

**Anticipated merger
between
J Sainsbury PLC
and
Asda Group Ltd**

Final report

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The Competition and Markets Authority has excluded from this published version of the report information which the Inquiry Group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [X]. Some numbers have been replaced by a range. These are shown in square brackets. Non-sensitive wording is also indicated in square brackets.

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Glossary

Summary

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:
 - (i) 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.
 - (ii) 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.
 - (iii) 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.
 - (iv) 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.
 - (v) 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.
 - (vi) 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.

- (vii) 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.
- (viii) 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:
 - (i) In-store groceries;
 - (ii) Online delivered groceries;
 - (iii) General Merchandise;
 - (iv) Fuel; and
 - (v) 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:
 - (i) 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'.
 - (ii) 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'.
 - (iii) 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:
- (i) Evidence on shares of supply;
 - (ii) Evidence from the Parties' internal documents;
 - (iii) Customer switching patterns, on an aggregated national basis, based on data from the third-party data provider, Kantar;
 - (iv) Views from other grocery retailers;
 - (v) Responses from the CMA store exit survey, which interviewed 20,500 customers at the exits to the Parties' stores across the UK;
 - (vi) Evidence on the Parties' and rivals' in-store offers;
 - (vii) 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.
 - (viii) 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:
 - (i) 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.
 - (ii) 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.
 - (iii) 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).
 - (iv) 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.
 - (v) 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.

(vi) 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:

(i) 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.

(ii) 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

(iii) 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:
- (i) Retailers need to be able to reach and monitor the coordination between them.
 - (ii) Coordination needs to be internally sustainable among the coordinating group, ie retailers find it in their individual interests to adhere to the coordinated outcome.
 - (iii) 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:
 - (i) Store-pick: the retailer's employees walk around the supermarket to 'pick' the orders, and then a driver delivers the groceries to customers.
 - (ii) 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:
- (i) 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.
 - (ii) 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.
 - (iii) 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:
 - (i) 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
 - (ii) 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:

- (i) the majority of the suppliers which engaged with us do not expect to change their prices to rival retailers following the Merger;
- (ii) for most retailers a small loss of market share is unlikely to lead to a significant increase in procurement costs; and
- (iii) 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:
- (i) prohibition of the Merger; and
 - (ii) 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.

Findings

1. The reference

- 1.1 On 19 September 2018, in exercise of its duty under section 33(1) of the Enterprise Act 2002 (the Act) the Competition and Markets Authority (CMA) referred the anticipated merger between J Sainsbury plc (Sainsbury's) and Asda Group Ltd (Asda), part of Walmart Inc. (Walmart) (the Merger), for further investigation and report by a group of independent panel members (the Inquiry Group).¹ Having decided to extend the statutory timetable by eight weeks, the Inquiry Group was required to publish its final report by 30 April 2019.² The terms of reference, along with information on the conduct of the inquiry, are set out in Appendix A.
- 1.2 In this investigation, the Inquiry Group must decide:
- (a) whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and
 - (b) if so, whether the creation of that situation may be expected to result in a substantial lessening of competition (SLC) within any market or markets in the United Kingdom (UK) for goods or services.
- 1.3 This requires that the CMA assesses 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).³
- 1.4 This document, together with its appendices, constitutes the Inquiry Group's findings, published and notified to Sainsbury's and Asda in line with the CMA's rules of procedure.⁴ Further information relevant to this inquiry, including non-confidential versions of the submissions received from Sainsbury's, Asda and third parties, as well as summaries of evidence received in oral hearings, can be found on the CMA's website.⁵

¹ The Act, [section 33\(1\)](#).

² [Notice of extension](#) (11 February 2019).

³ [Quick guide to UK merger assessment \(CMA18\)](#), paragraph 3.1.

⁴ [Rules of procedure for merger, market and special reference groups \(CMA17\)](#), paragraph 13.1.

⁵ [Sainsbury's/Asda merger inquiry webpage](#).

1.5 Throughout this document we refer to Sainsbury's and Asda collectively as 'the Parties'.

2. The Parties, the Merger and its rationale

The Parties

Sainsbury's

- 2.1 Sainsbury's is the UK's second largest grocery retailer, based on sales data for the full year to August 2018.⁶ It was founded in 1869. Sainsbury's generated £28.5 billion of group sales in the 52 weeks to 10 March 2018. It operates a network of 1,428 grocery stores (including 647 supermarkets and 781 convenience stores). Sainsbury's also operates 314 petrol filling stations (PFSs) and an online grocery business.⁷ In addition to selling various categories of general merchandise (GM) in its grocery stores and online, Sainsbury's operates Argos (a multi-format GM retailer) and Habitat (a retailer of furniture and homewares). Argos currently operates across 595 standalone stores and 274 concessions within Sainsbury's stores. Sainsbury's also offers retail banking, consumer credit, insurance and other customer financial services. In February 2018 Sainsbury's completed its acquisition of the Nectar loyalty card business. Sainsbury's had been part of the Nectar loyalty scheme since it launched in 2002.
- 2.2 Sainsbury's is a publicly listed company whose shares are traded on the London Stock Exchange. Its largest shareholder is the Qatar Investment Authority LLC which held 21.83% of the voting rights as at 12 April 2019. As at 12 April 2019, the only other investor who had notified Sainsbury's of an interest in 3% or more of the company's shares was Blackrock (5.01% of

⁶ This figure includes sales in Great Britain (GB) (Total Grocers including Marks & Spencer (M&S), 52 weeks to 12 August 2018) and Northern Ireland (Kantar Worldpanel data). We note that, based on Kantar (12 weeks to 24 March 2019), *Grocery market share snapshot* (GB only), Asda has overtaken Sainsbury's to be the second largest grocery retailer, while the relative position of all other retailers remains the same (albeit with growth for some retailers, including Aldi Stores Limited (Aldi)). This data has not been adjusted as set out in Chapter 4 below: it therefore includes GB only, and does not include M&S, as this is the basis on which Kantar quotes this data. In addition, since this is not an annual figure, it is not fully representative of the market shares of the companies (eg fairly reflecting the Christmas period). For these reasons, and unless stated otherwise, throughout this report we have used Kantar data for 52 weeks to 12 August 2018, as explained in Chapter 4 below (footnote 73).

⁷ These figures are up to date as of 12 April 2019 and exclude pipeline stores. For the purpose of our competition assessment in Chapters 8 and 14, we have taken into account stores that are likely to be opened (or closed) by December 2020, and stores that were scheduled to be open before the date of this report have been labelled as currently active rather than pipeline stores. Our analysis is based on the dataset provided by the Parties in January 2019 and on the Experian Catalist forecourt site dataset from November 2018. For these purposes, Sainsbury's has 1,455 grocery stores (including 654 supermarkets and 801 convenience stores) and 318 PFSs.

voting capital as at 17 May 2017). No individual shareholder exercises control over Sainsbury's.

Asda

- 2.3 Asda is the UK's third largest grocery retailer, based on sales data for the full year to August 2018. It was founded in 1965. Asda generated £22.9 billion of sales in the year ending 31 December 2018. 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, 321 PFSs and an online grocery business, as well as selling various categories of GM in its grocery stores and online.⁸ Asda offers consumer credit, insurance and other customer financial services. Asda also has a subsidiary, International Procurement and Logistics which sources products for Asda directly.
- 2.4 Asda is wholly-owned by Walmart, which is a publicly-listed company with its shares traded on the New York Stock Exchange. As at 1 February 2019, the only shareholders with 3% or more of the voting rights of Walmart are Walton Enterprises LLC and Walton Family Holdings Trust. No individual shareholder exercises control over Walmart. Walmart is aware from public filings that mutual funds affiliated with Vanguard Group Inc. hold in the aggregate approximately 3.9% of the common stock of Walmart. However, Walmart is not aware of how the voting power with respect to such shares is exercised, or if any individual affiliate of those funds holds voting rights with respect to an amount of such shares that would aggregate 3% or more.
- 2.5 Walmart is a multinational retail corporation that operates chains of hypermarkets, discount department stores and grocery stores under 65 banners in 28 countries and e-commerce websites. In the UK, Walmart does not have any activities other than those carried out by Asda.

The Merger

- 2.6 On 30 April 2018, Sainsbury's and Walmart announced the proposed combination of the Parties. Pursuant to the Merger, Sainsbury's would acquire the entire issued share capital of Asda from Walmart and, in turn, Sainsbury's would issue Walmart with Sainsbury's voting ordinary shares and

⁸ These figures are up to date as of 12 April 2019 and exclude pipeline stores. For the purpose of our competition assessment in Chapters 8 and 14, we have taken into account stores that are likely to be opened (or closed) by December 2020, and stores that were scheduled to be open before the date of this report have been labelled as currently active rather than pipeline stores. Our analysis is based on the dataset provided by the Parties on January 2019 and on the Experian Catalist forecourt site dataset from November 2018. For these purposes, Asda has 646 grocery stores (including 585 supermarkets and 61 convenience stores, although Asda notified us on 23 April 2019 that two of these convenience stores had closed or were just about to close), 33 Asda Living stores and 325 PFSs.

non-voting shares, such that Walmart group would hold 42% of the undiluted issued share capital of the Merged entity, but such that it and its concert parties hold no more than 29.9% of the total number of voting shares in the Merged entity (with the remainder of the 42% stake comprising of non-voting shares). Upon completion of the Merger, two Walmart representatives would join the Board of the Merged entity as non-executive directors. The details of the Merger are publicly available on the Sainsbury's website.⁹

2.7 The Merger is not subject to review by any other competition authority.

The rationale for the Merger

2.8 The Parties stated that the rationale for the Merger is to create a dynamic new player in the UK retail market. The Parties noted that they need to improve their customer proposition as a result of the changes in the UK market over the last decade, driven primarily by the mainstream success of Aldi Stores Limited (Aldi) and Lidl UK GmbH (Lidl).¹⁰

2.9 In their public announcement, the Parties stated that the Merger would 'generate net EBITDA synergies, post investment in price, across the enlarged group of at least £500 million'. They also stated that they 'expect to lower prices by c.10% on many of the products customers buy regularly' and that there were 'no planned Sainsbury's or Asda store closures as a result of the [Merger]'. Furthermore, the Parties plan to 'maintain both the Sainsbury's and Asda brands' post-Merger.¹¹ Following publication of the Provisional Findings,¹² the Parties made a number of additional commitments namely to invest £1 billion in lower prices by the end of the third year (with £300 million invested the first year post-completion of the Merger, and a further £700 million over the next two years), to implement a margin cap on Sainsbury's fuel prices for a period of five years post-Merger, to maintain the existing Asda fuel pricing strategy and for Sainsbury's to move to pay smaller suppliers promptly (ie within 14 days) (Asda to continue to pay its small suppliers within 14 days, in line with existing commitments) (the Public Commitments).¹³ These are discussed further in Chapter 16 on Efficiencies.

⁹ [Proposed combination of J Sainsbury plc and Asda Group Limited](#) (30 April 2018).

¹⁰ [Proposed combination of J Sainsbury plc and Asda Group Limited](#) (30 April 2018), page 1. [Parties' initial submission](#), paragraphs 5, 8 and 10. [Parties' response to the Issues Statement](#), paragraph 46.

¹¹ [Proposed combination of J Sainsbury plc and Asda Group Limited](#) (30 April 2018), page 1.

¹² [Provisional Findings](#) (20 February 2019).

¹³ [Sainsbury's and Asda commit to £1 billion of grocery savings and fuel cap](#) (19 March 2019). [Parties' response to the Remedies Notice](#), paragraph 4.6.

- 2.10 According to the Parties, the UK grocery sector is characterised by consumer expectations of increased quality and convenience at lower prices, competition from rivals with more efficient cost structures, as well as the increasing threat of further disruption from operators such as Amazon.¹⁴ In the Parties' view, addressing fully these challenges requires them to narrow the cost advantage of competitors such as Aldi, Lidl and Tesco PLC (Tesco) and this cost reduction requires a significant change to their underlying operating models.¹⁵
- 2.11 The Parties submitted that the Merger would unlock large cost savings and that a large proportion of these savings will be passed on to consumers in the form of price reductions. The Parties stated that the cost savings also mean that they can invest in greater quality, range, service and convenience to deliver a more compelling customer proposition overall.¹⁶ They consider the Merger to be pro-competitive and submit that it would result in substantial benefits to customers across local markets in the UK.¹⁷
- 2.12 At the same time, the Parties noted that the Merger would result in a dynamic market-wide increase in rivalry. According to the Parties, given the highly competitive nature of the UK grocery market, the Merger-specific cost reductions would make the Parties more competitive and, in turn, generate pro-competitive responses from their rivals. The Parties stated that consumers would thus benefit not only directly from the improved offering of the Parties, but from the dynamic and market-wide increase in rivalry that would result.¹⁸

3. Jurisdiction and the counterfactual

Jurisdiction

- 3.1 In accordance with section 36(1) of the Act and pursuant to our terms of reference (see Appendix A), we are required to decide first whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.¹⁹
- 3.2 A relevant merger situation is created if:

¹⁴ [Parties' Initial Submission](#), paragraph 4. [Parties' response to the Issues Statement](#), paragraph 46.

¹⁵ [Parties' response to the Issues Statement](#), paragraph 47.

¹⁶ [Parties' initial submission](#), paragraph 3. [Parties' response to the Issues Statement](#), paragraphs 44 and 48–49.

¹⁷ [Parties' response to the Provisional Findings](#), Executive Summary, paragraph 1.

¹⁸ [Parties' initial submission](#), paragraph 5. [Parties' response to the Issues Statement](#), paragraph 44.

¹⁹ The Act, [section 36\(1\)](#).

- (a) two or more enterprises cease to be distinct; and
- (b) the value of the turnover in the UK of the enterprise being taken over exceeds £70 million (the turnover test) or 'the share of supply test' is satisfied.²⁰

Enterprises ceasing to be distinct

- 3.3 The Act defines an 'enterprise' as 'the activities, or part of the activities, of a business'.²¹ A 'business' is defined as including 'a professional practice and includes any other undertaking which is carried on for gain or reward or which is an undertaking in the course of which goods or services are supplied otherwise than free of charge'.²² The Parties (and Walmart, via Asda) are each active in the provision of groceries in the UK. We are therefore satisfied that each of Sainsbury's, Walmart and Asda (including their subsidiaries) are enterprises for the purposes of the Act.
- 3.4 The Act provides that two enterprises 'cease to be distinct' if they are brought under common ownership or common control.²³ As a result of the Merger, the enterprise presently carried on by Sainsbury's and the enterprise presently carried on by Asda would be brought under common ownership or common control because, as mentioned above:
- (a) Sainsbury's shareholders will acquire 100% of the share capital of Asda.
 - (b) Walmart will hold 42% of the undiluted issued share capital of the combined Sainsbury's/Asda and no more than 29.9% of the total number of voting shares, together with two seats on the combined entity's board.
- 3.5 Accordingly, we are satisfied that Sainsbury's and Asda would cease to be distinct enterprises for the purposes of the Act.
- 3.6 Further, as recognised by the Parties, Walmart's 29.9% voting stake in Sainsbury's, combined with its board representation, would constitute material influence for the purposes of the Act, such that Sainsbury's and Walmart would cease to be distinct for the purposes of the Act.

²⁰ The Act, [section 23](#).

²¹ The Act, [section 129\(1\)](#).

²² The Act, [section 129\(1\)](#).

²³ The Act, [section 26](#).

3.7 We are therefore satisfied that the first limb of the relevant merger situation test, that two or more enterprises would cease to be distinct enterprises as a result of the Merger, is met.

Turnover test

3.8 The turnover test is satisfied if the value of the turnover in the UK of the enterprise being taken over exceeds £70 million.²⁴

3.9 In the accounting year ending 31 December 2017, the financial year preceding the reference of the Merger to phase 2, the annual value of the UK turnover of the Asda business was approximately £22 billion. We are therefore satisfied that the value of the annual UK turnover of Asda exceeds £70 million and that the turnover test is met.²⁵

Conclusion on relevant merger situation

3.10 In light of the above, we have found that the Merger, if carried into effect, will result in the creation of a relevant merger situation. As a result, we must consider 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.²⁶

The counterfactual

3.11 The assessment as to whether the creation of the relevant merger situation may be expected to result in an SLC involves a comparison of the prospects for competition with the Merger against the competitive situation that would exist in the absence of it.²⁷ This situation, referred to as the ‘counterfactual’, is the benchmark against which we assess the competitive effects of the Merger. We select the counterfactual that is most likely to have existed absent the Merger, based on the facts available to us and the extent of foreseeable events.²⁸ We may examine several possible scenarios to inform our judgement on the likely future situation in the absence of the Merger, one of which may be the continuation of the prevailing conditions of competition.

