has increased their mainstream appeal across all demographic groups. This makes them an equally compelling threat to both Sainsbury's and Asda (indeed, while their disruptive impact varies by retailer, none is immune, including M&S and Waitrose).
- The investment they have made to reposition their customer offer has driven a significant increase in sales intensity per square metre: Aldi is nearly three times more productive per square metre than it was in 2010; Lidl is nearly twice as productive. Building on this success, they have embarked on an aggressive store expansion programme.
- The result is that over the past five years, both Parties (and the traditional retailers as a whole) have lost significant market share (equating to billions of pounds of lost sales) to Aldi and Lidl's existing stores, and their newly-opened ones, across all local markets.

(9) Second, intense rivalry continues between each of the Parties, Tesco, Morrisons, M&S, Waitrose and Co-op, and their individual responses to Aldi and Lidl only serve to intensify that rivalry. For example, Tesco remains the largest player in the market, has significant cost advantages given its scale, and is investing in its proposition in response to the discounters' success. Other traditional retailers are likewise investing and responding in their own ways.[2]

(10) Third, the evidence shows that Sainsbury's and Asda are not particularly close competitors relative to other rivals, as demonstrated by their differentiation in customer demographics, consumers' different perception of the value proposition of the two brands, their degree of their store network overlap relative to those with rivals, and customer switching patterns.

B. The pro-competitive nature of the Proposed Merger

(11) Without the Proposed Merger, the Parties' current respective cost bases will continue to constrain them from becoming stronger rivals to competitors, including Aldi and Lidl: both Parties will be challenged to lower prices sustainably and make the necessary investments in quality, store environment and service.

(12) Both Parties operate traditional larger supermarkets, which has a significant influence on their operating models and cost structures.

(13) In addition, a number of their costs are rising faster than market volume growth: rental costs, business rates and labour wage rates. These increases do not apply to all rivals in the same way.

(14) Although both businesses are constantly striving to lower their operating costs through productivity and efficiency programmes, there are clear structural limits to how far they can adapt their costs without adversely impacting the customer experience.

[2] See further Chapter 5 of the Merger Notice: Profile and Activity of Grocery Rivals.

(15) In order to reduce prices to customers, the Parties need to reduce their purchasing cost of goods sold, which represents around [✂] of their costs. The Proposed Merger would enable this:

- As set out in their Merger Notice, an independent third party, the Independent Consultant has calculated [✂] in quantified efficiencies savings annually from [✂]. The vast majority ([✂]) of these are purchasing cost savings synergies through harmonisation of buying terms.[3] This would significantly narrow the purchasing cost gap to the discounters and Tesco, each of whom enjoy a much larger volume per product purchased.
- These savings are not achievable without the Proposed Merger: a purchasing alliance would not remove the legal constraint that prevents the Parties from comparing the disaggregated details of each other's cost of goods[4] and would prevent the requisite alignment of the grocery buying and sales functions of each brand.

(16) Given that the overwhelming majority of cost savings are direct variable cost savings, and given the intensity of competition in the market, these reductions will be passed through to consumers through price reductions, as well as in the form of investments in greater quality, range, service and convenience.[5]

(17) These consumer benefits can equally be expected to drive rivals to respond with their own efforts to make their retail offer more attractive. By enabling a significant increase in rivalry, the Proposed Merger is, therefore, fundamentally pro-competitive and to the benefit of customers.

II. Grocery

A. Market definition/WSS framework for assessing local unilateral effects

(18) The unilateral effects assessment in Grocery should take proportionate account of all the competitive constraints faced by the Parties, in circumstances where store location, store size and the brand-specific retail offer are all relevant. The fact that a particular competitor is included within the market does not mean it is a perfect constraint, nor does the fact that a competitor lies out of the market imply that it is not a constraint at all. The weighted share of shops ("**WSS**") framework allows the CMA to be concerned less with the precise market boundaries, as each constraint in the market can be weighted appropriately and proportionate to its competitive effect.

(19) Given the range of competition in the grocery market, the Parties believe that the boundaries of the market should be broadly drawn to avoid omitting significant constraints. The Parties

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3 As independent competitors absent the merger, the Parties could not legally compare their purchasing costs on a granular let alone SKU-level basis. [✂].

4 This is particularly so for granular product and supplier-level details. Compare OFT short form opinion in Palmer & Harvey/Makro, 27 April 2010, paras. 7.7 to 7.9.

5 Although the quantified synergies total is high, it is conservative. The Proposed Merger will also generate substantial non-purchasing synergies, a good example being rolling out Argos into Asda stores. The availability of Argos in Asda stores is a consumer benefit that will be welcomed by customers in the same way this has worked in Sainsbury's, but the Parties' quantified synergies total is conservative insofar as it only includes purchasing cost savings and does not include a variety of non-purchasing synergies (including, but not limited to, the Argos example); see further Chapter 2 of the Merger Notice.

submit that the following constraints should be specifically recognised within the relevant product market:

- Medium stores: The evidence set out in detail in the Response below shows that these belong in the market, as they are significant competitive constraints on Large stores. In particular, it shows that two Medium stores that sum to 1,250 sqm are stronger combined constraints than a single Large store at 2,500 sqm.
- Brands: There are at least nine large grocery operators that are active across the UK (Aldi, Asda, Co-op, Lidl, M&S, Morrisons, Sainsbury's, Tesco, and Waitrose), together with strong independents and other players (such as Booths, Musgrave, Harry Tuffins, McColl's etc.). In each local area in which they are present, all of these operators are constraints that belong in the relevant competitor set (or in the product market).
- Finally, the Parties submit that the bargain stores, online and convenience should be considered within the product market. However, even if these were to be considered outside the relevant market, these important constraints (together with out-of-catchment grocery stores) should be given appropriate competitive weight in the effects analysis, given their significant impact on sales.

(20) On the issue of geographic catchments, the weight of evidence supports wider catchments than those used in previous merger decisions, with a catchment of at least 10 minutes' drive time for urban Medium stores and at least 15 minutes' drive time for urban Large stores.

(21) Once the above elements are included in the market for purposes of the competitive assessment, the WSS methodology allows for them to be weighted in a way that neither overstates nor understates their "real-world" competitive constraint. In this respect, the Parties welcome the CMA's indication that it will consider the use of the WSS methodology as the basis for the CMA's unilateral effects assessment.

(22) The Parties submit that the addition of "fascia counting" as a second primary tool would be redundant and would increase the risk of "binary" errors in the assessment (by focusing on brand effects and ignoring the importance of distance/location). There is no reason why an appropriately calibrated WSS methodology cannot take into account relative strength of brands and fully capture the competitive constraints in each local area of overlap.

(23) In addition to the question of market definition for individual segments, the Issues Statement suggests that the ability to purchase grocery, GM and fuel together may create "interdependencies" that might warrant special assessment. This is not the case.

- First, any such interdependencies are already taken into account in the available evidence: in other words, if some customers prefer a retail offer that covers more than one of grocery, fuel or GM at the same store location, this will be reflected in their switching behaviour, as indicated by the impacts, entry/exit and survey evidence.
- Second, competition does not take place between the Parties on the basis of "bundled" cross-category offers. Notably: (i) Aldi and Lidl have transformed competition in the grocery sector without having Large grocery stores, a large GM range, and/or adjacent retail fuel offer; (ii) Amazon, Primark, Dixons Carphone and others command substantial sales of GM without having had retail grocery or fuel operations; and finally (iii) BP, Shell and other oil majors and independents still

represent the bulk of retail sales of fuel despite not operating large grocery stores adjacent to their retail fuel sites.

B. The Proposed Merger creates no national unilateral effects concerns

(24) At the "national" level, the Parties submit that there are no *discrete* "national" parameters of competition that exist in isolation from, and that are not economically derived from, local competitive pressures. Even where competitive parameters are set centrally and applied uniformly (such as price), these decisions are "bottom-up", based on profit performance (sales volumes and margins) of the store network that is an aggregate of local store inputs.

(25) Post-merger, even absent local divestments, the Parties will continue to face intense competition across their estates such that there is no significant economic incentive to raise centrally-set prices (or worsen other centrally-set parameters of competition). Further, any local store divestiture remedy package, will, by definition, comprehensively address any local concerns.

(26) However, competition concerns do not arise even if the CMA were to determine there are separate "national" parameters of competition. The Parties face significant competition from a number of competitors that are as close or closer competitors to the Parties than they are to each other. The switching data, other economic evidence and internal documents demonstrate the significant and ongoing constraint from these other competitors, in particular from Aldi and Lidl. The Parties' national shares of around 13% each do not understate the strength of competition between the Parties. Equally, their combined share at 26% is not sufficiently high to give rise to a national concern.

C. The online channel cannot be considered in isolation from physical store competition and raises no unilateral effects concerns

(27) The supply of online delivered groceries does not constitute a separate relevant product market. Grocery stores, accounting for 94% of retail supply, compete closely with the online channel at 6% of supply.[6] It would be wrong to exclude the vast bulk of grocery competition arising from and between grocery stores from any analysis of online competition.

(28) Moreover, the fact that the Parties offer the same products at the same prices in-store and online suggests that the two channels are constraints on each other in every location in which the Parties operate: put simply, customers shopping online expect the same prices and products as in-store, and are highly sensitive to the separate charge for home delivery. They would switch to physical stores if the online delivery proposition worsened and the delivery charge were no longer the same value for money in convenience terms. This is supported by survey evidence on consumer switching.

(29) Even if one considers just the online grocery channel, the Parties are not particularly close competitors, consistent with the grocery evidence described above. Within the online channel, this is evidenced by a range of switching and survey data, which demonstrates that the Parties face strong constraints from other grocery retailers operating online, in particular Tesco, Ocado and Morrisons. Competitors will continue to expand their online offering, bringing further competitive pressure to bear.

(30) Whilst the Issues Statement raises the possibility that the Parties could "*raise prices for customers in certain areas or with certain characteristics that mean they are more likely to*

[6] Online grocery sales are forecast to grow ahead of all other formats between 2018 and 2023, IGD, UK Channel Opportunities report (June 2018)

consider the Parties to be close alternatives to each other", the Parties would have no incentive to do so: both operate a single price file in-store and online, and to vary this would be costly and risk reputational damage. [✂].

D. The Proposed Merger will not lead to coordination between retailers

(31) The UK grocery sector is not conducive to coordination in aggregate across local markets and the Proposed Merger will not make it more likely that coordination would take place or be effective.

- First, the market is characterised by far more competing operators post-merger – eight significant national rivals – than is feasible for reaching a hypothetical common understanding.
- Second, these rivals have different business models, leading to differing incentives, making it especially difficult to align incentives sustainably without deviation. These include different cost structures, different price/quality positioning and differences in shares of supply. Most obviously, any attempt at coordination would be disrupted by the industry disrupters or "mavericks", Aldi and Lidl, who would have an increased incentive to continue to expand if there was any attempt to soften competition post-merger, as confirmed by their statements following the announcement of the Proposed Merger.
- Third, coordination would, in any event, not be feasible in practice, given the features of the market, such as the number and variation in products and the importance of competition beyond price on the retail offer as a whole, including quality, service and convenience.

(32) The above factors apply equally to a theory of coordination between a sub-set of operators (whether the Parties plus Tesco and Morrisons "inside" the group, or the Parties plus Tesco with Morrison's "outside" the group), given the lack of symmetry between these operators and the nature and extent of competition from other operators. Furthermore, given the disparate business models and the substantial uncertainty as to rival reactions, coordination on price on the basis of expectations of rivals' reactions is not feasible.

E. The Proposed Merger will not lead to anti-competitive buyer power

(33) Whilst the Issues Statement indicates that the CMA will examine the possibility that the Proposed Merger will reduce innovation on the part of suppliers or lead to a "waterbed effect" that would harm competitors and ultimately consumers, neither theory of harm is supported by the facts.

(34) The Parties do not have a sufficiently high share of procurement of any grocery category, which is a necessary condition to facilitate these theories. The absence of this pre-requisite indicates that the Proposed Merger cannot give rise to an anti-competitive buyer power.

(35) With respect to innovation, the vast majority of the expected efficiencies are driven by gains made from large multinational suppliers, active across countries and in channels other than grocery retail. These suppliers can easily spread the costs of innovation, given the volume of sales that accompany their international dimensions; their innovation incentives are in no way dependent on sales to the Parties. In addition, retailers benefit from and support innovation by suppliers, as this can expand sales for both supplier and retailer so that both share in competitive incentives to bring better value to the customer. As the businesses of both Parties are built on strong and often longstanding relationships with suppliers, the

Parties have no incentive to harm innovation or their supplier base more generally post-Merger.

(36) It is also clear that the conditions for a "waterbed effect" do not hold in this case. Where the Parties' harmonise their wholesale costs, the supplier is already profitably supplying one of the Parties at the relevant lower price. Suppliers continue to have substantial bargaining power to resist attempts to negotiate down the terms of supply beyond an amount that reflects the lower costs of supply available as a result of efficiencies derived from supplying the merged entity. In addition, suppliers should be expected to be already profit maximising in relation to their existing third party customers. As the CMA recognised in *Tesco/Booker*: "*if a supplier could profitably charge "weak buyers" higher prices, one would expect it already to be doing so*."

F. Entry and expansion in Grocery

(37) The UK grocery sector is characterised by dynamic competition, with ongoing expansion by a significant number of rivals to the Parties across different formats and channels. For example:

- Aldi and Lidl have already repositioned their retail offer for mainstream appeal, including both fresh and 'premium" products, with dramatic effect. Both also have strong store expansion pipelines, underpinned by increases in distribution capacity. Both of these competitors would look to open new stores in any local area where competition was diminished and the retail offer worsened.
- Amazon is expanding online via its Amazon Fresh offer, and has now signalled large-scale expansion in relation to in-store grocery (via AmazonGo) and is believed to be considering a greater physical UK retail presence, having already acquired a footprint of Whole Foods stores in the UK alongside its distribution warehouse presence.
- A diversity of other players, including Morrisons, Iceland, Home Bargains, B&M and Ocado, among others, are also expanding significantly.

(38) Given this pattern of entry and expansion, a local WSS approach, based on current distribution and profile of competitors, is inherently conservative. In addition, any national-level theory of harm must take into account the dynamic and disruptive nature of this array of recent entrants and expanding rivals. As demand is growing at best slowly, the net impact of these rivals is not to meet new demand but rather to intensify competition as they take sales and market share away from traditional retailers such as the Parties.

III. Fuel

(39) The Parties agree with the Issues Statement's focus on key factors of competition, such as site location/convenience and price, at the local level.

(40) The Parties consider that the cautious filters used in a Phase I context (with a lower legal standard for concerns) represent a useful Phase II starting point for the CMA to identify a subset of local areas warranting closer scrutiny. This will be subject to necessary adjustments (in particular to take account of the substantial evidence of larger catchment areas for the Parties' sites) and supplemented by available survey evidence.

(41) There is no basis for any national theory of harm in fuel that would go beyond concerns arising from an aggregation of local competitive interactions (and will already be addressed

by the CMA's local analysis). The UK fuel retailing sector is not concentrated, and the Parties have a combined share of under 18%, which is well below normal levels of concern. Currently, Sainsbury's is the fifth-largest player by volume, with a share of 10.2%, and Asda the seventh-largest player, with a share of 7.7%.[7] The Parties rank in volume shares behind both oil majors such as BP, Shell and Esso as well as Tesco and (in the case of Asda) Morrisons. Competition between fuel retailers is intense, reflected in relatively low industry margins, i.e. a low degree of mark-up over cost by fuel retailers, whereby the vast majority of the price paid at the pump is fuel duty, tax, and the crude price of oil.

IV. General Merchandise

(42) The Issues Statement notes the CMA's intention to take a closer look at the Parties' activities in relation to toys, electricals (in particular small kitchen appliances and personal care electricals) and clothing (in particular childrenswear). Supply-side substitution provides no basis for segmenting the market on a narrow and static basis. Unilateral effects concerns do not arise regardless of the approach taken to market definition.

(43) Across these categories, the Parties have low combined shares of supply, their offerings are not particularly close, relative to rivals, and the Parties face strong competition from a range of competitors. For retailing of toys, competitors include Amazon, Smyths, The Entertainer, Tesco, B&M, Aldi, Lidl and Morrisons. For retailing of electricals, competitors include Amazon, Dixons, John Lewis, Dunelm, Boots, B&M, Aldi, The Range, and Home Bargains. With respect to the retail sale of clothing, competitors include Primark, Next, M&S, Matalan, New Look, Very, Asos, Tesco and many others.

V. Conclusion

(44) The Proposed Merger is pro-competitive and will result in substantial benefits to consumers across the UK. The synergies created by the Proposed Merger will allow the Parties to reduce price and invest in greater quality, range, service and convenience to deliver a more compelling customer proposition overall. Given the highly competitive nature of the UK grocery market, consumers will thus benefit not only from the improved offering of the Parties, but also from the dynamic and market-wide increase in rivalry that will result.

(45) Further, the evidence shows, following any necessary local divestments, that the Proposed Merger will not result in local or national competition concerns, whether in Grocery, Fuel or GM. Not only are each of these markets characterised by a wide variety of strong retail operators, each of whom will continue to have the ability and incentive to compete strongly post-Merger, but the Parties are not particularly close competitors relative to these other operators. Finally, the UK groceries sector is characterised by dynamic entry and expansion across formats and channels.

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7 Based on Catalist Database April 2018 using "Company" to identify site owner. Note that this may indicate only one member of a joint venture as the owner (e.g. Tesco in the case of Tesco/Esso JV sites), which may not correctly reflect the price determination of the site.

PART II – MERGER RATIONALE AND EFFICIENCIES

> "*The Parties have publicly announced that the Merger is expected to generate £500 million of synergies net of any price investments and will allow them to reduce prices on many of the products customers buy regularly. The Parties consider that at least some of the synergies which they expect to generate would act as rivalry-enhancing efficiencies (in particular, any variable cost savings in purchasing), as discussed in the CMA guidance.*" (Issues Statement, paras. 128-129)

I. Merger Rationale

(46) The Parties need to improve their customer proposition as a result of the changes in the UK market over the last decade, driven primarily by the mainstream success of Aldi and Lidl. The UK grocery sector is today characterised by stronger-than-ever consumer expectations of increased quality and convenience at lower prices, competition from rivals with more efficient cost structures, as well as the increasing threat of further disruption from operators such as the bargain stores and Amazon. These factors have combined to exert intense competitive pressure by a variety of operators, including at least nine household names, at a time when boundaries between shopping formats, channels and missions have become fundamentally blurred.

(47) In the Parties' view, making sufficient investment in their propositions to fully address these challenges requires them to narrow the cost advantage of many competitors, including Aldi, Lidl, Tesco and bargain stores. This cost reduction requires a significant change to their underlying operating models – a change that the Parties would be unable to sustainably achieve without the Proposed Merger. The details of the relevant cost savings, which form the cornerstone of the Parties' case on rivalry-enhancing efficiencies, are set out in the following section.

II. The Parties' Case on Efficiencies

A. The Proposed Merger will generate significant rivalry-enhancing efficiencies

(48) The Proposed Merger offers the opportunity to unlock cost savings for both Parties on a transformational scale, against an industry background in which traditional grocery retailers have been striving to remove costs to invest in their customer offer and remain competitive with Aldi, Lidl and other grocery retailers. The Parties have publicly announced that the Merger is expected to generate at least £500 million of synergies net of any price investments – [✂]. As set out in their Merger Notice, the Parties commissioned an independent third party, the Independent Consultant, to undertake a detailed analysis to quantify the synergies generated by the Proposed Merger.[8] The Independent Consultant has calculated [✂] of annually recurring efficiencies from [✂].[9]

(49) Moreover, suggesting the Parties consider "*at least some of the synergies which they expect to generate would act as rivalry-enhancing efficiencies*" underplays the points made in the Merger Notice, where the Parties stated the "*vast majority*" ([✂]) of the estimated synergies are purchasing synergies that directly reduce the Parties' cost of goods sold and should be

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[8] The Independent Consultant's analysis did not encompass all possible synergies, albeit that the Independent Consultant covered those areas expected to be the largest sources of synergies.

[9] See Merger Notice, Chapter 2.

viewed as rivalry-enhancing efficiencies.[10] They will be substantially passed on to customers in the form of lower prices and an improved customer proposition – and, by doing so, will put competitive pressure on rivals to react by improving their own retail offer. The CMA's own Guidelines note that variable cost savings of this kind are seen as rivalry-enhancing: "*efficiencies that reduce marginal (or short-run variable) costs … tend to stimulate competition and are more likely to be passed on to customers in the form of lower prices*".[11]

(50) At the same time, these customer benefits from purchasing synergies will not harm customers via anti-competitive "buyer power" that harms suppliers. The benefits to suppliers, and the lack of any harm to suppliers that could impact customers, are explained in more detail in Section VI.

(51) In addition to the general purchasing synergies, the Independent Consultant has recently undertaken an exercise to estimate synergies that can be achieved from the [✂], and has identified annually-recurring variable cost savings in the region of [✂].[12]

(52) The Proposed Merger will also generate substantial non-purchasing synergies, such as rolling out Argos into Asda stores. Due to the highly competitive nature of the market, the Parties will have no choice but to pass on a substantial proportion of these synergies to consumers through further price reductions.

B. The expected efficiencies meet CMA criteria

(53) The Issues Statement notes that for rivalry-enhancing efficiencies to mean that the Proposed Merger "*does not result in an SLC*", they must be timely, likely and sufficient to prevent an SLC from arising, as well as merger-specific. The Parties have comprehensively addressed these criteria in their Merger Notice.[13] The synergies estimates do not rest on speculative long-term projections, but are robust calculations of savings expected to be achieved on an annual recurring basis within [✂] of the Proposed Merger, having been projected to reach run-rate in [✂]. In terms of the sufficiency of the cost savings, as noted above, the initial synergies analysis yielded a gross synergies estimate of [✂] billion per year of annually recurring synergies achieved by [✂] post-completion of the Proposed Merger, of which the predominant share (over [✂] of total, or £[✂] per year on the same timeframe) derives from variable cost savings from harmonisation of procurement terms.[14] This represents a [✂] reduction in total variable cost of purchases across grocery.

(54) As for merger specificity, whilst the Parties individually have every incentive to lower their respective individual cost bases and have done their best to do so to date, the Proposed Merger allows the removal of variable costs from the Combined Entity on a scale that is not conceivable absent the Proposed Merger. In particular, harmonisation of procurement terms self-evidently requires the combination of buying terms at a granular SKU level from each Party.

[10] See Merger Notice, Chapter 2. As further explained in the Parties' response to Question 127 of the RFI dated 24 September 2018, the revised purchasing synergies total is [✂].

[11] Guidelines, para. 5.7.9.

[12] The Independent Consultant [✂].

[13] See Merger Notice, Chapter 2.

[14] See the explanation in Footnote 7 regarding the [✂].

(55) Indeed, the CMA acknowledged the scope for parties to achieve merger-specific variable cost savings by way of harmonisation of procurement terms – and the likelihood of these being passed on to customers – in its recent *Tesco/Booker* decision, where it noted:

> "*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 … 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.*"[15]

(56) Harmonisation synergies clearly cannot be achieved if the two Parties remain independent competitors on the market. Nor could they be replicated through other forms of co-operation short of a merger, such as a buying alliance structure. In fact, the Parties consider that there are no realistic alternatives to the Proposed Merger, in terms of achieving anything close to the order of the synergies identified by the Independent Consultant.[16]

(57) The commercial and pro-competitive benefits of any alternative would be vastly lower, and much riskier to manage and execute, than the purchasing synergy benefits of the Proposed Merger. Both legal and practical constraints within a joint buying group would not entail or allow co-ordination and full transparency of buying terms. For instance, the potential of buying groups is limited by, amongst other things, the information exchange restrictions under competition law which apply to competing businesses. At the same time, the selling functions of the business would not be able to be co-ordinated with the buying function. This would introduce significant inefficiencies and make it harder to achieve what is ultimately the best proposition for customers.[17] International buying groups also typically have a narrow scope (for instance the AMS platform concentrates exclusively on international sourcing of own label); and differences in how retailers operate in different countries and variations in consumer preferences between countries can also limit their effectiveness.

C. The Parties have a strong track record in delivering transaction synergies

(58) The Issues Statement indicates the CMA will assess, amongst other things, "*evidence of the level of synergies claimed and produced in similar transactions in the past and evidence of efficiencies claimed in relation to other commercial arrangements…*".

(59) The Parties each have a proven track record in delivering significant merger synergies from their respective transactions, further demonstrating that the synergies are likely to be realised through the Proposed Merger. In *Asda/Netto* (2010), [✂].[18] [✂].

