Anticipated merger between J Sainsbury PLC and Asda Group Ltd

Summary of provisional findings

Notified: 20 February 2019

1. The Competition and Markets Authority (CMA) has provisionally found that the anticipated merger (the Merger) between J Sainsbury plc (Sainsbury's) and Asda Group Limited (Asda) (together, the Parties) may, on the balance of probabilities, be expected to result in a substantial lessening of competition (SLC) in markets in the UK in the following respects:

   (a) The supply of groceries in supermarkets on a national basis, ie in every local area in which one or both of the Parties are present.

   (b) The supply of groceries in supermarkets on a local basis in 629 of the local areas where both Parties are present, covering 45% of Sainsbury's supermarkets and 57% of Asda's supermarkets.

   (c) The supply of groceries in Asda convenience stores on a national basis, ie in every local area in which an Asda convenience store is present.

   (d) The supply of groceries in convenience stores on a local basis in 65 of the local areas where both Parties are present, covering 7% of Sainsbury's convenience stores and 18% of Asda's convenience stores.

   (e) The supply of groceries ordered online and delivered to the customer's location (online delivered groceries) on a national basis, ie in every local area in which one or both of the Parties are present.

   (f) The supply of online delivered groceries on a local basis in 290 of the local areas where both Parties provide online delivered groceries services, covering 7% of the delivery areas served by Sainsbury's and 95% of the delivery areas served by Asda.

   (g) Coordinated effects (between the Parties and Tesco) in the supply of online delivered groceries in areas of the UK where Ocado is entirely absent, which represents around 20% of UK postcode units.

(h) The supply of fuel on a local basis in 132 of the local areas where both Parties operate petrol filing stations (PFSs), covering 20% of the Sainsbury's PFSs and 20% of Asda's PFSs.

2. We now invite submissions from any interested parties on these provisional findings **by Wednesday 13 March 2019**.

3. Alongside these provisional findings, we have published a notice of possible remedies, which sets out the CMA's initial views on the measures that might be required to remedy the SLCs that we have provisionally found. We also invite submissions from interested parties on these initial views **by Wednesday 6 March 2019**.

4. We will take all submissions received by these dates into account in reaching our final decision, which will be issued by 30 April 2019.

The merger parties

5. On 30 April 2018, Sainsbury's and Walmart announced the proposed combination of the Parties. Sainsbury's will acquire Asda from Walmart and, in turn, Walmart will receive shares in Sainsbury's, such that Walmart will hold 42% of the shares (and 29.9% of the voting shares) in the merged entity. Walmart will also appoint two non-executive directors to the Board.

6. Sainsbury's operates a network of 1,428 grocery stores (including 647 supermarkets and 781 convenience stores), 314 PFSs and an online grocery business. Sainsbury's also operates Argos and Habitat.

7. Asda operates a network of 676 grocery stores (including 582 supermarkets and 61 convenience stores which are all attached to PFSs), 33 Asda Living stores (focused on non-grocery products including clothing), 320 PFSs and an online grocery business.

8. Sainsbury's and Asda are the second and third largest grocery retailers in the UK and two of the four largest retailers of online delivered groceries in the UK. The combination of these two grocery retailers will not only affect the groceries sector. Alongside core groceries in their larger stores, the Parties also sell items such as clothing, electricals and toys which we refer to as 'general merchandise' (GM) and supply fuel through PFSs, which are often located adjacent to the larger grocery stores. The Merger would create the largest retailer of fuel by volume in the UK.

The CMA’s investigation

9. The CMA’s investigation has necessarily been extensive and wide-ranging. We have conducted three large surveys of customers covering in-store groceries, online delivered groceries and fuel, through which we have received the detailed views of over 60,000 shoppers and motorists. In addition to conducting hearings with the Parties, we have conducted a roundtable in Edinburgh and have held hearings with a broad range of supermarket suppliers, the Parties’ competitors, trade and consumer bodies, and other interested parties, and we spent two days visiting the Parties’ head offices and supermarkets. We have reviewed hundreds of thousands of the Parties’ internal documents and have received thousands of pages of submissions from the Parties and other interested parties.

10. In this investigation, the CMA must first decide whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation for the purposes of the Enterprise Act 2002 (the Act). We have provisionally found that the Merger creates a relevant merger situation because Sainsbury’s and Asda (and Walmart and Sainsbury’s) would cease to be distinct from each other, and because the turnover of Asda (and Sainsbury’s) exceeds the £70 million threshold set out in the Act. This means that the CMA has jurisdiction to investigate the Merger.