²⁴ The Act, [section 23\(1\)\(b\)](#).

²⁵ As the turnover test in [section 23\(1\)\(b\)](#) of the Act is satisfied in this case, it is not necessary to consider the application of the share of supply test in [section 23\(2\)-\(4\)](#) of the Act.

²⁶ The Act, [section 36](#).

²⁷ [Merger Assessment Guidelines \(CC2 Revised\)](#), paragraph 4.3.6.

²⁸ [CC2 Revised](#), paragraph 4.3.2.

- 3.12 The most notable examples of situations where the CMA may use a counterfactual different from the prevailing conditions of competition are:
- (a) the exiting firm scenario;
 - (b) the loss of potential entrant scenario; and
 - (c) where there are competing bids and parallel transactions.²⁹

Parties' views

- 3.13 The Parties submitted that, in their view, the Merger should be assessed against a counterfactual of the prevailing conditions of competition.
- 3.14 The Parties noted that, in particular, both Sainsbury's and Asda would continue to lose customers to Aldi and Lidl, in addition to facing strong competition from Tesco, Wm Morrison Supermarkets plc (Morrison's), Waitrose & Partners (Waitrose), Co-operative Group Limited (Co-op) and Ocado.com (Ocado) among others. The Parties also considered that competitive pressures from other growing retailers such as B&M Retail Limited (B&M) and Home Bargains,³⁰ fixed price retailers, and foodservice and food delivery specialists (such as Just Eat, Deliveroo and UberEats) were also likely to increase.
- 3.15 In addition, Walmart submitted that [REDACTED].

Our assessment

- 3.16 We did not find evidence to the effect that, absent the Merger, either Sainsbury's or Asda would exit the markets for the retail supply of groceries in-store or online, for the retail supply of GM or for the retail supply of fuel (and neither Party has suggested that it might do so).
- 3.17 Given that we are examining an anticipated merger and neither company has yet acquired shares in the other, Sainsbury's and Asda are currently independent competitors. We considered Walmart's submission that the Merger [REDACTED]. We were told that [REDACTED]. In the absence of evidence of alternative plans or of evidence that either Party would exit the market, we consider that

²⁹ CC2 Revised, paragraph 4.3.7.

³⁰ TJ Morris Ltd trades as Home Bargains.

Sainsbury's and Asda absent the Merger would likely remain independent competitors, [✂].

Conclusion on the counterfactual

3.18 Based on the available evidence, we conclude that the counterfactual in this case should be the prevailing conditions of competition.

4. Industry overview

4.1 This investigation concerns the anticipated merger between the second and third largest grocery retailers in the UK and two of the four largest suppliers of online delivered groceries in the UK. Alongside core groceries, in their larger stores the Parties also sell items such as clothing, electricals and toys which we refer to as 'GM'. PFSs, which are operated and owned by the Parties, are often located adjacent to these larger grocery stores: the Merger would create the largest supplier of fuel by volume in the UK.³¹

4.2 Whilst these areas of activity may be defined as separate markets in economic terms, we have also considered them holistically and taken into account any interactions between the Parties' different activities (for example, the fact that supermarkets often use low prices for fuel as a way to attract customers to their grocery stores) in our investigation.³²

4.3 This chapter provides an overview of the markets in which the Parties are active, focusing on the products and services relevant to our investigation.

Groceries: Industry overview and key players

Importance of grocery retailing

4.4 UK groceries retailing is a critically important industry which was estimated to be worth around £190 billion in 2018. The industry is expected to grow by around 3% (in nominal terms) per year to 2023.³³

4.5 Grocery retailing touches every consumer in the UK. Average household spend on food and non-alcoholic drinks was approximately £60 per week in 2017/18 accounting for around 11%³⁴ of typical household expenditure,

³¹ According to the national fuel retail shares of supply by brand in 2018 based on Catalist Database April 2018.

³² See paragraph 6.18–6.20.

³³ See Figure 4.1 below.

³⁴ ONS (24 January 2019), *Family spending in the UK: April 2017 to March 2018*.

increasing to over 14%³⁵ for those on lower incomes (households with incomes in the lowest 20%). We understand this is likely to be higher in certain regions: family food shopping in Northern Ireland is estimated to be £5 per week more than the UK average and £11 more than the North East of England.³⁶ It has been estimated that the grocery sector accounts for just over half of all retail sales in the UK.³⁷

4.6 Different types of store (for example, large supermarkets versus convenience stores) or routes to consumers (such as online versus in-store) are referred to as 'channels' within the industry. Within these channels, the majority of grocery sales are generated by, and are expected in future to be generated by, large stores such as hypermarkets and supermarkets (around £106 billion in 2018 and £113 billion in 2023).³⁸ 'Convenience stores'³⁹ generate around £40 billion of sales in 2018 (£47 billion in 2023), the discounters⁴⁰ (who are presented separately from the supermarkets channel in many industry reports) around £23 billion in 2018 and £32 billion in 2023, and online groceries around £11 billion in 2018 (and £17 billion in 2023) (see Figure 4.1).

³⁵ ONS (24 January 2019), [Household expenditure as a percentage of total expenditure by gross income decile group for financial year 2017/18](#).

³⁶ The weekly household expenditure on regional level were calculated using figures for financial years 2016-2018, ONS (24 January 2019), [Household expenditure by countries and regions](#).

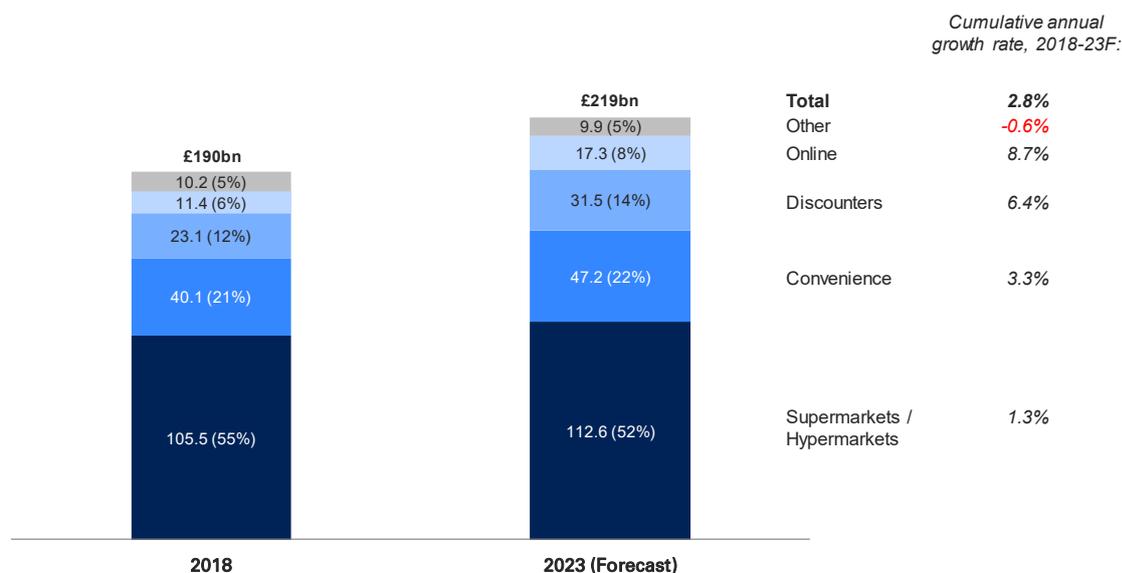
³⁷ IGD (16 June 2015), [UK grocery retailing](#).

³⁸ Hypermarkets are defined by IGD as large format stores that sell a full range of grocery items and a substantial non-food range. Sales areas are typically 60,000 square feet (around 5,500 square metres). Supermarkets are defined by IGD as food-focused stores with sales areas of between 3,000 square feet (around 280 square metres) and 60,000 square feet (IGD (16 June 2015), [UK grocery retailing](#)).

³⁹ Convenience stores are defined by IGD as including store formats typically under 3,000 square feet (around 280 square metres) that sell at least seven core convenience categories. Subsectors include: Symbol groups, forecourts, convenience multiples, co-operatives and non-affiliated independents (IGD (16 June 2015), [UK grocery retailing](#)).

⁴⁰ The definition of Discounter which IGD uses includes all sales of Aldi and Lidl as well as grocery-only sales of bargains stores (Poundland, Poundworld, B&M Bargains, Home Bargains, Wilkinson and Poundstretcher) (IGD (16 June 2015), [UK grocery retailing](#)).

Figure 4.1: UK grocery sales, by ‘channel’, 2018 and 2023 Forecast (£billion, %)



Source: IGD (5 June 2018), [UK food and grocery market to grow 14.8% by £28.2 billion by 2023](#).

Note: 'Other retailers' includes specialist food and drink retailers, CTNs (confectionery, tobacco and news), food sales from mainly non-food retailers and street markets. 'Discounters' includes all sales of Aldi and Lidl, and grocery-only sales of principal variety discounters, including Wilko.

Key trends

4.7 Several important trends in UK groceries retailing as submitted to us by the Parties and as noted by us during this investigation are described below.

Growth of discounters

4.8 One of the major developments in the groceries sector in recent years has been the growth of the so-called 'discounters', Aldi and Lidl. Since 2010, Aldi and Lidl have opened over 500 new stores (to a total of around 1,500),⁴¹ and have more than doubled their combined estimated groceries share in Great Britain (GB) to around 13% of sales.⁴² This growth is set to continue as Aldi has announced that it plans to open 130 new stores over the next two years⁴³

⁴¹ [Lidl: About us](#) and The Guardian (1 October 2018); [Aldi vows to take on Jack's as UK sales top £10 billion for first time](#).

⁴² Figure 4.3 below from around 6% in 2010 (Kantar (1 February 2011), [Grocery Market Share UK – A market of two halves](#)). Based on the 12 week period to 24 March 2019 (GB only, Grocery market share snapshot), Aldi and Lidl have a combined estimated groceries' share of around 14%. As noted in footnote 6, this data has not been adjusted and as such we consider it is not fully representative of the market shares of the companies.

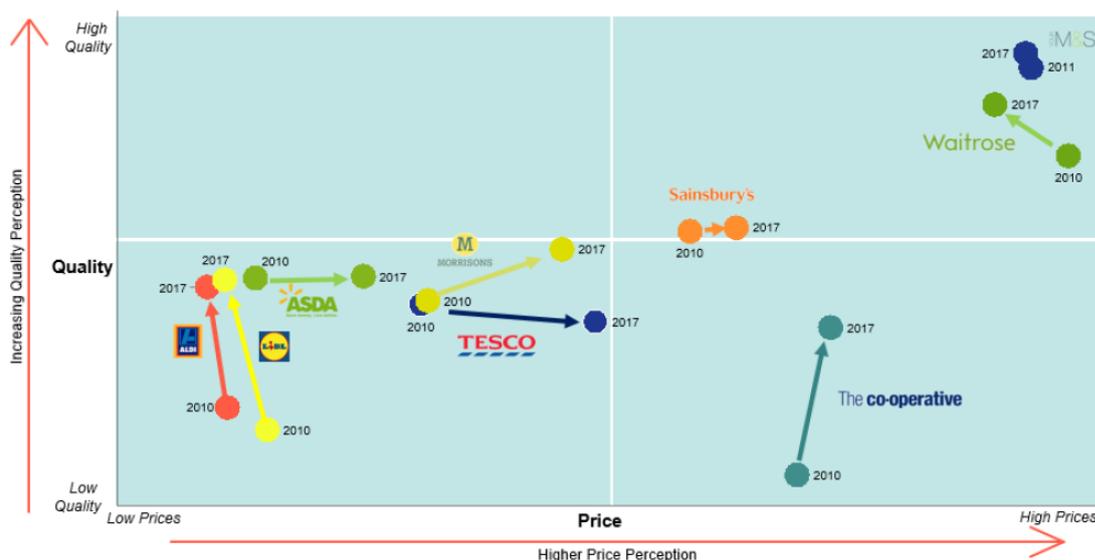
⁴³ Aldi (2 October 2018), [One million new customers drive record sales for Aldi](#).

and Lidl has announced that it intends to open 60 new stores a year over the next two years.⁴⁴

4.9 Aldi and Lidl have also invested in product quality and range in recent years with Aldi’s ‘Specially Selected’ premium range now attracting sales of over £1 billion annually and over 30% of its range having been reformulated to further improve product quality.⁴⁵ We have received some evidence that, in the past decade or so, the perceptions of Aldi and Lidl have changed, particularly with regard to consumers’ views on the quality of their products, which is perceived to have improved and to be seen as now broadly comparable to some of the ‘traditional grocery retailers’,⁴⁶ with total sales expected to grow to 14% of the total market by 2023.⁴⁷

4.10 Figure 4.2 below illustrates how shoppers’ quality and price perceptions of different grocery retailers are thought to have changed from 2010 to 2017.⁴⁸

Figure 4.2: OC&C Shopper Quality and Price Perception Ratings (2010-17)



Source: The Parties (Parties’ response to the Issues Statement, Figure 6).

⁴⁴ Retail Gazette (10 July 2017), [Lidl to open 60 UK stores a year in £1.45 billion push](#). See also Property Week (8 February 2019 and 15 March 2019), which included an advertisement by Lidl announcing that it is expanding and seeking 60 sites across the country each year (including freehold, leasehold or long leasehold opportunities).

⁴⁵ Aldi (2 October 2018), [One million new customers drive record sales for Aldi](#).

⁴⁶ The term ‘traditional retailers’ or ‘traditional grocery retailers’ has been used in the industry to refer collectively to the Parties, Tesco, Morrisons, Waitrose, Co-op and M&S. We use it as a shorthand in this report, but no inference should be made regarding the relevance of the use of this term to the CMA’s competitive assessment of the Merger.

⁴⁷ See Figure 4.1 above.

⁴⁸ We note that we have used Figure 4.2 for illustrative purposes, but as explained in paragraph 8.98, we have not relied on this analysis in our competitive assessment, as it does not provide any information on whether there remains a significant proportion of customers by whom the Parties are seen as close substitutes.

Change in shopping habits

- 4.11 A key trend in UK groceries retailing referred to by the Parties in their submissions is that customers are increasingly shopping ‘little and often’.⁴⁹ The Parties submitted that statistics show that customers now shop an average of 3.9 times a week⁵⁰ and use an average of 4.6 fascia (ie different brands)⁵¹ for all shops and 1.5 fascia for main shops (over a 12 week period).⁵² The Parties also submitted data on the number of main shop and top-up shopping missions (or trips) in 2010, 2014 and 2018.⁵³ This showed that across the total sector the percentage of main shop missions had declined from 40% to 37% and within the ‘supermarket’ section of the sector (not including the discounters), the percentage of main shop missions had declined from 49% to 42% over an eight year period (ie between 2010 and 2018).⁵⁴
- 4.12 The trend towards increased frequency of shopping is not a recent phenomenon. The Competition Commission (CC) noted already in the Groceries market investigation in 2008 that customers were visiting supermarkets more often than previously.⁵⁵ Whilst this is clearly a gradual trend, evidence also shows that larger stores remain important for consumers. Industry reports have found that although consumers are shopping more frequently, the weekly shop still dominates, representing the most common shopping mission.⁵⁶ According to these reports, 89% of customers still do a main weekly shop where they get all or most of their grocery shopping in one go, although 45% of customers combine this with other top-up shops.
- 4.13 In 2017, IGD stated that 98% of shoppers claim to use a supermarket or a hypermarket for some of their grocery shopping every month, with the most

⁴⁹ The Parties submitted the document IGD (9 February 2016), *Three key shopper insights to shape trading with Asda in 2016*.

⁵⁰ Based on Nielsen Homescan data for ‘Average Shops’ for the period ending January 2018 for the UK total grocers.

⁵¹ The fascia on a store front is any surface on the outside of the store that displays the company name, company logo and company colour scheme. By fascia we refer to the different brands (eg Sainsbury’s, Asda, Morrisons, Tesco, Aldi, Lidl, etc) that are present in the sector.

⁵² The data is over the 12 week period ending 7 October 2018 (Kantar).

⁵³ Shopping missions is a term used in the industry when differentiating between types of shopping trip. By main-shopping mission we refer to those big shops through which consumers purchase the bulk of their shopping needs usually on a weekly basis. By top-up shopping missions we refer to those smaller shops that are used to restock supplies that run out faster, or that were forgotten when doing the bulk of their main shopping.

⁵⁴ Based on Kantar data.

