Anticipated merger between J Sainsbury PLC and Asda Group Ltd

Summary of Final Report

Notified: 25 April 2019

1. The Competition and Markets Authority (CMA) has decided 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 a number of markets in the UK. The CMA has decided to prohibit the Merger in its entirety.

2. 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. They also supply fuel through petrol filling stations (PFSs), which are often located adjacent to their larger grocery stores. The Merger would create the largest retailer of fuel by volume in the UK.

3. We found extensive competition concerns which may be expected to lead to price rises or a worsening of quality, range or service for customers at either a national level or at individual stores. We found an SLC in markets in the UK in the following respects:

   (a) The retail supply of groceries in both Sainsbury's and Asda supermarkets on a national basis, ie in all 1,239 local areas in which the Parties are present.

   (b) The retail supply of groceries in supermarkets on a local basis in 537 of the local areas in which both Parties are present, covering approximately 40% of Sainsbury's supermarkets and 50% of Asda's supermarkets.

   (c) The retail supply of groceries in Asda convenience stores on a national basis, ie in all 59 local areas in which an Asda convenience store is present.

(d) The retail supply of groceries in convenience stores on a local basis in 18 of the local areas in which both Parties are present, covering 1% of Sainsbury's convenience stores and 10% of Asda's convenience stores.

(e) The retail supply of groceries ordered online and delivered to the customer's location (online delivered groceries) for Sainsbury's and Asda on a national basis, ie in all 531 delivery areas served by the Parties, as a result of the effects identified on a national basis in in-store groceries.

(f) The retail supply of online delivered groceries for Asda customers on a national basis, ie in all 286 delivery areas served by Asda, as a result of a national reduction in competition between the Parties' online offerings.

(g) The retail supply of online delivered groceries for Asda customers on a local basis in 143 delivery areas served by both Parties, covering 50% of the delivery areas served by Asda.

(h) The retail supply of fuel on a local basis in 127 of the local areas in which both Parties operate PFSs, covering 19% of the Sainsbury's PFSs and 21% of Asda's PFSs.

4. We also considered whether coordinated effects would arise, whereby, in certain areas of the UK, the Parties and other grocery retailers would recognise that they are mutually interdependent and that they can reach a more profitable outcome if they align their behaviour to limit their rivalry. On this basis, we found SLCs in the retail supply of online delivered groceries in areas of the UK where Ocado is entirely absent, which represents 108 of the Parties' delivery areas and around 20% of UK postcode units.

5. Since we published our Provisional Findings in February, we have engaged in significant further analysis and have held further hearings with the Parties and with other industry participants. Our final findings differ in some respects from our Provisional Findings.

6. The SLCs we found on a national basis in the retail supply of in-store groceries from supermarkets and convenience stores remain substantially unchanged, as do the SLCs on the basis of coordinated effects in the retail supply of online delivered groceries. The SLCs we provisionally found for the retail supply of online delivered groceries on a national basis have changed, particularly as a result of updated financial data, so that they cover only Asda's delivery areas for the standalone assessment of competition between the Parties' online offerings. For our analyses of the effects of the Merger in local areas, we have updated our data and methodology, resulting in a reduction in the number of SLCs identified on a local basis. We have reduced the number of supermarket SLCs on a local basis from 629 to 537 areas,

convenience store SLCs on a local basis from 65 to 18 areas, the SLCs in local online delivered groceries on a local basis from 290 to 143 areas, and the SLCs in the supply of fuel on a local basis from 132 to 127 areas. Our analysis also reflects that we have increased the level of efficiencies that we believe would have been generated by the Merger from £400 million to £500 million.

The CMA's investigation

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

8. The CMA's investigation into this Merger has necessarily been detailed 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. We also 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.

9. In any 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). In this investigation, we have 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.

10. The second question we must decide 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. As explained in more detail below, we have found a very large number of SLCs spanning a large part of the Parties' operations.

11. The final question we must decide is what action we might take for the purposes of remedying any SLCs we have identified. As explained in more detail below, we decided that the full prohibition of the Merger would be the only effective remedy to the SLCs we have found.

The context of the merger

12. 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.

13. Asda operates a network of 641 grocery stores (including 582 supermarkets and 59 convenience stores which are all attached to PFSs), 33 Asda Living stores (focused on non-grocery products including clothing), 321 PFSs and an online grocery business.

14. The combination of these two grocery retailers would 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.

15. 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 and non-alcoholic drinks represents around 11% of typical household expenditure, increasing to over 14% for those on lower incomes. It has been estimated that groceries account for just over half of all retail sales in the UK.

16. 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%).

