

## **J SAINSBURY PLC/ASDA GROUP LIMITED MERGER INQUIRY**

### **SUMMARY OF HEARING WITH TESCO HELD ON 9 NOVEMBER 2018**

#### **Groceries in-store**

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

1. Tesco said that all their plans are set nationally, but that they have separate plans for each of their retail store formats to reflect the different sizes and missions served by the stores operating under the Tesco brand. Tesco indicated that they determine prices, quality, product range, advertising and promotions nationally.
2. Tesco noted that, although all key competition parameters are set nationally, for large stores they give local store managers discretion to determine part of the range of their respective stores.

##### ***Range***

3. Tesco explained that they offer own-label products across a 'good, better, best' range hierarchy aiming to cater for all customer budgets, through their brands "Exclusively at Tesco", "Tesco Core" and "Tesco Finest". Tesco noted that, when they open a new store, they use the best representation of that range considering the size of the store, and the demographic and economic segmentation of the customers they are trying to serve, but that this would not imply a change on price or promotion, as these parameters are set at a national level.
4. Tesco stated that they review their range of products frequently, but that their proposition is to offer a large range of products as they want to support the full range of customer missions, and offer both branded and own label products to do this.
5. Tesco explained that they would not reduce their range levels below these numbers because their proposition is offering consumers the most convenient proposition, by offering them a full-service shop in one place. Tesco believes

this is also the strategy followed by the rest of the big four (by which Tesco meant Sainsbury's, Asda, Morrisons and themselves).

### *Marketing plan*

6. Tesco said that, until 2017, they had a local marketing strategy by which they would respond at a local marketing level when a competitor was going to open a new store locally. However, Tesco noted that this did not involve any local flexing on price, range or promotions, just an increased awareness of their store through local communication.
7. Tesco is of the view that the impact of a discounter opening a store is significantly less than any of the other big four opening a store in a similar place even if the big four store was slightly further away.
8. Tesco noted that they would react to a competitor change in offer, but this would depend on the scale of the impact. Tesco noted that they operate nationally, but that outcomes in stores can vary locally even though they have a national model.

### *Pricing model*

9. Tesco stated that they operate a national pricing structure across formats as do their main "big four" competitors (by which Tesco meant Sainsbury's, Asda and Morrisons).
10. Tesco said they consider their pricing is competitive. Tesco stated that minor changes on price are incredibly important in this market, and that optimum pricing is important to their business, as they will lose customers if they are 1 or 2 per cent off the price.
11. Tesco noted that range matters to customers and that the costs of branded goods are not determined by Tesco but by the suppliers, albeit they are subject to some negotiation. Once the cost price of branded goods is agreed, Tesco will decide what their market price is relative to the marketplace.
12. Tesco indicated that their pricing decisions on their own brand are very relevant: for 'Exclusively at Tesco' they price and quality benchmark versus Aldi and Lidl; for 'Core', they benchmark Sainsbury's on quality, and Asda on price; and for 'Finest' they benchmark the market leader in whichever category it happens to be.
13. Tesco told us how they responded to substantial cost pressures from suppliers after the Brexit vote. Tesco said that, out of the big four, they were able to hold price inflation lowest for the longest period. However, Tesco

noted that whilst they did not raise their prices as quickly as other competitors did, they nevertheless raised their prices when cost price increases eventually came through.

### ***Product market***

14. Tesco mentioned that, although there are some consumers who make more trips to more shops rather than 'one-stop shopping' with a main weekly shop, there remain a large group of consumers who value the convenience of one-stop shopping at large stores.
15. Tesco is of the view that the treatment of stores over 1,400 square metres should continue to be considered a separate market because that is the size needed to offer a full range of products with brands and own brands than can serve one-stop shops and other missions.
16. Tesco noted that each retailer has to choose the mission they serve and that other retailers (outside of the big four) operate, mainly, smaller stores. Tesco said that M&S and Iceland focus on specific categories and demographics, Co-op on small baskets and Aldi and Lidl on tightly construed value ranges. Tesco said that they look at each of these competitors in those specific areas, but that the biggest switching and the most similar ranges and, therefore, the biggest focus for them is against the big four. Tesco is of the view that gross switching is higher amongst the big four than with any other retailers because of competition for the big shop.
17. Tesco is of the view that large stores serve every mission, including customers who want a large shop, a small shop or a top-up shop.
18. Tesco said that the one-stop shops are just as relevant as they ever were, and that is why they believe the 1,400 square metre threshold remains valid for the purposes of product market definition.