(60) In light of the factors outlined above, the Parties' efficiencies claims meet the relevant criteria set out in CMA guidance and should be incorporated appropriately in the competitive assessment.

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15 *Tesco/Booker*, para. 26, attached at **Annex_005_002**.

16 See the Parties' response to **Question 7 of RFI7** at **Schedule 24**.

17 Please refer to the Parties' responses to **Questions 2 and 8 of RFI7** at **Schedule 24**.

18 OFT, *Asda/Netto*, Case No. ME/4551/10 (23.09.2010) attached at **Annex_005_003** to the Merger Notice. See Asda Internal Document, Project Norton (Feb 2010), Slide 6, attached as **Annex_002_034** to the Merger Notice. [✂]. Please refer to Asda's response to **Question 45 of RFI3** at **Schedule 23** for further details.

PART III – GROCERY

I. Market definition

"*The purpose of market definition is to provide a framework for the analysis of the competitive effects of a merger … The relevant market contains the most significant alternatives available to customers of the Parties and includes the most significant constraints on the behaviour of the Parties.*" (Issues Statement, para. 18)

(61) The Parties provide below their response to the key points raised by the market definition section of the Issues Statement. As recognised in paragraph 18 of the Issues Statement, market definition is an analytical tool to set the framework for the competitive assessment. As such, the fact that a particular competitor is considered within the market does not mean it is necessarily a perfect constraint, nor does the fact that a competitor lies out of the market imply that it plays no constraint. Indeed, the WSS framework allows the CMA to be less concerned with the precise market boundaries, given that each constraint in the market can be weighted appropriately to its competitive effect. Therefore, the Parties believe that there is no reason to draw the boundaries of the market narrowly at this stage. With respect to the specific parameters, the Parties make the following points:

- Store size: The evidence shows that today's "mid-sized" stores, or Medium stores, are significant competitive constraints on today's "one-stop" or Large stores, and therefore should be included in any definition of the relevant market. Excluding Medium stores from an analysis of one-stop stores is no longer appropriate and would make for a fundamentally flawed competitive assessment. The market definition framework should therefore at least comprise all "supermarkets" – that is to say, all grocery stores greater than convenience format (>280 sqm), whether Medium or Large. At the competitive assessment stage, proper account should be taken of the different competitive weights of Medium relative to Large stores.

- Catchments and store proximity/distance: The weight of evidence supports wider catchments than those used in previous merger decisions. The Parties submit that the appropriate geographic definition for urban catchments is 10 minutes' drive time for Medium stores and 15 minutes' drive time for Large stores. Excluding stores within this would exclude important constraints which can and should be considered directly in any competitive analysis. Within a catchment area, distance matters: the closer a rival store to the focal store, the stronger the competitive constraint. The issue of proximity of stores is also captured in the assessment of competitive weights.

- Brands: There are at least nine large grocery operators that are active across the UK (Aldi, Asda, Co-op, Lidl, M&S, Morrisons, Sainsbury's, Tesco and Waitrose), as well as strong smaller and regional players (such as Booths, Musgrave, Harry Tuffins, McColl's etc.). All of these operators provide a constraint in the local area in which they are present and should, as a result, be included within the market definition framework. However, at the competitive assessment stage, account should be taken of the different competitive weights that should be attached to these brands. The Parties have submitted extensive evidence in the Merger Notice and in response to the CMA's RFIs demonstrating the extent of the constraint from the many grocery operators and thus the appropriate weighting to give them.

- Other important aspects of grocery competition: Each of bargain stores, online, convenience and out-of-catchment grocery stores should also be given appropriate competitive weight in any competitive analysis. The Parties believe that these aspects should be considered within the relevant market. However, even if they were to be considered out of the relevant market, this does not imply that they have no competitive constraint. Being out of the relevant market should not imply a decision to ignore them completely. As set out in the Merger Notice, these constraints can and should be quantified and factored into the competitive assessment.

(62) Whilst this Part III of the Response to the Issues Statement is concerned with all of Grocery, the Parties take the opportunity to note here that the Issues Statement also singles out whether online delivered grocery should be considered a separate market. The evidence shows that this would be wrong. Grocery stores, accounting for 94% of retail supply, compete closely with and constrain the online channel (6% of supply).[19] It would be highly artificial to consider competition among online providers, and the Parties in particular, within a market definition framework that excluded the vast bulk of grocery competition arising from and between grocery stores. Nonetheless, for completeness, this Response to the Issues Statement addresses the online channel (both in terms of market definition and competitive assessment) at Part III Section IV below.

A. Grocery store size: medium and large supermarkets

"*At this stage, we consider that the store size categorisation used in previous cases of one-stop stores, mid-sized stores and convenience stores is likely to be a useful starting point for considering these issues. However, we will assess whether this categorisation remains appropriate as we review the evidence presented to us in the investigation.*" (Issues Statement, para. 28)

(63) The Parties submit that this distinction no longer has any meaningful relevance for market definitional purposes. Historical decisional practice labelled large supermarkets "one stop stores" (i.e. Large stores) and labelled any supermarket below a threshold of 1,400 sqm "mid-size stores" (i.e. Medium stores), and excluded the latter from the Large store market.[20] The last time this distinction was considered fully with reference to direct evidence was by the Competition Commission ("**CC**") in the Supply of Groceries Market Investigation (using 2006 data) and, in a Phase 2 merger context, it has not been considered since the 2002-3 data of the Safeway Report. Twelve to fifteen years later, this framework is no longer meaningful: the market has moved on. As the CC itself said in 2008 "*We are, however, conscious that our assessment will only remain valid as long as the evidence upon which it is based remains a reliable representation of consumer behaviour and preferences. This is why each time the CC has examined grocery retailing in recent years, we considered the issue of market definition afresh*".[21]

(64) Applied today, a hypothesis that would continue to treat Medium stores as falling outside a Large store market would perpetuate a version of the "*binary fallacy*" referred to in the CMA's

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[19] IGD Datacentre (2017).

[20] For convenience the remainder of this document uses "mid-sized" (the historical term) and "Medium" (the term used in the MN) interchangeably. The Merger Notice used "Large" stores in place of "one-stop shop" or "OSS" because the one-stop shop paradigm is fundamentally outdated, and the label is therefore particularly inapt. For this reason, the Parties will continue to refer to Large stores for stores above 1,400 sqm. Nonetheless, the evidence and argument are the same regardless of the competition law terminology used.

[21] Supply of Groceries Market Investigation, para. 4.4.

guidelines. This concern was usefully summarised by the Competition Appeal Tribunal recently in another context when it said:

> "*[W]e enter one note of caution. This relates to the need to avoid the so-called "zero:one" or "binary" fallacy, by which the competition analysis is conducted solely within the context of the defined market. It is fallacious to regard as relevant to the competition analysis only those products defined as falling within the relevant market and to disregard entirely any competitive pressure from those products defined as falling outside it. In our view, competition analysis is always a matter of degree and in each case the degree of competitive pressure, whether from inside or outside the relevant market as defined, must be carefully assessed.*"[22]

(65) This caution also applies to deciding whether to disregard the constraint from Medium stores in considering market definition.

(66) Overall, the evidence not only shows that Medium stores are a good alternative to Large stores for many customers, but also that very few customers shopping in Large stores consider the distinctions between Large and Medium stores to be decisive – that is, so important to these customers that they would not consider a Medium store to be substitutable even if the Large store offer worsened (e.g. in terms of its value for money or service). These two points are further reinforced by the fact that the economic evidence shows that, in practice, Medium stores can and do provide a meaningful constraint on Large stores.

1. Medium stores are good alternatives to Large stores

(67) The Issues Statement states that: "*Larger stores may have a wider range of products and a greater offer of amenities such as cafés, concessions, general merchandise, and specialist food counters, and mid-sized or smaller stores may therefore not provide a good alternative for customers who shop at larger stores to access this range of products/services*".[23]

(68) As set out below, the Large store differentiators mentioned above are neither decisive nor determinative of market definition because Medium stores are credible alternatives – or sufficiently good substitutes – for the bulk of customers.

(69) No two stores in a local grocery market will ever be perfect substitutes for each other. Nor would it be necessary for them to be perfect substitutes in order to provide an immediate constraint on each other and be included in the same relevant market.[24] There are many reasons why stores will not be perfect substitutes. First, no two store locations are the same (affecting convenience of location and travel time for customers). [✂]. Third, in addition to store location and size, pricing, quality, range and service vary by store operator (i.e. by brand).

(70) Similarly, the fact that in any market there will be some "dedicated" customers that will prefer particular aspects of a given retail offer is not sufficient to find that there is no constraint, such that stores must be in a separate market. The key question is whether a substitute is

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[22] See by analogy *Flynn v CMA*, *Pfizer v CMA* (2018) CAT 11, Judgment at para. 119, attached as **Annex_005_030** to the Merger Notice. The CMA's Merger Assessment Guidelines put the binary fallacy point in the following way: "*[a]n over-reliance on concentration measures to indicate changes in market power, in particular where products are differentiated, has been termed the 'binary fallacy': the assumption that all firms in the market exercise competitive constraints upon one another in proportion to their market shares, but that firms outside the market exercise no constraint at all*" (fn 63 to para. 5.3.2).

[23] Issues Statement, para. 27.

[24] It would be illogical if alternatives in a differentiated market were perfect substitutes for customers, because then the market would, by definition, not be a differentiated market (but rather a commodity market).

perceived a good substitute by “enough” customers such that it provides a constraint on the alternative store. The evidence is clear that this is the case with respect to Medium stores constraining Large stores.

(a) Medium stores score well on key drivers of customer choice and have taken share from Large stores

(71) Medium stores have optimised their model for mainstream appeal to as many grocery shoppers as possible, for all types of grocery shops (or “missions”). This is shown directly by the fact that the key drivers of customer choice are identical for both Medium and Large stores, and is also revealed by the fact that Aldi and Lidl, which operate predominantly Medium stores, have not only grown substantially over time, but have taken substantial share from the Parties, alongside other Large store operators.

(72) First, the constraint placed by Medium stores on Large stores is evidenced by the fact that Medium stores perform well in the most important and decisive factors that drive customer store choice, namely location, price and quality.[25]

- Convenience of location: This is frequently viewed as one of the most important factors in a customer’s choice of store.[26] Large stores have no advantage over Medium stores for convenience of location. Indeed, the changes in customer behaviour towards more frequent shopping, coupled with the increase in the number of Medium store locations, means that, on average Medium stores are more likely to be conveniently located than Large edge-of-town stores. For example, across the UK there are over 4,650 Medium stores versus 2,862 Large stores, making it more likely that the closest store to a customer will, on average, be a Medium store rather than a Large store.

- Price: Price is frequently cited as an important driver of store choice.[27] Prices are generally the same across Medium stores and Large stores (for example, Asda and Sainsbury’s have a single price file across all their supermarkets[28]). Therefore Medium stores provide an equally good alternative to Large stores with respect to this key driver. Indeed, the fact that Aldi and Lidl (who predominantly operate Medium stores) are the price leaders is evidence that Medium stores can and do appeal to consumers on the key drivers (see below).

- Quality: There is no difference in product quality between Medium and Large stores because both have the same products. Whilst the smaller the store (including within the Large store category) the smaller the range, range over and above a sufficient level for a main shop (see below) is generally considered to be a significantly lower driver of choice than location, price or quality.[29]

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[25] In a recent IGD survey, Location, Price and Quality were generally ranked the 1st, 2nd or 3rd driver for each of the brands considered; see IGD Retail and Shopper trends, May 2018, page 26, which cites Location as the most or second most important reason for going to a particular brands’ store (with the exception of Waitrose customers, who listed quality and cleanliness as the most important driver). Attached as **Annex_004_005**.

[26] Ibid.

[27] Ibid.

[28] Note that Sainsbury’s has an additional price file for its convenience stores, [✂] and therefore classified as Medium stores.

[29] And “comparable” has become “better” quality: most recently, Aldi and Lidl out-performed other competitors at the Grocer Own-Label Awards 2018 (winning 38 and 35 awards respectively).

(73) As Medium stores tend to be equally or more competitive on the most important dimensions to customers relative to Large Stores (i.e. convenient location, price and quality), customers would switch to a Medium store if the Large store offering was to worsen in relative terms.

(74) Second, Aldi and Lidl run predominantly Medium stores, and their success is clear evidence of the constraint from Medium stores. To presume that Medium stores do not constrain Large stores would be also to presume that Aldi and Lidl have not had any impact on Large stores, a statement clearly contradicted by a wealth of economic and documentary evidence. Therefore, evidence relating to Aldi and Lidl can be usefully understood as evidence of the broader set of Medium store competitors, including the Medium stores of Co-op, M&S, Morrisons, Tesco, and Waitrose.

(75) Finally, the attractiveness of Medium stores to customers can also be seen through the Parties and wider industry moving their portfolio towards smaller stores. This is reflected by the following passage from the GlobalData report "The UK Food & Grocery Market 2018-2023" (published July 2018):

> "*As consumer demand for convenience continues to rise and shopping frequency increases from weekly to daily shops, retailers need to shift store portfolio focus to convenience over larger one-stop shops. The largest grocers Tesco and Sainsbury's are already undergoing such a change, reducing average store size by 5.6% and 15.2% respectively since 2013.*"[30]

(b) "Main shops" are done in Medium stores

(76) The fact that Medium stores are a credible alternative to Large stores is very simply evidenced by millions of customers actually doing their "main" shop in Medium stores. As detailed in Chapters 3 to 4 of the Merger Notice, the predominance of the ritual weekly so-called "one stop" shopping mission is an obsolete notion for millions of UK customers. Grocery shopping has fragmented into more flexible patterns that, in general, still tend to comprise a "main" shop, but also a smaller one than the big weekly shop, and combined with several other grocery shops, at an average of 3.9 per week in 2018.[31] Almost two-thirds (62%) of grocery shoppers say that they now shop more than once a week[32] and customers are increasingly visiting a variety of different retailers to carry out these shops.[33]

(77) The range of shopping missions served by Medium stores is aptly demonstrated by the disruptive influence of Aldi and Lidl on competition for "main" shops, "top-up" shops and "food for later". Among the most telling statistics as to the relative customer usage of Medium stores (in particular those of Aldi and Lidl) for "main shops" are that:

- The proportion of spend through Aldi and Lidl characterised as "main shop" (49.7% in 2018) exceeds that for traditional retailers (41.8% in 2018).[34]
- Using the average number of items (approximately 40) in a Kantar Worldpanel "main" basket, [✂]% of all baskets in a Sainsbury's Large store are below 40 items ([✂]% by value). In Sainsbury's Medium stores this is [✂]% by number of baskets

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[30] Page 12, GlobalData, The UK Food & Grocery Market 2018-2023, attached as **Annex_004L_001**.

[31] Based on Nielsen Homescan data for the period ending April 2018 (Copyright © 2018, Nielsen) attached as **Annex_004_133**. [✂].

[32] Mintel, *Supermarkets UK* (November 2016), page 20, attached as **Annex_004_094** to the Merger Notice.

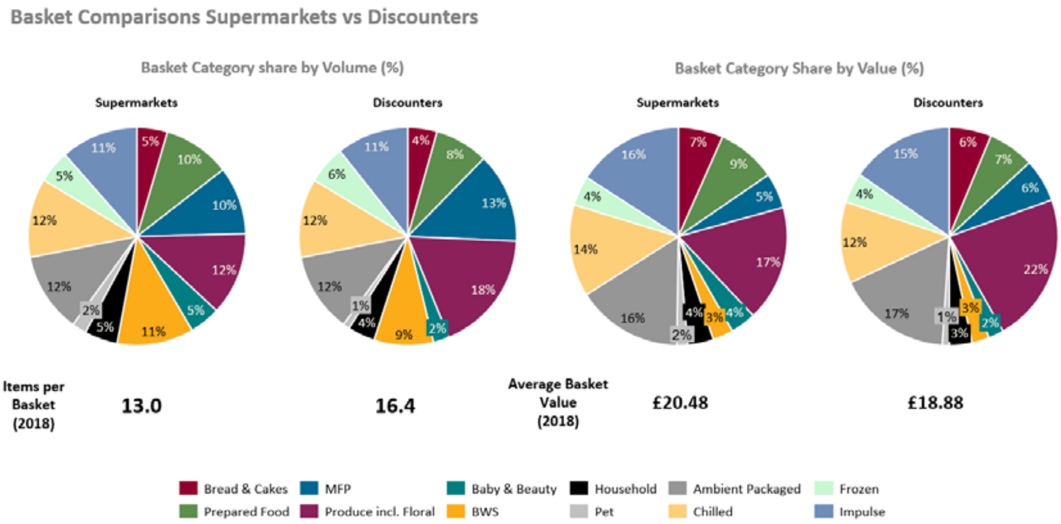
[33] See paragraph 36 below and GlobalData, *Retail and Shopper Trends*, May 2018, pages 23-24 attached as **Annex_004_005**.

[34] Kantar Worldpanel, based on Kantar Worldpanel channel definition for "supermarket".

([✂]% by value). This demonstrates the substantial overlap between baskets in Medium and Large stores.

- The average basket size at Aldi stores has more than 19 items in it, larger than any of the traditional grocery retailers [✂].[35]
- The composition of baskets at Aldi and Lidl are very similar to those at the traditional grocers, as shown by Figure 1 below.

Figure 1 Basket comparisons of Aldi/Lidl vs. traditional supermarkets



Source: Nielsen Panel (Total FMCG), 52 Weeks to 28th July 2018, Kantar Worldpanel 52 weeks to March 2018 for the items per basket and spend. Supermarkets based on sum of Tesco, Sainsbury's, Asda, Morrisons, Waitrose and M&S (excludes Co-op) (Copyright © 2018, Nielsen)

2. The "Large store features" listed by the Issues Statement are not decisive drivers of customers' choice of store

(78) The fact that Large stores are differentiated from Medium stores is not sufficient to conclude that Medium stores do not constrain them. As discussed above, the success of Medium stores has in no way relied upon them being perfect substitutes for (or down-sized replicas of) Large stores. Indeed, Medium stores have continued to grow at the expense of Large stores, notwithstanding any Large store features or amenities that could be isolated as a differentiator from the average Medium store.

(79) In this respect, it is important to highlight that, even within the category of Large stores, there can be significant differentiation: a store of 1,500 sqm will not be identical to a Large store of 3,000 sqm or 6,000 sqm, all else equal. In particular, the 1,500 sqm Large store will inevitably have a more limited product range, and may not have a café, concessions or food counters. However, the Issues Statement does not question whether it would be given the same competitive weight in recognition of the fact that it is a *sufficiently good* substitute to be a credible alternative choice. As far as a 1,300 sqm Medium store "outside" the traditional boundary is concerned, there is no reason why the features listed in the Issues Statement should indicate a lack of constraint that is not assumed for a 1,500 sqm store just within the Large store category boundary.

(80) Notwithstanding that Medium stores clearly can and do serve the same customer need as

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[35] Aldi press release, 2 October 2018, available at: https://www.aldipresscentre.co.uk/press-releases/view/614; Nielsen, Trended KPIs by Retailer, P1 2018-19, (Copyright © 2018, Nielsen) attached as **Annex_004_133** to the Merger Notice.

Large stores (whatever store size within “Large”), the features singled out in the Issues Statement do not support the conclusion that Medium stores are “outside” a Large store market.

(a) Grocery product range

(81) Whilst there is undoubtedly a difference in product range between a Medium store (with a few thousand SKUs) and the relevant multiple of that in a Large store, Medium stores are nonetheless a sufficiently good substitute for Large stores, given that a range of a few thousand SKUs is, in practice, sufficient for millions of customers to conduct their main shop at Medium stores. This is shown by the following.

(82) First, the sufficiency of range at a Medium store is clear from the fact that Medium stores provide all the categories of products that are likely to form part of a customer’s shop. As was demonstrated at the Sainsbury’s site visit, Sainsbury’s shopped for a representative basket of 40 items in Sainsbury’s, Aldi and Lidl.[36] The 40 items are listed below. All but one of the 40 items could be found at Aldi and Lidl, the exception being that Aldi had organic broccoli rather than plain broccoli at the time of shopping.

Table 1 Table of comparison goods

Bananas (x5)	Toilet Paper (x9)	Ready Salted Crisps (x6 pack)	Pink Lady Apples (x6)
Semi Skimmed Milk (4pt)	Easy Peelers	Pasta (500g)	Tinned Tuna (x4)
Whole Cucumber	Baked Beans (400g)	Tin Tomatoes	Tomato Pasta Sauce
12 Free Range Eggs	Sliced Bread 800g	Gold Instant Coffee	Mushrooms
Carrots (500g)	Smoked Bacon	Cornflakes	Mature Cheddar Cheese
Broccoli	Frozen Fish Fingers	Ketchup	Tea Bags
Strawberries (400g)	Frozen Chips	Chardonnay	Milk Chocolate Digestives
Onions Bag	Potatoes (2.5g)	Pizza Margherita	Fruit Yogurt (x6)
Chicken Breast	Orange Squash (1l)	Washing-up Liquid	Washing Capsules (20 washes)
Vine Tomatoes	Beef Mince (500g)	Salted Butter	Nappies

(83) Second, the evidence shows that the degree of product range that Medium stores stock is more than sufficient to appeal to consumers. For example, a recent Sainsbury’s customer survey at Figure 2 below shows that [✂]. This shows that a Medium store can provide sufficient choice for consumers.

Figure 2 [✂]

[✂]

(84) [✂].[37]

[36] [✂].

[37] Based on Sainsbury’s grocery P8 figures.

(85) Finally, the evidence shows that, in general, an extensive product range is not one of the key drivers for consumer choice. Retailers do not compete “on product range” in an isolated sense – they compete on the retail offer as a whole. It would be artificial to isolate one factor that consumers in fact trade off against other important considerations: their budget, their desire for sufficient product quality, and their time.

(86) For example, [✂].[38] [✂].[39]

(b) Specialist food counters

(87) Specialist food counters [✂] of the Parties’ sales in stores with counters. For Asda, counters make up on average [✂] of the Asda grocery sales in stores with at least one counter.[40] Similarly for Sainsbury’s, counters comprise [✂] of its grocery sales in stores with at least one counter. This shows that counters are not intrinsic to a store’s success, particularly as the products sold at the counter tend to be available on the shelf in any event.

(88) [✂].[41] [✂].[42]

Figure 3 [✂]

[✂]

(89) Further, the lack of competitive importance of specialist food counters can also be seen from the fact that neither Aldi nor Lidl has a meat or fish counter; however, it is precisely the area of Meat, Fish and Poultry (“**MFP**”) in which Aldi and Lidl overtrade (with a combined volume share of 22.3% in MFP)[43] and have had the largest impact on the traditional retailers.

(c) Non-grocery offer: “cafés, concessions, general merchandise”

(90) The vast majority of customers at the Parties’ stores are visiting primarily to purchase groceries. This is clear from the customer survey evidence available to the Parties, which suggests that cafés, concessions or non-grocery/general merchandise retail offers are not the predominant or sole driver of store visits [✂] of customers. For example, [✂].[44] [✂].[45] Similarly, GlobalData indicates that the most important drivers of customer choice in food and grocery are value for money (91.5%), quality (90.3%) and price (88.4%), with factors related to store facilities, such as instore experience (65.9%) and instore convenience (64.8%), shown to be considerably less important.[46]

(91) Second, this result is reinforced by the relatively small proportion of revenue accounted for by these non-grocery offerings. For example, the Parties’ transaction data indicate that the majority of baskets do not contain GM, with [✂] of all Asda grocery baskets and [✂] of all

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38 Asda Pledge Tracker Survey July-September 2016.

39 Asda Tracker Survey Jun 18-Aug 18.

40 Proportion is a weighted average across stores of the proportion of sales made through counters. Any stores that do not have at least one counter have been dropped to be conservative.

41 [✂].

42 [✂].

43 Nielsen data (52 w/e July 2018) (Copyright © 2018, Nielsen) attached as **Annex_004L_004**.

44 Asda Tracker Survey Jun18-Aug18. “What prompted you to choose X for this specific shopping occasion as opposed to using another Supermarket? (Please choose all that apply)”. “And of the reasons below, which one had the greatest influence over your decision to shop at X on this occasion?”

45 Ibid.

46 GlobalData UK Food & Grocer Market, July 2018, page 75. GlobalData results are based on asking shoppers to rate drivers of choice out of 10. Attached as **Annex_004L_001**.

Sainsbury's grocery baskets not containing any GM items.[47]

3. The wider economic evidence supports Medium stores being a good alternative to Large stores

(92) The Sections above show that (i) customers have demonstrated with their own shopping behaviour that Medium stores are good options for their "main" shops among others; and (ii) the additional features that may be present in a Large store are not a significant enough drawcard for customers to have made them shop at these Large stores instead.