17. 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. Our analysis confirms that they are now an important presence in the market.

18. 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 for most customers. Most 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.

19. There has also been continued growth in online delivered groceries in the UK with revenues of around £11.4 billion in 2018. This is now around 6% of UK groceries sales. While many in-store grocery retailers also supply online delivered groceries, Aldi and Lidl do not, and a few retailers such as Ocado operate only online.

Our approach

20. 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.

21. 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, and facing less competition than each of the Parties would otherwise face without the Merger.

22. 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

23. The Parties are large, nation-wide operators which set and implement important aspects of their business operations 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.

24. However, competition for the retail supply of in-store groceries takes place primarily at the local level because customers shop locally, choosing from the available options in their local area. Quality, range and/or service are, or would be, adjusted or '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.

25. 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

26. 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 the Parties’ stores. 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 loss in the competitive constraints that the Parties face across the local areas where they operate. This national effect therefore reflects an aggregation of local effects, but it is not an aggregation of the SLCs which we have identified as a result of our local assessment. The national assessments focus on nationally-set parameters of competition such as price levels and the quality of own-brand products which do not differ by store, whereas the local assessments focus on locally-set parameters such as the range of products on offer and customer service levels which can differ between individual stores.

27. 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 shares of supply;

    (b) Evidence from the Parties’ internal documents;

    (c) Customer switching patterns, on an aggregated national basis, based on data from the third-party data provider, Kantar;

    (d) Views from other grocery retailers;

    (e) Responses from the CMA store exit survey, which interviewed 20,500 customers at the exits to the Parties’ stores across the UK;

    (f) Evidence on the Parties’ and rivals’ in-store offers;

    (g) For each Party, the gross upward pricing pressure index (GUPPI) on a national weighted-average basis, including evidence on the scale of the geographic overlaps between the Parties. The GUPPI is a commonly-used measure, which indicates the incentive the Parties may have to worsen their PQRS as a result of the Merger.

(h) Other evidence, including on customer demographics data on consumer shopping behaviour and general market trends.

28. We found that the Parties are significant national operators in in-store groceries and are close competitors to each other. Their supermarkets overlap in locations representing around 77% of all Sainsbury's supermarkets and around 85% of Asda's supermarkets. They would have a national share of supply post-Merger of 29% making the merged entity the largest grocery retailer by share of sales, overtaking Tesco and growing to nearly three times the size of the next largest grocery retailer, Morrisons.

29. We 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. While the Parties face varying degrees of competitive pressures from a range of other groceries retailers, we found that Tesco and Morrisons generally act as the Parties' closest competitors.

30. 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.

31. Switching data shows that for both Parties, Tesco is the most 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 (albeit to different degrees between the Parties), but not to the extent of the other Party, Tesco, or Morrisons.

32. The Parties also differ from some other grocery retailers (particularly Aldi and Lidl), 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. We consider that this further supports our finding that the Parties are close alternatives for customers (and that some other retailers may be less close alternatives).

33. 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.

34. 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 indicate a level of upward pricing pressure that we consider would be substantial (having taken into account the rivalry-enhancing efficiencies which may arise from the Merger).

35. The use of GUPPI in our national assessments is different from the use of GUPPI in our local assessments (which are discussed in more detail below). Whilst the underlying data and methodology are the same, we have not set a specific threshold above which an SLC would arise in the national assessment. In setting a decision-rule SLC threshold for the GUPPI in the local assessments, we took account of uncertainty in our local GUPPI figures but the aggregation of the data reduces uncertainty at the national level. The national assessment does not rely directly upon the number of SLCs that have been found as a result of the local assessment, although we note that a finding of several hundred such SLCs is consistent with there being an SLC on a national basis.

36. We 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

37. 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. Their convenience stores overlap in locations representing around 25% of all Sainsbury's convenience stores and around 50% of Asda's convenience stores.

38. For Sainsbury's, we 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 found competition concerns regarding Sainsbury's convenience stores represent a small part of Sainsbury's overall convenience store estate (12 out of around 800 stores).

39. For Asda, the situation is different because its convenience stores charge the same prices as its supermarkets. Our 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

40. We assessed the effect of the Merger on the Parties' supermarkets in individual local areas. Where our local assessment results in SLCs, they are found on different grounds to the SLCs found in our national assessments, but the local assessment reflects the same loss of rivalry as the national assessment.

41. As the Parties operate over 1,000 supermarkets across the UK (including soon to be opened stores), we have had to assess the potential effect of the Merger in every local area where one or both Parties' supermarkets is present. To do so we 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 the CMA store exit survey 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.