11. The second question we must decide on is whether the creation of that relevant merger situation may be expected to result in an SLC within any market or markets in the UK for goods or services. This requires the CMA to assess what effect the Merger will have on competition, which is the process of rivalry over time between businesses seeking to win customers' business by offering them a better deal. An SLC occurs when rivalry is substantially less intense after a merger than would otherwise have been the case, resulting in a worse outcome for customers (through, for example, higher prices, reduced quality or reduced choice). The CMA is required to make this judgement on the balance of probabilities – ie to decide whether an SLC is more likely than not. In this case, we have provisionally found a very large number of SLCs spanning a large part of the Parties’ operations. However, we stress that these are not our final findings, and the number and nature of SLCs may well change before we come to our final decision.

12. The final question we must decide on is what action we might take for the purposes of remedying any SLCs we have identified. This is the subject of the notice of possible remedies we have published alongside these provisional findings, in which we discuss whether to prohibit the Merger in its entirety, or

whether a large-scale divestiture package could effectively remedy the SLCs we have provisionally found.

The context of the merger

13. UK groceries retailing is an important industry which was estimated to be worth around £190 billion in 2018. It is an industry that touches every household in the country. Food (excluding tobacco and alcohol) represents around 10.5% of typical household expenditure, increasing to 14.3% for those on lower incomes. It has been estimated that groceries account for just over half of all retail sales in the UK.

14. Taking in-store and online sales together, Tesco is the largest grocery retailer in the UK, accounting for approximately 27% of grocery sales. Sainsbury's is the next largest, accounting for approximately 15%, followed by Asda (14%), Morrisons (10%), Aldi (7%), Co-op (6%), Lidl and Waitrose (each 5%), M&S (4%), Iceland (2%) and Ocado (1%).

15. One of the developments in the groceries sector in recent years has been the growth of the so-called 'discounters' (Aldi and Lidl), which have challenged the so-called 'Big 4' grocery retailers (Tesco, Sainsbury's, Asda, Morrisons) and other traditional grocery retailers. Since 2010, Aldi and Lidl have collectively opened over 500 new stores in the UK (taking them to a total of around 1,500). The discounters tend to be cheaper than other supermarkets, they stock around one-fifteenth of the different product lines of a large 'Big 4' supermarket, and they offer fewer branded goods.

16. Another trend is that people are increasingly shopping 'little and often'. The big weekly shop is now less common than it used to be. However, this is a gradual and long-established trend, and large supermarkets remain important. Just under 90% of customers still conduct a single main weekly shop. Both Tesco and Sainsbury's now operate substantial numbers of convenience stores. Asda only operates a relatively small number of convenience stores, all of which are attached to its PFSs.

17. There has also been continued growth in online delivered groceries in the UK with revenues of around £11.4 billion in 2018. This is around 6% of UK groceries sales. It is forecast to be the fastest growing grocery channel, expected to increase in value to £17.3 billion by 2023. While many in-store grocery retailers also supply online delivered groceries, Aldi and Lidl do not, and other retailers such as Ocado operate only online.

Our approach

18. We have assessed the likely effects of the Merger in the following five areas:

    (a) In-store groceries;

    (b) Online delivered groceries;

    (c) General Merchandise;

    (d) Fuel; and

    (e) Buyer power, ie whether the increased power of the merged entity over suppliers would distort competition and result in adverse effects for customers of grocery retailers.

19. For groceries, GM and fuel markets, we have assessed the horizontal unilateral effects of the Merger. This means that we have assessed whether the merged entity could profitably increase prices, and/or worsen other aspects such as the quality, the range and the service it delivers to customers relative to the situation that would have existed absent the Merger (collectively, we refer to these price and non-price factors as 'PQRS'). The consumer harm would arise as a result of the merged entity acting unilaterally, ie independently of others in the market.

20. For groceries, we have also assessed the possible coordinated effects of the Merger. Coordinated effects may arise when firms recognise that they are mutually interdependent and that they can reach a more profitable outcome if they coordinate or align their behaviour. The consumer harm would arise due to the merged entity and others coordinating their behaviour, but without any explicit or unlawful arrangements or direct communications between them.

In-store groceries

21. The Parties are large, nation-wide players which set and apply important elements of their competitive offer consistently across all their stores. This includes the pricing of goods, their overall brand positioning, the quality of own-brand goods, innovations that affect product quality, and negotiations with suppliers on promotions.

22. However, competition for the supply of in-store groceries takes place primarily at the local level, as customers shop locally, choosing from the available options in their local area. Quality, range and/or service is, or would be, flexed locally in response to competition – for example, through varying in-store customer service, staffing levels, check-out facilities (which affect queue

lengths), maintenance and investment, the availability of promotions, stock availability or stock quality, or changing the product range in stores.

23. For in-store groceries, we have examined:

(a) Whether the Merger would give rise to an incentive to degrade PQRS across all of their supermarket (or convenience) stores, resulting in an SLC in each local area where either or both of the Parties' stores are present. By way of shorthand, we refer to this as our 'national assessment'.

(b) Whether the Merger would give rise to an incentive to degrade PQRS in individual local areas where the Parties' supermarket (or convenience) stores overlap. By way of shorthand, we refer to this as our 'local assessment'.