⁵⁵ Groceries market investigation (30 April 2008), *Final report*, paragraph 3.50.

⁵⁶ According to this data, the majority of consumers (46%) shop for food and grocery once a week, followed by consumers who shop once every few days (38.4%), and consumers shopping once every two weeks (6.9%) (GlobalData (May 2017), *The UK Food & Grocery Market, 2017–2022*, page 96).

frequently cited reasons being the convenience of having everything under one roof and the wider available choice.⁵⁷

Focus on convenience

4.14 In line with the gradual trend towards more frequent shopping trips, convenience store sales have been growing in recent years, representing an estimated 21% of food and grocery sales in the UK. Although convenience sales are expected to continue to grow, they are expected to grow just by 1% in the next five years.⁵⁸ Sainsbury's is planning to open approximately [✂]. Asda currently only operates convenience stores attached to a number of its PFSs.

Growth of online

4.15 Online sales of groceries were worth around £11.4 billion in 2018 according to IGD, and represent around 6% of the UK grocery sector. It is forecasted to be the fastest growing grocery channel, expecting to increase in value to £17.3 billion by 2023, equivalent to a compound annual growth rate of 9%.⁵⁹

4.16 Industry commentary suggests that online delivered groceries have yet to reach a stable footing financially however, with one established industry report of May 2017 stating that 'online profitability remains an enigma for the major grocers despite significant sales growth of 64.6% between 2012 and 2017 ... it is vital that the channel becomes a profit making division to the business'. This is also consistent with more recent press, according to which the current economics of online delivered groceries are poor if not loss making for the vast majority of grocery retailers.⁶⁰

Prior investigations

4.17 The groceries industry has previously been the subject of various in-depth investigations including most recently the CMA's phase 2 review of the Tesco/Booker merger in 2017.⁶¹ The industry was assessed by the CC in its

⁵⁷ See IGD (2017), *UK Food and Grocery Value 2017*.

⁵⁸ See Figure 4.1.

⁵⁹ See Figure 4.1. However, we note that there is some indication this growth may be slower than historically (Mintel (12 April 2019), *Brits spent £12.3 billion on online groceries in 2018*).

⁶⁰ Financial Times (1 March 2019), *The difficulties of making online delivery pay*; or KPMG/Ipsos Retail Think Tank (August 2018), *What does the future hold for the UK grocery sector?*.

⁶¹ *Anticipated acquisition by Tesco PLC of Booker Group plc* (2017). In addition, there have been a large number of phase 1 merger investigations in recent years, typically relating to the acquisition of packages of mid-sized or convenience stores.

Groceries market investigation in 2008 and the ‘one-stop shop’⁶² segment was a focus of its Supermarkets investigation in 2000.⁶³ The CC also reviewed the potential mergers of Safeway with Tesco, Sainsbury’s, Asda or Morrisons in 2003 and the acquisition of around 100 Somerfield stores by Morrisons in 2005.⁶⁴

- 4.18 Whilst the sector and the key players have previously been the subject of several previous inquiries or investigations, apart from the Tesco/Booker merger inquiry (which focused primarily on the wholesale/retail relationship in grocery retailing given the vertical nature of that merger), these investigations are now all over ten years old. Whilst findings from past cases may be informative, this Merger is being assessed against current conditions of competition and therefore the markets’ characteristics must be considered afresh.

Retail supply of groceries

Definition of groceries

- 4.19 In general terms in this report, ‘groceries’ can be understood to include food,⁶⁵ pet food, drinks (alcoholic and non-alcoholic), toiletries, cleaning products and household goods. Other non-consumable, non-food items such as clothing, kitchenware, electricals, DIY, furniture, CDs, DVDs and financial services which are also provided by some grocery retailers are included in the GM category. Fuel, including petrol, diesel and liquid petroleum gas (LPG), is considered separately.

Sizes and formats of grocery stores

- 4.20 Grocery retailing in the UK encompasses a broad spectrum of formats, store sizes, price points, ranges of products, and service levels. According to IGD, in 2018 there were nearly 6,000 supermarkets, over 42,000 convenience stores and around 4,600 discount stores in the UK.⁶⁶

⁶² In Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom (31 July 2000), [Final report](#), paragraph 4.3, one-stop shopping was defined as a form of shopping in which consumers purchase all or a substantial part of a household’s weekly grocery requirements in one place and during one shopping trip, rather than purchase such items from a number of different outlets or during different shopping trips.

⁶³ [Groceries market investigation](#) (2008); [Supermarkets investigation](#) (2000).

⁶⁴ [Safeway merger inquiry](#) (2003); [Somerfield/Morrisons merger inquiry](#) (2005).

⁶⁵ Not including food sold in restaurants and cafes for consumption on the premises, for take-away or for home delivery.

⁶⁶ According to IGD: Supermarkets are defined as stores over 3,000 square feet (around 280 square metres); Convenience are defined as stores under 3,000 square feet (around 280 square metres) and discounters include

- 4.21 Grocery stores range from small convenience stores selling a limited range of goods through to supermarkets and hypermarkets which provide a wide range of groceries, GM and other services (such as cafes and PFSs) and are sometimes referred to as ‘one-stop shops’ as a result. The consistent factor is that these stores stock a range of grocery items. Other specialist stores such as butchers, bakers and delicatessens which participate in the groceries industry focus only on a particular category (or categories) of products.
- 4.22 There is a category of grocery store which has been referred to as ‘limited assortment discounters’ in previous investigations⁶⁷ due to their more limited range and approach of offering products at a discount level (compared to traditional grocery retailers, which we may take to include retailers such as the Parties, Tesco, Morrisons, Waitrose, Marks & Spencer (M&S) and Co-op). Aldi and Lidl are currently the principal discounters. Whilst this categorisation remains broadly correct, the growth of Aldi and Lidl is one of the key developments in the industry in recent years and we have therefore considered the competitive constraint they pose within the relevant markets afresh in the competitive assessment section. We do, however, continue to refer to Aldi and Lidl as discounters in view of their differentiated offering and the common use of the term in the industry. We consider that Aldi and Lidl can be distinguished from other types of discounter (which we refer to as ‘Bargain stores’ below and which are sometimes referred to as ‘variety discounters’ in industry reports) due to their focus on a broader range of grocery products.
- 4.23 The different types of grocery retailing provide a range of services to cater to the needs of customers. For example, convenience stores aim to be in locations which minimise the time and distance which customers have to travel to and from stores. In contrast, large, ‘one-stop shops’ are often positioned in less convenient locations (such as out of town shopping centres) but offer a larger range of grocery products and GM and usually also offer a variety of other amenities such as large car parks, cafes and PFSs. Medium stores vary but broadly fall in between convenience stores and larger supermarkets both in terms of range and location.

Aldi, Lidl, B&M, Home Bargains, Poundland, Poundstretcher, Poundworld and Wilkinsons (IGD (2018), [UK grocery store numbers](#)).

⁶⁷ [Anticipated acquisition by Poundland Group plc of 99p Stores Limited \(2015\)](#); [Anticipated acquisition by Asda Stores Limited of five grocery stores and three petrol filling stations from Co-operative Group Limited \(ME/6466-14\) \(2014\)](#); [Anticipated acquisition by One Stop Stores Limited of 33 stores from Alfred Jones \(Warrington\) Limited, trading as Spar \(ME/6131/13\) \(2013\)](#); [Anticipated acquisition by Asda Stores Limited of Netto Foodstores Limited \(ME/4551/10\) \(2010\)](#); [Groceries market investigation \(2008\)](#); [Somersetfield/Morrisons merger inquiry \(2005\)](#).

Grocery retailers

- 4.24 Tesco, Sainsbury's, Asda, and Morrisons are the largest grocery retailers and are present throughout the UK.⁶⁸ They are often referred to as the 'Big 4' within the industry⁶⁹ (including by the Parties).⁷⁰ There are several other grocery retailers present in large parts of the UK, namely Waitrose, Co-op, M&S and Iceland. As previously mentioned, the discounters (Aldi and Lidl) now also have a significant presence throughout GB (and Lidl is also present in Northern Ireland). There are also some grocery retailers that are only present in some regions in the UK, such as Dunnes in Northern Ireland and Booths which is mainly present in northern England. Finally, there are a very large number of smaller grocery retailers, including those operating as part of a Symbol group (for example, Spar or Costcutter)⁷¹ and those operating as unaffiliated independent retailers. We consider that competition conditions vary in every local area and this will be taken into account in our competitive assessment.
- 4.25 We set out an overview of each of these retailers (or groups of retailers) below, starting with the Parties. A full discussion on how grocery retailers set their prices and other competitive parameters is included in Chapter 7.
- 4.26 Many grocery retailers operate national chains of supermarkets which are complex multi-product businesses with very high levels of turnover of products. The scale of these businesses means that supporting logistics and infrastructure including distribution centres, vehicle fleets, IT systems and central operations teams are required in order to support their retail operations in-store. Furthermore, considerable operational integration is necessary, with added complexity where the particular retailer also offers online delivered groceries.
- 4.27 In terms of sales, the largest grocery retailers in the UK are the major national supermarkets (Tesco, Sainsbury's, Asda, and Morrisons), with a combined share of nearly 70% of grocery sales including in-store and online sales. As Figure 4.3 below shows (based on the 52 week period to 12 August

⁶⁸ Except that Morrisons is not present in Northern Ireland.

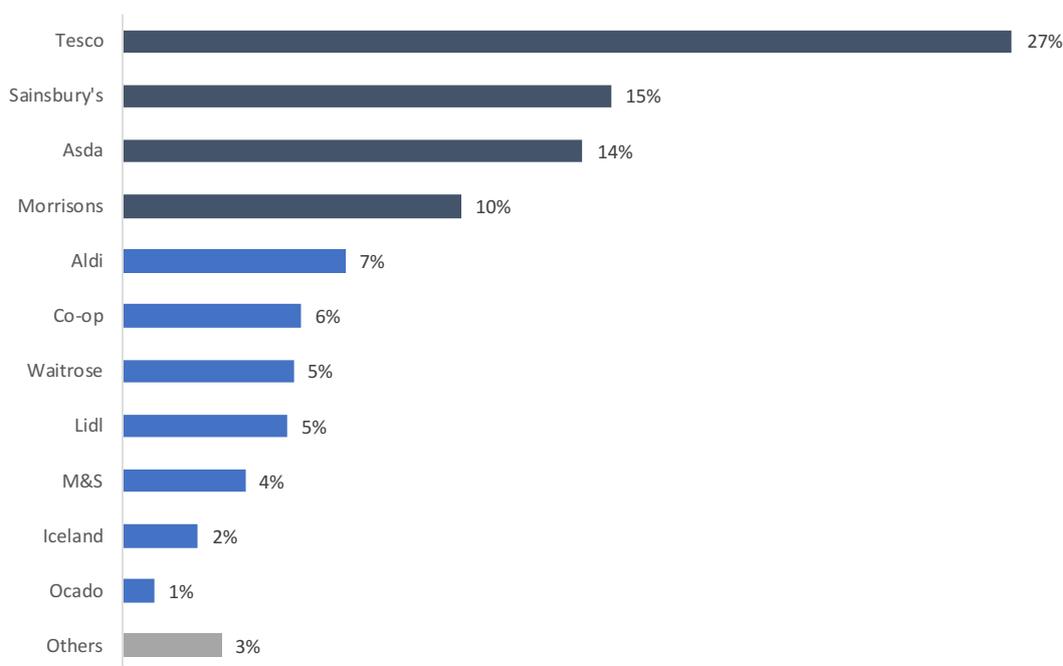
⁶⁹ The term 'Big 4' is widely used in the industry to refer collectively to Tesco, Sainsbury's, Asda and Morrisons. We use it as a shorthand in this document, but no inference should be made regarding the relevance of the use of this term to the CMA's competitive assessment of the Merger.

⁷⁰ For instance, see paragraphs 8.35(b), 8.41 and 8.42, with several examples of the use of this term by the Parties.

⁷¹ Symbol groups are collections of stores which are affiliated with a wholesale symbol group provider (the symbol group wholesaler), usually operating under a common brand or 'fascia'. The retailer is independent from the wholesaler, but generally commits to minimum purchase requirements (and other conditions which vary by wholesaler and symbol group brand), in return for use of the symbol brand and other benefits such as improved promotions.

2018), Tesco is the largest grocery retailer, 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%), the Co-op (6%), Lidl and Waitrose (each 5%), M&S (4%), Iceland (2%) and Ocado⁷² (1%).⁷³

Figure 4.3: UK grocery share of supply (online and in-store)



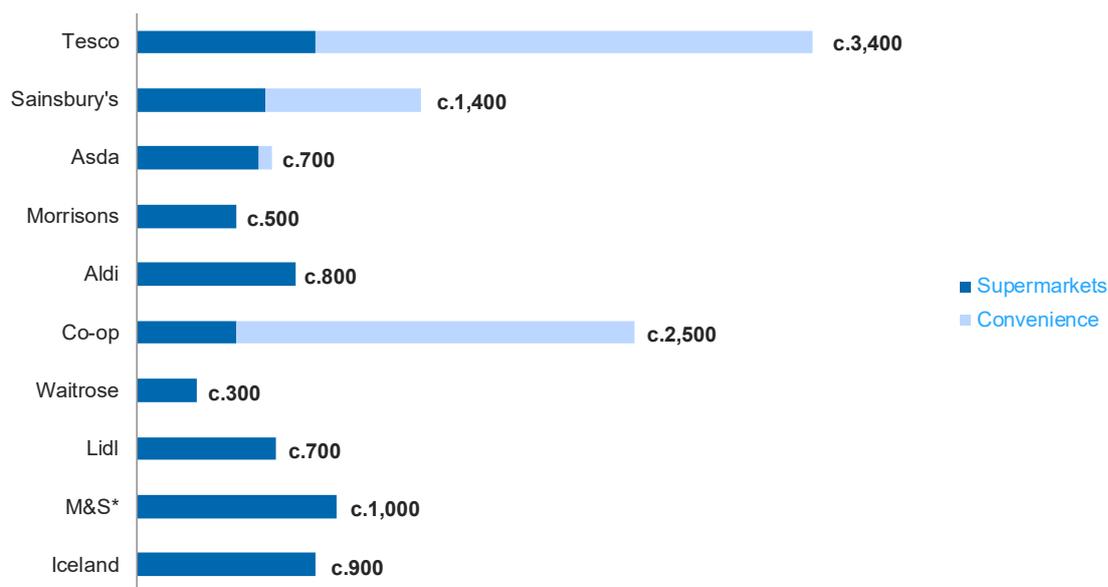
Source: Kantar, IGD, Nielsen.

4.28 Figure 4.4 shows the number of stores of the ten largest grocery retailers, split by supermarkets and convenience stores.

⁷² Note that Ocado only supplies online delivered groceries, with share based on Kantar (27 January 2018), [Grocery market share snapshot](#).

⁷³ These figures include sales in GB (Total Grocers including M&S, 52 weeks to 12 August 2018) and Northern Ireland (Kantar Worldpanel data). This has required using the relative sizes of these sectors, which we have based on IGD (5 June 2018), [UK food and grocery market to grow 14.8% by £28.2 billion by 2023](#) and Nielsen (1 September 2017), [Northern Ireland grocery market worth £3.7 billion annually](#). We note this approach excludes sales of grocery products from non-grocers such as Boots.

Figure 4.4: Number of stores for largest grocery suppliers



Source: Data from parties, CMA analysis as described below.

* M&S stores including food halls in its larger stores and the Simply Food standalone stores.

Sainsbury's

4.29 Sainsbury's is the UK's second largest grocery retailer, based on sales data for the full year to August 2018. Sainsbury's operates a network of 1,428 grocery stores (including 647 supermarkets which range from around 280 square metres to around 9,000 square metres, and 781 convenience stores), 314 PFSs and an online grocery business. In addition to selling various categories of GM in its grocery stores and online, Sainsbury's operates Argos (a multi-format GM retailer) and Habitat (a retailer of furniture and homewares). A fuller description of Sainsbury's is provided in Chapter 2.

Asda

4.30 Asda is the UK's third largest grocery retailer, based on sales data for the full year to August 2018. Asda operates a network of 641 grocery stores (including 582 stores ranging from around 450 to over 9,000 square metres and 59 convenience stores which are all attached to PFSs), 33 Asda Living stores (focused on GM products including clothing), 321 PFSs and an online grocery business, as well as selling various categories of GM in its grocery stores and online. A fuller description of Asda is provided in Chapter 2.