### ***Competitors***

19. Tesco stated the importance of their range and explained the key difference between them and the discounters. Tesco noted that Aldi and Lidl meet a customer need in the very specific and distinct offer of low prices with a very limited range, choice and service, and few brands, but they do not offer a full shop.
20. Tesco indicated that there has always been some form of discount offer in the market with circa 10 to 13 per cent of the market share. By way of example, Tesco mentioned Kwik Save, Shoppers Paradise or Netto. Tesco mentioned

that at the moment there are different discounter retailers, but with a similar share of the market.

21. Tesco is of the view that there are lessons to be learned from running the efficient, limited range discount formats operate and, to the extent possible, they will apply these lessons to their larger stores.
22. Tesco mentioned that, post-merger, Morrisons would be also part of the competitive dynamic of the market as they play particularly in the above 1,400 square metre space where they actually have more stores than Asda. As such they should not be discounted as a meaningful “big four” player.

## **Online groceries**

### ***Competitive offering***

23. Tesco said that online groceries is a model which services a particular customer base.
24. Tesco mentioned that they have reintroduced delivery charges. In terms of differentiating delivery charges, Tesco said that customers are charged according to the time slot and fulfilment channel they use (ie home delivery or collection), but Tesco does not differentiate these charges between different areas or consumer segments.
25. Tesco indicated that there is a minimum basket size for online delivery. Tesco noted that they have also recently changed the minimum basket size for Delivery Saver customers. Tesco mentioned that before introducing any of these changes, they first trial because they want to ensure they are acceptable for their customers.
26. Tesco confirmed that they do not offer free online delivery (other than a free 1-month trial for ‘Delivery Saver’ subscription) to promote online shopping at the moment, and that they do not have promotions online that are not available in store. Tesco said they have the same prices online as they have in store.
27. Tesco is of the view that the sale of groceries online is not a constraint on the in-store grocery business, as it is not a substitute for most customers. Tesco noted that some of its customers who shop in large stores only shop in large stores.

## ***Competitors***

28. Tesco said that Amazon's grocery offer is limited and only covers delivery for a small part of the country (primarily London postcodes).
29. As regards Ocado, Tesco said that it is an operator that is growing in the market with an aggressive strategy.

## ***Merger impact***

30. Tesco said that they do not believe the merger will have the potential to achieve cost savings online considering the merging parties statements of keeping separate brands and stores.

## **Fuel**

### ***Competitive offering***

31. Tesco said that they operate a local pricing policy on fuel. To set their prices at a local level, Tesco said that they look at nearby petrol stations considering distance and driving times.
32. Tesco noted that they apply local as opposed to national pricing due to the different market dynamics. They explained that there are still more independent players than there are in most retail markets but particularly in grocery, there is no online delivery comparison that forces harmonisation and customer behaviour is very local.
33. Tesco said that there is no buying advantage between players in this market, given the way the fuel is bought. Tesco explained that Asda is the operator setting the price in the market because they have a lower-cost operation model as their petrol stations are unmanned with no other additional services or shopping opportunity experience as part of the Asda offer. Tesco noted that they operate a different model with manned petrol stations (a choice of either paying at the pump or paying in the kiosk) and give their customers Clubcard points.
34. Tesco questioned whether, given the pricing dynamics, the merging parties may have a reduced incentive to maintain Asda's low prices, particularly in areas where there is not either a Morrisons or a Tesco petrol station. Tesco said that Asda has been very proud of being the price leader in fuel, but they do not know if this will be still the case post-merger.

