

J SAINSBURY PLC/ASDA GROUP LIMITED MERGER INQUIRY

SUMMARY OF HEARING WITH MORRISONS HELD ON 9 NOVEMBER 2018

Groceries in-store

Competitive offering

1. Morrisons noted that they run a national business and that any actions taken at the local level to respond to a competitor opening a new store would be determined and approved centrally by the Head Office.
2. To defend against competitor new store openings, Morrisons explained that they would first determine the impact of the competitor's store on theirs and, as a rule of thumb, if it reaches a threshold, they would consider some measures which might include: (i) having extra labour to provide even greater service levels to their customers; (ii) offering some local advertising or couponing; and (iii) some pricing promotions. Morrisons said that another factor they would consider is distance (ie how far away is the new competitor store). Morrisons said that these strategies would be coordinated centrally but with involvement from the store manager and the regional teams. Morrisons noted that these strategies mitigate some of the impact, but not all of it.
3. Morrisons said that this threshold is usually reached when one of the other Big 4 (by which Morrisons meant Sainsbury's, Asda and Tesco) open a store in a local area. If a discounter opens in a local area, Morrisons said that the impact would be lower than the Big 4, but that they may still react with a different strategy given the more limited range of products offered by discounters. For other grocery retailers opening a new store, such as M&S or Waitrose, Morrisons said that they would not have the same level of impact as the Big 4, given the different customer perception of these retailers.
4. Morrisons explained that they have an investment programme for their store estate and, within this, they would prioritise those stores that require action. Morrisons explained that these decisions will be based on what would be best for their business and their customers, and that it is not purely driven by a competitive standpoint.

5. Morrisons said that they will always consider potential opportunities, but that they have not considered a different format approach (such as Tesco's discounters format, Jack's) to date. Morrisons said that the majority of their estate are one-stop shops which cater for larger baskets and a fuller shopping mission in a weekly or monthly basis, and that this continues to be a significant part of their target strategy.

Pricing model

6. Morrisons said that they set their prices on a national basis, and that they would rarely discuss prices at a local level. By way of example, Morrisons mentioned that this would happen if they consider it is required when a new competitor opens in a particular local area, but only with regard to prices of certain promotions.
7. Morrisons told us that because of their unique vertical integration structure, they have a somewhat different cost model to their competitors.
8. Morrisons noted that, in price inflation scenarios, the largest retailers may have an advantage at the start but that eventually they would also raise their prices when cost prices increases come through, as they would be facing the same pressures from suppliers.

Product market

9. Morrisons said that there are customers that consider one-stop shopping as a convenience as they offer a wide range of products and services, that medium and small shops do not offer.

Competitors

10. Morrisons said that their main competitors are the Big 4. Morrisons said that they track their price position on a weekly basis, and, as part of this, they monitor each of the Big 4.
11. Over the last three and half years, Morrisons said their commercial teams have been focused on serving their customers better and being more competitive against their competitors.
12. Morrisons said that the presence of a discounter segment within the UK grocery market is not a new development, as they have always been in the market with circa 11 to 12 per cent of the market share. Morrisons mentioned that at the moment there are different discounter retailers, but with a similar share of the market.

13. Morrisons explained that discounters have a different offering to their business, as they do not offer fuel, a consistent general merchandise offer all year around, fresh food counters, cafés or tobacco. Morrisons said that most customers shopping in discounters would always have to shop elsewhere as discounters offer a significantly reduced product range. Morrisons said that discounters will be growing over the next few years, but they questioned whether, over time, discounters will keep growing as their new store growth will start to diminish as catchment areas would be saturated and organic growth would be difficult to achieve given their model based on a limited range.

Online groceries

Competitive offering

14. Morrisons explained that their online product offer is broadly reflective of the range in one of their large format stores, however, some products and promotions offered in-store may not be available online for commercial or operational reasons. Morrisons said that their online range is tailored to meet the operational and customer needs that are specific to home delivery and as such some products may not be available online, or may be an online-only product.
15. Morrisons explained that the minimum basket spend is necessary in their online business, as it is required contribute to their serving costs. Morrisons said that if they get enough density of operation to be able to fill the vans, the slots and spread the demand across the week, these serving costs might reduce.
16. Morrisons said that they do not have a uniform vouchering policy, as their vouchering can be personalised, product-based, offer-based or demand-based, depending on the circumstances for which they are using the vouchers.

Competitors

17. As regards Morrisons' relationship with Ocado, Morrisons said that Ocado is a partner that provides them fulfilment services and technology to enable Morrisons to conduct home delivery. Morrisons explained that Ocado has given them the option to build shared fulfilment centres with them, or on their own, but that they have not chosen to build one of these centres on their own yet.

18. Morrisons noted that Morrisons.com is a competitor of Ocado.com, and Ocado does not have a role in their business apart from providing them with the necessary technology and fulfilment services.

Future evolution

19. Morrisons said that when considering whether to expand their online grocery business in a particular local area they would consider whether the densities of population and customer demand in that area would make the business in that area economically viable.