42. 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. There is a risk that the Parties would have incentives to do this following the Merger because the threat of losing customers and profits to the other Party, which exists prior to the Merger, would no longer exist afterwards (ie those profits would instead be retained or 'recaptured' by the merged entity). We have used this approach to measure these effects in previous cases and its use was advocated by the Parties themselves in this case.

43. 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), separately for each of the Parties.

    (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 steps (a) and (b) 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), give 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. The higher the GUPPI figure, the greater the incentive to increase prices or degrade some other aspect of the competitive offer.

(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.

44. We believe that the GUPPI described above provides a reliable measure of the expected effect of the Merger, 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 store exit survey, which involved face-to-face interviews with over 20,500 supermarket customers, and which was the subject of careful planning and high-quality fieldwork. It also includes analysis of the impact on competition of stores opening and closing in a local area, 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 consumers when choosing where to shop – in particular brand, store size and distance from a competitor, in the local retail groceries market

(c) It allows us to directly factor into our decision rule an allowance for rivalry-enhancing efficiencies, which might result from the Merger and which would tend to offset the incentive to worsen PQRS.

45. Our GUPPI approach measures the Parties' financial incentives by combining profit margin information with those store characteristics which are important to customers (in this case, store proximity, store size, and brand) as well as how these factors vary (eg how quickly the competitive strength of a store declines if it is further away, and how different brands 'rank' in customers'

preferences relative to each other). It uses this information to 'weight' each store relative to all other stores in a local area, which in turn allows us to estimate in what proportion customers would switch from one Party's store to the other Party's store (the diversion ratio), in every local area where the Parties overlap. This approach more closely resembles how customers make their choices (and how stores compete) than other approaches, such as simply counting all the brands in a local area, or measuring revenues and market shares.

46. We then decided to set the threshold for the GUPPI decision rule for our local assessment of the Parties' supermarket overlaps at 2.75% for all local areas. This takes account of our view of the size of efficiencies that are likely to be generated by the Merger, and an allowance for 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 (i.e. where the GUPPI exceeds 2.75%), we found that the Merger is more likely than not to give rise to an SLC in the circumstances of this case.

47. On this basis, we 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 537 local areas.

Convenience stores

48. We assessed the effect of the Merger in individual local areas for the Parties' c.860 convenience stores, using a similar analytical approach to our assessment of the Parties' supermarket overlaps. This 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.

49. Similar to our assessment of the Parties' supermarket overlaps, we then used these GUPPIs as the basis of a decision rule. However, we adopted a threshold of 3.25%, which is 0.5 percentage points higher than the threshold adopted for supermarkets. The threshold includes a larger allowance for uncertainty in our analysis as regards the brand weightings and other aspects of the data and methodology. As in the supermarkets analysis, the threshold also takes account of the efficiencies which we consider likely to be generated by the Merger, together with the requirement in the legal test that any lessening of competition must be 'substantial'. In each area failing this

decision rule, we found that the Merger is likely to give rise to an SLC in the circumstances of this case.

50. On this basis, we 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 18 local areas.

Coordinated effects

51. 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).

52. 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.

53. 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 Sainsbury's, Asda, Tesco and Morrisons (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 found that there is no pre-existing coordination in the markets for in-store groceries.

54. There are features of UK grocery markets that make reaching a common understanding feasible, including the relatively stable, transparent environment and the similarity in business models adopted by Sainsbury's, Asda, Tesco and Morrisons. 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, we consider this complexity remains a significant barrier. On balance, we found that it is not likely that grocery retailers are currently able to reach and monitor terms of coordination over the pricing of in-store groceries.

55. We 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 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

56. Drawing on evidence from the CMA online survey, which was the subject of careful planning and high-quality fieldwork involving over 30,000 interviews with customers for online delivered groceries, and other evidence, we 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 took account of the constraints from in-store competitors who are outside the markets in our assessment of the competitive effects.

57. The eight retailers selling online delivered groceries today 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). We engaged extensively with current and potential suppliers of online delivered groceries so that we could take upcoming changes and future plans into account in our analysis, including the joint venture between Ocado and M&S.

58. 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.

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

60. 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.

61. 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.

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

National assessment

63. As discussed above, we have 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, which 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.

64. We also assessed the effects of the Merger in relation to prices, quality or service that are specific to the Parties’ online business. The Merger would result in a reduction in the number of competitors in online delivered groceries from eight to seven.

65. 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.

66. Only four online delivered groceries retailers (Tesco, Sainsbury’s, Ocado, Asda) have national shares materially above 5%. While Ocado is a relatively strong operator 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 much 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 altogether. Iceland and AmazonFresh both have low national shares of supply. Aldi and Lidl, whose growth has been a recent trend in in-store groceries, do not offer online delivered groceries.

