

## **ANTICIPATED MERGER BETWEEN J SAINSBURY PLC AND ASDA GROUP LTD**

### **SUMMARY OF HEARING WITH OCADO HELD ON 6 NOVEMBER 2018**

#### **ONLINE GROCERIES**

##### ***Competitive offering***

1. Ocado explained that their offering of online groceries does not vary across different geographies, as they offer the same products with the same prices across the UK. Ocado said that their offering is consistent across the whole UK, however there may be minor differences across the time slots they could offer because the way their business operates. Ocado explained that they have four large centralised warehouses (CFCs) where the products are stored and picked and around twenty spoke sites (smaller distribution centres) where the vans may pick up the products. Therefore, if the customers are a few hours away then they might have slightly fewer time slots, as the availability is limited by what else has been booked, but Ocado noted that they aim to offer the same level of slot availability across all the regions they serve in the UK.
2. Ocado indicated that there is no stock held in the spokes. The majority of orders are placed in those locations where there is a CFC, and then they deliver the products to a spoke from which they will be ultimately delivered to the customer.
3. Ocado stated that they have a vouchering policy targeted at different customer groups taking into account their purchasing behaviour. Ocado said that they do not adjust for local market conditions or differentiate between competitors when deciding what vouchers to send. Ocado explained that their vouchering is based on the shopping behaviour of their customers, as they use vouchers as a response to a decrease in sales, but not as a response to a particular competitor.
4. Ocado indicated that in the past 20 years, there have been only a small number of players entering the market.
5. Ocado indicated that they use a high proportion of vouchers for different reasons: (i) typically new customers use a voucher; (ii) early customer (ie customers who have placed a couple of orders) usually have a voucher; and

(iii) vouchers used as part of their price matching scheme, by which they send out vouchers to those customers that would have bought the products cheaper in Tesco. Ocado explained that they benchmark Tesco because it is the UK's biggest retailer and they want their prices to be in the UK mass-market price point.

6. Ocado said that they have different pricing grids that have been established based on historic levels of customer demand and Ocado's capacity in each day of the week, at a particular time of the day for each geography. Ocado noted that, as a result of this, there would be some days that are more expensive than others, with delivery charges varying between £0 and £6.99 (outside the Christmas period).

### ***Product market***

7. Ocado indicated that online groceries and brick and mortar stores compete for the same customers, so their offering tends to be similar in terms of price and range. Ocado stated that they consider competitors in both channels and they would respond to competitors of both channels.
8. Ocado explained that they consider competition from groceries sold in store when setting their online offering, as they believe their competitors use the same prices for their larger format stores and online.

### ***Competitors***

9. Ocado indicated that they use Tesco as their benchmark for their 'low price guarantee' because it is the biggest retailer and the number one player on online groceries. Ocado stated that they follow Tesco's prices, by which if Tesco's prices go up, they will follow with an increase in their prices, and vice versa.
10. Ocado said that competitors that do not have an online offer also impose a competitive constraint to online groceries. Although Ocado do not price price match discounters, they are indirectly doing so as long as the broader market, and Tesco in particular, reacts to the discounters actions.
11. Ocado explained that if Sainsbury's or Asda decided to increase the quality of their services, they will also take this into account when deciding their strategy, as they are a high-service retailer at mass-market pricing and they aim to offer to customers the best service. To improve the quality of the service, Ocado explained that they will offer quicker or shorter slots. To improve the quality of the product, Ocado said that they benchmark the rate of Ocado's own-label

products against the big four (by which Ocado meant Sainsbury's, Asda, Tesco and Morrisons) private label products.

12. As regards their agreement with Morrisons, Ocado explained that they are a service provider to Morrisons. Ocado provides Morrisons with an end-to-end online retail system for grocery home delivery (website, analytical tools, warehousing, delivery and call centre) as well as a store-pick technology system, but Morrisons chooses how to market the products, the prices and the rest of competitive parameters. From a customer point of view, Ocado confirmed that it would be Morrison providing the service, including Morrisons branded delivery vans.
13. Ocado confirmed that they were contractually precluded from supplying similar technology and logistics services to the rest of the big four, and that currently they only deliver for Morrisons and Ocado.
14. As regards their commercial relationship with Waitrose, Ocado explained that it is a supply relationship by which they get access to almost all Waitrose's products and they sell them in Ocado's website at the retail price of Ocado's choice. Ocado said that these products are branded as Waitrose, and they are just one of the brands that they sell products of. Ocado indicated that their contract with Waitrose is exclusive.

### ***Future evolution***

15. Ocado stated that they are considering sites in both the North and the South of the UK, but the exact location will depend on site availability rather than in a particular geography.
16. Ocado said that, outside of London, it would take approximately one year to source a property and build a new spoke. Ocado confirmed that they will add spokes within their existing geography, as that gives them network efficiency.
17. Ocado indicated that they do not have specific areas of expansion in mind, they would prefer to serve an area where they have density of population (provided that they have capacity) than expanding in new areas. In case they were at full capacity, Ocado explained that it makes more sense to open a CFC than a spoke.
18. Ocado explained that, in terms of profitability of their delivery business, the main driver is drop density improvements, but also gross margins. Ocado said that their online grocery delivery competitors are having losses on a fully-allocated cost basis, and that they are being subsidised by their in-store businesses.

19. Ocado stated that scale of purchasing is one of the main challenges they face, as with own-label they cannot get products made for them given that the volumes are not big enough, and with branded products they get worse prices than other bigger competitors such as Sainsbury's.
20. Ocado indicated that the online groceries sector will continue growing in the next two years, and the intensity of growth will depend on how good the online offering is as opposed to the in-store offering. According to Ocado the growth will come from both: customers who have never shopped online and customers who have shopped online but will shop more often in this channel.
21. In terms of barriers to expansion that new or emerging players face, Ocado explained that the main barrier is scale along with other factors such as the ability to sustain the cost of running a fresh food business with a credible range, which can be very expensive, and building a delivery network.
22. Ocado indicated that if all the major supermarkets decided to exit their online groceries businesses, Ocado would build more CFCs to try to get all those sales but would still aim to price at mass-market UK pricing, as if they priced higher than brick and mortar stores, they would limit their opportunity to grow.

## **SUPPLY CHAIN**

23. Ocado mentioned that as a result of the proposed merger, the merging parties will be able to obtain lower prices by harmonising prices with suppliers, as it would be not easy for suppliers to justify why they are charging one more than the other. Ocado indicated that this has happened also in previous mergers, such as Safeway and Morrisons.
24. Ocado stated that the proposed merger could lead to suppliers recouping lost profit from smaller grocery retailers. Ocado explained that this is because the reductions that suppliers will give to the merging parties will have to be recovered through other efficiencies or through other retail channels. Ocado explained that given that a large percentage of the suppliers' UK business is with the merging parties and Tesco, the remaining retailers will have less support from suppliers, and this will lead to higher cost prices and less choice for consumers in the market place.

## **MERGER EFFECT**

25. Ocado said that the proposed merger would impact competition and consumers. Ocado noted that an extra discount of 10% across a meaningful proportion of sales is extremely challenging to deliver given the industry margins.

26. Ocado noted that the proposed merger will not change much the dynamic in the online channel, in particular if they keep the two-brand positioning. Ocado said that the merging parties will have buying benefits, and competitors will have to deal with that.