Fuel

Competitive offering

20. In terms of their pricing policy, Morrisons said that they always endeavour to be the cheapest in a local market.
21. Morrisons noted that there has been some OFT research showing that there is a beneficial impact on pricing when a supermarket PFS is present in a local catchment area: the impact of Asda would be 0.7 or 0.8 pence per litre, depending on whether it is unleaded or diesel; for Sainsbury's it would be 0.1 or 0.2 and for Morrisons 0.3 or 0.4.
22. Morrisons said that they rarely regard non-supermarket fuel retailers in terms of price, as they are usually more expensive in comparison to them.
23. Morrisons noted that they do not change their fuel pricing considering the presence of other non-fuel providers such as Aldi or Lidl.

Expansion and future evolution

24. Morrisons confirmed that they do not have plans to open new fuel stations in the short-term but that opportunities would continue to be considered as they arise in the future.

Interaction between fuel and groceries

25. Morrisons explained that their fuel business has two main roles: (i) to bring customers to their stores, as they are a one-stop shop; and (ii) to drive overall price perception, as it is a significant display of value that a retailer can put in front of a customer.

26. Morrisons said that they make minimal margins in fuel and as such, they have never considered it as a standalone business.

General merchandise

Competitive offering

27. Morrisons explained that their general merchandise offering is complementary of their groceries offering. Morrisons said that general merchandise represents a small proportion of their total business, and that it is a convenience, supplementary category that it is not used as a customer acquisition tool.
28. Morrisons explained that they prioritise their food offer in their stores, and they only add general merchandise products once they have the appropriate food offer in place.
29. Morrisons said that they have plans to continue to optimise the space they dedicate to general merchandise in order to complement their offer.

Competitors

30. Morrisons noted that their main competitors on their general merchandise business are the Big 4. Morrisons said they offer general merchandise to be competitive against the other Big 4, as some customers appreciate the broader general merchandise offer when doing their groceries shopping.
31. Morrisons said that they endeavour to be competitive with the rest of the Big 4.
32. Morrisons also noted the importance of seasonal general merchandise (such as Halloween products), and how the offer may differ across different channels and retailers for these seasonal products.

Merger effect

33. Morrisons said that each of Sainsbury's and Asda are important suppliers of non-grocery products both nationally and locally, which could be adversely affected by the merger. Morrisons explained that, given the scale of general merchandise, the merged entity could potentially raise prices in general merchandise to, potentially, invest elsewhere in their business to compete with other grocery retailers, such as discounters.

Supplier relations / supply chain

34. Morrisons explained that the proposed merger could have an impact on the merging parties' incentive to innovate, in particular, in own-brand products. Morrisons said that some of the synergies that the merging parties expect to achieve would be dependent on harmonisation of their own-brands, and this would have an impact on customers, as the quality of the merging parties' own-brand products differs.
35. Morrisons said that, to the extent that the merging parties are able to drive purchase prices down and squeeze suppliers further, those suppliers are likely to react and to seek to recover the loss in profitability through other means (eg through their own raw material suppliers, price increases on other products/to other retailers, or by exiting the market), which could affect the future relationship that Morrisons has with those suppliers.
36. Morrisons also noted that, if as a result of the merger, the merging parties are seen as being an important trading partner for suppliers, because of their scale, it could mean that other grocery retailers, such as Morrisons, are disadvantaged in other ways as a result (eg through supply shortages during periods of high demand as suppliers focus on serving the largest retailers first). Morrisons said that the fact that there would be two grocery retailers of approximately the same size as Tesco is now, could exacerbate this issue for smaller supermarkets.
37. Morrisons said that, as a retailer grows its business, this would potentially enable it to get better prices from suppliers, as suppliers will be able to sell more volume through that retailer.
38. Morrisons questioned whether the merging parties would be able to lower their costs of goods after the merger, as the merger, in itself, does not give rise to volume or growth opportunity because suppliers are already supplying both merging parties, and suppliers are unlikely to invest if they cannot get new volume growth in exchange.

Merger effect

39. Morrisons said that the proposed merger will result in the creation of an effective duopoly formed by Tesco and the merged entity, as they will be controlling in excess of 60 per cent of the market. Morrisons is concerned that, as a result of the merger, prices may increase between those two companies because it would mean the loss of Asda as a major competitive force and, consequently, there would be less competition in the market. Morrisons mentioned that it would be possible for Tesco and the merged

entity to compete less fiercely and sustain this position for any length of time, as they will be controlling the majority of the market.

40. Morrisons said that there are many local areas across the UK in which any of the Big 4 are present, but not Morrisons, and that in these areas Tesco and the merged entity would not necessarily have to compete, as they would be dominating the market.
41. Morrisons said that the impact of the proposed merger in online services will be even larger, as post-merger approximately 75 per cent of the market will be controlled by Tesco and the merged entity. Morrisons said that the online groceries channel is a competitive market with high barriers of entry, and that a number of market players (including Morrisons) do not provide national coverage, which means that there are many areas in which customers would only have a choice between two retailers post-Merger.
42. Morrisons said that the creation of this duopoly could mean that Tesco and the merged entity would potentially increase their delivery charges in order to make their businesses more profitable, given the lack of competition in some parts of the UK.