### ***Expansion and future evolution***

35. In relation to changes in the market, and in particular, electric cars, Tesco is of the view that the rate of customer uptake means there will not be a substantial change in the market by which electric cars reduce demand for petrol stations in the UK for a long time.

### ***Interaction between fuel and groceries***

36. Tesco explained that they offer fuel as part of their offer in large stores because they believe it is important for their proposition of one-stop shop destination. Tesco noted that, according to customer research, a large store offering a petrol offer is part of the attractiveness of driving to a large store. Tesco confirmed that they link grocery purchasing with the fuel offer, for instance by running fuel promotions as part of the grocery shopping. Tesco said that they believe other retailers use different tools to link these two parts of their businesses.

## **General merchandise**

### ***Competitive offering***

37. In terms of their competitive offer, Tesco explained that they offer general merchandise products across a number of categories to offer complementary non-food products to customers on their food shopping trip. Tesco said that they think about identifying the right categories to put around a groceries shop that respond to the needs of the customer. Tesco noted that the categories have changed over time, mainly due to changes in customer demands (including the fast growth of online for certain GM categories).
38. Tesco explained that, in general, they do not consider they are a destination for general merchandise products, although this would depend on the category. Tesco said that, in a local area, customers will consider what other options are available, and depending on this, their general merchandise offer could be a good reason to visit their store if there are not many options available locally. Tesco explained that this does not mean that there is a stronger local dimension in their ranging, as their range decisions are taken nationally.
39. Tesco noted that sometimes they use concessions with other companies to bring a different brand into the Tesco store. Tesco said that they select which of these partners to include in a given store based on the space available and the local characteristics of the area.

40. Tesco explained that the biggest determiner for their local decisions is how much space they have. They prioritise their food offer, and for the remaining space they add those general merchandise categories that could be more relevant for the customers in that catchment area.

### **Competitors**

41. Tesco explained that, while all the big four have a similar combination of general merchandise categories in their stores, they all try to build their own brand. Tesco said that each of the big four has tried to build points of differentiation: Asda in school uniforms, Argos (Sainsbury's) in toys, whereas others have focused on other categories, e.g. small domestic appliances.

### **Supplier relations / supply chain**

42. Tesco explained that when negotiating with suppliers, three aspects are most relevant: volume, growth and efficiency. According to Tesco, the proposed merger does not appear to give rise to volume opportunity because suppliers are already supplying both merging parties; there does not appear to be any growth opportunity because it is a merger of two similar businesses; and there does not appear to be any efficiency because the parties plan to continue to run the two businesses separately, with separate brands and propositions, and already have national distribution in both companies.
43. Tesco said that it is important to understand the differences between own-label suppliers and branded suppliers. Tesco explained that retailers generally have to pay the prices branded suppliers set, otherwise they would not supply to them. Tesco said that without any growth opportunity or efficiencies to offer, branded suppliers will not be interested in reducing their prices.
44. Tesco also noted that commercial reality is very different to accounting views. Tesco explained that cost price harmonisation used by accountants is a relatively simplistic way of calculating the maximum potential procurement benefits arising from a combination, as the commercial negotiations with suppliers tend to focus not just on individual product level prices, but also in broader discussions around investments in growth or marketing and promotion activity, and the wider commercial context, that are not reflected in the cost prices.

### **Merger effect**

45. Tesco said that the proposed merger is a "four-to-three" deal that would not be approved without extensive remedies under existing precedent.

46. Tesco said that the proposed merger is a challenge in terms of economics, as there are few direct customer benefits. Tesco noted that Sainsbury's and Asda are not proposing to make any big operating cost savings, as they are going to keep the brands and the propositions separate. Tesco said that nearly all of the announced efficiencies rely on harmonising costs and prices from suppliers and that this is a big ask when the merging parties do not appear to be able to offer suppliers very much in return.