Tesco

- 4.31 Tesco is the largest UK grocery retailer, operating over 3,400 stores across the UK, of which approximately 2,500 are convenience stores and over 900 are larger stores/hypermarkets, the latter ranging from around 280 to over 9,000 square metres. It also operates around 500 PFSs and has the UK's largest online grocery business. In 2018, Tesco expanded its position upstream through the acquisition of food wholesaler Booker. Tesco reported over £38 billion of sales (excluding VAT and fuel) in the UK and Republic of Ireland in the financial year 2017/18.⁷⁴
- 4.32 Tesco has also recently launched Jack's, which is a cut-price brand and new format designed to offer quality British products at low prices, with some similarities to the offerings of Aldi and Lidl. Jack's will stock around 2,600 products, as compared to around 35,000 in a large Tesco. It has been reported that Tesco will open 10-15 Jacks stores in 2019 although many are expected to be on existing Tesco sites.⁷⁵

Morrisons

- 4.33 Morrisons is the fourth largest UK grocery retailer, operating almost 500 stores across GB that range in size from around 370 to 6,000 square metres and over 300 PFSs. Morrisons does not operate in Northern Ireland. Morrisons sold its M-Local convenience store network in 2015. Morrisons reported over £14 billion of sales (excluding fuel) in the UK in the financial year 2018/19.⁷⁶
- 4.34 In the last few years, Morrisons has expanded its wholesale activities: in 2017, it agreed a deal with convenience operator McColl's Retail Group to supply branded products and own label products under the Safeway brand to 1,300 convenience stores in the UK. Morrisons also provides online grocery shopping including via partnerships with Ocado and Amazon.

Co-op

- 4.35 Co-op is the sixth largest grocery retailer in the UK, with 2,065 convenience stores and 525 mid-range stores with a maximum store size of 2,000 square metres. Co-op forms part of the Co-op Group Limited, a registered society active across grocery, retail, insurance, funeral care and legal services.

⁷⁴ [Tesco Annual Report and Financial Statements \(2018\)](#).

⁷⁵ BBC (19 September 2018), [Tesco's new discount chain Jack's takes on Aldi and Lidl](#).

⁷⁶ [Morrisons Preliminary Results and Group Financial Statements 2018/19](#).

- 4.36 Co-op has also recently launched a trial online delivered groceries service, by which orders will be fulfilled using electric cargo bikes. The service will initially be available to shoppers within a four-kilometre radius of one store in Chelsea, London, before being rolled out to a further 24 stores in total by the end of June 2019.⁷⁷

Waitrose

- 4.37 Waitrose is the seventh largest grocery retailer in the UK, operating over 300 stores ranging from around 230 to over 6,750 square metres, as well as some convenience stores. Waitrose does not operate in Northern Ireland. Waitrose forms part of the John Lewis Partnership. Waitrose has traditionally focused on the quality of its products, range and consumer experience. Waitrose also sells groceries online via its own website and supplies products to Ocado. Waitrose has announced that its commercial arrangement with Ocado will come to an end in September 2020.⁷⁸

M&S

- 4.38 M&S is the ninth largest grocery retailer in the UK and operates just over 1,000 stores in the UK (including food halls in its larger stores and the Simply Food standalone stores) offering food, clothing and home products.⁷⁹
- 4.39 M&S has recently announced the creation of a joint venture (JV) with Ocado to supply online delivered groceries. Under the JV, M&S is acquiring a 50% share of Ocado's UK retail business. The JV will trade as Ocado.com but will benefit from access to M&S's brand, products and customer database from September 2020 at the latest, following the termination of the current Waitrose sourcing agreement and migration of JV sourcing to M&S.⁸⁰
- 4.40 In March 2019, M&S announced that it planned a shift towards food at its stores, to target the weekly family shop by increasing the number of its stores that offer its full range of food.⁸¹

⁷⁷ Co-op (22 March 2019), *Co-op brings home delivery closer to shoppers with launch of online service*.

⁷⁸ Waitrose (27 February 2019), *Waitrose & Partners Statement – Ocado*.

⁷⁹ Whilst most of these stores are owned and directly operated by M&S, a significant number are operated by its franchise partners.

⁸⁰ M&S (27 February 2019), *Bringing the best together: transforming UK online grocery shopping M&S and Ocado announce new joint venture*.

⁸¹ BBC (17 March 2019), *M&S plans big store shift towards weekly food shop*.

Iceland/The Food Warehouse

- 4.41 Iceland/The Food Warehouse⁸² (together, Iceland) is the tenth largest grocery retailer in the UK operating over 900 stores in the UK, and traditionally specialised in frozen food, but also sells chilled and grocery products, and GM. Iceland also offers groceries online, although its offer is more limited than other online grocery retailers (Iceland's online range comprises approximately 3,000 stock keeping units (SKUs)).

Discounters

- 4.42 As noted above, Aldi and Lidl are frequently referred to in industry reports and parlance as 'the discounters', and we adopt that term in this report. Aldi is the fifth largest grocery retailer in the UK, operating over 825 supermarkets with an average store size of just over 1,000 square metres in the UK.⁸³ Lidl is the eighth largest grocery retailer in the UK, operating over 700 stores with an average store size of 1,100 square metres.
- 4.43 Aldi and Lidl have adopted a different business model to traditional grocery retailers, focusing on:
- (a) A more limited range of products (usually around 1,800 to 2,000 compared with around 25,000 for a typical large supermarket, and excluding certain products such as tobacco) with fewer well-known brands, and using a 'when it's gone, it's gone' principle for some of their ranges.
 - (b) A standardised, lower cost proposition (eg placing pallets of product directly on the shopfloor rather than moving items onto shelves) with a lean store labour model and lower central costs. Their focus on certain key SKUs, including fresh produce, leads to a higher volume per SKU than traditional grocery retailers which also leads to lower costs.

⁸² The Food Warehouse is the concept launched by Iceland in September 2014, which consists of larger format stores offering extended range (including a broad range of groceries as well as homeware, electrical goods and other general merchandise) and usually located in out of town-centre locations. There are 91 Food Warehouse stores in the UK.

⁸³ The Guardian (1 October 2018), [Aldi vows to take on Jack's as UK sales top £10 billion for first time](#). In the course of our inquiry, Aldi informed us that it intends to trial a new store format which would have 582 square metres of retail space, be bound by Sunday trading laws and sell the Aldi standard range with only product duplications and bulky lines removed. A small price increase on a selected number of existing Aldi products would also be trialled. On 14 March 2019, an 'Aldi Local' store opened in Balham, London (Retail Gazette (20 March 2019), [Aldi launches new 'Local' concept store in South London](#)).

- (c) Smaller stores with no additional services (eg no PFSs, no in-store amenities such as cafes, fish or meat counters, etc) which leads to higher sales volumes per square metre.
- (d) Lower prices than traditional grocery retailers. For instance, Aldi aims to maintain a price discount of at least 15% on a typical basket of everyday items compared to the so-called 'Big 4' grocery retailers.⁸⁴

Bargain stores

4.44 Other retailers which are also sometimes referred to in the context of the groceries sector are the so-called 'Bargain stores' which supply particular categories of groceries, such as household, health and beauty, and petcare. These companies are sometimes referred to as 'variety discounters' in industry reports. This includes B&M Bargains, Home Bargains, Poundland, Poundworld, and Wilko. These retailers have been growing in recent years although they remain a very small proportion of the overall groceries sector.

Online delivered groceries

4.45 As noted above, online sales in the groceries sector have been growing strongly in recent years, although online delivered groceries still account for a small proportion of all groceries sold in the UK.⁸⁵ However, the ability to make purchases online has not yet had the same impact on grocery retailing as it has in certain GM sub-categories such as toys, electrical goods and clothing where online penetration has reached higher levels.

4.46 A number of UK grocery retailers offer an online service, where a customer can order groceries through the internet to have them delivered directly to their home (or other location) within a specified timeslot. The range of groceries offered is generally the same as products sold in-store, as is the price of the individual products.

4.47 There is typically an additional fee for each delivered service, although this may be reduced or removed entirely in some circumstances (eg if the basket being purchased is above a certain value, or if the customer has bought a 'delivery pass' whereby they paid an upfront fee in return for reduced or zero delivery charges, or if they have a voucher for free delivery).

4.48 There are two main models used to deliver online groceries:

⁸⁴ The Guardian (1 October 2018), [Aldi vows to take on Jack's as UK sales top £10 billion for first time](#). See also: [Summary of hearing with Aldi](#) (7 November 2018), paragraph 6.

⁸⁵ As noted in footnote 59 above there is some indication that this growth may be slower than historically.

- (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 CFCs in combination with store-pick.

- 4.49 The online sale of groceries has grown by around 13% per year since 2010 to represent around 6% of all grocery sales,⁸⁶ with all retailers continuing to expand their sales. IGD data indicates that in 2017, 90% of online groceries were supplied by four retailers: Tesco ([40–50%]), Asda ([10–20%]), Sainsbury's ([10–20%]) and Ocado ([10–20%]).⁸⁷
- 4.50 Most traditional grocery retailers sell a broad range of groceries online including Tesco, Sainsbury's, Asda, Morrisons, Waitrose and Iceland.⁸⁸ They primarily use the 'store-pick' model (see paragraph 4.48 below). Aside from the sale of alcohol by Aldi, the discounters do not sell online delivered groceries in the UK.
- 4.51 Ocado is the largest online-only grocery retailer (it does not have any physical stores that customers can visit) in the UK. It entered the sector in 2000 and now has three CFCs from which it supplies most of central and southern England. Ocado's retail revenues for the 2018 financial year were £1.48 billion.
- 4.52 Amazon sells groceries online in the UK through:⁸⁹
- (a) Amazon Pantry which was launched in November 2015 and which offers ambient grocery products (ie not chilled or frozen) for delivery throughout the UK for a flat delivery fee;
 - (b) Amazon Prime Now which offers a range of grocery products for free same day delivery (over a certain basket size) in certain locations across the UK; and

⁸⁶ See Figure 4.1 above.

⁸⁷ We note that other data provided by the Parties indicates a combined share varying between 70% and 90%: Kantar = 91%; IGD = 90%; Competitor performance tracker = [80–90%]; Mintel = 70%.

⁸⁸ As noted above, Co-op has recently launched online delivered groceries services from one of its stores (see paragraph 4.36) and M&S has announced its JV with Ocado by which M&S's products will be available on Ocado.com from September 2020 (see paragraph 4.39).

⁸⁹ Whole Foods Market, which has a common parent company with Amazon, has seven physical stores in the UK. More detail on Amazon's plans for online groceries is provided in Appendix H.

- (c) AmazonFresh which was launched in June 2016 and is primarily available in and around London. Amazon told us its AmazonFresh service offered around 20,000 SKUs, including a broad range of fresh food, frozen food and other grocery items.

General merchandise (GM)

- 4.53 GM can include a range of non-food categories and products, including: toys; homewares; white good electrical items; brown good electrical items; grey good electrical items; small domestic electrical appliances; nursery and baby; seasonal; DIY and garden; clothing; stationery; electronic games and entertainment; furniture; and financial services.⁹⁰
- 4.54 Sainsbury's offers GM through Argos and through its grocery stores. Asda sells GM primarily through its grocery stores but also through a small number of 'Asda Living' stores. By offering GM alongside their grocery proposition, supermarkets are able to fulfil a larger number of customer needs. This also allows for cross-selling between GM and grocery. The Parties' transaction data indicate that for Asda [20–30%] of all baskets contain both GM and grocery, and for Sainsbury's [10–20%].⁹¹ Non-grocery accounts for [5–10%] of store sales (excluding fuel) for Sainsbury's and [10–20%] for Asda. Both Asda and Sainsbury's also supply GM online.
- 4.55 GM is particularly important in larger supermarkets which have more space and so can accommodate a wider range of products.⁹² Other grocery retailers such as Tesco, Morrisons and Waitrose also supply a range of GM in their larger stores and online. Aldi and Lidl offer different types of GM at different times of the year on a 'when it's gone, it's gone' basis but do not have the same permanent range as the traditional grocery retailers.
- 4.56 The list of competitors, and associated shares of supply, for the different categories and products of GM varies significantly and will be considered in more detail in Chapter 13 below.

Fuel

- 4.57 Some grocery retailers (including all of the 'Big 4') sell fuel (ie petrol, diesel, and LPG from PFSs, which are generally located next or close to the

⁹⁰ Anticipated merger between J Sainsbury Plc and Asda Group Ltd (19 September 2018), [Phase 1 decision](#), paragraph 3.

⁹¹ [Parties' response to the Issues Statement](#), paragraph 164.

⁹² For example, GM makes up around [0–5%] of sales for the smaller 'Sainsbury's Local' stores, and around [10–20%] for other Sainsbury's stores.

supermarket. The other providers of fuel are the oil majors (eg Shell, BP, etc) and independents (eg the Motor Fuel Group, Rontec, Euro Garages as well as many smaller groups).

- 4.58 PFS sites are often franchised, resulting in a distinction between the owner and the operator. This results in three main categories of PFS:
- (a) Company owned, company operated – these are owned and operated by oil majors.
 - (b) Company owned, dealer operated – these are owned by an oil major which supplies the fuel but operated by an independent dealer. Usually, the oil company takes fuel pricing decisions while the dealer manages the daily operations.
 - (c) Dealer owned, dealer operated – these are owned and operated by non-oil companies (although many still license an oil company brand). This includes all supermarkets' PFSs.
- 4.59 According to the Parties' estimates, the largest number of PFSs by brand are those of the major oil companies, including BP (c.1,250 sites), Esso (c.1,150 sites), Shell (c.1,050 sites) and Texaco (c.750 sites). However, around three-quarters of these are owned and controlled by other third parties.
- 4.60 According to Experian Catalist data, Tesco has around 500 PFSs, while the other 'Big 4' supermarkets (including the Parties) have around 300 sites each. However, on average each of these supermarket sites supplies substantially higher volumes of fuel than the sites of the oil majors or other independent PFSs. Therefore, despite owning an estimated 18% of sites, the 'Big 4' supermarkets supply around 44% of fuel in the UK.
- 4.61 Fuel prices are generally set at a local level (ie they may differ for each PFS). Supermarkets sell their fuel as part of their overall proposition to attract customers, and so are often local price-leaders as a result.⁹³ From the retailer's perspective, the PFS customers that also shop in the grocery store have a positive impact on grocery volumes which is part of the reason why supermarkets choose to operate PFSs adjacent to their stores. Fuel sales account for [20–30%] of total store sales for Sainsbury's ([10–20%] across all stores including those with no PFS) and [10–20%] for Asda ([5–10%] across all stores including those with no PFS).

⁹³ For example, the AA estimated that supermarket prices were 3.7ppl lower than the UK average for unleaded petrol in December 2018 (AA: [Fuel price reports](#)).

- 4.62 In addition to fuel sales, PFSs will often have other associated services available (such as car washes, kiosk sales, etc).
- 4.63 The Parties submitted that local fuel markets tend to be intensely competitive, which is reflected in low industry margins, and the vast majority of price variations observed over time are driven by changes in commodity costs.⁹⁴

5. Market definition

- 5.1 The purpose of market definition is to provide a framework for our analysis of the competitive effects of the merger. The relevant market (or markets) is the market within which the merger may give rise to an SLC and contains the most significant competitive alternatives available to the customers of the merged companies. Defining relevant markets is therefore useful in identifying, in a systematic way, the immediate competitive constraints facing the merged entity. Market definition is a useful analytical tool, but not an end in itself, and identifying the relevant market involves an element of judgment and does not prevent us taking into account constraints outside the relevant market (or markets) in our competitive assessment.⁹⁵
- 5.2 We consider market definition to be an important starting point for our analysis of the competitive effects of a merger. We therefore start by assessing the relevant product and geographic markets. We examine demand-side and supply-side substitutability and also, where appropriate, whether markets can be segmented.
- 5.3 Given the theories of harm that have been considered in this inquiry, we have investigated market definition in relation to four areas of the Parties' operations:
- (a) the retail supply of groceries in-store;
 - (b) the retail supply of online delivered groceries;
 - (c) the retail supply of GM; and
 - (d) the retail supply of fuel.
- 5.4 Our assessment of market definition in respect of those areas is set out in Chapters 7 to 14.

⁹⁴ Parties' response to the Issues Statement, paragraph 41.

⁹⁵ CC2 Revised, paragraphs 5.2.1 and 5.2.2.

6. Assessment of competitive effects: overview

6.1 In this section we:

- (a) outline the theories of harm we have considered;
- (b) outline our general approach to assessing the theories of harm;
- (c) describe our approach to assessing any interrelations between the Parties' activities; and
- (d) outline the information and evidence we have gathered;

Outline of the theories of harm considered

6.2 Theories of harm describe the possible ways in which an SLC could arise as a result of a merger and provide the framework for our analysis. We have identified and assessed the following theories of harm related to specific markets, which we have grouped into five areas.