(c) Whether the Merger would give rise to coordinated effects.

National assessment

Supermarkets

24. Where the Merger lessens competition in local areas representing a significant proportion of the Parties' overall supermarkets, the Merger may result in price rises (and/or a worsening of other aspects) across all stores and not just those where there is a local SLC. The effect could be a worse deal for customers in each local area where one or more of the Parties is present (that is, including areas where they do not overlap). Any such deterioration across the Parties' stores as a whole would reflect the aggregate effect of the reduction in the competitive constraints that the Parties face across the local areas where they operate.

25. We undertook the national assessment of the Parties' supermarkets by considering the following qualitative and quantitative evidence, to form a decision in the round:

(a) Evidence on national shares of supply and the scale of the local overlaps between the Parties;

(b) Evidence from the Parties' internal documents on the competitors they monitor, and the importance of different competitors in their strategy setting;

(c) Customer switching patterns, on an aggregated national basis;

(d) Views from other grocery retailers on the offers of different retailers, and the competition between them;

(e) Responses from the CMA store exit survey, which interviewed over 20,000 customers outside the Parties' stores across the UK. Customers were asked, for example, which elements of a grocery retailer's offering were most important, which items or services they had just purchased, and how they might respond to price rises;

(f) Evidence on the Parties' and rivals' in-store offers, in terms of amenities, services, range, product offering, and how these differ;

(g) Other evidence, including customer demographics and data on consumer shopping behaviour; and

(h) For each Party, the gross upward pricing pressure index (GUPPI) on a national weighted-average basis. This is a commonly-used measure calculated by combining diversion ratios and profit margin information, which is intended to provide an indication of the incentive the Parties may have to worsen their PQRS as a result of the Merger.

26. We provisionally found that the Parties are significant national players in in-store groceries and are close competitors to each other. They would have a national share of supply post-Merger of 29% and their supermarkets would overlap in locations representing around [70-80]% of all Sainsbury's supermarkets and around [80-90]% of Asda's supermarkets.

27. We provisionally consider that the 'Big 4' grocery retailers (of which the Parties are two) compete directly with each other and that this competition is important for customers. The 'Big 4' retailers differ from other grocery retailers, in terms of features such as the overall pricing level, the extent of in-store services and amenities, the size and consistency of their product ranges, the availability of branded goods, and the offer of additional products and services on-site such as fuel and GM.

28. The evidence from the Parties' internal documents shows that while each Party monitors a wide range of competitors (including Aldi and Lidl, which are a clear competitive focus), both Parties recognise the 'Big 4' retailers as a distinct group, against whom they regularly measure their own competitive performance.

29. Switching data shows that for both Parties, Tesco is an important competitive constraint, with Morrisons and the other Party the next most important constraints. It also supports a finding that retailers such as Aldi, Lidl and

Waitrose are a constraint on the Parties, but not to the extent of the other Party, Tesco, or Morrisons.

30. Submissions we have received from other interested parties support a degree of distinction between the ‘Big 4’ retailers and other grocery retailers, albeit also recognising certain differences within this group. These submissions highlighted important points of difference between the ‘Big 4’ retailers and Aldi and Lidl, which some submitted reduced the extent to which they competed closely.

31. We provisionally found that the discounters provide a competitive constraint on the Parties, but that this constraint is generally less significant than that provided by the other ‘Big 4’ retailers.

32. The closeness of competition between the Parties and the absence of sufficient post-Merger constraints is consistent with our national weighted average GUPPI calculations which at [0–5]% (for Sainsbury’s) and [0–5]% (for Asda) indicate a level of upward pricing pressure that we consider in these markets would be substantial (having taken into account the rivalry-enhancing efficiencies which might arise from the Merger).

33. As a result, we provisionally found that the loss of competition between the Parties as a result of the Merger would give rise to an incentive and ability to degrade PQRS on a national basis across the Parties’ supermarkets, resulting in an SLC in each local area where one or more of the Parties’ supermarkets is present.

Convenience stores

34. We also undertook a national assessment of the Parties’ convenience stores. The Parties compete with a wider range of competitors in respect of their convenience stores than in respect of their supermarkets.

35. For Sainsbury’s, we provisionally found that the Merger would not give rise to an incentive for it to raise prices across all of its convenience stores, which charge different prices to Sainsbury’s supermarkets. This is because the local areas where we have provisionally found competition concerns regarding Sainsbury’s convenience stores represent a small part of Sainsbury’s overall convenience store estate (54 out of around 800 stores).

36. For Asda, the situation is different because its convenience stores charge the same prices as its supermarkets. Our provisional finding that the Merger would result in an SLC in each local area where Asda’s supermarkets are present through a degradation of PQRS which could include a national price

rise, would also mean that the Merger would result in an SLC in each local area where Asda's convenience stores are present.