67. 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 operators in in-store groceries, which means that the Parties themselves would benefit from the revenues from customers who would switch purchases from online to in-store, which reduces the effective constraint of in-store groceries on the Parties.

68. There are also differences between the Parties; Sainsbury's customers are more likely than Asda customers to consider Ocado and Waitrose as alternatives, while Asda customers are more likely to consider Sainsbury's than any other retailer bar Tesco. In other words, Asda's online customers would be disadvantaged by the reduction in choice following the Merger on a national basis to a materially greater extent than Sainsbury's online customers.

69. Consistent with this, for Asda customers, who are more likely to divert to Sainsbury's than vice versa, the national GUPPI figures show that the Parties would have an incentive to substantially worsen PQRS after the Merger. We do not come to the same conclusion as regards Sainsbury's customers, who would behave differently.

70. In light of this, we have found that the Merger would give rise to an incentive to degrade PQRS across Asda's online delivered groceries offer, resulting in an SLC in each local area across the country where Asda is present. Asda faces 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.

71. We have found that entry or expansion by other competitors would not be sufficient to offset the potential SLCs.

Local assessment

72. As the Parties operate 530 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 supermarkets, we adopted a GUPPI-based decision rule, with the same SLC threshold of 2.75%.

73. 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 the CMA online survey. In doing so, we took account of future entry or expansion by competitors by reducing the GUPPI figures where appropriate.

74. On this basis, we 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 143 local areas. All of these local areas are based on Asda supply points, reflecting the same reduction in choice for Asda customers as discussed above in the national assessment of online delivered groceries.

Coordinated effects

75. 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.

76. 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 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.

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

78. 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 consider it is relevant to our assessment of the likelihood of coordination arising after the Merger.

79. We 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 reduce the number of firms in the coordinating group from three to two (Tesco and the Merged entity). This would reduce the complexity of monitoring delivery pricing and there would only be one relationship to coordinate between the two retailers (instead of three relationships pre-Merger).

80. We 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 found that internal sustainability would be slightly increased, and that external sustainability would not be reduced by the Merger.

81. 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 found that the Merger would make coordination in online delivered groceries, in areas where Ocado does not operate, more likely than not. We therefore found that the Merger would be expected to result in an SLC in each of the local markets for online delivered groceries where Ocado does not operate.

Fuel

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

83. 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

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

85. 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 found that the Merger may not be expected to lead to an SLC at a national level.

Local assessment

86. As the Parties operate 635 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 two analytical approaches. In our provisional findings, we incorporated a third approach, which was a price concentration analysis, but we do not rely on that approach in our final decision because further analysis has shown that the other two approaches are likely to be more reliable.

87. The first analytical approach was a GUPPI analysis which, as for the in-store and online groceries analysis, combines two pieces of evidence: (i) the Parties' profit margins, and (ii) the WSS analysis. Our WSS analysis is based on evidence on customers' diversion from the CMA fuel survey (which interviewed nearly 8,000 customers at 32 of the Parties' PFSs), reflecting how customers would switch from the Parties' PFS to local competing PFSs. We

calculated a GUPPI for each local area where the Parties' 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.

88. We defined the appropriate threshold for the GUPPI at a level above which an SLC may be expected to arise, on the balance of probabilities. 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 threshold for fuel is lower than we adopt for in-store or online delivered groceries. An SLC is found for any PFS where the GUPPI is above a 1.5% threshold.

89. The second analytical approach was 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 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.

90. We consider that the Pricing Indicator provides evidence for finding an SLC if it is sufficiently high. We defined the threshold for the Pricing Indicator at a level above which an SLC may be expected to arise, on the balance of probabilities, even for local areas for which the GUPPI figure does not exceed the GUPPI threshold. In determining the appropriate threshold, we took into account the same considerations relating to substantiality and uncertainty as for the GUPPI threshold. An SLC is found for any PFS where the Pricing Indicator is above a 1ppl threshold.

91. On this basis, we 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 127 local areas.

General Merchandise

92. 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

93. 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).

94. 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.

95. 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.

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

Electricals

97. 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).

98. 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.

99. We 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

100. 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.

101. We 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

102. 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.

103. 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.

104. For the first concern, we have 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 commitments to support the product development activity of suppliers, though such support usually falls short of financial aid. For these reasons, our finding is that there is insufficient evidence to conclude that the Merger is more likely than not to significantly reduce incentives to invest and innovate on the part of suppliers.