(93) More generally, the Merger Notice draws from multiple sources of direct evidence on the strength of constraint from Medium stores on Large stores.

(94) The evidence in aggregate shows that the intensity of the competitive constraint between grocery store sizes is continuous and is proportionate to store size. There is no "step change" in constraint at 1,400 sqm. Indeed, the evidence shows that on a comparable per square metre basis, Medium stores exert a stronger constraint than Large stores because, in general, the strength of constraint increases by a smaller rate as store size increases. This is because, whilst Large stores have a greater grocery sales area, the sales intensity (sales per sqm) is actually higher in smaller stores. This relationship means that two Medium stores that sum to 1,250 sqm are stronger combined constraints than a single Large store at 2,500 sqm. Ignoring Medium stores would thus ignore constraints that may in aggregate be significantly stronger than the constraint of a Large store.[48]

(95) The fact that Medium stores are good substitutes (such that they should be included for the framing role of relevant market definition) is readily apparent from at least six individual sources of evidence. These include: (i) ordinary course internal documents; (ii) the Parties' impact analyses in the ordinary course of business; (iii) CRA's entry/exit analysis; (iv) Kantar Worldpanel national aggregate switching data; (v) customer survey evidence and (vi) the Parties' "gravity" models that they use to consider local competition.

- <u>Parties' internal documents and third-party market commentary</u>: The documentary evidence does not support a distinction between Medium stores and Large stores. [✂].[49] Similarly, whilst third party market reports frequently distinguish between shopping missions and between convenience stores and other stores, they do not distinguish between Medium and Large stores.
- <u>Parties' impact analyses and CRA entry/exit evidence</u>: If the historical approach to market definition was still valid, this would imply that, relative to entry by a new Large store, entry by a new Medium store would have a modest (if not zero) negative impact on the sales of a Large store. [✂].
- <u>National-aggregate switching data</u>: Switching data for Aldi and Lidl, which only operate Medium stores, illustrates the constraint on the Parties' Large stores. The Kantar Worldpanel data at Table 2 below shows that Sainsbury's and Asda each experienced significant customer switching both to and from Aldi and Lidl (evidencing

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47 See data supplied in response to RFI12 Q77.

48 That is not to say that the relative strength of constraint should be ignored in the competitive assessment. As set out in detail in the Merger Notice, the competitive assessment should give Medium stores a "fractional" competitive weight compared to Large stores that is proportionate to what is shown by the evidence as a whole (i.e. a weight between the extremes of zero and 1:1).

49 [✂].

the significant extent of ongoing competition for “share of grocery wallet” of customers between the two). [✂].[50]

Table 2 Sainsbury’s and Asda Switching for Grocery

	Asda’s switching £m Grocery 52 w/e 17 June 2018			Sainsbury’s switching £m Grocery 52 w/e 17 June 2018		
	Gains £m	**Losses £m**	**Net Switching £m**	**Gains £m**	**Losses £m**	**Net Switching £m**
Asda	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Sainsbury’s	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Morrisons	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
The Co-operative	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Iceland	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Farm Foods	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Waitrose	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Aldi	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Lidl	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Bargain Stores *	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
M&S	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
All Others	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Shifting Total	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

* Includes Home Bargains, B&M Bargains, Poundland, Poundstretcher, Poundworld and other smaller Bargain Stores. Source: Analysis of Kantar Worldpanel data (Grocery 52 w/e 17 June 2018)

- Customer surveys: [✂].[51]
- Parties’ models of local competition: Both Asda and Sainsbury’s use [✂] models to predict store sales for new stores, based on the significance of rival stores in a local area. [✂].

Figure 4 [✂]

[✂]

Figure 5 [✂]

[✂]

(96) [✂].[52] The results are that, consistent with evidence in the Merger Notice, the Parties model two Medium stores at 1,250 sqm as having a stronger impact on a Large store’s sales than a single Large store at 2,500 sqm.

(97) Overall, therefore, the weight of evidence consistently points in the same direction, namely that it would be wrong to exclude Medium stores from the market in which Large stores compete. Once they are part of the competitive assessment, the WSS framework allows for Medium stores to be weighted in a way that neither overstates nor understates the

[50] See Merger Notice, Schedule 6.

[51] See further analysis at paragraph 382 of the Merger Notice.

[52] [✂].

competitive constraint they exert on Large stores. This is one of the biggest virtues of the WSS framework that the CMA has developed.

B. Grocery Store Catchment Areas

(98) The Issues Statement notes at paragraph 29 that the CMA "*will examine the distance over which stores constrain each other, ie their geographic catchment area. We recognise that this may depend on a variety of factors, including the size and brands of the stores involved*".

(99) As with the issue of store size, the issue of store catchment size, or geographic market definition for physical grocery stores, has not been subject to detailed Phase 2 merger scrutiny since *Somerfield/Morrisons* over 13 years ago.

(100) It is therefore appropriate to consider the question afresh with contemporary evidence including more accurate data. Chapter 6 of the Merger Notice sets out the economic evidence available from a wide selection of data, namely Nectar customer loyalty card data, Sainsbury's internal catchment methodology, Asda's till survey data, Sainsbury's and Asda impacts data, and the CRA entry/exit analysis. All of this hard evidence supports the conclusion that actual geographic catchment area drive times are larger than those used in the past.

(101) Further, as set out in response to the CMA's requests for information, the Parties' [✂].[53] These models are consistent with the evidence in the Merger Notice that catchments are at least 15 minutes' drive-time in scope.

(102) The Parties propose that an evidence-led approach, but nonetheless still conservative approach, to catchment area results in the following drive-time catchments in urban areas:[54]

- Medium stores – 10 minutes; and
- Large stores – 15 minutes.

(103) The proposed catchments above are also fully compatible with the finding that the competitive constraint exerted by one store on another declines over distance, that is, that a distant store places an increasingly weak constraint on a focal or "centroid" store compared to a more proximate store.

(104) As explained in the Merger Notice, using the above catchment areas does not risk over-estimating the competitive constraint because an appropriately calibrated WSS would avoid the risk that a store at say 9.5 or 14.5 minutes away is treated the same as a store located next to the focal store. By contrast, adopting overly narrow catchment areas inconsistent with the evidence would give stores outside the narrow catchment zero weight, which would introduce a geographic "binary fallacy" and under-estimate the competitive constraint.

C. Brand

(105) At paragraph 30, the Issues Statement notes that the CMA "*will examine the strength of constraint exerted by stores of different brands*".

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[53] See response to **Question 32 of RFI3** at **Schedule 22** and **Schedule 23** for more details.

[54] There are virtually no rural areas at issue, but the respective catchments proposed on the same basis are 15 minutes for Medium stores and 20 minutes for Large stores.

(106) The Parties have submitted extensive evidence in the Merger Notice and CMA RFIs on this topic. Further, the discussion at Section 2 below on closeness of competition provides further evidence of the constraints that the Parties face from different retail operators.

1. The Parties face significant constraint from a wide variety of grocery retail operators

(107) The weight of the evidence demonstrates clearly that each of the Parties faces significant individual constraint from each of at least eight grocery operators active across the UK (Aldi, Co-op, Lidl, M&S, Morrisons, Tesco, Waitrose, and Asda or Sainsbury's, respectively).[55] [✂]. It is also clearly shown by the survey evidence of customer diversions, [✂], and CRA's analysis of the entry/exit analysis on the basis of competitors' stores size. These all show clearly that the market is characterised by strong competition from many operators, including Tesco, Morrisons, Aldi, Lidl, M&S, Waitrose, Co-op and others.

(108) The Parties' own [✂] models, discussed in detail in response to the CMA's request for information, provide further evidence of this constraint, as do third-party qualitative analyses such as the OC&C customer perception results and the Acorn/Cameo demographic analyses.

(109) Further, the evidence shows that there are many strong smaller and regional operators, such as Booths, Musgrave, Harry Tuffins, McColl's etc. which provide a strong constraint in the local areas in which they are present. Chapter 5 of the Merger Notice provides a complete list of competitors that constrain the Parties.

(110) For the purposes of market definition, each of these competitors should be included within the relevant market, with the weight to be attached to them to be determined and calibrated as part of the competitive assessment.

2. The Parties are not particularly close competitors

(a) Parties' respective retail offers to customers are not particularly close

(111) Reflective of the relatively low diversions between the Parties (at a national level – see further Section II below), customer perception of the Sainsbury's and Asda brands is very different, indicating that competition between the Parties is not particularly close in terms of the retail proposition. This can be seen from the third-party OC&C Index of customer perception at Figure 6 below, which not only has a significant "gap" between the two brands, but also has Morrisons and Tesco situated between the Parties' brands:

Figure 6 [✂]

[✂]

(112) Further, the Acorn consumer demographics graphs, provided at paragraph 552 of the Merger Notice, show that Asda generally over-indexes in the consumer groups in which Sainsbury's under-indexes, and vice-versa, indicating that they appeal to different consumer demographics. This is further illustrated by the Acorn indices at Figure 7 below. It is clear from this that Asda is much closer to Aldi and Lidl in terms of consumer demographics than to Sainsbury's (which, in turn, has the most in common with Waitrose).

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55 For certain other brands, as set out in Section I.D below, the approach taken is that while they may not individually rank as highly in grocery retailing as those listed above, in aggregate their constraint is significant (e.g. Iceland/Food Warehouse, B&M, Home Bargains, Ocado and Amazon).

Figure 7 Acorn indices (2018)

Acorn category	Sainsbury's	Asda	Aldi	Lidl	Morrisons	Tesco	Co-Opera	Waitrose
A Lavish Lifestyles	56	-52	-37	-38	-44	-22	-28	174
B Executive Wealth	25	-21	-12	-11	-5	8	4	104
C Mature Money	6	-27	2	-9	11	5	12	41
D City Sophisticates	42	-47	-51	-5	-36	-26	-29	148
E Career Climbers	29	-10	-9	0	-20	10	-9	61
F Countryside Communities	-17	-28	-2	19	13	9	25	-21
G Successful Suburbs	-1	-9	1	-1	6	10	-0	15
H Steady Neighbourhoods	11	12	8	4	10	6	-5	-24
I Comfortable Seniors	-8	7	21	-7	27	1	25	-8
J Starting Out	16	-0	-2	-9	14	5	19	25
K Student Life	8	-6	-12	8	-38	-6	-20	-9
L Modest Means	-16	15	14	2	5	-1	5	-54
M Striving Families	-18	12	12	-6	-5	-0	-3	-46
N Poorer Pensioners	-30	5	5	-10	5	-16	17	-55
O Young Hardship	-12	22	16	23	17	-4	-2	-49
P Struggling Estates	-3	22	-19	6	-11	-16	-21	-39
Q Difficult Circumstances	-23	36	3	4	-10	-7	-21	-55
R Not Private Households	-21	5	-46	61	-40	46	13	-44

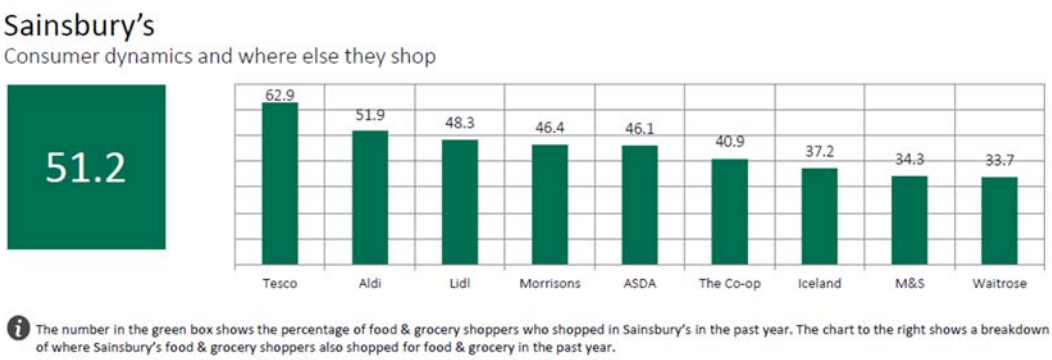
(113) The same result is seen from Cameo's indexes of consumer demographics applied to brands, where G1 is the highest affluence group and G10 is the lowest affluence group. Once again, Sainsbury's and Asda have very different demographics, with both Aldi and Lidl being generally closer to the Parties than the Parties are to each other.

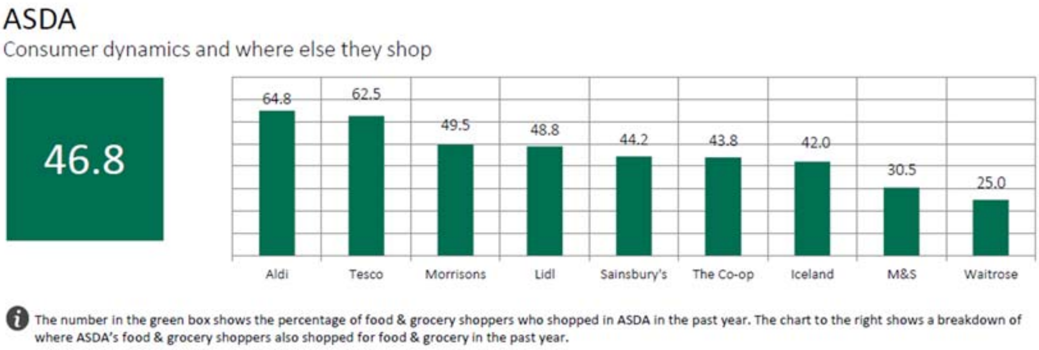
Figure 8 Cameo Demographic Indexes 2018

CAMEO category	Sainsbury's	Asda	Aldi	Lidl	Morrisons	Tesco	Co-op	Waitrose
CAMEOG1	40	44	-36	4	-32	-2	-7	146
CAMEOG2	33	39	-11	2	-16	2	-8	90
CAMEOG3	23	24	-23	8	-15	4	-5	79
CAMEOG4	11	16	2	2	-8	-1	0	39
CAMEOG5	15	15	-2	3	-5	1	-5	15
CAMEOG6	0	14	10	6	9	5	18	-9
CAMEOG7	-1	10	13	-1	1	-1	1	32
CAMEOG8	-20	10	4	-8	13	-2	13	33
CAMEOG9	-16	20	-6	-2	6	6	19	57
CAMEOG10	-42	62	14	-8	17	14	4	79

(114) Finally, cross-shop data from GlobalData at Figure 9 below shows that, in the past year, a higher proportion of Sainsbury's food and grocery shoppers also shopped in Tesco, Aldi, Lidl and Morrisons than also shopped at Asda. Similarly, for Asda shoppers, a higher proportion also shopped at Aldi than any other grocery retailer (including Tesco), with Sainsbury's in fifth place behind Aldi, Tesco, Morrisons and Lidl.

Figure 9 Cross-shop data for Sainsbury's and Asda (GlobalData 2018)





(115) The Parties' overall retail offerings are thus not similar to each other in terms of customer preferences or overall perception. On the contrary, in many ways the Parties are at different ends of the consumer preference spectrum, with a large number of other operators either coming between them or most closely meeting the same customer needs as either Party.

(b) Numerous grocery rivals are at least as close competitors, if not closer still

(116) The evidence shows that numerous other rivals are at least as close competitors, if not closer still, than the Parties are to each other. As explained in the Parties' Initial Submission,[56] the most direct measure of "closeness" is not a checklist of supposed similarities but the relative degree of customer switching: the closer two competitors, the more switching between them, relative to switching to and from other rivals. The Kantar Worldpanel switching data submitted in the Merger Notice provides evidence of this wider group of competitors. The level of net switching from Asda and Sainsbury's to each of the other main grocery retailers between 2014 and 2018 shows that, whilst both Parties occasionally are net gainers or net losers of sales from each other over the last four years, there is no systematic trend. On the other hand, the switching data at Table 2 above shows that the Parties have systematically been net losers of sales to Aldi and Lidl over the entire time period. Importantly Sainsbury's and Asda have each experienced ongoing and significant customer switching both _to_ and _from_ Aldi and Lidl (evidencing the significant extent of ongoing competition for a share of customers' grocery wallets).

(117) The Parties' internal documents support the strength of competition from other grocery operators:

- Asda monitors a range of competitors, including [✂].
- [✂].[57] [✂].[58]
- Like Asda, Sainsbury's also consistently monitors and tracks the performance of a broad competitor set comprising [✂]. This includes quantitative and qualitative assessments of these players against a range of metrics, including: year-on-year volume and transaction growth, price position, promotional impact, new product, merchandising and service initiatives, value growth differentials, market share and customer switching.

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[56] Paragraph 49, Initial Submission.

[57] [✂].

[58] [✂].

- [✂].

(118) Further, when it comes to the competitive benchmarking that inputs into the Parties' competitive decision-making, it is clear that the Parties focus to a far greater extent on other competitors than they do on each other. Considerable detail on the Parties' benchmarking has been provided in Chapter 4 of the Merger Notice and in response to the CMA's requests for information.

(119) On the basis of the above, it is clear that the Parties are not particularly close competitors relative to the many other competitors across UK grocery markets.

D. Other constraints: bargain, convenience, online, out-of-catchment stores

(120) When framing the competitive assessment for the Parties' grocery store overlaps, and in particular to avoid the "binary fallacy" highlighted in Section A above, the issue arises of how to capture competitive constraints from various rival sources that are significant, especially in aggregate, but do not take the form of grocery stores or "supermarkets" as traditionally understood. These include: (i) the online grocery channel; (ii) bargain stores such as B&M and Home Bargains; and (iii) convenience format grocery stores.

(121) The need to capture these constraints is particularly well illustrated by the Parties' [✂] models, which are used for business as usual planning and investment purposes. [✂].[59]

(122) The Parties submit that the important question is not whether these sources are considered explicitly "in" or "out" of the relevant market for physical stores: what is important is that they are not ignored or given insufficient credit in the competitive effects analysis.[60] The same point applies to constraints from grocery stores that are "in" the product market but "out-of-catchment" (i.e. beyond the relevant drive-time catchment of the store in question).

(123) As set out in more detail in the Merger Notice, the appropriate way to make sure that these constraints duly feature in the competitive assessment is to assign a proportionate aggregate weight to reflect the combined constraint that they place on the Parties' stores. This is more pragmatic than attempting to isolate the individual constraint from each source for each local market. Moreover, the Merger Notice takes a very conservative approach by proposing only a [✂]% weight for these constraints in aggregate.

(124) This general approach is also consistent with the approach taken by the CMA in *Ladbrokes/Coral* and *Tesco/Booker* for residual constraints not captured in their primary approach to the question of closeness of competition.[61] It is also consistent with the logic of the most recent Phase 2 merger case involving supermarkets, *Somerfield/Morrisons*.[62] These cases correctly avoid the binary fallacy error because they do not simply ignore

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59 [✂].

60 In contrast, when framing the competitive assessment of the online channel in its own right (as the IS seeks to explore), online should form part of the same relevant market definition as physical stores (and as the IS suggests is appropriate for click and collect) because the distortive impact of excluding stores is so significant when considering online in isolation. See further Section IV below.

61 See *Ladbrokes/Coral* at para. 7.128, attached as **Annex_005_007** and *Tesco/Booker*, Annex C, paragraph 62, attached as **Annex_005_002**.

62 In *Somerfield/Morrisons* (2005), the Competition Commission noted that survey evidence demonstrated customer diversions to a wider range of stores than the fascia identified at its Phase 2 "initial screen" (so-called Phase 2 "Stage 1") analysis. Thus, for the purposes of its Phase 2 "Stage 2" analysis to determine the SLC question, the Competition Commission included "*the competitive effects of all other grocery retailers, as revealed in the diversion ratios from our survey. The diversion ratios allow not only for retailers such as convenience stores, corner shops or specialist shops beyond the competitive set we have used but also for retailers beyond the isochrones [catchments] we have used in Stage 1*"; paragraph 7.21.

significant competitive constraints that, although real, do not fit neatly within a chosen category, such as Large/Medium grocery stores or "supermarkets".

II. Grocery stores: unilateral effects theories at national level

> "*Several aspects of the Parties' retail offering are determined centrally and applied uniformly across their entire store estates (or across large portions of it) … We will assess the extent to which the Merger may give rise to an incentive to worsen these national, uniformly-set parameters of competition.*" (Issues Statement, paras. 65-66)

(125) The Parties submit that the merger does not result in the ability or incentive to worsen centrally-set or "national" parameters of competition.

(126) First, as explained in detail in the Merger Notice and summarised below, there are no discrete "national" parameters of competition that exist in isolation from, and are not economically determined by, individual or aggregate local competitive pressures.

(127) Second, the aggregate incentives of the Parties will not change post-merger. Thus, there can be no SLC on the basis of centrally set, uniformly applied competitive parameters that take account of aggregate performance across the Parties' local estates. As set out in Chapter 7 of the Merger Notice, this is the case even prior to solving any local SLC concerns (see Section B below) but in any event holds true once any local SLC concerns are comprehensively solved (see Section C below).

(128) Third, even supposing there were separate "national" parameters of competition, the Parties face significant competition from a number of rivals that are as close or closer competitors to the Parties as they are to each other, and no SLC concerns can arise on that basis.

A. There are no discrete "national" parameters of competition

(129) While certain aspects of the Parties' retail offering are determined centrally and applied uniformly across their stores (such as most prices[63]), this is not a "top down" process, insulated from local retail market dynamics by which stores try to attract local shoppers. Rather, decision-making is "bottom up": based on an aggregate of information obtained from the local level. As the CMA's *Retail mergers commentary* notes, "*a retailer will take account of the extent of local competition faced by its stores when making decisions regarding prices and other competitive variables, even if these are set uniformly across all stores*".[64]

1. Key parameters of the retail offer are set on a "bottom up" aggregate basis

(130) Price is a key parameter of competition. Chapter 4 of the Merger Notice, as well as the Parties' responses to the CMA's requests for information,[65] set out in detail the ways in which the Parties determine their pricing. As is clear from this information, pricing is not determined on a "top down" basis. As was set out clearly on both Parties' site visits, [✂]. This data comes from aggregated store performance and is the most important input into determining price changes. Whilst both Parties [✂].

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[63] The main exception to this relates to alcohol prices in Scotland, which are affected by the local requirements on minimum pricing: see Merger Notice, paragraphs 226 and 248.

[64] *Retail mergers commentary*, paragraph 1.14.

[65] In particular, see the Parties' responses to Question 3 of the Request for Information dated 24 September 2018.

(131) As also shown on the Parties' site visits, the Parties receive ongoing feedback from stores to understand how centrally made decisions are impacting store sales. This comes not only from financial performance figures, but also from regular communication with store managers. For example, [✂].

(132) This bottom-up approach by the Parties, with a constant eye on overall performance, means that any significant changes across the local estate – whether changes in customer tastes or the intensity of competition – will contribute to central pricing decisions.

(133) Similarly, range is not determined in a purely "top down" manner, as is clear from the evidence provided in the Merger Notice, in response to the CMA's requests for information and at the site visit. Whilst decisions on range are taken centrally, no two stores in either Party's estate has the same product range mix on shelves as any other, as the Parties vary their range offerings substantially to take account of local demand. This local demand is a function of regional/local tastes, demographics and competition. This unique product range mix for each store results in different average selling prices by store, reflecting different shopping baskets, despite uniform pricing at individual product level. Both Parties constantly monitor their range to determine whether they should give greater space to certain products, add products or take away products that do not sell well locally, to maximise the size of customers' baskets and share of grocery spending.

(134) Decisions about quality and service are similarly determined centrally but take into account local and aggregate performance in local stores. For example, as set out in response to the CMA's requests for information, centrally set quality standards for own-brand products and in-store service are tracked and monitored at a local level, with performance at store level feeding into the Parties' positioning and decision-making at a central level. Both Parties have a number of measures to track customer satisfaction at store level for this purpose. The KPIs monitored at store level that input into decisions at central level have been described in detail in response to the CMA's information requests. As a result, no two stores in the Parties' estates, even if they are the same size, carry exactly the same grocery range.

(135) This bottom-up approach means that any significant changes across the local estate – whether changes in customer taste or the intensity of competition – will have a material impact on centrally made decisions regarding the overall retail offer.

2. Innovation and branding are similarly determined on a "bottom-up" basis

(136) The Issues Statement makes reference to brand and innovation as examples of "national" parameters of competition. However, in the same way as retail offer elements, brand and innovation are not determined on the basis of a separate "national" market but, rather, are influenced by aggregated local information resulting from local competitive impacts.

(137) Innovation is driven by the potential additional sales that, for example, new products or alternative means of shopping, can bring which are a function of the competitive conditions at the local level. Similarly, the more competition a retailer faces at local level, the greater the incentive to innovate in order to win share. As such, incentives to innovate depend on the aggregate level of competition across the estate rather than some notion of "national" competition.