Local assessment

Supermarkets

37. We assessed the effect of the Merger on the Parties' supermarkets in individual local areas.

38. As the Parties operate over 1,000 supermarkets across the UK (including soon to be opened stores), we systematically assessed the potential effect of the Merger in every local area where one or both Parties' supermarkets is present, and then applied a decision rule to determine (based on that assessment) in which (if any) local areas the Merger gives rise to an SLC. This involved using evidence of competitive conditions and interactions at a local level, which we derived from our survey of customers and other sources, to measure systematically the degree of competition the Parties face in each local area. We call this the weighted share of shops (WSS) model. The WSS then allowed us to produce a measure (the GUPPI) of the potential effect of the Merger on the Parties' incentives to worsen their offer at their supermarkets in each of those local areas.

39. The main steps we have followed to produce the WSS model are as follows:

    (a) We analysed different types of evidence to decide which weighting to attach to different types of competing stores depending on their store characteristics (brand, size, distance from the Parties' store).

    (b) We then considered the appropriate allocation for 'out-of-market constraints' – ie stores located further away, online delivered groceries, and non-supermarket retailers – which are not already accounted for in the primary weightings.

    (c) We then used the weights determined in the first step and the out-of-market allocation to generate our best estimate of the proportion of customers who would choose the other Party in each local market if one of the Parties started offering a worse deal to customers (we call this diversion between the Parties).

    (d) Estimates of diversion between the Parties, together with information about the profitability of those customers (through our assessment of the Parties' profit margins), gives us an indication of the value of business

which the Parties would recapture if they were to worsen PQRS in a particular store following the Merger.

(e) We are then able to produce a GUPPI index for every store which indicates the potential effect of the Merger on the Parties' incentives to worsen their offer in a particular store.

(f) Finally, we considered carefully at what level of this GUPPI index we believe, on the balance of probabilities, the Merger would give rise to an incentive on the part of the Parties to degrade PQRS in a particular store sufficiently to represent an SLC in a particular local market.

40. We believe that the GUPPI described above provides a reliable measure of the expected effect of the Merger, and is therefore a strong basis for our decision for the following reasons:

(a) It relies on evidence that we consider to be robust, and which has been subject to careful scrutiny. This includes the CMA in-store survey, which involved face-to-face interviews with over 20,000 customers, and which was the subject of careful planning and high-quality fieldwork. It also includes entry/exit analysis and analysis of profit margins.

(b) It allows us to effectively combine these pieces of information in an aggregate measure, which incorporates and reflects the key factors of relevance to our competitive assessment, including on brand, store size and distance, which our investigation confirmed are key factors affecting competitive strength.

(c) We carefully assessed the assumptions underlying each of the components of the GUPPI.

(d) It allows us to directly factor into our decision rule an allowance for rivalry-enhancing efficiencies, which would go some way towards offsetting the incentive to worsen PQRS.

41. For these reasons, we believe that the GUPPI incorporates the best available evidence and is sufficiently robust to form the basis of our decision rule in the local assessment.

42. We have provisionally decided to set the threshold for the GUPPI decision rule for our local assessment of the Parties' supermarket overlaps at 2.5% for all local areas. This takes account of our view of the efficiencies that are likely to be generated by the Merger, and an allowance for any uncertainty in our analysis together with the requirement in the legal test that any lessening of competition must be 'substantial'. In each area failing this decision rule, we

provisionally found that the Merger is more likely than not to give rise to an SLC in the circumstances of this case.

43. On this basis, we provisionally found that the loss of competition between the Parties as a result of the Merger would give rise to an incentive to degrade those aspects of the offer that can be locally flexed at certain supermarkets, resulting in an SLC, in 629 local areas.

Convenience stores

44. We assessed the effect of the Merger in individual local areas for the Parties' 842 convenience stores, using a similar analytical approach to our assessment of the Parties' supermarket overlaps, which was further informed by the analysis undertaken by the CMA in the recent Tesco/Booker merger investigation which included an assessment of convenience stores. We constructed a WSS model that allowed us to calculate weights for each local overlap, and used these, together with information on local margins, to produce GUPPIs for each overlapping convenience store.

45. Similarly to our assessment of the Parties' supermarket overlaps, we then used these GUPPIs as the basis of a decision rule, again adopting a threshold of 2.5%. This threshold takes account of the efficiencies which we consider likely to be generated by the Merger, and an allowance for any uncertainty in our analysis together with the requirement in the legal test that any lessening of competition must be 'substantial'. In each area failing this decision rule, we provisionally found that the Merger is likely to give rise to an SLC in the circumstances of this case.

46. On this basis, we provisionally found that the loss of competition between the Parties as a result of the Merger would give rise to an incentive to degrade those aspects of the offer that can be locally flexed at certain convenience stores, resulting in an SLC, in 65 local areas.

Coordinated effects

47. Coordinated effects may arise when firms operating in the same market recognise that they are mutually interdependent and that they can reach a more profitable long-term outcome if they avoid strong rivalry in the short term and instead coordinate, or align, their behaviour so as to raise their profitability (but without entering into any unlawful express agreement or direct communication).