105. For the second concern, we 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.

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

Efficiencies

107. The Parties have said that cost-savings (referred to here as 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 the Merger. We assessed the efficiencies that would be generated by the Merger and which might improve competition, with a view to including any such benefits in our assessment of the Merger.

108. We found that the Merger can be expected to produce rivalry-enhancing efficiencies, which would lead to an incentive to reduce some grocery and GM prices, but with no equivalent effect for fuel prices. We assessed the evidence provided by the Parties and their professional advisors, including updated figures provided following our Provisional Findings. We also assessed a range of other evidence available in this case, such as the effect of increased buying scale and comparisons with other transactions in the industry. We concluded that the rivalry-enhancing efficiencies arising from the Merger would equate to around £500 million per annum. This compares to the ‘sensitised’ purchasing synergies of £729 million estimated by the Parties’ professional advisors.

109. This scale of efficiencies is equivalent to around a 1.25% downwards pricing pressure on prices, 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. However, as explained above, we found that this effect is more than outweighed by the negative impact of the reduction in competition which would be brought about by the Merger in both our national and local assessments.

110. The Parties have also made a number of public commitments, namely to reduce prices by £1 billion per annum relative to an undefined future pricing level over a period of three years, to implement a margin cap on Sainsbury's fuel prices, to maintain the existing Asda fuel pricing strategy and for Sainsbury's to pay smaller suppliers promptly. Such commitments would be time limited, so they would not address the permanent change to the market brought about by the Merger. We also consider it would be difficult to verify compliance with the commitments. The Parties have confirmed that these commitments are not intended to remedy any SLCs and they therefore do not have direct relevance to this aspect of our investigation. Our national and local assessments show that despite these commitments the Parties' overall economic incentives post-Merger would be to raise prices (and/or degrade other aspects of their offering) when compared to what would have happened absent the Merger.

Remedies

111. The CMA must have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to remedy the SLCs and any adverse effects resulting from these. To this end, the CMA will seek remedies that are effective in addressing the SLCs and their resulting adverse effects and will select the least costly and intrusive remedy that it considers to be effective. The CMA will seek to ensure that no remedy is disproportionate in relation to the SLCs and their adverse effects.

112. Structural remedies are generally one-off interventions that seek to restore or maintain the competitive structure of the market. Behavioural remedies are generally enabling or controlling measures that are designed to regulate the behaviour of the merging parties on an ongoing basis. The CMA has a preference for structural remedies because they are more likely to deal with an SLC directly and comprehensively at source, with less ongoing regulation of companies' conduct.

113. We assessed two potential structural remedies for the SLCs:

(a) prohibition of the Merger; and

(b) divestiture to a suitable party (or parties) of assets and operations sufficient to address effectively each of the SLCs identified.

114. Prohibition of the Merger would result in Asda and Sainsbury's continuing to operate under separate ownership as independent competitors. It would therefore prevent an SLC from resulting in any relevant market. Given this, prohibition would represent a comprehensive solution to all aspects of the SLCs identified by the CMA (and consequently any resulting adverse effects) and the risks in terms of its effectiveness are very low.

115. The Parties proposed a divestiture remedy based on an alternative scenario whereby the number and nature of SLCs was significantly different to those set out in our Provisional Findings and in this final decision. The Parties' divestiture package comprised around 125-150 supermarkets, potentially a number of convenience stores, and a number of PFSs. The large difference in scale and nature between the SLCs that we have found and the much smaller set by reference to which they designed their proposal means that their remedies package does not respond to or address the SLCs we have found. The Parties also indicated that they would be unwilling to consider remedies on a scale, and of the form, that would be required to address the extensive SLCs identified in our Provisional Findings, which have largely been confirmed by our subsequent analysis. We therefore do not consider the Parties' divestiture proposal to be an effective solution.

116. While we have found the Parties' proposals to be inadequate, we nonetheless considered whether it would be possible to identify a divestiture package that would be effective in addressing the SLCs. It is unlikely that a suitable package of assets could be found, or a suitable purchaser (or purchasers) found to operate the assets as a competitor to the Parties, to provide an effective and comprehensive remedy to the widespread SLCs we have found. A divestiture remedy would therefore carry a significant and unacceptable risk of being an ineffective remedy.

117. We also considered behavioural remedies. We concluded that the number of SLCs, the existence of SLCs in in-store groceries, online delivered groceries and fuel, and the complexity of the Parties' operations would make a behavioural remedy or remedies that addressed all these aspects impractical.

118. Having decided that prohibition would be the only effective remedy, we also satisfied ourselves that it would be a proportionate measure in response to the large number of SLCs we found and their adverse effects. We therefore prohibited the Merger in its entirety.