(138) Branding is similarly driven from the "bottom up". As explained in the Merger Notice, brand perception is a composite reflection of more tangible competitive variables such as price, quality, range, service and convenience experienced by customers. It is this local experience

of the customer base that drives customer choice of brand. However, to the extent that branding drives additional sales (for example through advertising strategies), the level of additional sales, and hence effort, will reflect the aggregation of local competitive constraints the Parties face from different retailers across their estates in the same way as for other aspects of their retail offerings.

B. The Parties' aggregate incentives will remain unchanged post-merger

(139) The evidence shows that the Parties face intense competition across their estates, with competition from each other being no more intense or significant than competition from other retailers. For example, [✂].

(140) This overall intensity of competition across the Parties' estates post-merger is such that, even absent divestments, there would be no substantial reduction in aggregate competitive pressure on centrally-set parameters, such as pricing, and therefore no economic incentive to raise centrally-set prices post-merger. Indeed, the Proposed Merger is predicated on achieving sufficient synergies to enable compelling price reductions to customers.

(141) In the Merger Notice, the Parties have demonstrated the lack of incentive to raise prices or worsen other centrally-set parameters replicating the CMA's analyses on aggregated price competition incentives applied in its reports on *Poundland/99p* and *Ladbrokes/Coral*. This shows aggregate diversions of [✂]% from Sainsbury's to Asda and [✂]% from Asda to Sainsbury's. The low aggregate diversion reflects the degree of competition at the local level. Combined with a variable margin of [✂]%, a diversion ratio of [✂]% (from Sainsbury's to Asda) and [✂]% (from Asda to Sainsbury's) translates into a GUPPI of [✂]% for both Parties. A GUPPI of this magnitude (even in the absence of compensating cost-reduction efficiencies) suggests insufficient upward pricing pressure to be consistent with an expectation of a material adverse effect.

C. No SLC can arise on an aggregated basis in the presence of local divestments

(142) The fact that local competition aggregates into centrally-set and implemented decisions means that, so long as no SLC arises in any individual local area, there can be no SLC in aggregate on centrally-set parameters (such as price). Any attempt to increase centrally-set prices would simply result in the same volume losses in each local area as would occur pre-merger and, given that such an attempt was unprofitable pre-merger, it would by definition be unprofitable in aggregate post-merger. Therefore, given that any local store divestiture remedy package will, by definition, comprehensively address and solve local SLC areas, there will also be no change in the aggregate incentive on centrally-made decisions.

(143) Furthermore, based on the aggregate analysis above, even absent local divestments, the loss of aggregate incentives is minimal.

D. Even on a putative discrete "national" basis, no concerns will arise

(144) Even if the CMA were to consider the impact of the Proposed Merger on a national basis, it is clear that there will be no SLC on this basis. First, as set out at Section I.C.2 above, the Parties are not particularly close competitors. Second, as set out at Section I.C.1 above, there are many significant competitors present in the market, each of whom poses a considerable constraint on the Parties. Third, as set out below, the Parties' market shares on a putative national basis are not sufficiently high to give rise to concern.

(145) There is no one authoritative source of national share of supply data for grocery retailing in the UK. However, the picture across the various data sources consistently shows that the

Proposed Merger will result in a combined percentage share in the 20s (ranging from 23% to 26.2%).[66] The Parties note, in this respect, that on a conservative basis, they have referred to the highest of these (26.2%) in their submissions.

(146) Further, these shares have to be considered in the context of an environment in which both Parties have been losing market share since at least 2011 (as can be seen from Table 3 below.[67] Considered on a combined basis, their market share has declined from 29.9% in 2011 to 26.2% in 2018 (a decline of over three percentage points, equivalent to revenue shrinkage of over £3 billion or a 10% reduction) while competitors such as Aldi, Lidl, M&S and Waitrose all increased their market shares over the same period.[68]

Table 3 Kantar Worldpanel Total Grocery Market Shares 2011 to 2018

Brand	2011	2012	2013	2014	2015	2016	2017	2018*
Tesco	27.3%	27.3%	26.8%	25.8%	25.3%	25.2%	24.6%	24.5%
Sainsbury's	15.0%	15.0%	15.0%	14.7%	14.6%	14.2%	13.6%	13.5%
Asda	14.9%	14.7%	14.5%	14.5%	14.0%	13.2%	12.7%	12.7%
Morrisons	11.5%	11.2%	10.8%	10.4%	10.2%	10.0%	9.6%	9.6%
Aldi	2.0%	2.5%	3.1%	4.0%	4.7%	5.3%	6.0%	6.3%
Co-op	5.9%	5.6%	5.4%	5.2%	5.1%	5.2%	5.0%	5.0%
Waitrose	4.1%	4.3%	4.5%	4.7%	4.9%	5.0%	4.9%	4.8%
Lidl	2.3%	2.4%	2.6%	3.1%	3.6%	3.9%	4.4%	4.6%
M&S	3.1%	3.1%	3.2%	3.2%	3.3%	3.5%	3.5%	3.5%
Iceland	2.0%	2.1%	2.1%	2.1%	2.1%	2.2%	2.2%	2.1%
Others	12.0%	11.6%	11.8%	12.1%	12.0%	12.2%	13.4%	13.4%

Source: Analysis of Kantar Worldpanel Total Grocery Share data 2011 to 2018.

(147) Given these market shares and the wide competitor set, as evidenced above and in the Parties' previous submissions, it is clear that no "national" SLC can arise.

III. Grocery stores: unilateral effects local analysis

"*We expect to use our findings to construct a framework for indicating the closeness of competition between the Parties and the strength of constraint from rivals in each given local area, which will allow us to rank areas and 'score' them in terms of the likelihood that the Parties may have an incentive to worsen their competitive offering post-Merger. In order to do this, we will consider the use of a 'weighted share of shops' methodology, used in some previous retail merger cases…*" (Issues Statement, para. 76)

(148) The Parties welcome this general statement of intention and, in particular, the CMA's consideration of the WSS methodology as the basis for the CMA's competition assessment.

66 Merger Notice, paragraphs 547 and 548, Table 14.

67 Merger Notice, paragraph 558, Table 15.

68 Ibid.

A. The WSS is the appropriate methodology for an assessment of retail constraints

(149) At the local level, closeness of competition and the strength of rivals vary according to a number of factors, including the location of rival stores, their size, and their brand, all of which are taken into account in a WSS model. Furthermore, the Parties face a range of competitors at a local level as set out in the Merger Notice.[69]

(150) The ability to assign different weights to competitors allows the WSS to recognise and take account of the fact that different store locations, sizes or retailer brands may place a greater or lesser constraint on the Parties. The WSS can account for the impact of proximity and distance on the intensity of a competitive constraint – clearly a key factor in local retailing where convenience is important to customers. The same is true for store size and store brand.

(151) The WSS can also accommodate other constraints – such as online retailing, bargain stores, convenience stores, and stores beyond the chosen catchment area – that are real and should be recognised.

(152) Finally, the WSS and the related GUPPI model used by the CMA in *Ladbrokes/Coral* and *Tesco/Booker* provide an ideal method not only to measure upward pressure on price but in this case to account also directly for variable cost saving efficiencies that exert downward pressure on price and are thus rivalry-enhancing. Adapted to the contemporaneous evidence, the WSS analysis therefore provides a comprehensive methodology for analysing the effect on competition across all the local areas in which the Parties compete.

B. Fascia counting is inappropriate as an additional primary screen

(153) The Issues Statement notes that the CMA will consider other methodologies alongside the WSS, such as "*a fascia counting exercise, as adopted in the Phase 1 decision*".[70] The Parties submit that this would be inappropriate as an additional primary screen.

(154) As has been recognised by the CMA, the risk of a simple fascia count is that it gives rise to the "binary fallacy" risk, summarised in the CMA's Merger Assessment Guidelines as follows:

> "*An over-reliance on concentration measures to indicate changes in market power, in particular where products are differentiated, has been termed the 'binary fallacy': the assumption that all firms in the market exercise competitive constraints upon one another in proportion to their market shares, but that firms outside the market exercise no constraint at all.*"[71]

(155) Similarly, the Commentary observes at paragraph 3.27 that "*Simple counts of fascias … may under or overstate the extent of competition in an area because they do not reflect important differences between fascia…*" Applied to the grocery sector, fascia screens represent an acute example of the binary fallacy, as they treat distance (convenience) as irrelevant. For example, they treat:

- all rival stores as being of equal competitive constraint (100% weighting, the same "market share") irrespective of the distance they are from the focal store, leading to

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69 See Chapters 3, 5 and 7 and Schedule 14 of the Merger Notice.

70 CMA, Issues Statement, paragraph 76.

71 Merger Assessment Guidelines, para. 5.3.2, fn 63. Similarly, the Commentary observes at paragraph 3.27 that "*Simple counts of fascias or stores may under or overstate the extent of competition in an area because they do not reflect important differences between fascia or stores*", attached as **Annex_005_010** to the Merger Notice.

obvious errors, both positive and negative. For example, a third-party rival with a single store 15 minutes' drive away counts for the same 100% weight as a merger party with, for sake of argument, a store only one minute's walking distance away; and

- certain rival stores as having a constraint of zero if they are not included in the traditional "effective competitor set" or "fascia count", even if, for sake of argument, that rival had the most stores in the catchment, was the fastest-growing player in the local market, and/or had a Large store only one minute's walk from the focal store.

(156) Importantly, the incorporation of a fascia count alongside the WSS methodology risks severely *understating* the importance of location (and convenience of location) to customers. This would be contrary to the weight of evidence showing the importance of location/convenience (and thus distance) as a driver of store choice, including third-party market research showing that location remains either the first or second most important driver of choice for most traditional retailers,[72] [✂].[73]

(157) Whilst the WSS approach allows for the weighting of all stores in a local area based on distance, a simple fascia count assumes that each individual fascia imposes the same competitive constraint, regardless of their location relative to the Parties' stores. Overlaying or considering the outputs of a fascia count alongside a WSS methodology would therefore necessarily reduce the overall importance placed on location in the competitive assessment for overlapping local areas.

(158) Furthermore, fascia counting risks *overstating* the importance of brand to customers. The importance of brand can be fully captured in the WSS methodology through the assignment of appropriate brand weightings, as discussed above (and set out in more detail in the Merger Notice).[74] Using fascia counting alongside the WSS, which already weights for brand, therefore risks distortion of the brand effect by over-weighting (or double-counting) it.

(159) More generally, the inclusion of fascia counting would add needless complexity to the conceptual "framework" for the assessment. A properly constructed WSS methodology is already a sophisticated approach to identifying local areas of concern – which is why it is more frequently used in Phase 2 rather than Phase 1 merger investigations – and is capable of significant calibration. This is reflected, for instance, in the discussion of the approach to weightings under the WSS methodology in paragraph 10 above.

(160) Finally, given the large number of overlaps generated by the Proposed Merger, taking a binary approach with regard to competitive constraint is likely to result in a large number of errors (both finding problems where there are none (false positives), and vice versa (false negatives)). Using the more nuanced WSS approach that was applied by the CMA in *Ladbrokes/Coral* and *Tesco/Booker* would significantly reduce these errors and better reflect the true competitive constraints in the market.

C. The evidence in each of grocery, general merchandise and fuel already captures any interdependencies in the Parties' respective retail offers

"*While [groceries, general merchandise and fuel] are each addressed separately for the purposes of market definition, we are nevertheless aware that customers may*

[72] IGD – Retail and Shopper Trends 2017, page 26, attached as **Annex_004_005** to the Merger Notice.

[73] [✂].

[74] See in particular the Merger Notice, Chapter 6, Section V.

purchase a number of these products in combination, and may take this into account when making their purchasing decisions: for example, a customer may choose to buy groceries at a supermarket where they can also fill up their car with petrol. The Parties, too, may consider their activities across a number of product areas when setting their commercial strategy in any one product area: for example, they may set low prices for one category of products, so as to draw in customers who may then purchase another category of products. We will take these interdependencies into account in our investigation, and will consider how the Parties' activities across all markets in which they operate, may impact upon how the Merger may affect competition in any one market." (Issues Statement paragraph 20)

(161) The Parties agree it is appropriate for the CMA to examine the competitive effects separately for each category, not least as the competitor set and the way that competition works varies across the three categories. Many of the most important competitors faced by the Parties are different across these segments, and in none of the segments is competition limited to those suppliers who offer all three of grocery, GM and fuel. Therefore, a separate assessment for each of these categories is necessary.

(162) The question posed by paragraph 20 of the Issues Statement is then whether this approach to identifying (and solving) competition concerns could miss a "bigger picture" given the activities of the Parties in local markets across all three product areas. This will not be the case.

(163) First, a minority of customers today purchase baskets which encompass two or more of these categories. The Parties' transaction data indicate that for Asda, typically only [✂]% of all baskets contain both GM and grocery, and for Sainsbury's, only [✂]%.[75] Because fuel sales do not take place in the same transaction as sales at the main grocery store, Asda (which does not have a loyalty scheme) is unable to track what proportion of customers make purchases at both the PFS and the main grocery store in the same trip. However, Sainsbury's analysis based on Nectar card data suggests that only [✂]% of Nectar customers using the PFS also used the main grocery store in the same visit, while only [✂]% of Nectar customers using a grocery store that has a PFS also used the PFS on the same visit (and only [✂]% of customers at these stores bought groceries, GM and fuel on the same visit).

(164) This means that the merged firm will primarily compete for customers who are not buying a "basket" across more than one category – for whom there is no reason to believe that rivals with a full grocery/GM/fuel offer would be seen as particularly close competitors. Moreover, even for those customers who do currently purchase across more than one of these categories on a single visit, there is no evidence to suggest that they would not split their basket if the price of any element were to increase. Indeed, [✂].[76]

(165) Second, the evidence used to conduct the closeness of competition assessment already captures within it any "interdependencies" that could suggest that the Parties' stores are closer competitors in any one of groceries, general merchandise, or fuel, than they would be in a hypothetical scenario in which they were not also active locally in the other product category. This is clear from a consideration of the different types of evidence available:

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75 See data supplied in response to RFI12 Q77.

76 CRA's analysis of the Parties' data. See Schedule 19 of the Merger Notice for further details.

- For the grocery impacts and entry/exit data, the extent to which a competitive impact is more intense from a new Large store opening that offers GM and fuel will be clear from the data – as those customers that sufficiently value the "combination" offer above other factors will switch to that new store. To the extent that many customers, in contrast, switch to a new Medium store that offers a smaller GM range, and/or no adjacent PFS, this will also show up in the data, revealing that the combination offer was not sufficiently important to them.
- The same is true for grocery survey data; those customers that prefer the combination offer will say they will divert to another store that offers GM and/or fuel as well; those customers for which grocery value for money/convenience is more important will say they will switch to stores that focus their retail offer on these parameters (and will buy GM and fuel elsewhere).
- The same principles will hold true in relation to survey and other customer preference evidence gathered in relation to GM or fuel.

(166) Broader evidence on the development of these markets is consistent with the evidence above that the majority of customers either don't purchase across all these categories or, for the minority that do, they would follow the majority and split their basket if any element were to become less attractive.

- Aldi and Lidl have succeeded in upending competition in the grocery sector without having large grocery stores, a large GM range, or adjacent PFS. Amazon and other online competitors have disrupted GM via physical store sales without stores, and without the simultaneous sale of fuel. BP, Shell and other oil majors and independents still represent the bulk of retail sales of fuel based on convenient locations and other factors, despite the fact that they do not operate large grocery stores adjacent to their PFS. All these basic facts imply that the combination of a Medium or Large grocery store site that also offers GM, or GM and also fuel, is not critical to customer preferences or to competitive success.
- The Parties' commercial decision-making in relation to groceries, GM and/or fuel is consistent with this: [✂].

(167) These observations are consistent with the evidence set out above in that [✂]. Even those that do buy a combination in a single trip would be expected to respond to any significant worsening of any of the elements of that combination, such that combinations are not critical to competitive success.

D. Loss of future potential competition

(168) There are no credible residual theories of harm, such as a loss of "pipeline competition", that a local store overlap analysis would not address.

(169) The local overlap analysis and dataset prepared for the CMA already capture the Parties' pipeline stores. Moreover, [✂]. As explained in detail in the Merger Notice,[77] [✂].

(170) Conversely, the growth in new space in UK grocery retail in recent years has been driven by Aldi and Lidl (with each opening over 650 new stores since 2010), bargain stores and convenience operators. These trends are projected to continue:

[77] See paragraph 544 of the Merger Notice.

- Aldi and Lidl are continuing their aggressive store opening plans and are projected to open another 480 stores by 2022.
- Iceland has "active and aggressive" plans to expand the Food Warehouse format by an additional 30 stores per year.
- B&M has been opening almost one store per week, with an ultimate target of 950 stores.[78]
- Co-op is continuing its extensive opening programme,[79] while Tesco and M&S continue to launch circa 10 sites annually under their convenience brands.

(171) Accordingly, there are no valid dynamic theories of the type that concerned the CMA at Phase 1 in *Pure Gym/The Gym*,[80] or examined as "loss of potential competition" at Phase 2 in *Ladbrokes/Coral*.[81]

IV. Grocery online

> "*We will examine whether the Merger results or may be expected to result in an SLC from unilateral horizontal effects in relation to the supply of online delivered groceries … This could occur nationally, to all of the Parties' delivered customers, or to subsets of those customers.*" (Issues Statement, paras. 78-79)

(172) The Parties submit that there is no credible basis for an SLC arising with respect to the supply of online delivered groceries.

(173) First, consistent with the retail grocery sector as a whole, online grocery is inherently local: delivery occurs locally from (almost entirely) local stores from which products are picked, and shoppers choose from ranges available in those local stores (or in some cases OFCs). Second, even if one was to ignore the evidence of in-store constraints and only look narrowly at the online grocery channel, the evidence shows that the Parties are not close competitors. There will therefore be no incentive for the Parties to degrade their online grocery offers post-merger.

A. No separate online market: physical store sales clearly constrain online sales

(174) The supply of online delivered groceries does not constitute a relevant market. Grocery stores, accounting for 94% of retail supply, compete closely with the online channel (6% of supply). It would be highly artificial, and a particularly egregious example of the binary fallacy (see paragraph (64)), to consider competition among online providers, and the Parties in particular, within a market definition framework that excluded the vast bulk of grocery competition arising from and between grocery stores.

(175) Given the Parties' almost wholly store-picked models, it is clear that physical store sales act as a constraint on online grocery sales in every area in which the Parties deliver online groceries. Furthermore, the constraint from physical stores on online sales is a substantially

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78 https://www.retailgazette.co.uk/blog/2017/05/bm-plans-to-nearly-double-its-uk-operation-amid-soaring-figures/.

79 https://www.co-operative.coop/media/news-releases/co-op-to-bag-100-new-stores-in-2018-as-part-of-gbp160-million-investment. See also https://www.retailgazette.co.uk/blog/2018/02/co-op-bets-big-london-28m-expansion/.

80 CMA, *Pure Gym/The Gym*, paragraph 72 et seq., attached as **Annex_005_022** to the Merger Notice.

81 *Ladbrokes/Coral*, paragraphs 9.41 – 9.51, attached as **Annex_005_007** to the Merger Notice.

larger constraint than vice versa, commensurate with the fact that physical store sales still represent the vast bulk (94%) of purchasing behaviour by UK consumers.

(176) In a differentiated sector such as grocery retailing, it is not necessary to show that there are no (material) differences at all between the channels. In-store local grocery competition is itself differentiated, with competition between rivals differentiated by factors such as location, store size, and brand. The key question is whether customers trade off differences and substitute between the two channels. There is compelling evidence that this is the case.[82]

1. The key parameters of competition are similar across both channels

(177) The main elements of grocery competition – product price and range/quality – are very similar regardless of whether customers shop online (either for delivery, or collection at a store), or in physical stores.

(a) Price

Product prices

(178) Both base product prices and promotional prices are uniform across the Parties' online and physical store offerings,[83] and, as set out in response to the CMA's requests for information, [✂].

Vouchers

(179) The Issues Statement suggests that one reason why shopping in a physical store may not be a good substitute for online shopping is that certain customers may "*place particular value on the vouchers or discounts that are available only to online customers*" (para. 36). The Parties do not consider this to be the case.

(180) The Parties do [✂] online vouchering. For Asda, the value of total online voucher transactions accounts for [✂]% of total online transactions and [✂]% of total online sales (with the discounts achieved from using a voucher accounting for [✂]% of total online sales); for Sainsbury's the value of discounts provided through vouchers in online transactions is [✂]%. It is also important to note that for Sainsbury's, approximately [✂].

Delivery charges

(181) The charge for delivery is part of the overall cost of purchasing groceries online rather than in-store. From a customer perspective, it can be understood as the trade-off for the convenience that home delivery provides compared to other options, such as click and collect and travelling to the grocery store and navigating around the store in person. Should the charge be too high or the "convenience gap" reduce (for example because of longer store opening hours), customers would have a greater incentive to switch to click-and-collect, or shopping in-store rather than online. This is supported by survey evidence on consumer switching.

[82] The Parties note that much of the evidence available is based on survey work conducted across multiple local areas. As such, it provides a view of the degree of substitution and competition on average across all online delivery areas. However, given that centrally set parameters are the aggregate of local overlaps, such evidence is likely to be a good proxy for the aggregate impact on centrally set parameters.

[83] [✂].

(182) Customers' purchasing decisions are based on an assessment of total basket value (including pricing the value of convenience). If this were not the case, one would expect to see both:

- a greater degree of alignment in delivery pricing between suppliers in response to customers focusing on comparing delivery charges (for what is a highly commoditised service), rather than total basket value; and
- very significant switching to suppliers offering free delivery.

(183) Instead, delivery charges vary considerably and there are a wide range of basket size thresholds for free online delivery (e.g. Waitrose's free delivery threshold is £60, while Sainsbury's is £100[84]).

(184) As a result, while online delivery charges are a distinct online-only "cost", they are constrained by in-store competition because customers trade off the overall costs/benefits of shopping online or using click and collect with the overall costs/benefits of shopping in-store. In this way, online grocery suppliers compete against each other and in-store grocery suppliers for the "whole of basket" price, inclusive of delivery.

(b) Range

(185) Almost all of the Parties' online orders ([✂]% for Sainsbury's and [✂]% for Asda) are supplied via a store-pick model, which means that almost exactly the same range of groceries is available online as is available from the store from which the home delivery basket is picked.[85] Given that the vast majority of online sales are taken from the same shelves as in-store customers, these by definition will have the same availability, and it would not be possible to reduce availability for one without adversely affecting the other.

2. There is no relevant customer segmentation by reference to "bulky goods"

(186) The Parties note the suggestion at paragraph 36 of the Issues Statement that a physical store may not be a good substitute for online grocery shopping if, for example, customers are purchasing bulky items. The evidence does not bear this out.

(187) Figure 10 and Figure 11 below show the proportion of total customer spend on different grocery categories across the online and physical channels for Sainsbury's and Asda. Contrary to the suggestion in the Issues Statement, customers purchase the same grocery products and essentially the same product mix (shopping baskets) online as they do for physical purchases. This is consistent with the majority of spend on the two channels being substitutes rather than complements.

[84] If booked for delivery on Monday – Thursday after 2pm.

[85] A small number of products are not available online [✂]. Further detail on these exceptions have been provided in response to the CMA's requests for information.

Figure 10 [✂][86]

[✂]

Figure 11 [✂][87]

[✂]

(188) The figures show that whilst there is some over-indexing in certain categories ([✂]), the extent of this over-indexing is relatively small. For example, when looking at the largest difference in [✂] for Sainsbury's, the absolute difference is only [✂]%. Further, there is some (albeit small) under-indexing in [✂], which could be considered a "bulky" category.

(189) Similarly, whilst there is some degree of under-indexing online for non-bulky categories, such as [✂], this under-indexing is not particularly marked. For example, for an average Sainsbury's superstore basket, [✂] makes [✂]% of the basket value and it makes up [✂]% of overall basket value for online. A similar result applies for Asda.

3. No relevant customer segmentation by reference to "routine/convenience"

(190) The Issues Statement also suggests at paragraph 36 that shopping in a physical store may not be a good substitute for customers who need grocery shopping to fit around their routine, or who simply value the convenience of having goods delivered. Again, the data does not bear this out.