48. All three of the following conditions must be satisfied for coordination to be possible:

(a) Retailers need to be able to reach and monitor the coordination between them.

(b) Coordination needs to be internally sustainable among the coordinating group, ie retailers find it in their individual interests to adhere to the coordinated outcome.

(c) Coordination needs to be externally sustainable, ie the coordination is not undermined by competition from other retailers who are outside the coordinating group.

49. While we found some evidence that could be consistent with pre-existing coordination (significant levels of competitor monitoring and stable market shares), we have not seen evidence of significant or persistent pricing alignment between the 'Big 4' (which we believed to be the most likely coordinating group) for in-store groceries. Overall, we considered the evidence to be more consistent with competition and we therefore provisionally found that there is no pre-existing coordination in the markets for in-store groceries.

50. There are many features of these markets that make reaching a common understanding feasible, including the relatively stable, transparent environment and the similarity in business models amongst the 'Big 4'. We consider the main barrier to reaching and monitoring a common understanding to be the complexity of pricing across such a wide range of different products. We do not consider the problem posed by this complexity would be impossible to overcome and note that grocery retailers already deal with a high degree of complexity when setting prices and that further advances in technology will likely increase their ability to do so in the future. However, at present we consider this complexity remains a significant barrier. On balance, we provisionally found that it is not likely that grocery retailers are able to reach and monitor terms of coordination over the pricing of in-store groceries at present.

51. We provisionally found that the Merger was likely to increase the ability to reach and monitor a common understanding to some extent. However, we did not consider that the Merger would make it more likely than not that a group of coordinating firms would be able to reach and monitor terms of coordination in relation to in-store groceries. We therefore did not need to assess the other conditions for coordination. As a result, we provisionally found that the Merger would not result in an SLC on the basis of coordinated effects in any of the markets for in-store groceries.

Online delivered groceries

52. Drawing on evidence from our online survey, in which we conducted over 30,000 online delivered groceries interviews, and other evidence, we provisionally found that online delivered groceries represents a separate product market rather than being part of a product market that also included in-store groceries. However, while we have excluded in-store competitors from the relevant product markets, we nonetheless took account of the constraints from in-store competitors who are outside the markets in our assessment of the competitive effects. For example, we used diversion ratios based on survey questions where respondents could state that they would switch to in-store.

53. The eight retailers selling online delivered groceries are AmazonFresh, Asda, Iceland, Morrisons, Ocado, Sainsbury's, Tesco and Waitrose. Neither Aldi nor Lidl sell online delivered groceries (though Aldi does sell alcohol online). There are two main models used for online delivered groceries:

    (a) Store-pick: the retailer's employees walk around the supermarket to 'pick' the orders, and then a driver delivers the groceries to customers.

    (b) Customer fulfilment centres (CFCs): groceries are picked in a specialised centre which only supports online sales. These centres typically service a larger geographic area than individual local stores. This is the method used by online-only grocery retailers such as Ocado, but other retailers also use this approach.

54. We use the term 'Supply Point' to refer to both stores which are used for store-pick and CFCs.

55. Both Parties set some aspects of their online offer at the national level and apply them uniformly, including product prices, delivery pass prices and the quality of their website and apps. Asda also currently sets its delivery prices at the national level.

56. At the local level, the Parties can or do flex some aspects of their online offer, such as delivery prices for Sainsbury's. Furthermore, post-Merger, the Parties could change their approach and flex Asda's delivery prices at the local level.

57. As for in-store groceries, we have conducted national, local and coordinated effects assessments for online delivered groceries.

National assessment

58. As discussed above, we have provisionally found SLCs for in-store groceries. Product prices are the same across both in-store and online delivered groceries, and we do not consider that this is likely to change post-Merger; there is therefore likely to be an equivalent increase in the prices of online delivered groceries sold by the Parties. This means that the Merger would result in an SLC in each local area where one or more of the Parties is present in online delivered groceries.

59. We also assessed the discrete effects of the Merger on competition in online delivered groceries, whereby the Merger would result in a reduction in the number of competitors in online delivered groceries from eight to seven.

60. Only three online delivered groceries retailers (Tesco, Sainsbury's, Asda) have a near-national presence and many online delivered groceries customers would have a restricted choice following the Merger: sometimes limited to only the Parties and Tesco. The Parties overlap in all but one Asda Supply Point.

61. Only four online delivered groceries retailers (Tesco, Sainsbury's, Ocado, Asda) have national shares materially above 5%. While Ocado is a relatively strong player overall, with a national share of supply similar to Asda, its presence is limited to certain parts of the UK. Morrisons has a national share of supply of [5–10]%. This smaller presence, relative to in-store groceries, may partly be explained by the fact that Morrisons entered online delivered groceries far later than Sainsbury's, Asda or Tesco, but may also reflect that it is a weaker competitor in certain areas due to consumer preferences, and is absent from some geographic areas. Iceland and AmazonFresh both have low national shares of supply. The discounters, Aldi and Lidl, whose growth has been a recent trend in in-store groceries, are absent from online delivered groceries.