- (a) In-store groceries:
 - (i) Horizontal unilateral effects at both the national and the local level.
 - (ii) Coordinated effects.
- (b) Online delivered groceries:
 - (i) Horizontal unilateral effects at both the national and the local level.
 - (ii) Coordinated effects.
- (c) GM – horizontal unilateral effects at the national level.
- (d) Fuel – horizontal unilateral effects at both the national and the local level.
- (e) Buyer power theories of harm, including both the effect on innovation and the effect on rivals' purchasing costs (the 'waterbed effect').

6.3 Of the above theories of harm, those listed in paragraph 6.2(a) to 6.2(d) examine how the horizontal overlap between the Parties' activities (ie the fact that they are both active in the same sector, at the same level of the supply chain) may result in a SLC in the markets in which they operate following the Merger.

- 6.4 The theories of harm listed in paragraph 6.2(e) examine how the Merger may affect the Parties' relationship with their suppliers, and the knock-on effects for competition.
- 6.5 We describe these theories of harm in more detail in the later chapters. In this chapter, we explain in general terms how each of these theories of harm operates, and our approach to assessing them. Further details can be found in the CMA's 'Merger Assessment Guidelines' (the Guidelines).⁹⁶
- 6.6 In each of the unilateral and coordinated effects theories of harm, we consider whether the Merger could lead to the Parties (and in the case of the coordinated effects theories of harm, also certain other grocery retailers) increasing prices, or worsening non-price aspects of their offering such as quality, range or service (collectively, we refer to these price and non-price factors as 'PQRS') relative to the counterfactual. By 'worsening' we also capture a situation where absent the Merger, as a result of competition, the Parties would have improved some aspect of PQRS, but post-Merger, given a lessening of competition, do not improve it such that overall the Merger results in a degradation compared to what would have happened otherwise. In each case, we have considered whether this deterioration would apply to elements of PQRS that are set centrally and applied uniformly across the Parties' stores/PFSs, such that all of the Parties' stores/PFSs would be affected (national assessment) or to elements of PQRS that are varied across local areas, such that only certain of the Parties' stores/PFSs would be affected (local assessment).⁹⁷

Approach to assessing theories of harm

Horizontal unilateral effects theories of harm

- 6.7 Horizontal unilateral effects can arise when one firm merges with a competitor that previously provided a competitive constraint, the loss of which allows the merged entity profitably to increase prices, lower quality, reduce the range of their services and/or reduce innovation (relative to the situation that would have existed absent the merger). After the merger, it is less costly for the merged entity to raise prices (or lower quality, range or service)

⁹⁶ [CC2 Revised](#).

⁹⁷ When considering this, we have examined whether: (a) the Parties currently set some aspects of their retail offer with regard to local competitive conditions; and (b) if the Parties do not currently set their retail offer with regard to local competitive conditions, whether they would have an incentive to do so post-Merger ([Retail mergers commentary \(CMA62\)](#), paragraph 1.5).

because it will recoup the profit on recaptured sales from those customers who switch to the offer of the other merging company.

- 6.8 Under such theories, the harm arises as a result of the merged entity acting unilaterally, ie independently of others in the market. In response, competitors of the merged entity may also, unilaterally, increase their prices or otherwise worsen their offering (known as ‘second order effects’), which may lead to further consumer harm.
- 6.9 We assess these horizontal theories of harm by considering how important a competitor of one of the merging parties is to the other, or was likely to become in the foreseeable future, relative to other competitive constraints in the market; and whether the removal of that constraint is likely to lead to a substantial lessening of competition and thus worse outcomes for consumers.

Coordinated effects theories of harm

- 6.10 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 outcome if they coordinate or align their behaviour, to limit their rivalry.
- 6.11 Under such theories, the harm arises as a result of the merged entity and others in the market jointly aligning their behaviour.
- 6.12 Coordination can be explicit or tacit. Explicit coordination is achieved through communication and agreement between the parties involved. Tacit coordination is achieved through implicit understanding between the parties involved, but without any formal arrangements or direct communications.
- 6.13 Coordinated effects arise when a merger makes coordination more likely or more effective. This behaviour does not require any direct contact between firms and can arise purely from firms’ perception of the interdependence between them. Our focus is not on any explicit or illegal agreement to coordinate between grocery retailers but rather on whether the Merger could make it easier for grocery retailers to coordinate or align their behaviour in a way which limits the rivalry between them without entering into any express agreement or direct communication.

6.14 We set out further details on the CMA's approach to assessing coordinated effects, as set out in the Guidelines,⁹⁸ in Chapters 9 and 12.

Buyer power theory of harm

6.15 Where the merging parties purchase the same products, the merged firm may enjoy greater buyer power than the merging parties could previously exert individually.

6.16 For the purposes of our competitive assessment, we would be concerned by an increase in the buyer power of the merged entity only to the extent that it may distort competition in the relation to the supply of groceries and result in adverse effects on end-consumers.⁹⁹ In and of itself, a reduction in the profitability of suppliers does not give rise to an SLC.

6.17 We have considered two theories of harm regarding buyer power:

- (a) the exercise of increased buyer power by the Merged entity might result in reduced incentives to invest and innovate on the part of suppliers; and
- (b) the exercise of increased buyer power by the Merged entity might raise the purchasing costs of rival grocery retailers, which, under certain circumstances, may result in price increases to certain end-customers of those retailers.

Interrelation between the Parties' activities

6.18 For the purposes of our assessment, we have examined the effect of the Merger under a number of distinct theories of harm, related to distinct activities or product areas where the Parties overlap.

6.19 Nevertheless, we are aware that there are important interrelations between these different areas of overlap. Customers may purchase a number of the Parties' products in combination, and may take this into account when making their purchasing decisions: for example, a customer may choose to buy groceries at a supermarket where they can also fill up their car with fuel. The Parties, too, may consider their activities across a number of product areas when setting their commercial strategy in any one product area: for example, they may set low prices for one category of products, so as to draw in customers who may then purchase another category of products, or they

⁹⁸ [CC2 Revised](#).

⁹⁹ This is the approach prescribed in [CC2 Revised](#) (paragraph 5.4.19), and followed in the Groceries market investigation (30 April 2008), [Final report](#), paragraph 9.3 and the Tesco/Booker merger inquiry (20 December 2017), [Final report](#), paragraph 8.10.

may use the customer experience in one channel (eg online/in-store) as a way of influencing customers' perception of the company's overall brand proposition.

- 6.20 We have taken these interdependencies into account in our investigation and considered how the Parties' activities across all markets in which they operate may influence the effect of the Merger on competition in any one market. We have done this for example by considering: what our fuel¹⁰⁰ and store exit¹⁰¹ surveys tell us about the extent to which customers buy fuel and groceries in a single shop, and how that affects customers' purchasing decisions; and how in turn the fact that increased (or lost) sales in one part of their business may affect sales in another part of their business, and how this may affect the Parties' commercial incentives overall.

Overview of information and evidence gathered

- 6.21 In our phase 2 inquiry we have gathered and used a broad range of evidence. We have:
- (a) commissioned three surveys: one, interviewed over 20,000 of the Parties' customers at 100 of their grocery stores across the country; another, over 30,000 of the Parties' customers of online delivered groceries and the third, almost 8,000 of the Parties' fuel customers at 32 of their PFSs;¹⁰²
 - (b) received submissions, internal documents, analysis and commercial data from the Parties and their advisors, and held several meetings and hearings with them;¹⁰³
 - (c) received submissions, internal documents, analysis and commercial data from a range of industry participants. This included: responses to written questionnaires (as well as formal and informal requests for information); and telephone interviews and hearings, with grocery suppliers, grocery retailers, GM retailers, fuel retailers, trade bodies and consumer groups, and independent investment analysts and market research companies. We received responses to our questionnaires from 74 suppliers,

¹⁰⁰ [DJS Research report: petrol filling stations](#) (CMA fuel survey) (21 February 2019).

¹⁰¹ [Kantar Public consumer research: findings from the store exit survey](#) (CMA store exit survey) (21 February 2019).

¹⁰² [Kantar Public consumer research: findings from the store exit survey](#); [GfK research report](#) (CMA online survey); [DJS Research report: petrol filling stations](#) (21 February 2019).

¹⁰³ These include, among others, hearings with the Parties' advisers [the consultant] and [the third party]. Each of these hearings was focused on the Parties' submissions on efficiencies.

12 grocery retailers, 31 GM retailers; 10 fuel retailers and held 14 hearings in-person or by telephone; and

(d) received responses to our Issues Statement,¹⁰⁴ Provisional Findings,¹⁰⁵ and throughout the investigation, from members of the public.

7. In-store groceries: overview

Introduction

- 7.1 As set out in Chapter 4, each of the Parties is a large-scale, national operator of a grocery chain. They operate under national brands; they advertise at a national level; and important elements of their offering, such as pricing, quality and overall brand positioning, are uniform across their national estates. Customers have an affinity (or at least familiarity) with the Parties' brands (and those of other national grocery retailers) and with the in-store shopping experience they offer.
- 7.2 The Parties operate complex, multi-product businesses, with considerable operational integration across business lines (in particular, between in-store groceries, online delivered groceries and fuel); sophisticated distribution and logistics systems, which are optimised to the current configuration of the Parties' store networks; and centralised buying teams which are purchasing at scale. Key decisions on important competitive parameters (especially price, but also aspects of ranging, product quality and service levels) are taken centrally, and applied uniformly across all stores, nationally.
- 7.3 Customers shop locally, choosing from the available options in their local area. The national scale of the Parties, however, contributes to making the Parties effective competitors in each of the local areas in which they operate. In turn, the competitive conditions which the Parties face in each of those local areas feeds up to, and drives, the decisions taken at a national level by the Parties regarding their competitive strategy.
- 7.4 In this chapter, we discuss the relevant market(s) for the retail supply of in-store groceries, considering first the relevant market definition for supermarkets (stores over 280 square metres, encompassing both Medium and Large stores) and then for convenience stores (stores under 280 square metres). We note that market definition is an analytical tool and not an end in itself, and the boundaries of the market definition do not determine the

¹⁰⁴ [Issues Statement](#) (16 October 2018).

¹⁰⁵ [Provisional Findings](#) (20 February 2019).

outcome of the analysis of the competitive effects of a merger in any mechanistic way.¹⁰⁶ In this case, the relevant market has been defined primarily to determine the framework and parameters of the weighted share of shops (WSS) model used to conduct our local assessment. As set out above, we assess the effect of the Merger (and any reduction in competition) on the Parties' conduct at a national level, and thereby in every local market where either Party operates a store, as well as in individual local markets where the Parties overlap.

- 7.5 In this chapter, we then discuss which parameters of competition the Parties flex at the local level and so may vary from one local market to another, and which parameters they set centrally and apply uniformly across all stores, and so apply nationally in every local market. This is relevant to assessing: first, whether any harm arising from the Merger may be expected to arise in only certain local areas (if there was no prospect of local flexing, then there would not be any need to assess whether any harm will arise in certain local areas and not others, as any effect of the Merger would be expected to apply across all of the Parties' stores nationally); and second, how any harm that may arise from an SLC finding in a particular local area would materialise. We also discuss the interaction between the Parties' different business lines and, in particular, whether the Parties' ability to offer additional products and services on-site such as GM and fuel has an impact on their supply of in-store groceries.

Market definition

Product market (supermarkets)

- 7.6 The Parties both supply groceries through physical grocery stores ('in-store groceries'). Sainsbury's operates approximately 1,400 grocery stores of varying sizes, approximately 800 of which are convenience stores. Asda operates a network of around 650 grocery stores, the vast majority of which are mid-sized and larger supermarkets (it also operates 59 convenience stores located at PFSs).^{107,108}

¹⁰⁶ *CC2 Revised*, paragraph 5.2.2.

¹⁰⁷ See paragraphs 4.29 and 4.30.

¹⁰⁸ The Parties both also offer 'Click and Collect' services, whereby groceries are purchased online and collected in-store by the customer. Given that Click and Collect services are part of the service offered at some stores, and that location of the physical stores is important for the provision of these services, we do not consider Click and Collect services to be a separate relevant market, and as such, we have assessed them within the retail supply of in-store groceries.

Previous cases

- 7.7 The CMA (and its predecessor bodies) have conducted a number of investigations into mergers involving grocery retailing in recent years.¹⁰⁹ In these cases, the CMA has analysed competitive constraints between grocery stores according to the size of their net sales areas and has distinguished between three sizes of grocery store:
- (a) One-stop shops (greater than 1,400 square metres), which for the purposes of this report we refer to as Large stores;
 - (b) mid-sized stores (280 to 1,400 square metres), which for the purposes of this report we refer to as Medium stores; and
 - (c) convenience stores (under 280 square metres), including both large convenience stores (100 to 280 square metres) and small convenience stores (under 100 square metres).
- 7.8 In these previous cases, the CMA (and its predecessor bodies) have found that the competitive constraint faced by such stores is asymmetric, in that Large stores will constrain a smaller store (ie Medium or convenience stores), but not vice versa.
- 7.9 The reasoning behind this delineation by store size has been that shoppers may not consider smaller stores to be good substitutes for larger stores, on the basis that they may not supply the full range of products or associated amenities (eg car parking, toilets, ATMs, cafés or PFSs) which a larger store is able to offer, and therefore may be unable to cater for shopping missions that involve a wider range of products.¹¹⁰
- 7.10 According to the evidence in these previous cases, there is a strong relationship between store size and product range for stores with a net sales area larger than 280 square metres. This relationship between store size and product range supported the view that customers may not find stores with

¹⁰⁹ Including (within the last five years), Anticipated acquisition by Co-operative Group Ltd of Nisa Retail Ltd (ME/6716-17) (23 April 2018), [Phase 1 decision](#); Completed acquisition by Henderson Retail Limited of part of the Martin McColl Limited portfolio (ME/6716-17) (16 February 2018), [Phase 1 decision](#); Tesco/Booker merger inquiry, [Phase 1 decision](#) (21 July 2017) and [Final report](#) (20 December 2017); Anticipated acquisition by Martin McColl Ltd of 298 groceries stores from Co-operative Group Ltd (ME/6632/16) (20 December 2016), [Phase 1 decision](#); Completed acquisition by Co-operative Foodstores Limited of eight My Local grocery stores from ML Convenience Limited and MLCG Limited (ME/6625/16) (19 October 2016), [Phase 1 decision](#); Anticipated acquisition by Co-operative Foodstores Limited of 15 Budgens grocery stores from Booker Retail Partners (GB) Limited (ME/6588/16) (6 June 2016), [Phase 1 decision](#); Completed acquisition by Netto Limited of three grocery stores from Co-operative Group Limited (ME/6529-15) (25 February 2016), [Phase 1 decision](#). A very significant amount of analysis relating to supermarket groups was also carried out in the [Groceries market investigation](#) (2008); [Safeway merger inquiry](#) (2003); and [Supermarkets investigation](#) (2000).

¹¹⁰ Groceries market investigation (30 April 2008), [Final report](#), paragraph 4.55.

less floorspace an effective substitute for stores with more floorspace due to their smaller range of products.¹¹¹

Parties' views

7.11 The Parties submitted that all of their Large and Medium stores are constrained by other grocery stores of all sizes, discounter stores, online grocery retailers, bargain stores, convenience stores, independent and specialist retailers (eg butchers, bakers and greengrocers), stores outside the geographic catchment area, and food delivery specialists (eg Just Eat, Deliveroo), subscription meal kits and prepared food specialists.

Store size

7.12 The Parties submitted that the CMA should reconsider the delineation used in previous merger cases involving grocery retailing. They submitted that excluding Medium stores as a constraint on Large stores was no longer appropriate and that the market definition should comprise at least all 'supermarkets' (ie all grocery stores larger than convenience format, whether Medium or Large stores), whilst also including additional constraints such as online grocery retailers and stores outside of the geographic catchment area.

7.13 The Parties recognised that there are limited data points available on which to calibrate any specific approach with respect to store size. The Parties therefore suggested we should adopt the CMA's traditional classification boundary of 1,400 square metres, but calibrate the weights attributable to stores in the categories above and below that boundary (ie Large stores and Medium stores) to reflect the average competitive constraint within that store size category.