(191) Kantar Worldpanel Grocery data indicates that there are virtually no customers who might be perceived as "captive" to online. Almost all (99.4%) of online shoppers also buy groceries in-store, with a very small minority (only 0.6%) of online shoppers purchasing groceries exclusively online. For Asda, only [✂]% of Asda online shoppers purchase groceries exclusively online from Asda, whilst for Sainsbury's the figure is [✂]%.[88]

(192) Even if the proportion of customers who shop online only were less than minimal, since the Parties do not charge different product prices in-store and online, it would not be possible to discriminate against those customers. Nor are the Parties able to identify whether the very small number of customers who shop only online with Sainsbury's/Asda (as the case may be) are shopping at other parties' physical stores.

4. Survey and switching data provides compelling evidence of substitution between online grocery shopping and physical stores

(193) The available evidence shows that online grocery is constrained by the presence of physical grocery stores in every area in which the Parties deliver.

(194) Sainsbury's conducted research through ABA in June 2018 to look at where Nectar Card customers move to, once they no longer use the Sainsbury's online service.[89] ABA asked Sainsbury's customers who were spending less at Sainsbury's online, or were no longer

[86] [✂].

[87] [✂].

[88] Kantar Worldpanel Grocery data covering 52 weeks up to 17 July 2018.

[89] [✂].

using the online service, what they were doing instead. The results are set out in full at paragraph 61 of Schedule 25 to the Merger Notice and show that, [✂].

(195) A similar ABA study conducted for Asda during the period 24 August 2016 – 5 September 2016[90] shows that [✂].[91]

(196) CRA has analysed Kantar Worldpanel switching data for online and in-store sales for the 52 weeks ending 17 June 2018. Table 4 below presents Kantar Worldpanel switching gains, switching losses and net switching broken down by Asda's in-store channel, other in-store switching and other online rivals. The table shows that switching to physical stores is the major constraint for Asda online sales. Nearly [✂] of all online lost sales went to the in-store channel.

Table 4 Kantar Worldpanel switching analysis to/from Asda online – 52 weeks ending 17 June 18 (Great Britain)

Competitor/channel	Switching Gains (£m)	Switching Losses (£m)	Switching proportion based on Losses	Diversion ratio based on Losses (excl. Asda stores)	Net Switching (£m)
All Physical Stores	[✂]	[✂]	[✂]	[✂]	[✂]
Asda Stores	[✂]	[✂]	[✂]	[✂]	[✂]
Other Physical Stores	[✂]	[✂]	[✂]	[✂]	[✂]
All online	[✂]	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CRA analysis of Kantar Worldpanel data, Total Grocery 52 w/e 17 June 18 for Great Britain.

(197) Table 5 below presents Kantar Worldpanel switching gains, switching losses and net switching broken down by Sainsbury's in-store channel, other in-store switching and other online rivals. This shows that switching to physical stores is the major constraint for Sainsbury's online sales. Approximately [✂]% of all online lost sales went to the in-store channel.

Table 5 Kantar Worldpanel switching analysis to/from Sainsbury's online – 52 weeks ending 17 June 18 (Great Britain)

Competitor/channel	Switching Gains (£m)	Switching Losses (£m)	Switching proportion based on Losses	Diversion ratio based on Losses (excl. Sainsbury's stores)	Net Switching (£m)
All Physical Stores	[✂]	[✂]	[✂]	[✂]	[✂]
Sainsbury's Stores	[✂]	[✂]	[✂]	[✂]	[✂]
Other Physical Stores	[✂]	[✂]	[✂]	[✂]	[✂]
All online	[✂]	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CRA analysis of Kantar Worldpanel data, Total Grocery 52 w/e 17 June 18 for Great Britain.

[90] [✂].

[91] Merger Notice, Schedule 25, paragraph 56.

5. In the absence of a separate product market, it is unnecessary to consider geographic market scope

(198) It is clear from the above that the supply of groceries online does not constitute a separate product market from the supply of groceries in physical stores.[92] The question of relevant geographic market is therefore a broader one, relating to the supply of groceries across all channels (which is dealt with in Section I above), and the assessment of the online delivery coverage offered by the Parties relative only to other online grocery offerings is not a relevant question for the purposes of defining the market for the supply of groceries.

B. No unilateral effects SLC at national level

(199) The Issues Statement states that, when assessing whether the Proposed Merger may give rise to the incentive to worsen nationally set parameters of competition, such as the price of base products and delivery prices or investments in online technology, it will examine closeness of competition between the Parties and the extent of the competitive constraint from other retailers operating online/from physical stores; whether competitors would be likely to enter an area currently served by the Parties; and the extent to which online customers use discounts (through targeted vouchers).

(200) Taking these factors in turn, there is no prospect that the Proposed Merger will give rise to an SLC in relation to online delivered groceries.

1. The Parties are not particularly close competitors in the online grocery channel and are constrained by a range of competitors

(201) As demonstrated above, the online grocery channel is primarily constrained by in-store grocery sales. The degree of competitive constraint faced by the Parties in every local area (and, in the aggregate, on a national basis) will therefore be captured by the local unilateral effects assessment described in Section III above. On this basis, there can be no doubt that the Parties are not close competitors and that they are constrained by many strong grocery operators.

(202) Even if one considers the narrower context of online grocery alone, the Parties are not particularly close competitors, relative to rival online brands. This is consistent with the broader demographic and customer-proposition evidence for grocery overall, which shows that the Parties are generally considered to appeal to different types of customer. It is further evidenced by a combination of Kantar Worldpanel, ABA and Nielsen data described and set out in detail in paragraph 74 of Schedule 25 to the Merger Notice which demonstrates that the Parties face strong constraint from other grocery retailers operating online, in particular Tesco, Ocado and Morrisons.

(203) For example, Kantar Worldpanel switching gains, switching losses and net switching data for Asda shows that switching losses to Sainsbury's online were only 3.5% of the total switching losses from Asda online. This was fourth in the list of online channels after Tesco (13.2%), Ocado (4.4%) and Morrisons (4.1%) and is consistent with Sainsbury's and Asda's online channels not being relatively close competitors.

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[92] Although the Parties note that the geographic dimension of local competitive constraints for online grocery is likely to be wider than for bricks and mortar stores, given that online grocery is picked from a subset of stores.

(204) The same picture emerges if one looks at Kantar Worldpanel data for Sainsbury's online. Sainsbury's losses to Asda Internet are [✂] than the losses to Tesco, and [✂] the loss Sainsbury's makes to Ocado.

(205) Similarly, Nielsen share of consumer wallet data looks at the proportion of total customer expenditure included in the panel that is attributed to each competitor and their channels. Table 6 below summarises this data by presenting the percentage of grocery spend by retailer and channel depending on whether they had shopped at a given retailer in a given channel at any time over the 52 weeks to P3 2018/19. For those shoppers who have used Sainsbury's online channel, [✂] of their expenditure was on Sainsbury's online, [✂] was at Tesco online, [✂] at Asda and [✂] at Morrisons. For shoppers who have used Asda's online channel, [✂] of their expenditure was at Asda online, [✂] was at Tesco online, [✂] at Sainsbury's online and [✂] at Morrisons online.

Table 6 Nielsen share of wallet analysis[93]

	Sainsbury's Online Shoppers	Asda Online Shoppers
Tesco Online	[✂]	[✂]
Sainsbury's Online	[✂]	[✂]
Asda Online	[✂]	[✂]
Morrisons Online	[✂]	[✂]
Other Online Players	[✂]	[✂]
Total in-store	[✂]	[✂]
Total	**100%**	**100%**

(206) The fact that there is such a low proportion of expenditure by Sainsbury's online shoppers at Asda online and vice versa is indicative of the Merging Parties not being each other's closest competitors. It is worth noting that the analysis above does not consider the proportion of expenditure to smaller online operators such as Ocado, Amazon and Iceland due to limitations with the Nielsen data.

2. Competitors continue to expand their online offering

(207) The second factor that the CMA intends to examine is the extent to which competitors would be likely to start delivering to new areas. In this respect, it is clear that the online channel is dynamic, and that competitor entry is to be expected. The Parties already have online coverage across nearly all of the UK and as such, are not competing with each other to introduce online grocery delivery in new areas. However, as set out in Section VII.D below, multi-channel operators such as Morrisons are continuing to expand their online offerings, and pure-play operators such as Ocado and Amazon are rapidly extending their online capabilities.

(208) In any event, as noted above, while there are some local areas where not all online grocers are currently present, this is not material to the competitive assessment given that in-store sales are a constraint in every one of these local areas.

[93] Source: Nielsen Panel 52 weeks to P3 2018/19. (Copyright © 2018, Nielsen)

3. Extent of online vouchers is not significant

(209) As noted earlier, the extent of online vouchering by the Parties is limited. For Asda: In financial year 2017, online vouchers accounted for [✂] of total online transactions and [✂] of total online sales. For Sainsbury's: in financial year 2017/18 the value of discounts provided through vouchers in online transactions was [✂].

(210) Further, vouchers issued as part of online groceries campaigns are [✂]. As a result, the extent to which vouchering could impact on competition between the Parties or indeed between either of the Parties and any other competitor is extremely limited.

C. No unilateral effects SLC at local level

(211) Whilst the Issues Statement indicates that it intends to consider the potential for an SLC at local level in relation to online grocery, it is clear that the conditions for such a theory of harm to be made out do not exist.

1. Separate local assessment is unnecessary

(212) Noting that factors such as delivery slot availability and delivery efficiency may result in a differentiated offer across geographic areas, the Issues Statement indicates that the CMA intends to assess the competitive effects of the merger in each geographic area, and that its starting point is that "*some customers in different geographic areas may have a more limited set of alternative options, either because a retailer does not deliver to their postcode, or because it offers a narrow range of groceries*" (Issues Statement, para. 86).

(213) The Parties do not dispute that there are some local areas where not all online grocers are currently present. However, this is not material to the competitive assessment given that, as set out above, in-store sales are a constraint in every local area, and there are no grounds for concluding that the supply of online groceries constitutes a separate market.

2. Prospect of tailored vouchering or pricing

(214) The Issues Statement notes at paragraph 87 that the CMA will assess "*whether the Parties could raise prices for customers in certain areas or with certain characteristics that mean they are more likely to consider the Parties to be close alternatives to each other*", for example by cutting back on the vouchered discounts offered to customers.

(215) Leaving aside the question of what "certain characteristics" the Parties could base targeted price rises on, as noted above, the Parties have the same product pricing (both base prices and promotional prices) across online and in-store ranges. Thus, tailored pricing is not an option.

(216) [✂].

V. Grocery: co-ordinated effects theories

> "*We will assess whether there is evidence that coordination already exists, whether the characteristics of these markets are conducive to such behaviour and what the effects of the Merger can be expected to be on the likelihood and/or effectiveness of coordination*." (Issues Statement, para. 92)

(217) As the Parties have demonstrated in the Merger Notice, and further below, the UK grocery market is not conducive to co-ordination and the Proposed Merger will not make it more likely that co-ordination would take place or be effective.

(218) The evidence shows that there is strong pre-merger competition and no evidence of co-ordination. Further, the Proposed Merger will leave at least eight significant grocery operators as competitors in the market, each a household name with whom UK customers spend at least approximately £5 billion,[94] and each with diverse business models and therefore dis-aligned incentives.

A. The market is characterised by strong competition from a diverse array of grocery operators

(219) It is well established that the greater the number and diversity of firms competing in a market, the harder it is to sustain co-ordination.[95] This is because the potential gains from deviating increases for each firm (by undercutting the collusive price, a firm can steal market share from all of its competitors), and the long-term benefits of maintaining collusion are reduced (each firm gets a smaller share of the co-ordinated profit amount). The UK grocery market is just such a market, with at least nine strong competitors present.

(220) Grocery market shares over the last seven years based on Kantar Worldpanel data show the dynamic and competitive nature of the market. As shown above at Table 3, shares have been steadily declining every year for the large traditional grocery retailers, whilst, over the same period, there have been consistent annual increases in market share for competitors such as Aldi, Lidl, Waitrose and M&S.

(221) As set out in detail in the Merger Notice, the Parties' benchmarking and monitoring, as well as their strategic documents, demonstrate that competition from this wide competitive set is fierce. The extent of the competitor set is also demonstrated by the local impact analysis, entry/exit analysis, and survey data provided in the Merger Notice. Co-ordination amongst such a wide number of firms is inherently unlikely.

B. There is no common incentive across rivals to maintain a co-ordinated outcome

(222) As recognised at paragraph 94 of the Issues Statement, for any theory of co-ordination to hold, firms in the hypothetical co-ordinating group must have the incentive to maintain a co-ordinated outcome, taking into account the costs and benefits of deviation.

(223) It is clear from the evidence that this condition cannot be met in respect of the UK grocery market. Not only is the market characterised by a large number of competing operators, but the operators have very different characteristics that drive differing incentives, further diminishing the likelihood that co-ordination would occur. For example:

- Both Aldi and Lidl have business models that rely on high volumes and low cost, accompanied by substantial growth of new stores – all of which make it highly unlikely that Aldi or Lidl would have the same hypothetical co-ordination incentives as larger grocers. As set out below, their recent growth has been at the expense of the traditional retailers. Those operators have no incentive to halt their trajectory.

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[94] GlobalData, UK Food & Grocery Market 2013-2023 (February 2018), attached as **Annex_004B_109** to the Merger Notice; also cited in response to Question 5 of RFI1 at Schedule 22.

[95] See Marc Ivaldi, Bruno Jullien, Patrick Rey, Paul Seabright, Jean Tirole, The Economics of Tacit Collusion IDEI, Toulouse, March 2003 http://ec.europa.eu/competition/mergers/studies_reports/the_economics_of_tacit_collusion_en.pdf at page 12, attached as **Annex_005_033** to the Merger Notice.

- Both Waitrose and M&S have a proposition that is centred on a "premium" customer perception and high quality/convenience, a different focus from the other grocery players.
- Co-op has a different business model from other grocery retailers, including the Parties. It has grown in the convenience sector, having recently acquired Nisa,[96] and in January 2018 launched a £160 million expansion plan.[97] It therefore has the incentive to compete fiercely to continue to grow at the expense of the larger players.
- Morrisons will not have increased incentives to co-ordinate after the Proposed Merger, because post-merger it will have a smaller share compared to the Parties and Tesco, and therefore its incentives relative to the Parties and Tesco will be significantly different. Indeed, Morrisons will have significant incentives to increase its share in order to achieve similarly low costs to the Combined Entity. The lack of symmetrical interests in the status quo is reinforced by Morrisons' vertical integration in food.

(224) Given the variety of business models and approaches, together with the movements in market share shown above, there is no clear basis around which the incentives of the different grocery operators could align (see further at Section E below for a discussion of the lack of incentives for co-ordination between a subset of grocery operators).

C. The nature of grocery competition renders alignment unfeasible

(225) Even if the incentives of the many diverse players could be aligned, co-ordination would not be feasible in practice given the nature of grocery retailing.

1. Price co-ordination would not be practicable across the range of grocery products

(226) Grocery retailing encompasses competition on the entire "retail offer", which covers a wide variety of products, with many variations in terms of quality levels and price points. Indeed, the fact that there are thousands of different product SKUs was one of the key reasons given by the CC in 2008 for why co-ordination is unlikely in grocery: "*sustaining coordinated conduct over thousands of differentiated products or choosing a smaller group of products on which to coordinate would be sufficiently complex to prevent the emergence of tacit coordination*".

(227) Further, whilst the Parties and third-party research companies refer to shopping missions (e.g. the "main shop" or "top up" shops), there is no accepted definition of an "average basket". What is average to one retailer may be different for others. This would make it difficult to reach a co-ordinated outcome.

(228) Finally, it should be noted that co-ordination on price across any product or subset of products would be time-consuming and costly to implement. Not only is there a lag in the time at which price movements become known, but any decision to react to such a

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[96] Co-op, Co-op completes acquisition of Nisa Retail Limited (8 May 2018), available at: https://www.co-operative.coop/media/news-releases/co-op-completes-acquisition-of-nisa-retail-limited, attached as **Annex_004_161** to the Merger Notice.

[97] The Guardian, Co-op launches £160m expansion plan for 2018, available at: https://www.theguardian.com/business/2018/jan/02/co-op-launches-160m-expansion-plan-for-2018, attached as **Annex_004_162** to the Merger Notice. See also https://www.co-operative.coop/media/news-releases/co-op-to-bag-100-new-stores-in-2018-as-part-of-gbp160-million-investment and https://www.retailgazette.co.uk/blog/2018/02/co-op-bets-big-london-28m-expansion/.

movement would require shelf-edge prices across all stores to be manually changed.[98] This would entail significant colleague resource and cost, especially at a time when [✂].[99]

2. Price co-ordination would be unstable because co-ordination across key non-price competitive parameters is not feasible

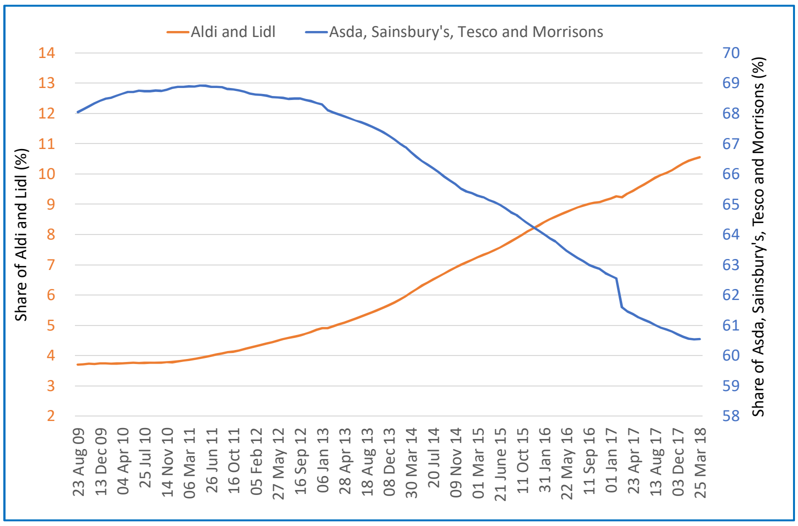
(229) Competition between the differentiated retail offers of the Parties and their rivals involves a variety of factors important to grocery customers that are key parameters of competition, including: (i) convenience of store locations locally; (ii) value for money on product quality and price (not just price); and (iii) other aspects of the in-store offer, including range or service, and other aspects of the in-store shopping experience.

(230) These factors make one-dimensional co-ordination on price unstable, because it is far from the only factor influencing customer choice, and thus suppliers' gains and losses in sales and profits. Further, as set out in the Merger Notice at paragraphs 717 to 722, co-ordination on these other dimensions would be incredibly difficult, given their nature and complexity.

D. Aldi and Lidl have the ability and incentive to disrupt any attempt at co-ordination

(231) As established above, Aldi and Lidl have significantly disrupted the UK market and have indicated that they intend to continue to do so. Consistent with their maverick status, Aldi and Lidl's market share growth has had a disproportionate impact on the traditional retailers, as can be seen from Figure 12 below.

Figure 12 Market share trends 2009 to 2018



Source: Analysis of Kantar Worldpanel Total Grocery Share 2009 to 2018.

(232) Aldi and Lidl place great importance on their value-for-money reputation (built on their low-cost model), meaning they would have no incentive to co-ordinate with traditional players. Indeed, following the announcement of the Proposed Merger, both Aldi and Lidl reaffirmed their commitment to low pricing. The new Aldi UK & Ireland CEO, Giles Hurley, commented that: "*fundamental to our offer is the contract with our customer that we'll have a 15% discount on an average basket of goods. It's a cornerstone of our business strategy. It hasn't*

98 [✂].

99 [✂].

changed. It won't change. That's what we do".[100] Similarly, Lidl was reported as stating that its global buying power and simple operating model provided the business with "*unparalleled resilience*" and that "*our customers can be assured that we cannot be beaten on price*".

(233) Further, they have the financial and structural capability to disrupt co-ordination. Both Aldi and Lidl have considerable price advantages over traditional retailers due to the significant structural advantage they have in terms of their lower buying costs and lower operating costs relative to the Parties.[101]

(234) They also have significant spare capacity to absorb greater customer volumes going forward and a business model that strongly incentivises the growth of scale. Unlike the traditional retailers, who have effectively ceased opening new Large stores, Aldi and Lidl have a strong store expansion programme which is likely to continue. They have opened approximately 650 new stores since 2010 (the equivalent of a new store opening every four to five days over eight years) and are projected to open another 480 stores by 2022.[102]

(235) Aldi and Lidl will be particularly effective as a "maverick" constraint post-merger, given their ubiquity. [✂].[103] This strongly suggests that any attempt at co-ordination between the largest traditional retailers would be disrupted on a comprehensive local geographic basis.

E. Co-ordination amongst a subset of retailers is not sustainable

(236) Paragraph 93 of the Issues Statement states that the CMA will specifically "*consider alternative hypothetical coordinating groups of retailers, which could include narrower groups of retailers (e.g. the merged company and Tesco, or the merged company, Tesco and Morrisons, which are sometimes referred to collectively as the 'Big 4') or possibly a wider group of retailers*."

(237) A theory of co-ordination amongst the post-merger "Big 3" is not supported by the evidence. As set out in detail in the Parties' Initial Submission, any reasonable reading of the impacts, entry/exit, survey and internal documentary evidence shows that there is currently no "Big 4" market that excludes other competitors.

(238) As a result, the "fringe" outside the co-ordinating group under such a "Big 3" theory comprises at least five household names with collective sales of over £30 billion,[104] whose shares have been growing at the large retailers' expense: Aldi, Lidl, Waitrose, M&S and Co-op. Added to this set of significant rivals is the aggregate constraint from Iceland, the bargain

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[100] https://retailanalysis.igd.com/news/news-article/t/new-aldi-ceo-on-uk-market-and-growth/i/19984.

[101] Their lower buying cost base results from their pan-European procurement scale (given that their ranges are international and highly consistent across geographies) and from the efficiencies created by having more volume per SKU than larger competitors, allowing them to focus their price investments on a smaller number of products. "*Both Aldi and Lidl have the buying power of big international groups. This helps to create huge efficiencies in products such as parmesan and feta cheese, pasta, rice, tinned tomatoes and some wines*" (see: Financial Times, Aldi and Lidl lead charge of discount supermarkets (9 July 2014), attached as **Annex_004_157** to the Merger Notice).

[102] Aldi and Lidl store opening figure for 2018-2022 from IGD data centre, 5 March 2018. Aldi plans to open 130 stores in the UK over the next two years, creating 5,000 jobs and taking it closer to its target of 1,000 stores by 2022. It also expects to beat its 2022 target and has publicly stated that it intends to have 1,200 stores by 2025 (see "Aldi vows to take on Jack's as UK sales top £10bn for first time", The Guardian, 1 October 2018, available at: https://www.theguardian.com/business/2018/oct/01/aldi-sales-exceed-10bn-for-first-time-in-uk-and-ireland).

[103] CRA analysis using Parties' property data.

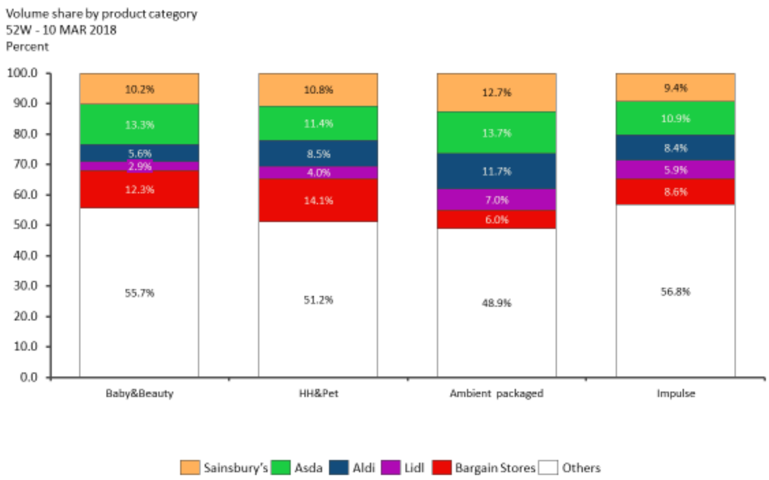
[104] See: GlobalData, UK Food & Grocery Market 2013-2023 (February 2018), attached as **Annex_004B_109**; also cited in response to Question 5 of RFI1 at Schedule 22. Consistent with GlobalData's estimate of the total food and non-food grocery market at £141 billion, based on retailers' reported sales together with national statistics and market interviews, but noting that the GlobalData market definition excludes some category specialists in non-food and hence underestimates the total market for non-food grocery.

stores, convenience, as well as online-focused players such as Ocado and Amazon/Whole Foods, among others.

(239) It would be irrational for the Parties (and likewise for Tesco and Morrisons) to dismiss these rivals post-merger simply because Sainsbury's and Asda are under common ownership. It would, similarly, be difficult to count Morrisons as a "large" retailer that is part of a hypothetical co-ordinating group (with a 9.6% share) on the one hand, and ignore the 10.9% combined share of Aldi and Lidl, or the 9.8% combined share of Waitrose and Co-op, on the other.