62. Online delivered groceries are constrained to some extent by in-store groceries offerings and we take this into account in our assessment. However, the Parties are both also important national players in in-store groceries.

63. Consistent with this, the national GUPPI figures show that the Parties would have an incentive to worsen PQRS (including an incentive to innovate less) after the Merger, particularly for Asda customers.

64. In light of this, we have provisionally found that the combination of two of the four largest online delivered groceries retailers (each with a share of supply [10–20]%) would give rise to an incentive to degrade PQRS across the Parties' online delivered groceries offer, resulting in an SLC in each local area

where one or more of the Parties is present. The Parties face varying degrees of competitive pressures from a range of other groceries retailers, including in-store, but these constraints would not be sufficient to offset the substantial loss of competition between the Parties in online delivered groceries post-Merger.

65. We have provisionally found that entry or expansion by other competitors would not be sufficient to offset the potential SLC.

Local assessment

66. As the Parties operate 531 Supply Points across the UK, we have systematically assessed the potential effect of the Merger in every local area and then applied a decision rule to determine in which (if any) local areas the Merger gives rise to an SLC. As for in-store groceries, we adopted a GUPPI-based decision rule, with the same SLC threshold of 2.5%.

67. We calculated a GUPPI for each Supply Point in which the Parties overlap by combining national online and in-store margins with diversion ratios from our online survey.

68. On this basis, we provisionally found that the loss of competition between the Parties as a result of the Merger would give rise to an incentive to degrade those parameters of their offer that can be locally flexed at certain Supply Points, resulting in an SLC, in 290 local areas.

Coordinated effects

69. We assessed whether the Merger might be expected to give rise to an SLC in online delivered groceries through coordinated effects, using the same framework as for in-store coordination discussed above, ie assessing the ability to reach and monitor the coordination; internal sustainability; and external sustainability.

70. We conducted our assessment of the potential for coordinated effects with a specific form of coordination in mind. Based on the characteristics of the markets, we provisionally considered that were tacit coordination (ie alignment without any explicit agreement among the coordinating group) to occur pre-Merger, it would most likely have the following characteristics:

    (a) The coordinating group would comprise Asda, Sainsbury's and Tesco, which are three of the four largest retailers of online delivered groceries at the national level, with a combined national share of supply of [70–80]%, and which have the broadest geographic coverage. It is less likely that

other retailers would be sufficiently aligned with these three to be part of the coordinating group.

(b) The focus of coordination (ie the aspects of competition on which they would avoid short-run rivalry and instead seek to align) would be delivery pricing, including related elements, such as slot length and minimum basket size. This is an aspect of competition that is specific to online delivered groceries, and over which there is a high level of transparency. The coordination would emerge over time and with repeated interactions between the members of the coordinating group. For instance, one member of the coordinating group would increase its delivery prices and see how the other members responded before considering what to do next.

(c) Given the differing geographic coverage of retailers of online delivered groceries and the ability to flex delivery pricing by local area, the coordination would be most likely to occur in geographic areas where the constraints external to the coordinating group are weakest. This would comprise areas where Ocado is not active.

71. We did not find sufficient evidence to support a provisional finding of pre-existing coordination in online delivered groceries. Of the three conditions for coordinated effects, we provisionally found that only the first condition (the ability to reach and monitor a common understanding) is not met pre-Merger.

72. We did find evidence of online delivered groceries retailers recognising their mutual interdependence. It is not clear that this is evidence of attempts to coordinate, but we nonetheless consider it is relevant to our assessment of the likelihood of coordination arising after the Merger.

73. We provisionally found that the Merger would increase the ability of the coordinating group to satisfy the first condition sufficiently for it to be met. The Merger would increase the symmetry between the two members of the coordinating group (Tesco and the merged entity), and there would only be one relationship to coordinate between the two retailers (instead of three relationships pre-Merger).

74. We provisionally found that the markets' characteristics are consistent with coordination being internally and externally sustainable at present because the benefits of deviating from the coordination (eg by lowering delivery prices) would be short-lived, and the coordinating group would face limited constraints in areas of the country where Ocado is not present. We also provisionally found that internal sustainability would be slightly increased, and that external sustainability would not be reduced by the Merger.

75. Given that the three conditions for coordination were likely to be met and satisfied to a greater extent overall as a result of the Merger, and considering all the evidence in the round, we provisionally found that the Merger would make coordination in online delivered groceries, in areas where Ocado does not operate, more likely than not. We therefore provisionally found that the Merger would be expected to result in an SLC in the local markets for online delivered groceries where Ocado does not operate.

Fuel

76. The Parties both supply road fuel (petrol and diesel) at the retail level in the UK. We have conducted national and local assessments for fuel.