7.14 In support of this argument, the Parties explained that market developments have had a significant impact on larger format stores, with the largest stores particularly struggling in light of the increased emphasis on convenience and smaller shopping missions. The Parties also noted that convenience stores continue to grow in number, whilst the Large stores opening programmes of traditional retailers have effectively ceased. According to the Parties, economic evidence shows that Medium stores can and do constrain Large stores: the Parties noted that the results of their surveys, their respective internal 'impacts' analyses, the Parties' gravity models and econometric analysis of competitor entry and exit events, all show that Medium stores place a material constraint on Large stores. The Parties also noted that, on a

¹¹¹ Groceries market investigation (30 April 2008), [Final report](#), paragraph 4.22.

like-for-like floor space basis, Medium stores exert a larger impact on Large stores given that smaller stores generally have a greater sales density per square metre, and as such, the aggregate constraint of two identically sized Medium stores is greater than the constraint of one Large store that is twice as large as each of the two Medium stores.

Discounters

- 7.15 In relation to discounters, the Parties submitted that the significant and growing proportion of UK shoppers shopping at Aldi and Lidl evidences their mainstream appeal, having increased their combined market share from 3.8% in 2007 to 11.1% in 2018 (up to 11.4% based on the latest Kantar data, being the 12 week period to 24 March 2019).¹¹² According to the Parties, Aldi and Lidl offer a sufficient range for most shopping needs and missions, and they compete closely with the traditional retailers for large baskets and main shops. The Parties submitted that Aldi and Lidl's strength is intrinsically linked to the changes that have taken place in the last decade or so with respect to how customers shop, as industry statistics show that big weekly shops have now fragmented into several grocery trips, with customers shopping in a variety of different retailers, and Aldi and Lidl are part of the enlarged mainstream set of grocery stores used by UK customers for these shopping needs.

Online delivered groceries

- 7.16 The Parties submitted that the supply of online delivered groceries does not constitute a separate market and that the in-store groceries channel, accounting for 94% of retail supply, competes closely with the online channel (6% of supply). According to the Parties, both in-store and online grocery channels serve the same customer demand and offer the same products. The Parties submitted that survey and customer switching data suggests that online delivered groceries are constrained by the presence of in-store groceries in every area in which the Parties deliver.

Bargain stores

- 7.17 The Parties submitted that 'bargain stores' (including B&M, Home Bargains, Wilko, Poundland and Poundstretcher) have been attracting increasing

¹¹² The Parties also submitted that based on the 12 week period to 24 March 2019 (GB only, Grocery market share snapshot), Aldi now has a higher market share than Morrisons by volume. However, we note that this data has not been adjusted as set out in footnote 73: it therefore includes GB only, and does not include M&S, as this is the basis on which Kantar quotes this data. In addition, since this is not an annual figure, it is not fully representative of the market shares of the companies.

numbers of UK shoppers. According to the Parties, Nielsen data shows that bargain stores have significant shares in certain branded grocery product categories, and therefore represent a significant constraint for branded products. The Parties also noted that bargain stores are a growing constraint and gave the example of B&M opening more than 200 stores in the past five years with an ultimate store target of 950.

Convenience stores

- 7.18 The Parties submitted that shopping habits have evolved and customers in aggregate are now more likely to do smaller 'main' shopping trips for key items, topping-up with (fresh) items as needed through the week. According to the Parties, this has resulted in an exponential growth of convenience shopping options and grocery retailers have been investing heavily in the convenience format to ensure that they are aligned with short-term meal planning and more flexible consumption occasions, such that convenience retailing is now the second fastest growing channel in food and grocery retail, after online.

Others

- 7.19 The Parties submitted that competitive pressures from food chains, food service and food delivery specialists (such as Just Eat, Deliveroo and UberEATS) are also likely to increase. According to the Parties, the constraint from these players may not be on par with the numerous grocery rivals of the Parties but their growth contributes to the leakage of sales away from home-prepared lunch and evening meals and thus supermarkets.
- 7.20 The Parties also submitted that their Medium and Large stores are constrained at a local level by specialist grocery retailers (including bakeries, butchers, fishmongers, greengrocers, health food shops and off-licences).

Third parties' views

- 7.21 The Parties stated that third party views submitted to the CMA in this investigation, in particular by Tesco and Aldi, were inconsistent with statements made by the same retailers in earlier inquiries or in public statements. They submitted that their competitors had a clear commercial incentive to object to the Merger (on the basis that it will narrow the cost gap and competitive advantage that at least Tesco, Aldi and Lidl enjoy, and result in a dynamic market-wide increase in competition) which affects the extent to which these views can be relied upon.

- 7.22 We acknowledge that different retailers will have different incentives when engaging with the CMA, and that views submitted by third parties (as with all evidence, including that of the Parties) should be carefully evaluated in light of all of the available evidence. We note, however, that a retailer's statements in previous inquiries and public statements must also be carefully evaluated, as these too will have their own motivations. We have taken this into account when considering the views of third parties and the weight that can be placed on them.

Store size

- 7.23 Third parties generally indicated that the store-size delineation used by the CMA in previous cases involving Large and Medium stores was an appropriate starting point for its analysis in this case. Tesco, Morrisons, Aldi, Lidl, M&S and Waitrose suggest that Medium stores exert a lower competitive constraint on Large stores compared to other Large stores. M&S noted that distinctions between different types of shopping mission and different types of store had become more blurred in recent years, such that some shoppers may be willing to substitute some parts of their shopping demands between different store sizes (eg substituting parts of their 'main shopping basket', traditionally purchased at larger stores, to top-up or convenience purchases in smaller stores). However, it also submitted that this trend should not be over-exaggerated, indicating that for customers of Large stores, the next best alternative remained another Large store.

Discounters

- 7.24 Third parties generally indicated that discounters have a different offering compared to that of traditional grocery retailers, and that they offer a smaller range.
- 7.25 The discounters generally emphasized that they had a very different offering to the traditional retailers, and that they did not compete with them for all products or for all customers. Aldi highlighted as differences between Aldi and the 'Big 4' retailers: smaller average store size; more limited range of products offered; lower proportion of items on promotion; lower staffing level (due to a leaner operating model) and significantly higher range of own-branded products (designed to keep complexity and costs to a minimum). Aldi noted that customers may however choose to use a combination of retailers: for example, customers may source their core grocery needs from a discounter like Aldi to maximise value for money, but visit a 'Big 4' retailer to supplement this with products from their more extensive range. As a result,

Aldi submitted that it competed with the 'Big 4' retailers for a share of customer spend for some customers.

- 7.26 However, we also note that in their public statements, both discounters have claimed that more customers are doing their main shop at their stores.¹¹³
- 7.27 Tesco, Morrisons and Waitrose noted that discounters compete with traditional retailers but that there are some differences in terms of store environment, breadth of range and level of customer service, and as such they are not full effective competitors to the Parties. Tesco submitted that the discounters only compete with traditional retailers over a small share of the range, meaning that 'they are not yet a full substitute' for customers, while Morrisons submitted that while competition from discounters had had an effect on traditional retailers' pricing of commodity items, their effect had been limited beyond this due to their different position. However, we also note that in previous submissions to the CMA (ie the Tesco/Booker merger inquiry),¹¹⁴ Tesco submitted that the discounters (and also Iceland) were effective competitors across all customer missions.¹¹⁵ In that case, Tesco submitted that it had made several significant commercial decisions to respond to the competitive threat of discounters and Iceland and that the strong competitive pressure exerted by discounters had resulted in Tesco (and other retailers) significantly changing their offering to consumers.¹¹⁶ In public statements, Morrisons has also acknowledged that consumers have started to shop at the discounters in the same way they would at a traditional supermarket.¹¹⁷
- 7.28 Co-op and Iceland made a reference to the direct impact of discounters on the Parties' competitive offering and commercial strategy. These third parties stated that a focus for Asda has been on competing on price with discounters and seeking to offer the lowest possible prices. Iceland also noted that they expect the Parties to improve their fresh food offering in response to the discounters' efforts in this area. [Another competitor] noted that both Sainsbury's and Asda had indicated an aim to close the price gap relative to the discounters, although this third party noted that the discounters retained a strong price advantage.

¹¹³ BBC (27 September 2017), [The man driving Aldi's remarkable growth](#); Lidl Press Release (2016), [Lidl beats Waitrose to be named Good Housekeeping Supermarket of the Year 2016](#).

¹¹⁴ [Tesco/Booker merger inquiry](#) (2017).

¹¹⁵ Tesco/Booker merger inquiry (2017), [Tesco/Booker response to phase 1 decision and issues statement](#), paragraph 3.18.

¹¹⁶ Tesco/Booker merger inquiry (2017), [Tesco/Booker response to phase 1 decision and issues statement](#), paragraph 3.16.

¹¹⁷ Morrisons (13 March 2014), [News Release: Preliminary results for the year ended 2 February 2014 and strategic update](#).

- 7.29 M&S and Booths also noted that, in the last few years, there has been a change in grocery retailing linked to the growing strength of discounters. According to M&S, this change means that discounters have moved ‘value’ associations towards them and away from other retailers such as Asda and Tesco.

Online delivered groceries

- 7.30 Third parties submitted different views on the degree to which the online groceries channel constrains in-store delivered groceries and vice versa. Ocado and Amazon (both online-only retailers) noted that there was a single grocery market segment that encompassed both online and in-store channels. Co-op, Iceland and Lidl submitted that online delivered groceries constrain in-store groceries and vice versa to some extent. Morrisons noted that online delivered groceries provide only a limited constraint to in-store groceries since customers use the two channels for predominantly different shopping missions. Tesco submitted that the sale of groceries online is not a constraint on the in-store grocery business, as it is not a substitute for most customers.¹¹⁸

Bargain stores

- 7.31 Morrisons noted that bargain stores (including B&M, Poundland and Home Bargains) offer a very limited constraint to supermarkets. Tesco submitted that bargain stores (including B&M, Home Bargains, ‘etc’) are increasingly important competitors in some packaged categories (noting for example that Tesco [🔗]), but are yet to establish a significant presence in most fresh grocery categories. Generally, few third-party grocery retailers who responded to the CMA’s investigation listed the bargain stores as amongst their main competitors.

Convenience stores

- 7.32 Tesco noted that convenience shopping has become more popular in the last few years; however, it submitted that customers’ main shop is still happening in Large stores.
- 7.33 Tesco, Waitrose and Lidl differentiated Co-op from other grocery retailers on the basis of its greater focus on convenience missions or its store locations.

¹¹⁸ [Summary of hearing with Tesco](#) (9 November 2018), paragraph 27.

Others

- 7.34 With respect to other grocery retailers, in general, third parties identified M&S and Waitrose as high-priced grocery retailers with a higher perceived level of quality and service while one third party submitted that Iceland targets specific categories, missions and customer demographics.

Our assessment

- 7.35 We have assessed the effect of the Merger (and any reduction in competition) on the Parties' conduct at a national level, and thereby in every local market where either Party operates a store, as well as individual local markets where the Parties overlap.
- 7.36 In past cases involving the retail supply of in-store groceries, the CMA has defined the relevant market primarily to determine the framework (typically described as a filtering methodology) used to identify relevant local overlaps and exclude from further analysis local areas where competition concerns are unlikely to arise. In this case, we have defined the relevant market primarily to determine the framework and parameters of the WSS model that we have used to conduct our local assessment.¹¹⁹

Store size (supermarkets)

- 7.37 We consider that the delineation used in previous merger cases between Large, Medium and convenience stores is a good starting point for our analysis. As noted in paragraph 7.9 above, shoppers may not consider smaller stores to be good substitutes for larger stores, on the basis that they may be unable to cater for shopping missions that involve a wider range of products. While the Parties submit that there is no 'step change' that distinguishes Medium and Large stores from each other, they supported this classification as a pragmatic means to take size differences into account (subject to the weights attributable to each category being calibrated appropriately). This classification was also supported by the majority of third parties.

¹¹⁹ We have used a WSS model instead of a fascia-based filtering approach because simple fascia counts may under or overstate the extent of competition in an area, as they treat each brand as being equally important and therefore do not reflect the differences between them. On the contrary, the WSS model recognises that not all stores are equal for customers and adjusts the weight given to each specific competitor by taking into account evidence on which factors are important for customers when choosing a store. For more information on the differences between the fascia count and the WSS model, see [CMA62](#), paragraphs 3.26–3.32.

7.38 According to the available evidence, the strongest constraints on the Parties' Large and Medium stores are the Large and Medium stores of other traditional grocery retailers (which as mentioned previously, we take to include the Parties, Tesco, Morrisons, Waitrose, M&S and Co-op),¹²⁰ discounters (Aldi and Lidl) and, to a much lesser extent, Iceland. As explained in the competitive assessment in paragraph 8.203 below, our survey and entry-exit evidence suggest that Medium stores do constrain Large stores, which represents a change to findings in previous cases involving in-store groceries (undertaken several years ago):

- (a) across all surveyed local areas in the CMA's store exit survey, diversion within a 15-minute drive catchment area to the Medium stores of traditional retailers, discounters and Iceland is on average [20–30%];¹²¹ and
- (b) the entry-exit analysis¹²² suggests that Medium stores constrain Large stores, albeit, on average, to a lesser extent than Large stores constrain Large stores. For example, a Large Tesco has a stronger impact compared to a Medium Tesco on Asda's revenue at a 0–5 minutes distance band.¹²³

7.39 However, within the broad category of Large and Medium stores, the strength of constraint varies considerably by size (Large versus Medium) and across different rival brands. The constraints provided by these competitor stores also varies as between Sainsbury's and Asda. As stated in the local competitive assessment in Chapter 8:

¹²⁰ As noted in footnote 46 above, we use this term as a shorthand in these report, but no inference should be made regarding the relevance of the use of this term to the CMA's competitive assessment of the Merger.

¹²¹ Paragraph 8.203. The diversion ratio from Store A to Store B is the proportion of customers that would switch to Store B in response to a worsening of Store A's competitive offering, as a proportion of all customers that would switch away from Store A. In other words, if Store A raises its price and 100 customers switch away from Store A and, of those 100 customers, 20 choose Store B, the diversion ratio from Store A to Store B would be 20%. In this case we have measured diversion from a range of Sainsbury's and Asda supermarkets. Diversion ratios provide an indicator of the closeness of competition between stores and we have used the results of our survey to calculate them. The diversion ratio attempts to capture what customers would do in response to a worsening of PQRS. However, given that it can be difficult to survey a sufficiently large number of customers who would switch in response to a worsening of PQRS to estimate a robust diversion ratio, we asked customers what they would do in response to the closure of a store (*CMA62*, paragraphs 5.6–5.11).

¹²² As explained in paragraph 8.170, entry-exit analysis is used to assess whether and how the entry and exit of competitors' stores affect the Parties' grocery sales. It allows us to estimate the average impact of one additional (or one fewer) competitor store on the Parties' sales. The more customers consider a new or closing store a good substitute to the Parties' stores, the larger the impact of the entry-exit of the competitor on the Parties' sales at those stores.

¹²³ Appendix C.

- (a) Individual Medium stores exert a material constraint on the Parties' supermarkets (including Large stores), but in general this is materially weaker than the constraint exerted by Large stores:¹²⁴
- (i) The CMA's store exit survey suggests that the larger a competitor's store when compared to the size of the Parties' stores, the greater the strength of constraint.
 - (ii) We note that there are often several Medium stores in the local area surrounding the Parties' supermarkets. In the 100 surveyed local areas of the CMA's store exit survey, there are on average seven Large stores and 16 Medium stores within a 15-minute drive-time per local area. However, despite there being more Medium stores, total diversion within a 15-minute drive-time per local area is still higher to Large stores than to Medium stores in those areas. Across all local areas surveyed in the CMA's store exit survey, diversion to Large stores (traditional retailers, discounters and Iceland) within a 15-minute drive catchment area is on average [50–60%], whereas, diversion to Medium stores (traditional retailers, discounters and Iceland) within the catchment area is on average [20–30%].
- (b) The constraint exerted on the Parties' supermarkets varies depending on the brand of the competing store. For example, as explained in the competitive assessment in Chapter 8, the constraint exerted by the other Party, Morrisons and Tesco on the Parties' supermarkets is stronger than the constraint exerted by M&S or Co-op all else equal.¹²⁵

7.40 In light of the above, for the purposes of the product market definition, we have included Large and Medium stores of traditional retailers, discounters and Iceland in the same product market. However, within our competitive assessment we consider the variation in the strength provided by different brands.

Relevant competitor set

7.41 In previous cases involving the retail supply of in-store groceries, the CMA has typically defined a list of retailers deemed 'effective competitors'. This list was primarily used to determine which grocery retailers should be included in

¹²⁴ We note that for Sainsbury's centroid the weight we accord to Tesco Medium stores is not materially lower than the weight accorded to Tesco Large stores implying that the constraint does not vary considerably between this size of store for Tesco. However, we note that this may be due to low sample sizes in our evidence base for Tesco Medium stores. This is discussed further in paragraphs 65 to 70 of Appendix E.