(240) Furthermore, co-ordination between the post-merger "Big 3" would not be sustainable because of competition from a fringe that includes Co-op, Waitrose, M&S and, in particular, B&M and Home Bargains. Data from Nielsen at Figure 13 below shows that these operators have a steadily increasing share of sales, a trend that would only be accelerated if prices on goods were to rise at the post-merger "Big 3".

Figure 13 Nielsen volume share by product category[105]



(241) The possibility of co-ordination just between the Combined Entity and Tesco (whether on branded products or more widely) is even less likely. As an initial point, given that the Proposed Merger will allow the Parties to achieve substantial purchasing synergies, it is likely to increase rivalry between the Parties and Tesco rather than reduce it. Thus, Tesco's incentives to co-ordinate will not increase post-merger.

(242) A theory of co-ordination between the Combined Entity and Tesco would be incorrect in suggesting that a similar national share between Tesco and the Combined Entity produces two "symmetrical" players in a meaningful sense. Grocery competitors do not compete for customers based on their national share: they compete for local customers through their local stores. As such, their local shares may be far from symmetrical. Furthermore, the Proposed Merger will not create two symmetrical brands, each with a similar share, because post-merger the dual-brand strategy that the Combined Entity will pursue means there will still be three differentiated brands, each with differing incentives and strategies.

[105] Source: Nielsen Panel Data, March 2018. (Copyright © 2018, Nielsen)

(243) In any event, given that none of the other market participants (with combined sales of over £68 billion)[106] would be party to such co-ordination, it is clear that any hypothetically co-ordinated outcome would be unsustainable, as it would involve losing significant sales to maverick players.

F. Co-ordination in delivered online groceries is equally unfeasible

(244) At paragraph 90, the Issues Statement indicates that the CMA will examine the possibility for co-ordinated effects in relation to both bricks and mortar grocery retailing and the supply of delivered online groceries.

(245) Whilst there are fewer operators active in relation to delivered online groceries, co-ordination on such a basis is no more feasible than co-ordination in relation to bricks and mortar because both form part of the same overall market, as has been clearly set out in Part IV.A.

(246) Thus, to the extent that operators active in delivered online groceries managed to align their incentives to reach a co-ordinated outcome, customers would be both willing and able to purchase more of their groceries in physical stores, thus reducing online sales and rendering any attempt at co-ordination unviable. Further, for the reasons set out above, any attempt to reach alignment on a multichannel basis (i.e. across online and physical stores) would be disrupted by the remaining bricks and mortar grocery operators.

VI. Grocery: buyer power theories

> "*We will investigate whether a potential increase in the buyer power of the merged company … might result in reduced incentives to invest and innovate on the part of suppliers … for the development of new products [or] might raise the purchasing costs of rival retailers, which, under certain circumstances, may result in price increases to certain customers … referred to as the 'waterbed effect'.*" (Issues Statement, paras. 115-121)

(247) Neither of these potential harms will occur as a result of the Proposed Merger.

(248) Most importantly, the Parties do not have market power in the procurement of groceries or in any grocery product category. The absence of this basic prerequisite indicates that the Proposed Merger will not give rise to an anti-competitive buyer power effect.

(249) With respect to the potential for harm to innovation, the vast majority of the expected efficiencies are driven by gains made from *large multinational suppliers*. Further, rather than undertake any action that may harm innovation, retailers benefit from and support innovation by suppliers, as this can expand sales for both supplier and retailer. A range of evidence demonstrates that both Parties support suppliers where this ensures long-term viability and supplier choice. The innovation undertaken by branded suppliers, which, for multinational players, occurs at a global rather than UK level, will very rarely, if ever, involve significant upfront investment or products specific to an individual retailer.

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[106] See: GlobalData, UK Food & Grocery Market 2013-2023 (February 2018), attached as **Annex_004B_109** to the Merger Notice; also cited in response to Question 5 of RFI1 at Schedule 22. Consistent with GlobalData's estimate of the total food and non-food grocery market at £141 billion, based on retailers' reported sales together with national statistics and market interviews, but noting that the GlobalData market definition excludes some category specialists in non-food and hence underestimates the total market for non-food grocery.

(250) With respect to the "waterbed effect" theory of harm, conditions for the waterbed effect are not present, given the highly competitive nature of the UK grocery market.

A. The Combined Entity will not have significant buyer power

(251) The CMA has not defined a market for the procurement of groceries in the Issues Statement. Nevertheless, following previous CMA precedent,[107] a procurement market includes all purchasers of a product, regardless of whether they are active in downstream in the retail supply of groceries. The Parties also agree with the CMA's approach in the Issues Statement that it will only be concerned with distortions in the overall grocery market rather than individual product categories.

(252) On the procurement market, the Combined Entity's market share would be well below any threshold level of concern.

(253) Using market shares of the total UK food and grocery retail market as a proxy for overall procurement share, the Parties have an estimated combined share of 23%.[108] Clearly this estimate will significantly overstate the Parties' true procurement shares, as in many product categories the Parties compete as buyers, not just with other grocery retailers but with a wide range of retailers (for example, the food service channel (Horeca), retail pharmacy chains, off-licences and the on-trade, etc.) that are routes to market for suppliers.

(254) As the CMA previously observed in *Tesco/Booker*, shares of supply within this range do not suggest that the merged entity would be in a position to substantially lessen competition: "*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.*"[109]

(255) Even if the CMA were to look at the procurement share in narrow individual product categories and even with the bias of the share estimation methodologies towards overstating the Parties' position, the Parties' share of procurement using market shares as a proxy is less than 30% across all grocery categories as set out in the Merger Notice at paragraph 605.

B. The Proposed Merger will not reduce supplier incentives to invest and innovate

(256) According to paragraph 118 of the Issues Statement, the CMA's innovation theory of harm is most likely to occur where: (i) suppliers have significant upfront investment costs; (ii) there are no guaranteed terms of supply; and (iii) suppliers cannot spread risk across multiple customers. The CMA notes that this set of circumstances is most likely for the development of new branded products.

(257) This theory appears to be based on a number of cumulative assumptions; namely that: (i) the Combined Entity would need to be in a position to negotiate better terms from suppliers that have driven innovation; (ii) this innovation has involved significant upfront costs and is

[107] See *Tesco/Booker* Issues Statement, paragraphs 18 and 19.

[108] See paragraph 598 of the Merger Notice, and GlobalData UK Food & Grocery Market report dated July 2018 (attached as **Annex_004L_001**).

[109] *Tesco/Booker*, para. 8.70, attached as **Annex_005_002** to the Merger Notice.

specific to the retailer (i.e. the supplier cannot spread the risk); and (iii) the reduced profitability of sales to the Parties changes the overall incentives for the supplier to innovate. In effect, the CMA is suggesting that suppliers would make significant investments in new products specific to the Combined Entity, which could effectively "strand" the supplier *ex post* to such an extent that investment made by the supplier would be unsustainable, and that, anticipating this, the supplier would *ex ante* decide not to make the investment. This stranded supplier would also need to have a meaningful impact on innovation and competition downstream in "*the overall groceries market*".

(258) None of these propositions hold true in practice. As outlined above, the Parties' procurement shares are not indicative of the Combined Entity having material, or materially increased, buyer power over suppliers. A large portion of the efficiencies that are expected to arise from the merger are driven by large multinational suppliers. The development of new branded products will rarely involve significant upfront investment and will rarely, if ever, be specific to an individual retailer (or to the Parties). The incentives for branded suppliers to invest and innovate are not driven by the terms received by the Parties but a wide range of factors, including international sales and sales to other UK retailers (both grocery and non-grocery). Moreover, if innovation will lead to increased demand within a product category (i.e. more sales), a retailer will wish to encourage this. The Parties consider these further below.

1. The Parties will have every incentive to continue to support innovation

(259) The Parties' relationships with suppliers are driven by the need to offer the products customers want to buy (with the right mix of quality and price points), together with the logistics and supply chain capability and capacity to deliver them through the supply chain to the end consumer. This is a virtuous circle: when suppliers are successfully producing quality products efficiently and developing new products, the retailer benefits through greater sales; when a retailer performs well, its suppliers will benefit through greater volumes and economies of scale.

(260) The Parties will therefore continue to have incentives to work with their suppliers in the supportive and collaborative manner that they currently do. The businesses of both Parties are built on strong, often long-standing relationships with their suppliers, and both have made significant investments in a number of projects and partnerships with suppliers, including a range of initiatives to support, for example, British farming and the introduction of new products.

2. New product development and the expected efficiencies from the Proposed Merger are driven by large multinational suppliers, who will continue to have significant investment incentives

(261) Across product categories, the majority of products purchased by the Parties are purchased from a limited number of large multinational suppliers, national suppliers and aggregators (processors and packers) with considerable bargaining strength.

- For Asda, large suppliers (those supplying at least [✂] COGS annually) account for [✂]% of all goods supplied, including multinational household names such as [✂].
- Similarly, large suppliers provide Sainsbury's with [✂]% of all goods, including [✂]. Each of these tends to supply multiple product categories.

(262) For these suppliers, the Parties are not significant purchasers. Not only do these suppliers supply a large number of retailers, but they also supply outside the retail channel, to

wholesalers, pubs, restaurants, etc. Their incentives will be driven by this much wider market and cannot therefore be impacted significantly by the Proposed Merger.

(263) Further, a significant proportion of innovation with respect to the grocery offerings of the Parties is led by large multinational suppliers who determine at a global level the scale of their investments in innovation based on the potential worldwide returns associated with those investments. It is clear from the fact that the United Kingdom represents just 3% of worldwide GDP that any changes in the UK market are unlikely to influence the level of investment in innovation by these suppliers.[110]

(264) Additionally, innovation is not channel-specific or driven particularly by the retail channel, or necessarily by the supplier. For example, innovations may take place in the food service channel and then migrate across to the retail channel. [✂]. Similarly, Aldi noted that it had been inspired by Nando's for the recent launch of its range of halloumi fries.[111]

(265) In light of the above, it is clear that there can be no credible concern that large suppliers cannot spread innovation costs/risks across multiple large customers.

(266) Indeed, given that the Proposed Merger will result in an increase in competition for own-brand products, it can be expected to stimulate branded innovation. As the Groceries Market Investigation found, when faced by strong competition from own-brand players across their global supply, branded players were forced to innovate in order to maintain their shares.[112] Any enhanced competition between own-brand and branded products is therefore likely to result in further branded innovation and therefore benefits to consumers, rather than consumer harm.

3. New product development will not involve significant upfront costs specific to an individual retailer

(267) Of the new products added to the Parties' respective master assortments in any given year, the vast majority involve package size changes or minor product reformulations and so will not involve any meaningful upfront investment by the supplier. Further, in the vast majority of instances where new branded products are introduced, the supplier will itself develop the new product and then try to have it listed across numerous retailers. New products introduced by branded suppliers will rarely be concentrated within a single retailer (i.e. the risk can – and typically is – spread across multiple large retailers).[113]

4. The GSCOP would prevent the conditions anticipated by this theory of harm

(268) The CMA's theory of harm envisages an *ex post* transfer of investment risk to the supplier in a manner that causes harm to the supplier (or at least the threat of such a transfer, significant enough to warrant the supplier deciding not to make the investment in the first place). This is exactly the type of conduct that the Groceries Supply Code of Practice

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[110] https://data.worldbank.org/indicator/NY.GDP.MKTP.CD.

[111] https://www.thesun.co.uk/money/6255793/aldi-halloumi-fries-sale-price-stores-location/.

[112] Competition Commission, The supply of groceries in the UK market investigation, 30 April 2008, para. 43, Annex A9-10, attached as **Annex_005_019** to the Merger Notice.

[113] The exception to this is smaller niche brands that are only sold through a single retailer. For example, a specialist gin brand or craft beer brand. These are not relevant for this theory of harm as the brands (or suppliers) involved will have no meaningful impact on innovation or competition in that particular product category. Furthermore, the investment or innovation will rarely be specific to a single retailer, as the supplier will likely seek to have a variation of the product stocked by other retailers

(GSCOP) was designed to prevent. GSCOP contains detailed rules regarding conduct in relation to all direct suppliers, both large and small, in order to remove the risk of excessive risks or unexpected costs being passed on to the suppliers. For example:

- Retailers must at all times deal with their suppliers fairly and lawfully. Fair and lawful will be understood as requiring the retailer to conduct its trading relationships with suppliers in good faith, without distinction between formal or informal arrangements, without duress and in recognition of the suppliers' need for certainty as regards the risks and costs of trading, particularly in relation to production, delivery and payment issues; and
- Retailers are prevented from varying any supply agreement retrospectively, and must not request or require that a supplier consent to retrospective variations of any supply agreement.

(269) Compliance with GSCOP is monitored and enforced by the Groceries Code Adjudicator (the "**GCA**"), whom the Government recently found to be an "*exemplary modern regulator with an international reputation*".[114] There is no reason to believe that the GCA could not continue to effectively protect the interests of suppliers in their dealings with the Parties post-merger. It is clear that the GCA herself considers that this is the case. She has stated that "*the size of the retailers makes no difference to my ability to regulate them*" and that "*because my penalty powers are 1% of turnover, so the bigger you are, the more it is going to hurt*". As reported, the GCA stated "*the larger the retailers, the more they are likely to embed … proper systems and IT investment [to be Code compliant]*".

C. The Proposed Merger will not lead to a "waterbed effect"

(270) It is clear that the conditions under which waterbed theories of harm may be a concern do not hold in the current case. Suppliers continue to have substantial bargaining power (given that significantly more than 70% of downstream retail demand from groceries alone is accounted for outside of the Parties, and that many suppliers have alternative channels to supply to, including food service, wholesalers, off-licences and the on-trade, and Professional and Business Users (PBUs)).

(271) This countervailing bargaining power enables suppliers to resist attempts by the merged entity to negotiate down its terms of supply beyond an amount that would reflect the lower costs of supply available to the supplier as a result of synergies and efficiencies derived from supplying to the larger merged entity.

(272) It is also not credible to suggest that suppliers will gain incremental market power over other buyers as a result of the Proposed Merger. This was correctly recognised by the CMA in *Tesco/Booker*, which noted that "*if a supplier could profitably charge 'weak buyers' higher prices, one would expect it already to be doing so*". This applies equally to the Proposed Merger.

(273) Indeed, the opposite is more likely to occur, as other retailers are likely to fight to obtain similar benefits to avoid being placed at a competitive disadvantage and suppliers are likely to offer better terms to weaker buyers to ensure they remain in the market to maintain their

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[114] Department for Business, Energy & Industrial Strategy, Statutory Review of the Groceries Code Adjudicator: 2013-2016, July 2017, Ministerial Foreword, p. 2, attached as **Annex_005_025** to the Merger Notice.

outside options.[115] Just as retailers anticipate the consequences on supplier choice of putting so much pressure on suppliers that they do not invest, so suppliers anticipate the consequences of putting too much pressure on weaker buyers. The CMA also recognised this to be the case in *Tesco/Booker*, which notes that: "*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*." As such, it is highly unlikely that competition for customers would decline.

(274) For other closely competing smaller grocery retailers to suffer harmful discriminatory price increases, these retailers would need to operate at negligible profitability, have no buyer power to resist attempts by suppliers, or have no ability to respond themselves (for example, by increasing the scale of buyer groups).

VII. Grocery: entry and expansion

> "*We will consider whether entry or expansion by competitors could prevent any SLC that might otherwise arise.*" (Issues Statement, para. 126)

(275) As set out in detail in the Merger Notice and above, the UK grocery market is characterised by dynamic competition, with ongoing expansion by a large number of competitors across different formats and channels.

(276) The possibilities for expansion are fuelled by the fact that commercial property is widely available at low rent/rates across towns and cities in the UK, as well as the sheer size of the UK grocery market (greater than £140 billion[116]). These offer significant incentives for companies to invest in UK grocery expansion.

(277) A key example of this is Amazon, which has not only expanded online (as outlined further in paragraph (290) below), but is now signalling a large-scale expansion in in-store grocery. As set out in a press article on 28 October 2018, "*The US giant has hired property agents to search for up to 200 sites for Amazon Go, a new convenience store using cutting-edge technology to dispense with the need for checkouts. Meanwhile, it is also understood to be considering an offer to snap up a large block of bigger stores to expand Whole Foods in the event that regulators force Sainsbury's and Asda to sell supermarkets to their rivals as the price of their proposed merger.*"[117] According to analysts, "*The potential for Amazon Go is extraordinary … The tech will be difficult for other retailers to replicate and the convenience of it is hugely enticing for shoppers, who just want the retailer to get out of the way*."[118] With initiatives such as this on the horizon, it is clear that entry and expansion is a critical part of the competitive assessment of the Proposed Merger, not least in relation to the national theories of harm.

(278) Further examples of competitive expansion in both in-store and online grocery retailing are set out below.

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[115] Basic bargaining theory points to the merger providing the other retailers with greater negotiating strength in their relationship with suppliers. If the supplier supposedly loses an outside option as a result of the merger while the alternatives available to other retailers remain unchanged, other retailers gain negotiating strength over the supplier, thus can also obtain better terms.

[116] See Paragraph 557 of the Merger Notice.

[117] Sunday Times, *Amazon primes its technology to invade the high street*, 28 October 2018. See: https://www.thetimes.co.uk/article/amazon-primes-its-technology-to-invade-the-high-street-9tc2q5w80.

[118] Ibid.

A. Continued expansion of Aldi and Lidl

(279) Both Aldi and Lidl have expanded hugely over the last five to 10 years (growing to 757 and 745 stores, respectively). Aldi, for example, opened 60 new stores in 2017, whilst Lidl opened 42,[119] together accounting for c.70% of all new store openings in 2017.[120]

(280) As noted above at paragraph (234), they have a strong store expansion programme which is likely to continue. They have opened approximately 650 new stores since 2010 (the equivalent of a new store opening every four to five days over eight years) and are projected to open another 480 stores by 2022. Moreover, they are expanding their geographic footprint to target more affluent areas, with Aldi "*expanding its footprint south into Sainsbury's traditional heartlands*" and Lidl opening more stores in London and the South East.[121] The Aldi and Lidl websites list 409 locations and 991 locations where they are currently interested in opening new stores.[122]

(281) These store expansions are supported by increases in distribution capacity. Aldi plans to open three new regional distribution centres (at Sheppey, Sawley and Bedford), as well as extensions to existing centres in Darlington and Bathgate.[123] Lidl intends to open new warehouses in Doncaster, Bolton, Peterborough and Luton, having opened two new distribution centres last year (in Exeter and Wednesbury).[124]

(282) With such definitive and widely publicised plans, it is undoubted that expansion by Aldi and Lidl will be a timely and constraint on the Parties post-merger even in the decreasing number of local areas in which one or both are not already present. Indeed, an examination of recent store openings by Aldi and Lidl indicates that they can open new stores within no more than a year to 18 months from submitting planning applications.[125]

B. Increased focus on grocery for Iceland and M&S

(283) Whilst Aldi and Lidl are key competitors, it is important not to underestimate the continuing constraint from operators such as Iceland and M&S, which are each expanding their grocery operations.

(284) Iceland operates approximately 844 supermarkets, and has grown over the last five years, developing its proposition to include fresh and frozen food.[126] Iceland's launch of the larger Food Warehouse brand of stores, which includes fresh products, ambient products and a wider range of alcoholic drinks, will have an increasingly significant impact. Managing Director Richard Walker has announced plans to expand at a pace of 30 new Food

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[119] IGD, Space Forecast (5 March 2018), attached as **Annex_004_003** to the Merger Notice.

[120] UBS, "UK Food Retailers, UBS Evidence Lab – Grocery Competition Monitor 4Q17" (January 2018), page 4, attached as **Annex_004_160** to the Merger Notice. UBS notes that of the new store formations of +250bps in 4Q17: Aldi accounts for +109bps; Lidl +72bps. Of the other players, Sainsbury's accounts for +40bps (primarily local convenience stores); Tesco +13bps; Asda +10bps; Waitrose +6bps; Morrisons N/C.

[121] UBS, UK Food Retail note, page 32, attached as **Annex 004_016** to the Merger Notice.

[122] See: https://www.aldi.co.uk/about-aldi/property/required-towns and https://www.lidl.co.uk/en/Site-Requirements-5377.htm.

[123] See: https://www.logisticsmanager.com/aldi-to-open-130-new-stores-and-three-dcs/.

[124] See BBC article "Lidl plans new Leeds warehouse creating 500 jobs" (17/09/18): https://www.bbc.co.uk/news/uk-england-leeds-45548915.

[125] Analysis of recent Aldi and Lidl planning permission applications and opening dates.

[126] Fiscal Year 2018 Interim results for 40 weeks ended 29 December 2017, Iceland, 15 February 2018 available at: https://brait.investoreports.com/wp-content/uploads/2018/02/Iceland-Foods-FY18Q3-Bond-Investor-Presentation.pdf, attached at **Annex 004_080** to the Merger Notice.

Warehouses a year, with a view to eventually reaching 400 stores.[127] In May 2018, he noted that Food Warehouse has "*an active and aggressive requirement out in the market for new stores*".[128]

(285) Similarly, M&S's grocery sales have grown steadily in recent years (in large part due to a rapid standalone grocery store opening programme). Although the M&S business is already 60% food, this proportion is expected to continue to shift in favour of food, reaching 70%.[129] M&S operates food halls in its larger stores and Simply Food standalone stores. M&S operates 593 stores, ranging from 3,108 to 61,000 square feet.[130] M&S's Simply Food format has grown significantly over the last 10 years and, along with the M&S Simply Food franchises operated by BP (and others), has made the M&S food range much more accessible to a large part of the UK population.

C. Expansion of other bargain stores

(286) Expansion by bargain stores, such as B&M and Home Bargains, will also increase the sum of competitive constraints on the Parties post-merger. These stores have outperformed the market in recent years, and are expected to continue to roll out stores and expand their share in ambient food and non-food grocery, selling branded products at very low prices and increasing the pressure on grocery players. They are also growing significantly in respect of fresh and frozen food. For example, B&M has recently added frozen food to around 80 of its stores, raising like-for-like sales in those outlets by c. 5%.[131]

(287) Market analysts TCC Global have observed: "*The media is obsessed with Aldi and Lidl, but is overlooking the pain that the likes of B&M and Home Bargains are inflicting on Big Four supermarkets*".[132] B&M is pursuing a dynamic growth strategy, having opened more than 200 stores in the past five years,[133] including 19 stores in just 13 weeks to 23 December 2017,[134] with an ultimate store target of 950.[135] Similarly, Home Bargains owner TJ Morris

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[127] Iceland, "Iceland: 60 second update" (8 November 2017) available at: https://retailanalysis.igd.com/retailers/iceland/news-article/t/iceland-60-second-update/i/17835, attached as **Annex_004_076**, also cited in Schedule 14, Overview of the Parties' Competitors, para. 54.

[128] Retail Gazette, "Iceland mulls "aggressive" expansion for Food Warehouse" (29 May 2018) available at: https://www.retailgazette.co.uk/blog/2018/05/iceland-mulls-aggressive-expansion-for-food-warehouse-fascia/, attached as **Annex_004_077**; also cited in Schedule 14, Overview of Parties' Competitors, para. 54.

[129] See interview with Steve Rowe at: https://uk.news.yahoo.com/m-boss-not-food-first-074509541.html?guccounter=1.

[130] In May 2018, M&S announced that it is to accelerate its store closure programme, with a total of 100 full-line branches closing by 2022, an increase from the 60 originally planned. See: https://corporate.marksandspencer.com/media/press-releases/2018/m-and-s-uk-store-estate-update, attached as **Annex_004_149** to the Merger Notice; and https://www.ft.com/content/e2de940a-5d9e-11e8-ad91-e01af256df68, attached as **Annex_004_150** to the Merger Notice.

[131] See B&M Retail: UBS Evidence Lab UK Retail survey still promising for value retailers, 26 October 2018.

[132] "Watch out Aldi and Lidl – bargain kings B&M set to sell pizza and ice cream after buying grocer in £152m deal." This is Money, 12 January 2018, available at: http://www.thisismoney.co.uk/money/markets/article-5264023/Bargain-kings-B-M-set-sell-pizza-ice-cream.html, attached as **Annex_004_049** to the Merger Notice.

[133] Asda Internal Document, Bargain Stores, B&M Update, page 3, attached as **Annex 002_036** to the Merger Notice.

[134] "Discount chain B&M's expansion pays off", BBC News, 12 January 2018, available at: http://www.bbc.co.uk/news/business-42661782, attached as **Annex_004_108** to the Merger Notice.