77. Although retail fuel markets are local, and the Parties set fuel prices locally, we assessed whether the Merger could create an incentive to worsen the Parties' offerings across all their PFSs, including aspects of their offerings that are set uniformly across their entire fuel business, such as their overall approach to setting prices.

National assessment

78. The Parties' PFSs overlap in locations representing around [70-80%] of all Sainsbury's PFSs and around [80-90%] of Asda's PFSs.

79. In our national assessment, we considered that: (i) the Parties' combined national share of supply (18% by volume, and 7.5% by number of sites) is lower than the level that may be typically expected to give rise to concern where the products offered (fuel) are largely the same between competitors; (ii) based on their pre-Merger pricing strategies, the Parties may be expected to find it profitable to adopt more localised pricing approaches post-Merger; and (iii) the average national GUPPI for the Parties' fuel businesses is low. We therefore provisionally found that the Merger may not be expected to lead to an SLC at a national level.

Local assessment

80. As the Parties operate 634 PFSs, we systematically assessed the potential effect of the Merger in every local area and then applied a decision rule to determine (based on that assessment) in which (if any) local areas the Merger gives rise to an SLC. The evidence available to us in our assessment of fuel differed to that in groceries, so our decision rule combined three analytical approaches:

(a) A WSS analysis based on evidence on customers' diversion from the CMA fuel survey (which interviewed nearly 8,000 customers at the Parties' PFSs), reflecting how customers would switch from the Parties' PFS to local competing PFSs; we refer to this as the survey-based WSS.

(b) A WSS analysis based on a price concentration analysis (PCA), which reflects how prices at supermarket PFSs are affected by the presence of other local competitors; we refer to this as the PCA-based WSS.

(c) An analysis based on pricing rules that reflect how the Parties currently set their prices. We computed a Pricing Indicator as the difference between the prices that are generated by the pricing rules when the other merging party's PFSs are taken into account and when they are ignored, and we used this as an indicator of the likely effect of the Merger in each local market.

81. We used the results of the survey-based and PCA-based WSS approaches, in combination with information on the Parties' margins, to calculate a GUPPI for each local area where their PFSs are present. In our analysis, we took into account the interrelationship between the Parties' PFSs and their grocery stores. This is because the Parties' incentives to worsen any aspect of their competitive offering for fuel (likely by raising prices) will be affected not only by the loss of revenue from fuel sales, but also by the extent to which loss of fuel customers would also lead to a loss of revenue from non-fuel sales (groceries and GM) to those customers.

82. For both the GUPPI and the Pricing Indicator, we defined appropriate thresholds which in our provisional view would represent a substantial lessening of competition. We considered that a high GUPPI was indicative of a problematic area even if the Pricing Indicator was low (and vice versa). As with our local assessments of in-store and online delivered groceries, we established a threshold having regard to the need for the lessening of competition to be substantial and any uncertainty in our analysis. In the case of fuel, we did not consider that the Parties would realise efficiencies to offset the incentive to raise prices. As a result, our GUPPI decision rule for fuel is lower than we adopt for in-store or online delivered groceries. We therefore provisionally adopted a decision rule according to which an SLC is found for any PFS where **either** the GUPPI is above a 1.5% threshold **or** the Pricing Indicator is above a 0.75ppl threshold.

83. On this basis, we provisionally found that the loss of competition between the Parties as a result of the Merger would give rise to an incentive to increase prices at certain PFSs, resulting in an SLC, in 132 local areas.

General Merchandise

84. We have focused our investigation on those GM segments (or sub-segments) in which the Parties have a relatively large market presence. These are clothing (in particular, childrenswear and generic schoolwear, which is a sub-segment of childrenswear), electricals (in particular, personal care electricals (PCEs) and small kitchen appliances (SKAs)), and toys.

Clothing

85. Sainsbury's offers clothing, footwear and accessories under its Tu brand and Asda offers clothing, footwear and accessories under its George brand. Both Parties sell childrenswear, including schoolwear. The Parties offer only generic schoolwear (ie clothes that are suitable for school, and marketed as such, but which do not include school logo embroidery or other features that are specific to a particular school).

86. The Parties have relatively low national shares of supply in clothing with a combined share of supply of [5–10]% by value. Considering the narrower sub-segments of womenswear, menswear and childrenswear, the Parties have higher shares of supply in childrenswear of [10–20]% by value. This would mean that post-Merger, the Parties would have the largest share of supply by value in childrenswear in the UK. Within the segment of childrenswear, the Parties appear to compete closely in generic schoolwear. Post-Merger the Parties would have a combined share of supply in generic schoolwear of [20–30]% by value, making the merged entity the largest generic schoolwear retailer in the UK.