¹²⁵ Paragraphs 8.155–8.161.

the fascia counting exercise adopted in those cases as a first-stage filter to exclude local areas where competition concerns were unlikely to arise.

- 7.42 As discussed further in Chapter 8, our local competitive analysis in this case does not adopt a fascia based filtering approach, but instead uses a WSS model to assign weights to different competitor stores based on drivers of store choice that are important for consumers, such as their brand, size and distance from the Parties' stores, and then uses this to produce a measure of the upward pricing pressure likely to arise as a result of the Merger (known as the 'GUPPI') for each local area.
- 7.43 As set out in Chapter 8, in calibrating the 'brand' element of the weight, eight grocery retailers (in addition to the Parties) were found to provide the most important competitive constraints on the Parties' Large and Medium stores and were assigned brand-specific weights. These were: Tesco, Morrisons, Waitrose, M&S, Co-op, Aldi, Lidl and Iceland. The constraint provided by all other retailers was grouped together, and taken into account as part of the 'out of market' constraint recognised in the analysis.
- 7.44 Whilst Tesco, Morrisons, Waitrose, M&S, Co-op and the Parties have all previously been considered as part of the 'effective competitor set' used in past groceries cases (although noting that the competitive constraint identified for each varies), Aldi, Lidl and Iceland typically have not. Including these grocery retailers in the effective competitor set is therefore an important development, which reflects their strengthening position in UK grocery retailing in recent years. We further discuss the competitive constraint exerted by these grocery retailers below.

Discounters

- 7.45 As discussed in paragraph 7.38, according to the available evidence, the strongest constraint on the Parties' supermarkets are the Large and Medium stores of other traditional retailers and discounters.
- 7.46 As noted above, Aldi and Lidl have not typically been included within the 'effective competitor set' defined in past groceries cases for the fascia counting exercise used as a first-stage filter in those cases. Where present, their stores have been considered in some cases as part of the in-depth assessment of certain local areas which failed this initial filter. However, these cases have primarily focused on the competitive constraint from such

stores on the merging parties' convenience stores.¹²⁶ Similarly, in the CMA's Tesco/Booker merger inquiry, Aldi and Lidl were included within the relevant competitor set for convenience stores (albeit as a weaker constraint than some other retailers, given their lack of tobacco sales).¹²⁷

- 7.47 As explained in Chapter 4, the growth of the discounters has been a key development in the retail grocery sector in recent years. That growth is set to continue as both Aldi and Lidl have announced they are planning more store openings this year and thereafter.
- 7.48 As explored in-depth in Chapter 8, the evidence gathered in this investigation (and the weights assigned to these grocery retailers in the WSS model) demonstrates that both Aldi and Lidl pose a material constraint on the Parties' supermarkets, albeit this constraint is more limited than that provided by some other grocery retailers. The strength of constraint differs between the Parties, with Aldi in particular acting as a more important constraint on Asda's stores than on Sainsbury's stores.
- 7.49 The large majority of discounters' stores are Medium stores. Consistent with our findings in paragraph 7.39, the CMA's store exit survey indicates that such stores represent a materially weaker constraint on the Parties' supermarkets than the Large supermarkets of traditional retailers such as Tesco, Morrisons and the other Party. However, this evidence also demonstrates that the constraint from an Aldi or Lidl Medium store may be greater than the constraint from a 'Big 4' Medium store, particularly on Asda stores, for which Aldi stores were found to be a stronger constraint than the Medium stores (but not Large) of Tesco.¹²⁸
- 7.50 Taking into account the above, and the evidence set out in Chapter 8, we consider it appropriate to include the discounters in our product market definition. We take account of the variation in the relative strength of the constraint provided by discounters on the Parties' supermarkets in our competitive assessment.

Iceland

- 7.51 Like Aldi and Lidl, Iceland has not typically been included in the effective competitor set used for the purposes of the fascia count filter in past cases, although its stores have been taken into account in some past cases when

¹²⁶ Martin McColl/Co-operative merger inquiry (20 December 2017), [Phase 1 decision](#), paragraphs 121 and 127; Co-operative/ML Convenience and MLCG merger inquiry (19 October 2016), [Phase 1 decision](#), paragraph 67.

¹²⁷ Tesco/Booker merger inquiry (20 December 2017), [Final report](#), paragraph 7.50.

¹²⁸ Paragraph 8.161.

assessing competition in particular local areas.¹²⁹ In the Tesco/Booker merger inquiry, in the context of convenience retailing, the CMA did not find it necessary to conclude on the extent of the constraint that Iceland provided, as its sensitivity test showed that the inclusion of Iceland did not materially affect the results.¹³⁰

- 7.52 As noted in Chapter 4, Iceland is the tenth largest grocery retailer in the UK, operating over 900 stores across the UK. Iceland has had a stable share of supply in recent years.
- 7.53 The CMA store exit survey indicates that Iceland does exert a constraint on the Parties' supermarkets, albeit that the survey evidence indicates that this is a materially weaker constraint than that provided by traditional retailers or the discounters. According to the CMA's store exit survey only [0–5%] of respondents said that they would divert to Iceland. By contrast, [50–60%] of respondents would divert to another supermarket of the 'Big 4' and [10–20%] to a discounter.
- 7.54 This is supported by other evidence (discussed further in Chapter 8), such as the review of the Parties' internal documents, which shows that Iceland is amongst the broad range of competitors which both Parties regularly monitor, albeit that it appears with less frequency or prominence than other competitors (such as the traditional retailers or the discounters).
- 7.55 Taking into account the above, and the evidence set out in Chapter 8, we consider it appropriate to include Iceland in our product market definition. We take account of the variation in the relative strength of its constraint on the Parties' supermarkets in our competitive assessment.

*Online delivered groceries*¹³¹

- 7.56 The Parties submitted that customer switching data suggests that the online grocery channel is constrained by the presence of physical grocery stores in every area in which the Parties deliver groceries. However, we consider that this evidence is not useful for the purposes of defining the market for the retail supply of in-store groceries for two reasons: first, we are considering whether online grocery retailers constrain in-store grocery retailers and not vice versa; secondly, this data does not allow us to understand whether

¹²⁹ Martin McColl/Co-operative merger inquiry (20 December 2017), [Phase 1 decision](#), paragraphs 96 and 112.

¹³⁰ Tesco/Booker merger inquiry (20 December 2017), [Final report](#), paragraph 7.51.

¹³¹ We use the term online delivered groceries to refer to groceries which are delivered to the customer's location following an order placed online. For the reasons explained in footnote 108, we have assessed Click and Collect services within the retail supply of in-store groceries.

customers are switching shopping missions between online and in-store options in response to changes in the offers of different retailers, and it is this aspect which is important for market definition.¹³²

- 7.57 The CMA store exit survey suggests that the constraint from online delivered groceries on the Parties' Medium and Large stores is relatively weak. When customers were asked what they would do in the hypothetical situation where the Parties' grocery store they were visiting was closed, on average, only [0–5%] of respondents from the CMA store exit survey said that they would divert online, including to the online offering of the Party whose store they had just shopped at. There may be several reasons why online delivered groceries may not be a substitute for such grocery customers: for example, customers may want to purchase groceries for immediate use, or to see and choose the products they are purchasing, instead of somebody else picking for them.
- 7.58 Based on the above, we have excluded online delivered groceries from our product market definition. However, the constraint provided by online delivered groceries is considered within the competitive assessment in Chapter 8 as part of the out-of-market constraints recognised in the analysis.

Bargain stores

- 7.59 Bargain stores have been growing in recent years, although they remain a very small proportion of the overall groceries sector. According to the CMA store exit survey, total diversion to brands other than the Parties, Tesco, Morrisons, Waitrose, M&S, Aldi, Lidl, Co-op and Iceland is small. Only [0–5%] of respondents said they would divert to a brand other than these brands, albeit with some variation between the stores surveyed.
- 7.60 According to the available evidence, bargain stores are not perceived as a main competitor by third party grocery retailers (see paragraph 7.31). This is also supported by Kantar switching data, which shows that bargain stores are a very weak constraint to the Parties, each accounting for less than 5% of switching losses.
- 7.61 Based on the above, we have excluded bargain stores from our product market definition. However, the constraint provided by such retailers is considered within the competitive assessment in Chapter 8 as part of the out-of-market constraints under the category of 'Other' retailers.

¹³² See Appendix D (paragraph 15), in which we explain the reasons why little weight should be placed on Kantar switching data if it is being used to understand the constraint between channels.

Convenience and specialist stores

- 7.62 As noted in Chapter 4, the convenience channel has been growing in recent years in line with the gradual trend in the industry of consumer purchasing behaviour moving away from a single, big weekly shop, towards shopping 'little and often'. However, evidence shows that larger stores remain important for consumers,¹³³ and although convenience sales are expected to continue growing, this channel is expected to grow by only 1% in the next five years.¹³⁴
- 7.63 The CMA store exit survey suggests that the total diversion to convenience stores and specialist stores from the Parties' Large and Medium stores is small. Only [5–10%] of respondents to the CMA store exit survey said that they would divert to a convenience store, a corner shop, or a specialist store, albeit with some variation between the stores surveyed. We note that this group of retailers includes a wide range of different fascia and different types of store offerings considered in aggregate; as such, the diversion to each of these stores considered on an individual basis would be much lower than [5–10%].
- 7.64 Based on the above, we have excluded convenience and specialist stores from the product market definition. However, the constraint provided by convenience stores is considered within the competitive assessment in Chapter 8 as part of the out-of-market constraints recognised in the analysis.

Others

- 7.65 Finally, we note that, for the purposes of our current analysis, we have included a range of different types of retailer within a category of 'Other' retailers.¹³⁵ This category includes bargain stores (as noted above), Symbol groups and a number of other retail chains which operate a small number of stores nationally (eg because they operate regionally). The constraint from this category of retailers is considered within the competitive assessment in Chapter 8 as part of the out-of-market constraints recognised in the competitive analysis.

¹³³ Mintel (November 2016), *UK Supermarkets*; IGD (2017), *UK Food and Grocery*.

¹³⁴ See Figure 4.1.

¹³⁵ 'Other' refers to those stores above 280 square metres of Booths, Costcutter, Dunnes, Farmfoods, Heron Foods, Musgrave, Nisa and Spar.

Conclusion on product market definition (supermarkets)

- 7.66 As noted above, in this case we have defined the relevant market primarily to determine the parameters of the WSS model we have used to conduct our local assessment.
- 7.67 Based on the evidence set out above, regarding the relevant product market, we conclude that:
- (a) it remains appropriate to distinguish between Large, Medium and convenience stores;
 - (b) Medium stores are constrained by other Medium stores and also by Large stores, with Large stores exerting a stronger constraint on Medium stores than other Medium stores;
 - (c) Large stores are constrained by other Large stores, but also by Medium stores, although to a lesser extent than by other Large stores; and
 - (d) the strength of constraint varies by brand of competitor store, with the most important constraints on the Parties' stores coming from the stores of the other Party, Tesco, Morrisons, Waitrose, M&S, Aldi, Lidl, Co-op and Iceland (the relative strength of each differing to some extent between the Parties).
- 7.68 We have therefore concluded that the product market definition includes all Large stores and Medium stores of the Parties, Tesco, Morrisons, Waitrose, M&S, Aldi, Lidl, Co-op and Iceland. We take account of the variation in the strength of constraint provided by different stores, due to distance, store size and brand, within our competitive assessment.
- 7.69 Online retailers, bargain stores, specialist stores, convenience stores and a range of other grocery retail chains that operate a smaller number of stores nationally have been excluded from the product market definition. However, these other players are considered within the competitive assessment as out-of-market constraints.

Geographic market (supermarkets)

Previous cases

- 7.70 The CMA has previously adopted as the geographic scope of its market definition for Large and Medium stores the following:

- (a) Medium stores are constrained by other Medium stores within a 5/10 minute drive-time (urban/rural areas), and by Large stores within a 10/15 minute drive-time (urban/rural areas); and
- (b) Large stores are constrained by other Large stores within a 10/15 minute drive-time (urban/rural areas).¹³⁶

Parties' views

- 7.71 The Parties submitted that the CMA should carry out the assessment of competition between grocery retailers at the local level. According to the Parties, the competitive constraints on local stores vary according to a number of factors (such as store proximity, size, and brand) that influence the intensity of the constraints faced by the Parties' local stores. The Parties consider that the WSS methodology is the most appropriate methodology to account for the impact of any competitive constraints within a given catchment area from a store.
- 7.72 The Parties submitted that there was no need for a separate 'national' assessment independent of local overlaps.¹³⁷ According to the Parties, retail competition is fundamentally local in nature and, as set out in the Retail mergers commentary, the total effect of any change in the retail offer is determined by the aggregate change in competitive conditions across all individual stores operated by that retailer.¹³⁸
- 7.73 With respect to the size of catchment areas, the Parties proposed that evidence from various sources (including Sainsbury's Nectar customer loyalty card data, Asda's till survey, each of the Parties' impacts data and entry-exit analysis) suggested that drive-time catchments were 10 minutes for Medium stores and 15 minutes for Large stores in urban areas, and 15 and 20 minutes for Medium and Large stores in rural areas.

Third parties' views

- 7.74 We received mixed evidence from third parties. Tesco and Waitrose agreed with the approach to the geographic scope adopted by the CMA in previous cases.

¹³⁶ For example, Martin McColl/Co-operative merger inquiry (20 December 2017), [Phase 1 decision](#), paragraph 32; Co-operative/ML Convenience and MLCG merger inquiry (19 October 2016), [Phase 1 decision](#), paragraph 43; Co-operative/Booker merger inquiry (6 June 2016), [Phase 1 decision](#), paragraph 37.

¹³⁷ Also: Grocery retail competition is fundamentally local. National competition is the sum of local competition. All relevant unilateral effects can fully be captured in the local analysis.

¹³⁸ [CMA62](#), paragraph 1.15.

- 7.75 Morrisons and Lidl submitted that, particularly for urban stores, the relevant catchment areas should be smaller compared to the approach adopted by the CMA in previous cases.
- 7.76 Aldi suggested that the relevant catchment areas should be larger compared to the approach adopted by the CMA in previous cases but smaller compared to the approach submitted by the Parties.

Our assessment

- 7.77 From a demand-side perspective, consumers choose their grocery retailer based on the options available to them in their local area. The identity, number and strength of competitors varies from local area to local area. For this reason, the market for the retail supply of in-store groceries is primarily local.
- 7.78 As regards the geographic scope of this local market, the CMA store exit survey indicates that the majority of diversion is to stores within a 15 minute drive-time. Based on the responses received, Large stores within 15 minutes receive [50–60%] of diversion on average in the sampled areas, while Medium stores within 15 minutes receive [20–30%] of diversion on average.¹³⁹ Within this catchment, both the CMA store exit survey and the entry-exit analysis indicate that the strength of constraint decreases the further away the store. The diversion analysis discussed in the local assessment in Chapter 8 shows that the weights for all stores declined to close to zero after approximately 15 minutes' drive-time,¹⁴⁰ indicating that stores that are outside of a 15 minute drive-time catchment are likely to be at best very weak demand-side substitutes.
- 7.79 Previous cases have distinguished between stores in urban and rural areas, with larger catchment areas applied for rural stores. As explained in the local assessment in Chapter 8, there is some evidence to support a finding that customers are generally willing to travel further to stores in rural areas. However, the vast majority of the Parties' stores are located in urban areas and our survey reflects this.¹⁴¹ In addition, the evidence for the precise scope of rural catchment areas is limited given that the CMA's exit survey contains a limited number of observations concerning rural stores and the entry-exit analysis does not contain any data on rural stores. For these reasons, we have treated rural areas in the same way as urban areas in our competitive

¹³⁹ These averages are calculated across all local areas and include only traditional retailers (the Parties, Tesco, Morrisons, Waitrose, Co-op and M&S), Iceland and Discounters (Aldi and Lidl).

¹⁴⁰ See paragraph 8.162.

¹⁴¹ According to the dataset provided by the Parties, the Parties' Large and Medium stores located in urban areas amount to 94%.

analysis, and applied a consistent catchment area for both. For the reasons in paragraph 8.167(d), we expect this to have a small impact on our assessment overall, such that this approach is appropriate given the lack of specific evidence on which to base a differential treatment for rural areas.