[135] "B&M Retail to open yet more stores as it defies inflation worries", Telegraph, 25 May 2017, available at: https://www.telegraph.co.uk/business/2017/05/25/bm-retail-open-yet-stores-defies-inflation-worries/, attached as **Annex_004_109** to the Merger Notice.

increased sales to £2.1 billion, representing close to a 15% increase on the previous year.[136] Home Bargains now operates over 500 stores, with an ultimate target of 1,000 UK stores.[137]

D. Expansion of online grocery retail

(288) The constraint from online retail is significant and consistently increasing. Online grocery sales are forecast to grow ahead of all other formats between 2018 and 2021 (at a compound annual growth rate of 10.7%).[138] As part of this, significant expansion by both pure-play operators and multichannel operators is expected.

(289) Ocado is the largest pure-play online grocery operator. In FY2017, it generated annual retail sales of £1.3 billion with year-on-year growth of 12.4%, and grew its active customer base by 11.2% to 645,000. Since the merger was announced, Ocado has opened its fourth, and largest, Central Fulfilment Centre ("**CFC**") in Erith which, as well as increasing capacity for Ocado, has enabled Morrisons to significantly expand its online grocery service in South-East England. According to Ocado's 2018 Half Year Report, the Erith CFC achieved the same level of throughput in three weeks as its first CFC achieved in 32 weeks.[139] According to press reports in October 2018, Ocado is "*hunting for two new distribution centres to capitalise on the surge in demand for online deliveries. The internet grocer is understood to be looking for one warehouse between London and Birmingham, and another in the north of England within easy reach of customers in Liverpool, Manchester and Leeds*".[140]

(290) In addition to pursuing its Amazon Go convenience offering (as discussed in paragraph (277) above), Amazon is significantly expanding its presence in the UK grocery sector in a number of other ways, having recently reached a delivery agreement with Morrisons and invested in improving its grocery delivery service through a range of different services, including Amazon Pantry, Amazon Prime Now and Amazon Fresh. The acquisition of Whole Foods in 2017 gave Amazon a platform for further expansion in the UK, both online and through physical stores. The acquisition was widely perceived as evidencing Amazon's long-term commitment to expansion in the grocery sector. Immediately following the acquisition, Amazon announced that it would be reducing prices at Whole Foods to make the offer more accessible (resulting in a decline in share prices of UK grocery retailers such as Tesco and Sainsbury's). Whole Foods products have also now become available for online purchase through Amazon Fresh for Amazon Prime customers. IGD expects that Amazon's scaling up of its food operations in the UK via its acquisition of Wholefoods, could *"make… [it] an even more formidable competitor"*.[141]

(291) In terms of multichannel operators, Morrisons is poised to expand its online operations significantly. According to its 2018 Interim Results, Morrisons.com is adding substantial new

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[136] See: https://www.retailgazette.co.uk/blog/2018/10/home-bargains-boss-takes-home-1m-paycheck/. For the previous year's figures, see: "Home Bargains Owner Drives Turnover Towards £1.9BN", Insidermedia, 16 October 2017, available at: https://www.insidermedia.com/insider/northwest/home-bargains-owner-drives-turnover-towards-1.9bn, attached as **Annex_004_050** to the Merger Notice.

[137] Ibid.

[138] IGD, The Future of Retail, (August 2016), page 6, attached as **Annex_004_009** to the Merger Notice and IGD Datacentre Channel Analysis (2017), attached as **Annex_004_019** to the Merger Notice.

[139] Ocado Half Year Report (10/07/2018). See: http://www.ocadogroup.com/~/media/Files/O/Ocado-Group/reports-and-presentations/2018/fy18-half-year-results.pdf on page 2.

[140] Times article "Ocado, led by Tim Steiner, looks for warehouses to cater for online expansion" (21/10/18). See: https://www.thetimes.co.uk/article/ocado-led-by-tim-steiner-looks-for-warehouses-to-cater-for-online-expansion-8kfl3lv8s.

[141] IGD, Country presentation, United Kingdom, dated August 2017, page 11, attached as **Annex_004_021** to the Merger Notice.

capacity, and has now extended its reach to over 75% of British households. Through a combination of more store-pick capability and transitioning to the newly opened Ocado CFC in Erith, it has significantly expanded its online delivery catchment areas to include South London, Surrey and Kent, the south coast and Devon, as well as Edinburgh and Glasgow. Morrisons expects its CFC/store-pick hybrid model to enable it to "*plan better for more profitable online growth*".[142] Further, at the end of the first half of 2018, Morrisons launched "Eat Fresh", a new online nationwide recipe box service. Customers can order a wide variety of fresh meals to be delivered direct to home, with each "Eat Fresh" box providing the fresh ingredients. Finally, under an arrangement with Amazon, Morrisons' ambient grocery products are now available nationwide and Morrisons' fresh grocery products are available in nine major cities.

[142] Morrisons Interim Results (18 September 2018). See: https://www.morrisons-corporate.com/Documents/corporate2018/morrisons-interim-results-announcement-2018-09-13.pdf on page 10.

PART IV – GENERAL MERCHANDISE

I. General merchandise: market definition

"*As a starting point, we intend to take a closer look at market definition for the categories which are currently of interest, namely toys, electricals and clothing. For those categories where the available information indicates that the Parties' combined market share in the category overall is not particularly high, but their combined market share is relatively high in a narrower sub-category, we also intend to consider the competitive constraints within that narrower sub-category, i.e. personal care electricals and small kitchen appliances as sub-categories within electricals, and childrenswear as a sub-category within clothing.*" (Issues Statement, para. 45)

A. Market definition overview

(292) While the Parties remain of the view that there is no need to define a precise product market for general merchandise products given the supply side substitutability between general merchandise segments, each of the categories identified as of interest in the Issues Statement is discussed briefly below.

(293) As discussed further in Section II below, the Parties face competition from a range of retailers, including not only grocery retailers (including Aldi and Lidl) but also retailers that do not sell groceries (both bricks and mortar and online general merchandise retailers). The relevant competitor set is therefore extremely broad.

(294) The Parties also remain of the view that it is not necessary and would not be proportionate to carry out a full local analysis in relation to general merchandise, because there could not plausibly be a competition issue in a local area where no equivalent competition issue exists with respect to groceries. Even if not all grocery competitors sell all general merchandise products in catchment areas where the Parties have overlapping general merchandise offers, the Parties' general merchandise offers face a series of significant additional constraints:

- the aggregate constraint from online competitors such as Amazon is strong across all local markets;
- in addition to online players such as Amazon, there are a number of very large general merchandisers, including department stores such as John Lewis and Debenhams, and bargain stores such as Wilko and B&M, with a growing network of stores; and
- for every sub-segment of general merchandise, there are a number of large specialist competitors with large networks of bricks and mortar stores in addition to an online presence, including Dixons Carphone, Boots, Next, M&S, Matalan, Smyths and many others.

(295) Therefore, the Parties submit that, while the scope of the relevant markets is local, it is not necessary to carry out a full local analysis, as it is clear from the Parties' national shares and the degree of online penetration (which continues to grow) that the market is fragmented. After the Proposed Transaction, there will remain a large number of competitors that are active throughout the UK.

B. Toys

(296) As set out in the Merger Notice, the CMA has previously considered the retail sale of toys sector in *Sainsbury's/HRG*,[143] where its analysis proceeded on the basis of a single toys segment. The Parties do not consider it necessary or appropriate to further segment the toys category, given that:

- the Parties and major competitors are active across all sub-segments;
- retailers of toys are readily able to alter their competitive positioning (product portfolio, marketing, etc.) to focus on any toy sub-segment to constrain attempted SSNIPs by competitors; and
- as previously noted by the CMA in *VTech/Leapfrog*, there is no commonly accepted segmentation, with different retailers using different categories.[144]

C. Electricals

(297) The OFT previously considered the electrical goods sector in *GUS plc/Index/Littlewoods Ltd*, without further segmentation. In *Carphone Warehouse/Dixons*, the European Commission segmented the retail supply of electrical goods by reference to "white goods", "brown goods" and "grey goods". The CMA also considered such a segmentation in its recent decision in *Sainsbury's/HRG*, considering in addition a possible segment for small domestic appliances ("**SDA**").

(298) The Parties do not consider it necessary or appropriate to segment the electricals category, given that retailers supplying products in certain sub-categories of the electricals segment will typically supply those products alongside a much wider set of products. For example, in the case of SDA/small kitchen appliances ("**SKA**") or personal care electricals ("**PCE**"), these products are typically sold alongside a wider set of electrical products (in particular, by electrical retailers such as Dixons Carphone or AO.com), a wider set of homewares products (for example, by retailers such as Dunelm, Next Direct, Wilko, B&M, The Range and Robert Dyas), a wider range of health and beauty products (e.g. Boots, Superdrug), or, in the case of generalist retailers such as Amazon, Very/Littlewoods and John Lewis, as part of an even broader range.

(299) As retailers can easily engage in supply-side substitution between these categories in response to changes in competitive tension in any one category, given that the upstream manufacturers of these products are likely to already have a supply relationship with retailers present in the market, the Parties do not consider that sub-segments of the electricals segment could plausibly represent separate markets. There is nothing specific about any of these categories that means retailers could not readily substitute between categories. In any event, Asda's relatively small share of supply across all product categories makes it unlikely that the Proposed Transaction would give rise to a material increment in any sub-segment of this product category.

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[143] *Sainsbury's/HRG*, attached as **Annex_005_001**.

[144] CMA, *Completed acquisition by VTech Holdings Limited of LeapFrog Enterprises Inc.*, Case No. ME/6614/16, decision of 12 January 2017, paragraph 7.26, attached as **Annex_005_038**.

D. Clothing

(300) The clothing market has been considered in a number of previous UK merger decisions.[145] The CMA/OFT has not found it necessary to conclude on the precise scope of the market, given the absence of competition concerns in any previous case.

(301) The Parties submit that the appropriate frame of reference is the retail supply of clothing in the UK. It is not necessary or appropriate to segment the market into narrower sub-categories, as there is a high degree of supply-side substitutability between sub-categories: the conditions of competition do not vary significantly across narrower segments, and retailers active in each segment are able to adjust their offerings within and across segments with relative ease.

(302) In particular, there is no reason to consider that childrenswear constitutes a separate relevant market, given that a range of retailers already supply each of childrenswear, menswear and womenswear and that it would be easy for retailers that do not currently supply childrenswear to expand into this segment, and/or for retailers with an existing childrenswear offer to increase their focus on this segment. Indeed, the manufacturing supply base is generally common across suppliers, with most manufacturers already producing childrenswear, as well as menswear and womenswear.[146]

(303) Examples of retailers that have expanded from womenswear and/or menswear ranges into childrenswear include River Island, Zara, Cos, H&M and JD Sports, among others. High street retailers are increasingly seeing childrenswear ranges as a way to engage with parents, such as "mini me" ranges where the adult and child products match, or as a way to bring in customers who will grow with the brand.

II. General merchandise: unilateral effects theories

A. Toys

(304) There is no prospect of an SLC arising in respect of toys.

1. Shares of supply

(305) The Parties' shares of supply are set out below.

Table 7 Parties' shares of supply for Toys (2017)

Sub-segment	Sainsbury's Group (Sainsbury's/Argos)	Asda	Combined
Toys[147]	18.0% (3.6%/14.4%)	5.6%	23.6%

145 See, for example, OFT, *Completed acquisition by TBH Retail Limited of USC Group plc*, Case No. ME/1233/04, decision of 22 September 2004, attached as **Annex_005_039** to the Merger Notice; OFT, *Anticipated acquisition by Pentland Group plc of The John David Group plc*, Case No. ME/1744/05, decision of 30 June 2005, attached as **Annex_005_040** to the Merger Notice; OFT, *Completed acquisition by Associated British Foods plc of Littlewoods stores*, Case No. ME/1838/05, decision of 9 August 2005, attached as **Annex_005_041** to the Merger Notice, and OFT, *Anticipated acquisition by House of Fraser plc of James Beattie plc*, Case No. ME/1821/05, decision of 7 August 2005, attached as **Annex_005_042** to the Merger Notice.

146 While there are some technical requirements associated with baby clothing in particular, such as metal detection, manufacturers are generally already familiar with these requirements, and many suppliers [✂] employ metal detection standards across their entire clothing range (this is also applicable to lingerie, for example).

147 NPD, "UK Toys Market Overview: NPD Consumer Panel – Full Year 2017" (March 2018), attached as **Annex_004B_042**.

(306) As can be seen from Table 7 above, the Combined Entity will not have a particularly strong share in toys, and customers will retain a wide variety of alternative suppliers for these products – both online and in-store. The exit of Toys “R” Us[148] will not materially change this position, as, even if Toys “R” Us’s previous sales were distributed across the competitors in the market in line with their previous market shares, the Parties’ combined shares would remain well below 30% and the increment in shares would remain low. Further information on the impact on the market from the exit of Toys “R” Us is set out below.

2. Closeness of competition and competitive constraints

(307) The Parties are not particularly close competitors in respect of toys.

(308) According to its internal documents, Sainsbury’s Argos considers its top competitors in the Toys category to be [✂] (based on the number of similar products sold), and Sainsbury’s references to a lesser extent [✂]. Market research indicates that people who shop through Sainsbury’s Argos are more likely to shop at Amazon and Smyths Toys than they are to shop at Asda for toys.[149] The Transaction will not therefore result in any material loss of constraint on Sainsbury’s Argos’ competitive offering in this category.

(309) Similarly, Asda references a wide range of competitors in its internal documents, including [✂].[150]

(310) There have been some recent developments in this category as it reacts to the closure of Toys “R” Us.

- The Entertainer has recently announced a 38% YOY profit increase for the 12-month period ending January 2018, with a total sales increase across all channels of 7.4% and TheToyShop (the Entertainer’s online platform) reporting a sales increase of 28%. The Entertainer now has 148 stores across the UK.[151] This growth is expected to continue, with half year 2018/19 total sales increasing by 25%, and a further 12 new stores set to open, along with 10 existing stores being refitted/relocated. Further, a successful trial with Matalan during 2017 has seen The Entertainer open 59 in-store toy departments within Matalan stores during September 2018.[152] Aside from being “*the fastest-growing high street toy retailer in the UK*” according to its website, The Entertainer is also continuing to grow its presence internationally, with 27 international stores through its successful partnerships.[153]
- Smyths is also continuing to expand, with recent store openings in Greenford, Liverpool Croxteth and Stevenage[154] and new store openings planned, such as in Lincoln.[155] Smyths has purchased 93 Toys “R” Us stores across central Europe to

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[148] 25 Toys “R” Us stores closed in March 2018 and the remainder in April 2018 after Toys “R” Us UK failed to find a buyer.

[149] GlobalData, “The UK Toys and Games Market 2017-2022” (October 2017), page 61, attached as **Annex_004B_043**.

[150] [✂].

[151] See The Entertainer’s press release “Outstanding financial results for The Entertainer to year end January 2018 and 25% sales growth at the half year” (4 October 2018, available at https://www.thetoyshop.com/press/2018-financial-results).

[152] *Ibid*.

[153] See The Entertainer’s press release “The Entertainer continues international growth and expands into Kazakhstan” (3 August 2018, available at https://www.thetoyshop.com/press/kazakhstan).

[154] See https://www.getwestlondon.co.uk/whats-on/shopping/greenford-smyths-toys-new-superstore-15291029, https://www.liverpoolecho.co.uk/whats-on/shopping/new-smyths-toy-superstore-opening-14487339.

[155] City X, “Smyths Toys coming to Lincoln” (20 August 2018, available at https://cityx.co.uk/2018/08/smyths-toys-coming-to-lincoln/).

expand its operations[156], in addition to its over 100 stores throughout the UK and Ireland.[157] [✂].

- B&M has also recently been gaining momentum following the closure of Toys "R" Us, both in terms of the ranges now stocked (e.g. Lego) to which it previously did not have access, and the deals it is offering customers, with a focus on heavily marketing these offers. The Parties expect B&M to continue to focus on this space and grow share in the toys market.
- In addition, Morrisons has also increased its focus recently on toy promotions and new toy ranges, with Tesco similarly increasing promotions in this space.
- Shop Direct is currently offering toys promotions, with up to 25% off on thousands of toys, through both Very[158] and Littlewoods[159] (both until November 2018). Shop Direct features strong toys brands, including VTech, Little Tikes, Paw Patrol, Lego, Leap Frog and Barbie.
- Finally, just as growing pressure from Amazon is thought by many to be partly responsible for the demise of Toys "R" Us,[160] reports suggest that Amazon will benefit from its exit. Bloomberg has reported that Amazon intends to print and distribute a holiday toy catalogue to fill the void left by the "Big Book" that Toys "R" Us published.[161]

(311) This is consistent with the view that customers will continue to have a wide range of alternative suppliers of toys to choose from post-merger – both in-store and online.

B. Electricals

(312) There is no prospect of an SLC arising in respect of electricals – whether assessed on a broad basis or by reference to the narrower categories identified in the Issues Statement, namely personal care electricals and small kitchen appliances.

1. Shares of supply

(313) The Parties' shares of supply are set out below. As for toys, the increment in share resulting from the Proposed Merger is low.

Table 8 Parties' shares of supply for electricals (2017)

Sub-segment	Sainsbury's Group (Sainsbury's/Argos)	Asda	Combined
Electricals[162]	<11.3% (<0.7%[163]/10.6%)	2.3%	12.9%-13.6%

[156] https://www.retailgazette.co.uk/blog/2018/04/smyths-buys-every-former-toys-r-us-store-3-countries/.

[157] See Smyths' "About Me" page, available at https://www.smythstoys.com/about-us.

[158] https://www.very.co.uk/toys/e/b/5132.

[159] https://www.littlewoods.com/toys/e/b/5132.

[160] By disrupting the toys sector by offering many of the same items as bricks and mortar stores, at significantly lower prices and with the convenience of delivery. See for example https://www.retailgazette.co.uk/blog/2018/03/amazon-eyes-toys-r-us-vacancies/.

[161] https://qz.com/1322124/amazon-is-capitalizing-on-the-demise-of-toys-r-us/.

[162] GlobalData, "The UK Electricals Market 2018-2023" (May 2018), **Annex_004_165** to the Merger Notice and Asda from GlobalData, "The UK Electricals Market 2013-2023" (February 2018) as not included in more recent report, **Annex_004B_031** to the Merger Notice.

[163] Sainsbury's not reported. Shares of supply estimated as being no higher than the smallest reported share of a top 10 player.

Personal Care Electricals (2018)[164]	(2.7%, 12.4%)	<1.4%[165]	15.1%-16.5%
Small Kitchen Appliances[166]	19.2% (3.6%/15.6%)	5.2%	24.4%

(314) Shares of supply for Personal Care Electricals were provided in Schedule 16 to the Merger Notice as 24.2% combined (Sainsbury's 3.3%, Argos 16.2% and Asda 4.7%). These shares were from the most recent market report the Parties had at the time, the 2016 Verdict Retail "Personal Care Electricals" (December 2016).[167] Since then, the Parties have received the GlobalData "Personal Care Electricals" (August 2018) report, which shows a decline in the Parties' shares for Personal Care Electricals, as reflected in Table 8 above. Indeed, Asda is no longer named amongst the top 10 retailers, and therefore its share of supply is no longer reported in this industry report.

2. Closeness of competition and competitive constraints

(315) The Parties are not close competitors for the supply of electrical products (whether assessed overall, or on a sub-category basis). Further, there are many strong competitors in the market, including Amazon, John Lewis, Dixons Carphone, Boots, B&M Bargains, Very/Littlewoods, and others.

(316) Sainsbury's (through the Argos brand) considers its top three competitors to be [✂], which carry a similarly full range of electrical products. These suppliers compete on the basis of range, product support and convenience, supplying products at all price points. Indeed, industry reports suggest that Sainsbury's Argos is expected to lose share to competitors such as Dixons Carphone and Amazon going forward.[168] Argos monitors the prices of [✂].[169] [✂]. Across the top three competitors whose prices are monitored, Argos is able to [✂].

(317) Amazon is named in industry reports, [✂], as a key competitive threat, and this remains the case when considering both PCE and SKA products in particular.[170] GlobalData expects Amazon to continue to gain share in PCEs[171] and SKAs.[172] The discounters are also increasingly growing share (notably B&M and Aldi) across electricals as they increasingly access more brands, and dedicate more retail space. The share growth of Amazon, B&M and Aldi is predominantly coming from a mixture of Tesco, traditional high street retailers (such as Robert Dyas) and Sainsbury's Argos, which has seen declining share.

(318) Alongside Amazon, competition in PCE products also comes from health and beauty-focused high street retailers such as Boots and Superdrug, along with Wilko and Shop Direct (Very/Littlewoods), department stores, such as John Lewis and Debenhams, and other

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[164] GlobalData, "Personal Care Electricals" (August 2018), attached as **Annex_004L_002**.

[165] Asda not reported. Shares of supply estimated as being no higher than the smallest reported share of a top 10 player.

[166] GlobalData, "Small Kitchen Appliances" (November 2017), attached as **Annex_004B_029** to the Merger Notice.

[167] Verdict Retail, "Personal Care Electricals" (December 2016), attached as **Annex_004_176** to the Merger Notice.

[168] See for example, GlobalData, "Small Kitchen Appliances" (November 2017), pages 22 and 25, attached as **Annex_004B_029** to the Merger Notice.

[169] [✂].

[170] [✂].

[171] GlobalData, "Personal Care Electricals" (August 2018), page 25, attached as **Annex_004L_002**.

[172] GlobalData, "Small Kitchen Appliances", November 2017, page 22, attached as **Annex_004B_029**.

grocers, such as Tesco.[173] Premium health and beauty retailers, such as Space NK and online offering Feelunique, are also increasingly active in this space.[174] Dyson's impact on the market (revolutionising hair dryers) has been felt at the retailer level, as those who have access to the products (such as Currys, Boots and John Lewis) have been positively impacted, whereas those who do not have access have suffered. Over the past 12 months, Sainsbury's Argos [✂].[175]

(319) Market reports note that Argos continues to lose share (for the fourth consecutive year) in SKA products, with general merchandisers growing share and Aldi and Lidl also growing their SKA offers.[176]

(320) Both B&M and The Range sell an extensive collection of discounted branded SKA.[177] Asda competes closely with these and is expected to lose share in SKA products, particularly to "*B&M and Home Bargains, which are both rapidly expanding*".[178]

(321) Amazon is expected to gain share, as is Dixons Carphone, which has focused on improving its delivery proposition, with promotions of products with free next-day delivery, and offering click and collect through Carphone Warehouse.[179] In addition, in 2017, Dixons Carphone launched Currys PC World concessions (which cover a range of electrical goods, including PCE and SKA products) in Tesco superstores on a trial basis.[180] John Lewis, Shop Direct, Tesco, Wilko and Lakeland are also strong in SKA products.[181]

(322) Furthermore, as with other sub-segments in the market for general merchandise, the increasing penetration of online sales provides a strong constraint on the Parties, reducing barriers to entry for new suppliers and negating many barriers to expansion for existing suppliers. The existence of homogeneous products in the market makes it easy to compare and switch between retailers, especially online.[182] The sale of PCEs and SKAs online is only expected to grow further.[183]

C. Clothing

(323) There is no prospect of an SLC arising in respect of clothing – whether assessed on a broad basis or by reference to childrenswear only.

1. Shares of supply

(324) The Parties' shares of supply are set out below.

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[173] GlobalData, "Personal Care Electricals" (August 2018), page 20, attached as **Annex_004L_002**.

[174] GlobalData, "Personal Care Electricals" (August 2018), page 22, attached as **Annex_004L_002**.

[175] [✂].

[176] GlobalData, "Small Kitchen Appliances" (November 2017), page 4, 10 and 22, attached as **Annex_004B_029** to the Merger Notice.

[177] GlobalData, "Small Kitchen Appliances" (November 2017), page 10, attached as **Annex_004B_029**.

[178] GlobalData, "Small Kitchen Appliances" (November 2017), page 22, attached as **Annex_004B_029**.

[179] GlobalData, "Small Kitchen Appliances" (November 2017), page 22, attached as **Annex_004B_029**.

[180] See Dixons Carphone's press release of 21 July 2017 (available at https://www.dixonscarphone.com/news-and-media/press-releases/2017/21-07-2017).

[181] GlobalData, "Small Kitchen Appliances" (November 2017), page 23, attached as **Annex_004B_029**.

[182] Verdict Retail, "How Britain Shops for Electricals" (June 2015), page 6, attached as **Annex_004K_0959** to the Merger Notice.