87. However, the Parties face major competitors in each segment and sub-segment of clothing. Even in the sub-segment of generic schoolwear, there are a large number of competitors with competitive prices and with a wide geographic coverage, such as Tesco, M&S, Next, Matalan, Debenhams, Morrisons and Aldi. Additionally, the Parties' shares may be overstated as our data does not include retailers such as Primark that supply childrenswear items that can be worn as part of a school uniform, but which are not specifically marketed as schoolwear. In this regard, Primark is a strong competitor in childrenswear generally, and particularly at the lower price end (where the Parties operate), and is monitored closely by the Parties in their internal documents.

88. On this basis, we provisionally found that the Merger would not be expected to result in any SLC with respect to clothing or any sub-segment of clothing.

Electricals

89. Sainsbury's (including Argos) and Asda sell a variety of electrical products, including small domestic appliances (eg vacuum cleaners, fans), 'grey' goods (eg computers, tablets and phones), and 'brown' goods (eg televisions and other audio-visual appliances).

90. The Parties would have a combined share of supply of less than [10–20]% in electricals. In the narrower sub-segments of electricals, the Parties' combined shares accounted for [10–20]% of sales of PCE and [20–30]% of sales of SKA. The Parties face competition from a range of grocery and non-grocery retailers, such as Boots, Dixons Carphone, Tesco and Amazon.

91. We provisionally found that the Merger would not be expected to result in an SLC with respect to electricals, or the narrower segments of PCE or SKA. These findings do not depend on the extent to which online sales constrain in-store sales.

Toys

92. Sainsbury's (including Argos) and Asda have a combined share of supply in toys of [20–30]%. The Parties face competition from a range of grocery and non-grocery retailers, such as Tesco, Smyths, the Entertainer, and Amazon.

93. We provisionally found that the Merger would not be expected to result in an SLC with respect to the retail supply of toys. These findings do not depend on the extent to which online sales constrain in-store sales of toys.

Buyer power

94. We have considered whether a potential increase in the negotiating power or 'buyer power' of the Parties could distort competition in the supply of groceries, with adverse effects for customers. It is not within the CMA's powers to consider adverse effects on suppliers which do not have competition implications.

95. We have considered two possible ways in which competition could be distorted:

(a) the exercise of increased buyer power by the merged entity might result in reduced incentives or ability to invest and innovate on the part of suppliers who may have less funds to do so; and

(b) the exercise of increased buyer power by the merged entity might cause suppliers to raise prices to and hence the purchasing costs of rival

retailers, which, under certain circumstances, may result in price increases to customers of those rival retailers. This is often referred to as the 'waterbed effect' in competition inquiries.

96. For the first concern, we have provisionally found that only a small minority of new product development projects involve significant upfront costs and significant reliance on the terms obtained from the Parties. The few projects that appear to meet these criteria were developed by large multinational companies, typically with a view to initiating a new product line or broadening distribution in the medium- to long-term, such that their profitability might be less dependent on the terms obtained from the Parties than might be implied from short-term financial forecasts. We also found evidence that in certain circumstances retailers can and do provide some forms of commitments to support the product development activity of suppliers, though such support usually falls short of financial aid. For these reasons, our provisional finding is that there is insufficient evidence to conclude that the Merger is likely to significantly reduce incentives to invest and innovate on the part of suppliers.

97. For the second concern, we provisionally found that:

(a) the majority of the suppliers which engaged with us do not expect to change their prices to rival retailers following the Merger;

(b) for most retailers a small loss of market share is unlikely to lead to a significant increase in procurement costs; and

(c) a price reduction by the merged entity produces conflicting incentives for rival retailers, which might lead some rival retailers to reduce, rather than increase prices.

98. Overall, it seems unlikely that many retailers will raise their prices in response to the Merger; and even if it were to occur for some individual retailers, the overall net effect on UK households is unlikely to be negative. On that basis, our provisional finding is that the Merger is unlikely to lead to customer harm through a waterbed effect.

Efficiencies

99. The Parties have said that cost-saving efficiencies are the main rationale for the Merger and that these efficiencies would mean that UK customers would benefit from lower prices as a result of Merger. We have assessed the efficiencies that would be generated by the Merger and which might improve competition in the relevant markets, with a view to including any such benefits in our assessment of the Merger.

100. We provisionally found that the Merger is likely to give rise to potential efficiencies, some of which would lead to an incentive to reduce prices, but for the specific purpose of our competition assessment we have not accepted the evidence advanced by the Parties regarding the scale of those efficiencies. However, based on a range of other evidence available in this case, such as assessments of increased buying scale and comparisons with other transactions in the industry, we have provisionally found that the Merger can be expected to produce some measure of sustainable rivalry-enhancing efficiencies, across groceries and GM markets, but that there are unlikely to be any relevant efficiencies in fuel markets.

101. The scale of efficiencies we have found is equivalent to around a 1% downwards pricing pressure in groceries and GM markets, which we have taken into account in our national assessments of in-store and online groceries, and which we have included in the GUPPI thresholds used in our local assessments of in-store and online groceries.