[183] GlobalData, "Personal Care Electricals" (August 2018) noted that "*the online PCE market is forecast to grow 27.4% between 2018 and 2012*", page 8 attached as **Annex_004L_002**; GlobalData, "Small Kitchen Appliances" (November 2017) noted that "*online SKA sales are set to grow by 10.8% over the next five years…*." page 7, attached as **Annex_004B_029**.

Table 9 Parties' shares of supply for clothing (2017-2018)

Sub-segment	Sainsbury's Group (Sainsbury's/Argos)	Asda	Combined
Clothing[184]	2.3% (2.3%/0) by value 4.8% (4.8%/0) by volume	4.5% by value 10.7% by volume	6.8% by value 15.5% by volume
Childrenswear[185]	4.1% (4.1%/0) by value 6.5% (6.5%/0) by volume	11.5% by value 20.0% by volume	15.6% by value 26.5% by volume

2. Closeness of competition and competitive constraints

(325) The UK clothing sector, including the childrenswear segment, is highly fragmented, and the Parties are not particularly close competitors in clothing. In 2017, 71% of clothing sales (by value) in the UK were made by specialist retailers, and these are the Parties' primary competitors.[186]

(326) Asda has an aspiration to better compete with [✂] over the next three years. It also considers itself to compete with the [✂], both in terms of price and product quality (fashion), closely monitoring [✂].[187] These constraints will clearly remain just as strong for the Merged Entity.

(327) Sainsbury's Argos primarily benchmarks itself against [✂]. Its internal documents also focus on retailers such as [✂],[188] noting that these retailers are bucking the declining market trend that is particularly impacting portfolio players such as [✂].[189] Of these retailers, [✂].[190] Sainsbury's Argos is focusing on [✂].[191]

(328) GlobalData's "How Britain Shops" survey found that a significant proportion of customers that had shopped for clothing at Sainsbury's in the past year had also shopped at M&S, Primark, Next and Tesco.[192] Similarly, customers that had shopped at Asda had also shopped in Primark, Tesco, M&S, Next and New Look.[193] Post-merger, the Parties will continue to face strong competition from these and many other retailers, including pure-play online retailers such as Very, ASOS and Boohoo.

[184] Kantar Worldpanel, "Monthly Report – GB Fashion Market – Market Estimates & Retail Shares" (52 weeks ending 11 February 2018), attached as **Annex_004_171**.

[185] Kantar Worldpanel, "Monthly Report – GB Fashion Market – Market Estimates & Retail Shares" (52 weeks ending 11 February 2018), attached as **Annex_004_171**.

[186] GlobalData, "The UK Clothing Market 2013-2023" (February 2018), attached as **Annex_004B_049** to the Merger Notice.

[187] [✂].

[188] [✂].

[189] See "M&S board plotted to break up business", The Sunday Times, 4 November 2018, available at https://www.thetimes.co.uk/article/m-s-board-plotted-to-break-up-business-b7w8vxkqd.

[190] The most recent GlobalData market report on clothing, "The UK Clothing Market 2018-2023" (July 2018), noted that "*It is important for retailers to make natural extensions to their propositions via complementary categories in order to drive market share, with ASOS and Coast holding potential within the childrenswear market…*" page 10, attached as **Annex_004L_003**.

[191] *Ibid* pages 20 and 21.

[192] GlobalData, "The UK Clothing Market 2017-2022" (June 2017), page 51, attached as **Annex_004B_025** to the Merger Notice.

[193] *Ibid* page 55.

(329) Amazon and ASOS continue to grow in the clothing market,[194] with a recent industry report noting: "*The growth of the online channel continues to disrupt traditional retailing with ASOS and Amazon leading the charge with their combination of own label and branded items, competitive pricing, and efficient fulfilment, including delivery saver schemes.*"[195] Online revenues are expected to grow in clothing by 7.4% to 35.1% of the market in 2023, while offline revenues have declined year on year.[196]

(330) With respect to childrenswear in particular, internal Sainsbury's Argos documents benchmark Sainsbury's Argos' childrenswear offer against [✂].[197] [✂].[198]

(331) The constraint from Primark, not least in childrenswear, is only increasing as "*… its focus on fashion means it is winning out against the grocers … Primark continues to open stores, further extending its reach*".[199] Indeed, Primark is not only expanding its footprint with new stores but is also forecast by GlobalData to become the UK's second-largest retailer (by value) this year.[200] In terms of childrenswear, Primark is a particularly strong player, with a prominent focus on topical and licensed products, such as Harry Potter and Disney.[201]

(332) A significant number of high street retailers have expanded into childrenswear over recent years. For example, H&M, Zara and Cos all offer childrenswear ranges. River Island has increasingly devoted space in stores to childrenswear, as well as offering baby ranges online, and has seen recent share growth.[202] High street retailers are increasingly seeing the value of bringing customers in early to grow with the brand, and the complementary role childrenswear can offer alongside clothing for adults (e.g. "mini-me" ranges where the children and adult outfits match). Amazon has strengthened its childrenswear offering in recent years, and discounters are also increasingly active in this area.

(333) Similarly, pure-play online operator Boohoo launched a childrenswear range for ages 4 to 12 in 2016,[203] and could devote more resources to these ranges. As childrenswear is a high-volume area, it can help to support volume efficiencies for menswear and womenswear ranges. Offering ranges on websites which are not available in-store is a means for retailers to expand their offering or to test the success of a new offering before introducing it in-store. For example, H&M launched a new online-only baby collection in 2018.[204]

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194 Amazon has recently launched a pop-up fashion shop in central London, where customers can buy goods in the store and take them away, or scan codes on product tags with Amazon's mobile phone app, or use in-store tablets, to order for home delivery. The fashion products on sale at the pop-up changed every two days but included a mix of Amazon's own labels, as well as brands ranging from Calvin Klein to New Look. Amazon has also announced it is launching its "try before you buy" fashion service in the UK. Prime Wardrobe delivers a bag of three to eight clothing items with no upfront charge and free delivery for people signed up to Amazon's subscription service. Wardrobe shoppers are offered discounts relating to the number of items they choose to keep, and they can return any unwanted items free of charge within seven days.

195 GlobalData, "The UK Clothing Market 2018-2023", July 2018, page 6, attached as **Annex_004L_003**.

196 GlobalData, "The UK Clothing Market 2018-2023", July 2018, pages 9 and 12, attached as **Annex_004L_003**.

197 [✂].

198 [✂].

199 GlobalData, "The UK Clothing Market 2018-2023", July 2018, page 33, attached as **Annex_004L_003**.

200 *ibid,* page 3.

201 GlobalData, "The UK Clothing Market 2017-2022" (June 2017), page 51, attached as **Annex_004B_025**; [✂].

202 Elias Jahstan, "River Island opens first standalone childrenswear store" (Retail Gazette, 13 February 2018, available here https://www.retailgazette.co.uk/blog/2018/02/river-island-opens-first-childrenswear-store/).

203 Fashion United "Boohoo launches kidswear" (27 September 2016) (available at: https://fashionunited.uk/news/fashion/boohoo-launches-kidswear/2016092721921).

204 [✂].

(334) Finally, the Parties note that new entrants continue to enter the clothing market, including childrenswear, winning share primarily when providing a differentiated offering. For example, South African retailer Pep & Co launched in the United Kingdom in July 2015, opening 50 shops in 50 days, and in its first 15 months of trading reached £29.1 million in sales. Pep & Co offers womenswear, childrenswear, babywear and homewares. The retailer has recently altered its strategy to focus on rapidly expanding its portfolio of shop-in-shops across Poundland stores.[205]

[205] GlobalData, "The UK Clothing Market 2018-2023", July 2018, page 50, attached as **Annex_004L_003**.

PART V – FUEL

I. Fuel: market definition

> "*In terms of considering the appropriate market definition for our assessment, the Parties overlap in the supply of both petrol and diesel (which previous Office of Fair Trading (OFT) and CMA decisions have considered together as a single product market) … Our starting point is that competition takes place mainly at the local level, as customers will consider options available to them in a local area when they need to buy fuel.*" (Issues Statement, paras. 49-50)

(335) The Parties agree with the above. The CMA also noted that in terms of catchments for the retail supply of fuel, whilst "*past OFT and CMA decisions have adopted a 10-minute drive-time catchment in urban areas and a 20-minute drive-time in rural areas*", the Parties have submitted that "*there is evidence to suggest that the catchment areas for the Parties' PFS are significantly wider at 25-minute drive-time*".[206]

(336) The Parties' views on market definition are set out in their Merger Notice.[207]

(337) In terms of the relevant product market, the CMA (and OFT) have consistently found that further segmentation between petrol and diesel is not necessary as a result of substantial supply-side substitution opportunities. In particular, previous decisions have made reference to the following factors:

- the distribution of petrol and diesel is made at the same point of sale;
- fuel forecourts generally supply both petrol and diesel; and
- suppliers monitor competitors' prices for both petrol and diesel.

(338) There is no reason to depart from the established practice of defining the relevant product market as the retail supply of "fuel", encompassing both petrol and diesel.

(339) With respect to geographic market definition, recent CMA and OFT decisional practice supports the conclusion that competition in the retail supply of fuel is fundamentally local. For example, in *Asda/Co-operative Group* (2014), the CMA observed that "*the OFT has consistently considered competition to take place mainly at the local level*",[208] while in *Sainsbury's/Rontec* (2012), the OFT reported that "*third parties consistently viewed the retail supply of fuel to be local*".[209]

(340) The Parties presented in the Merger Notice considerable evidence to support the conclusion that the most appropriate catchment area for the Parties' fuel sites is a 25-minute drive-time.[210] Most notably:

- [✂];
- Sainsbury's data on Nectar customers indicates [✂]; and

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[206] CMA, Issues Statement, paragraph 50(a).

[207] Merger Notice, Chapter 11, Section V.

[208] *Asda/Co-operative Group*, paragraph 23, attached as **Annex_005_066**.

[209] *Sainsbury's/Rontec*, paragraph 24, attached as **Annex_005_065**.

[210] Merger Notice, Chapter 11, Section V, paragraphs 912-918.

- surveys conducted by the Parties show that, to capture 80% of customer responses, catchments would need to be drawn on average at [✂] (the Parties have not distinguished between urban and rural, because there are only few overlaps between the Parties' rural stores and therefore surveys focused on urban sites).[211]

(341) The available evidence all indicates a substantially wider catchment than has been identified in previous fuel cases – and it is submitted that the most appropriate threshold is 25 minutes for both urban and rural areas.

II. Fuel: theories of harm

(342) The Proposed Merger will clearly not result in unilateral effects in the supply of fuel at the national level, or in most local areas where both Parties have fuel sites, for the following reasons:

- The Parties are small players in the retail supply of fuel: Sainsbury's is the fifth-largest player, with a 10.2% share, and Asda is the seventh-largest, with a 7.7% share (by volume).[1] This combined share of 17.9% is well below the level at which concerns typically arise.
- Fuel retailing is a small part of the business of both Parties, [✂].
- Competition in fuel retailing is fundamentally local, and the sector is characterised by fierce rivalry on parameters including location, price and "on-site" convenience (including on non-fuel retail offers).
- The Parties will continue, post-merger, to face strong competitive pressure from rival fuel retailers in most local areas where they are both present.

A. Closeness of competition and the extent of competition that would remain post-merger from other rivals

(343) The Issues Statement indicates the CMA will:

> "*assess the closeness of competition between the Parties [in fuel retailing], and the extent of competition that would remain post-Merger from other providers. As part of this assessment, we will consider whether supermarket PFS tend to have lower prices than non-supermarket PFS, and their competitive role in the retail supply of fuel in the UK*" (Issues Statement, para. 109)
>
> and
>
> "*also consider how the Parties' ability to offer customers a combined bundle of fuel and groceries in a single shopping trip may affect our assessment. This may include whether a preference amongst customers to purchase groceries and fuel in a single shopping trip is strong enough that competitors that supply only groceries or only fuel may not provide a sufficient constraint on retailers (like the Parties) that supply both*" (Issues Statement, para. 110).

(344) As discussed in Section I above on market definition, it is common ground that competition in fuel retailing takes place "*mainly at the local level, as customers will consider options available to them in a local area when they need to buy fuel*". As a result, closeness of

[211] Merger Notice, Chapter 11, Section V, paragraphs 912-918.

competition is best viewed through the lens of local competitive dynamics, in which the key factors are the number of rivals, convenience of location for customers, (including the ease of entering and exiting the site), price and convenience on-site. The latter includes convenience of the fuel purchase itself (e.g. ability to pay in cash or by card at an automated pump), as well as the non-fuel retail offer.

(345) Accordingly, the degree to which the Parties are close or more distant local competitors will depend on the local circumstances.

(346) On the issue of a retail fuel offer adjacent to a grocery store, this may be convenient for those customers wishing to combine a grocery and a fuel shop. However, the evidence suggests that the proportion of the Parties' fuel customers that combine both purchases in a single trip is relatively low: [✂]% at Sainsbury's, according to Nectar data.[212] Similarly, in a recent survey of a sample of the Parties' sites, it was found that only [✂]% (Asda), [✂]% (Sainsbury's exit survey) and [✂]% (Sainsbury's online survey) of customers mention the location being next to their preferred grocery store as one of their top three most important reasons for being attracted to a fuel station.[213] The clear inference is that most of the Parties' customers are choosing their fuel retailer based on more conventional factors, such as convenience of location and price. Even in the case of those customers who do combine a fuel purchase and grocery shopping in a single trip, there is no reason to believe that these customers would not split these purchases if either the fuel or grocery offer of a particular site became less attractive.

(347) Even if the ability to combine a fuel purchase with a grocery shop was a stronger driver of choice for fuel customers, many fuel operators are increasingly expanding their non-fuel offerings (particularly food-to-go, convenience grocery and coffee), and would remain viable alternatives. This trend was explored at length in the Merger Notice.[214] Additionally, non-supermarket fuel operators are increasingly offering collection points for online shopping deliveries or drive-in promotions, using apps that send promotions and discounts directly to customers' phones as soon as they drive onto the forecourt. Examples of this include Amazon lockers, CollectPlus or InPost click and collection points available at a wide range of brands of PFS. This both attracts fuel customers and encourages them to buy something from the shop, driving retail sales.[215] One example is Tyneside Autoparc in North Gorsforth, which has a Greggs drive-thru and Morrisons convenience store, designed to "*cater for top-up food and incidental convenience shopping and is expected to derive the vast majority of its turnover from passing trade*".[216]

(348) Moreover, non-supermarket fuel rivals are typically better able to compete on a primary driver of choice: convenience of location. As a general rule, locations will be most convenient if they are easy to access from main thoroughfares (i.e. located on main roads/at intersections), are visible at some distance, and are easy to pull into and out of, preferably from more than one direction (e.g. more than one entry/exit point).[217]

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[212] According to Nectar data, only [✂]% of customers purchasing fuel at a Sainsbury's PFS were found also to have bought groceries from the main grocery store on the same day. See also paragraph 873 of the Merger Notice.

[213] See paragraph 873 of the Merger Notice and, for the full description, see Schedule 19 of the Merger Notice.

[214] Merger Notice, paragraphs 895-898.

[215] *Ibid* page 50.

[216] Chronicle Live, "*This is not a drill! Newcastle is to get its first drive-thru Greggs*" (6 June 2018), available at: https://www.chroniclelive.co.uk/news/north-east-news/not-drill-newcastle-first-drive-14750059.

[217] See, for example, Asda, "*Golden Principles WIP – Onsite and Adjacent PFS*", page 3, attached as **Annex_002_038**.

(349) The oil majors, such as BP and Shell, typically have the most convenient sites for historical reasons (and also have many more sites). As early entrants into the UK retail fuel industry, and without needing to find sites that are also sufficiently large and well situated to be optimal for grocery retailing, they were able to select the best sites for motorists, and have retained these. Additionally, the oil majors dedicate resources to choosing strategic site locations that have the most volume/revenue potential specifically for fuel retail, and have relative flexibility in choosing these sites. The same advantages apply to independent operators, who can operate a retail fuel site in any location where a site is permitted and operationally viable.

(350) A retail fuel site with a strategic location at the intersection of two arterial roads may offer time-saving convenience to many motorists, such that they prefer to pay a small premium for refuelling at this site rather than a location that is more complicated to get to, costing them time (and fuel). In contrast, supermarket operators are generally constrained by the locations of their existing grocery stores, as their fuel sites are almost always located in or around their stores (often requiring motorists to drive off main roads into busy retail locations).

(351) For the reasons given above, competitors that supply fuel only will continue to constrain the Parties post-merger, and should be given appropriate weight in any assessment of competition at the local level.

B. Applying a systematic approach to identify local areas where the Proposed Merger may raise competition concerns

(352) In the Issues Statement, the CMA flagged that it expects to apply a systematic approach to identify which local areas are likely to raise competition concerns, and to this end would:

"*(a) analyse the number, brand, locations, and (historical) price levels of the Parties' PFS and competing PFS in every overlap area, including drive-time distances between these PFS;*

(b) consider evidence from a survey of the Parties' fuel customers, which is already underway, about closeness of competition and diversion between the Parties and remaining competitive constraint from other competitors; and

(c) use historical fuel prices and the Parties' current pricing methodologies to understand the relative importance of different competitors and closeness of competition."[218]

(353) The Parties welcome the CMA's commitment to a systematic approach, as well as the focus on key factors of competition at the local level, including location and price. The CMA's (and OFT's) previous cases in the fuel retailing sector have all been Phase 1 cases, and therefore have taken a conservative approach to assessment. The specific filters used in previous CMA (and OFT) cases were as follows:

- <u>fascia counts</u>: "4 to 3" or worse on a 10-minute drive time catchment (urban areas) or 20 minutes (rural areas) – in more recent cases on both a fascia and an ownership basis;[219]

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[218] CMA, Issues Statement, paragraph 109.

[219] See, for example, *MFL/Shell*, paragraph 53, attached as **Annex_005_068** to the Merger Notice; *MFL/Murco*, paragraph 64, attached as **Annex_005_067** to the Merger Notice, and *Rontec/Total*, paragraph 30, attached as **Annex_005_063** to the Merger Notice.

- nearest competitor: parties are each other's nearest competitor by drive time;[220]
- price marking: either party identifies a site of the other party as its primary price marker or either party identifies a site of the other party as one of three or fewer competing sites;[221] and
- supermarkets: merger removes the only remaining supermarket rival.[222]

(354) Although these are conservative Phase 1 filters, for the most part they provide a useful starting point for the CMA's in-depth Phase 2 investigation in this case, where a higher burden of proof applies. There are two qualifications to this:

- if any of these filters are applied, in light of the evidence on the Parties' fuel retailing catchments set out in Section I above on market definition, they should be adapted to reflect 25-minute drive time catchment areas [✂]; and
- [✂].

(355) It is also submitted that the CMA's consideration of evidence from its survey of the Parties' fuel customers should follow the approach taken in previous cases, such as *Shell/Rontec*, which suggests that an area is unlikely to raise competition concerns even on a Phase 1 "realistic prospect" standard where there is good survey evidence that the diversion ratio between the relevant parties is under 40%.[223] The Parties note that the 40% threshold is a conservative Phase 1 approach to critical diversions, and is therefore likely to be overly conservative at Phase 2 given the higher statutory test.

(356) This is particularly the case given the evidence of the Parties' [✂][224].[225] On the basis of a [✂] GUPPI, this would imply that raising prices would not be profitable unless extremely high diversions between Asda and Sainsbury's were observed (well above the previous 40% threshold). Nonetheless, and given that it still generates a "manageable" number of sites, the Parties have taken the 40% threshold used in *Shell/Rontec* as a starting point for identifying sites for more detailed competitive review.

(357) Moreover, in this case, in terms of filtering out areas below 40%, the Parties consider the surveys they have already conducted themselves to be conservative in the sense that they are likely to overestimate diversion between the Parties due to a framing bias in favour of supermarket fuel operators. This is supported by the fact that online surveys on average tend to find lower diversion ratios between the Parties than exit surveys taken in the same areas.[226]

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[220] See, for example, *MFL/Shell*, paragraph 53, attached as **Annex_005_068** to the Merger Notice; *MFL/Murco*, paragraph 64, attached as **Annex_005_067** to the Merger Notice; *Shell/Rontec*, paragraph 64, attached as **Annex_005_064** to the Merger Notice, and *Rontec/Total*, paragraph 30, attached as **Annex_005_063** to the Merger Notice.

[221] See, for example, *MFL/Shell*, paragraph 53, attached as **Annex_005_068** to the Merger Notice; *MFL/Murco*, paragraph 64, attached as **Annex_005_067** to the Merger Notice; *Shell/Rontec*, paragraph 80, attached as **Annex_005_064** to the Merger Notice, and *Rontec/Total*, paragraph 37, attached as **Annex_005_063** to the Merger Notice.

[222] See OFT, *Anticipated acquisition by Tesco plc of a former Safeway site at Coulby Newham from Wm Morrison Supermarkets plc*, Case No. ME/1862/05, decision of 21 August 2005, paragraph 42, attached as **Annex_005_072** to the Merger Notice.

[223] *Shell/Rontec*, paragraphs 99 and 107, attached as **Annex_005_064** to the Merger Notice.

[224] Gross margins, calculated based on revenue excluding VAT.

[225] Even excluding VAT and including margins from shop, car wash and grocery store that may be associated with fuel volumes, margins are around [✂]% at Sainsbury's and [✂]% for Asda.

[226] This is discussed in more detail in Schedule 19 of the Merger Notice.

(358) The CMA also signalled its desire to "*examine whether either Party has plans to open PFS in the future in local areas where the other Party is present, and if so, whether the Merger may result in a loss of future potential competition between the Parties*".[227] [✂], and [✂]. Accordingly, any additional overlaps created through new openings that are planned can be addressed on a case-by-case basis at the local level, using the same systematic approach as for overlaps generated by existing sites.[228]

C. Proposed Merger does not raise concerns at the national level

(359) The CMA has indicated that it will also consider "*whether there are national aspects of competition in the supply of retail fuel, for instance, in relation to pricing strategies, initiatives, or target levels of profitability or margin which are applied nationally across the Parties' fuel businesses*".[229]

(360) The Parties explained in their Merger Notice that, consistent with the fundamentally local nature of competition in fuel retailing, the key aspects of their fuel offers are either set locally or through a central framework that is implemented or varied locally – in either case driven by local competitive conditions.[230] Moreover, neither past cases nor the Parties' own experience suggest a basis for any national theory of harm that would go beyond concerns arising from an aggregation of local competitive interactions.[231]

(361) It is also clear that the UK fuel retailing sector is not concentrated, and the Parties on any measure will have a combined share of no more than 18%, which is well below normal levels of concern.[232] Currently, Sainsbury's is the fifth-largest player by volume with a share of 10.2% and Asda the seventh-largest player with a share of 7.7%.[233] The Parties rank in volume shares behind both oil majors such as BP, Shell and Esso as well as Tesco and (in the case of Asda) Morrisons.[234]

(362) Following the Proposed Merger, the sector will remain fragmented, with many significant competitors holding broadly similar (low) levels of shares. For instance, there will be seven players with national shares (of volume) between 5% and 20%: Sainsbury's/Asda, Tesco, BP, Shell, Esso, Morrisons, the merged MFG/MRH group and Texaco, as well as numerous smaller chains and independents.[235]

(363) Aside from the unconcentrated nature of the UK fuel retailing industry, it is also relevant that competition between fuel retailers is intense, reflected in relatively low industry margins (i.e. a low degree of mark-up over cost by fuel retailers).[236]

(364) Furthermore, as noted above in Part II, Merger Rationale and Efficiencies, in addition to the general purchasing synergies, the Independent Consultant has recently identified annually-

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227 CMA, Issues Statement, paragraph 113.

228 All potential pipeline PFS for both Parties were included in the previously submitted overlap analysis. See the Merger Notice, Chapter 11, and Schedule 21.

229 CMA, Issues Statement, paragraph 52.

230 Merger Notice, Chapter 11, Section VII, paragraph 939.

231 For example, see *MFL/Shell*, attached as **Annex_005_068** and *MRH/Esso*, attached as **Annex_005_069**.

232 See the market share data presented in the Merger Notice, Chapter 11, Section VII, Table 30 and 31.

233 See the market share data presented in the Merger Notice, Chapter 11, Section VII, Table 30 and 31.

234 See the market share data presented in the Merger Notice, Chapter 11, Section VII, Table 30 and 31.

235 See the market share data presented in the Merger Notice, Chapter 11, Section VII, Table 30 and 31.

236 [✂].

recurring variable cost savings in the region of [✄]. [✄].[237] These savings should also be factored into the competitive assessment.

(365) On the basis of the above, it is clear that, even if the CMA were to consider fuel retail on a "national" basis, separate from the aggregation of competition across local areas, there could be no concerns raised by the Proposed Merger.

[237] [✄].