- 7.80 Based on the above, we have assessed the constraints within a 15 minute drive-time catchment around each Large and Medium store, with reducing weight given to competitors at further distances within this catchment. Those supermarkets located more than 15 minutes' drive away from each Large and Medium store are treated as out-of-market constraints.

Conclusion on geographic scope (supermarkets)

- 7.81 As noted above, in this case we have defined the relevant market primarily to determine the parameters of the WSS model we have used to conduct our local assessment.
- 7.82 For the purposes of the local assessment, we have assessed the constraints of competing grocery retail stores within a 15 minute drive-time catchment area around each Large and Medium store of the Parties, with reduced weight given to competitors at further distances within this catchment.
- 7.83 As set out in paragraphs 7.1 to 7.5, and notwithstanding that on the demand side the relevant geographic scope of the market is primarily local, our competitive assessment also takes into account the fact that the Parties are nation-wide, large-scale operators, with nationally-recognised brands, sophisticated integrated operations, and centralised buying teams. Important elements of the Parties' competitive offering, such as pricing and quality, are set centrally and applied uniformly across all stores, nationally. We consider that this affects their effectiveness as a competitor in every local area where they operate. In our competitive assessment, we assess the effect of the Merger (and any reduction in competition) on the Parties' conduct at a national level, and thereby in every local market where either Party operates a store, as well as in individual local markets where the Parties overlap.

Product market (convenience stores)

Previous cases

- 7.84 With respect to convenience stores, in previous cases the CMA (and its predecessors) have concluded that convenience stores are constrained by other convenience stores, Medium stores and Large stores.¹⁴²
- 7.85 In these previous cases, the CMA has sometimes distinguished between large convenience stores (100 to 280 square metres) and small convenience stores (under 100 square metres):
- (a) In some cases where the CMA has considered possible worsening of services at large convenience stores (100 to 280 square metres), it has taken a cautious approach and excluded small convenience stores from its analysis – meaning that for large convenience stores it considered constraints only from other large convenience stores, Medium stores and Large stores, but not smaller convenience stores (under 100 square metres).¹⁴³
 - (b) The CMA has also noted that there is no clear threshold between smaller and larger convenience stores,¹⁴⁴ and has sometimes taken account of competition between small and large convenience stores, albeit noting that the strength of constraint may differ by size of store.¹⁴⁵
- 7.86 The OFT and the CMA considered in a number of cases whether it was appropriate to distinguish stores attached to PFSs (also referred to as kiosks) from other types of convenience stores, on the basis of their smaller size and more limited offering, but either did not conclude or concluded that no such

¹⁴² For example, Tesco/Booker merger inquiry (20 December 2017), [Final report](#), paragraph 6.13; Groceries market investigation (30 April 2008), [Final report](#), paragraph 4.63; Anticipated acquisition by Tesco plc of a Spar grocery store in Wroughton from Capper & Co Limited (ME/4162/09) (14 July 2009), [Phase 1 decision](#).

¹⁴³ The exclusion of convenience stores under 100 square metres was first introduced in the Co-operative/Booker merger inquiry (6 June 2016), [Phase 1 decision](#), and then applied in Co-operative/ML Convenience and MLCG merger inquiry (19 October 2016), [Phase 1 decision](#). The OFT also previously considered that smaller convenience stores (including kiosks attached to petrol stations) may not be in the same frame of reference as larger convenience stores due to factors such as their small size and more limited range: Anticipated acquisition by Co-operative Group Limited of David Sands Limited (ME/5317/12) (16 April 2012), [Phase 1 decision](#), paragraph 20.

¹⁴⁴ The CMA recognised in Co-operative Foodstores Limited/Booker that there was no clear threshold between smaller and larger convenience stores. However, the CMA considered that, in that case, using a threshold of 100 square metres provided a useful starting point for segmenting between different sizes of convenience store: Co-operative/Booker merger inquiry (6 June 2016), [Phase 1 decision](#), footnote 16.

¹⁴⁵ Martin McColl/Co-operative merger inquiry (20 December 2017), [Phase 1 decision](#), paragraph 43. In Tesco/Booker, small and large convenience stores were considered together given the limitations on the data on store size and the lack of evidence on an appropriate size threshold at which competition ceases between smaller and larger convenience stores (Tesco/Booker merger inquiry (20 December 2017), [Final report](#), paragraph 6.13).

distinction was appropriate on the basis of the available evidence.¹⁴⁶ More recently, the CMA has treated stores located at PFSs like any other convenience store, and has not identified a separate product market for such stores.¹⁴⁷

Parties' views

7.87 As noted above, the Parties propose that we adopt the CMA's traditional classification of distinguishing between Large stores, Medium stores and convenience stores. While the Parties made no specific submissions on the relevant product market for convenience stores, the Parties submitted that the offer of the Asda convenience stores was differentiated from the convenience stores offering of Sainsbury's and other retailers, on the basis that:¹⁴⁸

- (a) unlike standard convenience stores, which tend to be situated on high streets or in other convenient locations, all of Asda's convenience stores are attached to its PFSs (of which 43 are co-located with a supermarket);
- (b) as a result, they are particularly small: 48 of Asda's 61 convenience stores are less than 100 square metres;
- (c) they also carry fewer SKUs: Asda's 18 standalone PFS-based stores carry on average [REDACTED] SKUs, while the remaining 43 PFS-based stores co-located with a supermarket carry just [REDACTED] SKUs. This is compared to c.[REDACTED] SKUs in an average Sainsbury's convenience stores; and
- (d) almost three-quarters of the range in Asda convenience stores is 'kiosk', 'food to go' and 'confectionary', whereas these ranges would comprise around one third of the range in its supermarkets.¹⁴⁹

7.88 As such, the Parties argue that Asda's stores are not 'convenience stores' in the sense commonly understood, but are instead petrol station shops. The

¹⁴⁶ Proposed acquisition by J Sainsbury plc of 18 petrol stations from Rontec Investments LLP (ME/5407/12) (7 June 2012), [Phase 1 decision](#), paragraphs 17–22; Completed acquisition by Midcounties Co-operative Limited of Tuffin Investments Limited (ME/5452/12) (18 October 2012), [Phase 1 decision](#), paragraphs 36–43. This was also the position adopted by the CMA in a more recent case Asda Stores/Co-operative Group (5 stores) merger inquiry (28 November 2014), [Phase 1 decision](#), paragraphs 19–22.

¹⁴⁷ For example, completed acquisition by CD&R Fund IX of MRH Limited (ME/6750/18) (31 August 2018), [Phase 1 decision](#), paragraphs 39–43; Anticipated acquisition by Motor Fuel Limited of 90 petrol stations from Shell Service Station Properties Limited, Shell U.K. Limited and GOGB Limited (ME/6534/15), 26 August 2015, [Phase 1 decision](#), paragraphs 30 and 31; Completed acquisition by Motor Fuel Limited of 228 petrol stations and other assets from Murco Petroleum Limited (ME/6471-14) (22 December 2014), [Phase 1 decision](#), paragraphs 42–45; Anticipated acquisition by MRH (GB) Limited of 78 service stations from Esso Petroleum Company Limited (ME/6563/15) (26 November 2015), [Phase 1 decision](#), paragraphs 29 and 30.

¹⁴⁸ [Parties' response to the Provisional Findings](#), paragraph 488.

¹⁴⁹ We note that the Parties do not compare to the typical range composition in a Sainsbury's convenience store.

Parties submit that any assessment of the constraint on such stores at a local level should therefore include other local PFS shops, which the Parties submit are the primary source of competitive constraint for Asda's convenience stores.¹⁵⁰

Third parties' views

7.89 The CMA has not received any submissions from third parties regarding the product market definition for convenience stores (including those attached to PFSs).

Our assessment

7.90 The Parties both operate convenience stores. We note, however, that Asda's convenience stores are limited to convenience stores located at certain of its PFSs. We also note the Parties' submissions that the great majority of these stores are smaller than the average Sainsbury's convenience store, and carry a more limited range.

7.91 As noted above, the convenience store sector has been the subject of several phase 1 investigations and a recent in-depth phase 2 investigation in the Tesco/Booker merger inquiry. We consider that the conditions of competition that led to the conclusions on market definition in the Tesco/Booker merger inquiry are unlikely to have materially changed, such that the market definition for convenience stores adopted in that case is likely to remain appropriate. We note that a number of convenience stores considered in that case were also convenience stores attached to PFSs, and that the same market definition applied to all convenience stores regardless of this distinction (albeit that the question of whether petrol station stores should be treated differently was not one that was considered explicitly).

7.92 As the majority of the overlaps between the Parties arise from their respective Medium and Large stores, and in view of this recent investigation into convenience stores, we did not consider it necessary to undertake a detailed assessment of the market definition for convenience stores, thereby adopting an approach which reflects proportionality to the particularities of this case. We therefore consider that the conclusions regarding the relevant market definition for convenience stores in the Tesco/Booker merger inquiry are also valid for this case, and that it is not necessary to further distinguish convenience stations attached to PFSs from other types of convenience store, or to distinguish between convenience stores above and below 100

¹⁵⁰ [Parties' response to the Provisional Findings](#), paragraphs 489 and 490.

square metres. As such, for the purposes of market definition, we consider that convenience stores are competitively constrained by other convenience stores (small and large), Medium and Large stores. In the competitive assessment in Chapter 8 we do nevertheless take into account the Parties' arguments regarding the differences in size and product offering of the Asda convenience stores, and consider the implications of this for the degree of competition between the Parties and from other retail stores.

Conclusion on market definition (convenience stores)

7.93 In line with evidence from past cases and, in particular, the recent phase 2 Tesco/Booker merger inquiry, we conclude that convenience stores are constrained by other convenience stores, as well as by Medium and Large stores. We have considered small and large convenience stores together, given the lack of evidence on an appropriate size threshold at which competition ceases between smaller and larger convenience stores, and have not distinguished convenience stores at petrol stations from other types of convenience stores (although we consider this further as part of our competitive assessment).

Geographic market (convenience stores)

Previous cases

7.94 At a local level, the CMA has previously adopted as the geographic scope of the market definition for convenience stores a 5 minute drive-time catchment¹⁵¹ or a one mile catchment area in both rural and urban areas, noting that the constraint is likely to be stronger the closer another retailer is to the store in question.¹⁵²

Parties' views

7.95 The Parties have not made any submissions regarding the geographic market definition for convenience stores.

¹⁵¹ Tesco/Booker merger inquiry (20 December 2017), *Final report*, paragraph 6.15. For example, Martin McColl/Co-operative merger inquiry (20 December 2016), *Phase 1 decision*, paragraph 32; Co-operative/ML Convenience and MLCG merger inquiry (19 October 2016), *Phase 1 decision*, paragraph 43, Co-operative/Booker merger inquiry (6 June 2016), *Phase 1 decision*, paragraph 37.

¹⁵² Tesco/Booker merger inquiry (20 December 2017), *Final report*, paragraph 6.24.

Third parties' views

7.96 The CMA has not received any submissions from third parties regarding the geographic market definition for convenience stores.

Our assessment

7.97 As noted in paragraph 7.91 above, as the majority of the overlaps between the Parties arise from their respective Medium and Large stores, and in view of the recent investigation into convenience stores in Tesco/Booker, we did not consider it necessary to undertake a detailed assessment of the market definition for convenience stores in this case, thereby adopting an approach which is proportionate within the context of this case. We consider that the conditions of competition that led to the conclusions on market definition in that case are unlikely to have materially changed and that the approach adopted in that case to market definition is therefore likely to remain appropriate. As such, we consider that the geographic scope is local, and that it is appropriate to use one mile catchment areas for the purposes of our local competitive assessment.

Conclusion on geographic market definition (convenience)

7.98 Consistent with previous cases, we conclude that the geographic scope is local. For the purposes of the local competitive assessment, we have considered a one mile catchment area, noting that the constraint is likely to be stronger the closer another retailer is to the store in question.

Nature of competition

7.99 In this section we consider how grocery retailers compete to attract customers, and in particular:

- (a) whether grocery retailers locally flex competitive parameters in response to competition; and
- (b) the interactions between the Parties' business lines and, in particular, whether the Parties' ability to offer additional products and services on-site such as GM and fuel has an impact on their supply of in-store groceries.

Local flexing

7.100 Local flexing refers to the process of retailers varying some aspects of their offering locally, having had regard to local competitive conditions (ie varying

certain parameters of PQRS from store to store in response to local competition). For example, a retailer may set the range available at a store taking into account the number and type of competitors present in the local area where the store is located. As a result of this strategy, there are unlikely to be two stores in a retailer's estate with identical ranges, as the mix of competitors will be different in each local area in which the retailer has a store. Other examples of local flexing may include changing staffing levels or opening hours, or investing in the presentation of products in its store, in order to respond to local competition.

- 7.101 We note that retailers may also vary some parameters of PQRS locally for some other reasons not directly related to competition, such as customer demographics or the layout or the size of the store. In this section, when discussing local flexing, we have focused on whether the Parties vary some parameters locally in direct response to competition and/or in response to factors likely to be influenced by competition (such as sales levels). See paragraphs 7.121 to 7.125.
- 7.102 The benefit of local flexing to a retailer is that it is able to improve their retail offer where they face more competition so as to win more customers from their rivals, and degrade (or choose not to improve, where they would otherwise have done so) their offer where they face less competition. The benefits are greater when local demand and the intensity of local competition differ between the areas where the retailer operates.¹⁵³
- 7.103 The costs of local flexing (or of moving to local flexing where the retailer does not do so currently) might include the cost of carrying different ranges in different stores, the fragmenting of sales volumes with suppliers and the additional complexity associated with such a change in policy, which may require different systems or adverse reputational effects for certain stores or for the brand as a whole (if customers expect a consistent offer across all of the retailers' stores).¹⁵⁴
- 7.104 In this section, we examine whether the Parties do (or could) flex their offer locally, and which parameters of their offering are (or could be) flexed in this way across their estates (including both supermarkets and convenience stores). This is relevant to assessing: first, whether any harm arising from the Merger may be expected to arise in only certain local areas (if there was no prospect of local flexing, then there would not be any need to assess whether any harm will arise in certain local areas and not others, as any effect of the Merger would be expected to apply across all of the Parties' stores

¹⁵³ [CMA62](#), paragraph 1.11.

¹⁵⁴ [CMA62](#), paragraph 1.10.

nationally); and second, how any harm that may arise from an SLC finding in a particular local area would materialise.

Previous cases

- 7.105 The CMA has found local flexing to be likely in past cases involving the retail supply of in-store groceries. In particular, in the Groceries market investigation,¹⁵⁵ the CC conducted an econometric analysis of the relationship between local competition and store profit margin.¹⁵⁶ According to this analysis, variation in local store margins may reflect local flexing. This is because grocery retailers amend some aspects of their offering (PQRS) depending on the performance of the store, and these strategic decisions have an effect on consumer expenditure or store costs.¹⁵⁷ The CC found that more intense local competition resulted in lower store-level variable profit margins, suggesting that the extent of local competitive constraint faced by individual grocery stores is one of the factors that determine store profits.
- 7.106 In Morrisons/Safeway, the CC noted that there was scope for local pricing and as such, there was no reason to conclude that national pricing must or would inevitably continue in the future. The CC also found this to be true of other aspects of the merging parties' store offering, including product range and quality, store layout and fittings, and levels of service. The CC noted that they would expect firms to pursue whichever of the two strategies (ie national or local) was most profitable in the prevailing circumstances of the market.¹⁵⁸
- 7.107 The CMA has also found there to be a degree of local flexing (and the potential for further local flexing of some parameters which are not flexed locally presently) in a number of more recent groceries investigations.¹⁵⁹

Parties' views

- 7.108 The Parties submitted that competition between grocery retailers across key competitive parameters is fundamentally local (either because elements of competition can be flexed at the local level or because they are uniformly

¹⁵⁵ Groceries market investigation (30 April 2008), [Final report](#).

¹⁵⁶ Groceries market investigation (30 April 2008), [Final report](#), Appendix 4.4.

¹⁵⁷ The CC noted that, once a retailer is present in a local area, it competes on price but also on non-price aspects (QRS), and any change in these variables will contribute to a store attracting or losing customers (and as such margins will be higher or lower). For instance, the CC mentioned that in case of supply shortages, some retailers only stocked the product in stores located in the most competitive environment. The CC also found evidence that retailers undertake management reviews and locate better managers, and therefore more expensive ones, in markets where local competition is more vigorous.

¹⁵⁸ Safeway merger inquiry (18 August 2003), [Final report](#), paragraphs 2.94–2.98.

¹⁵⁹ For example, Tesco/Booker merger inquiry (20 December 2017), [Final report](#), paragraphs 10.8–10.13; Co-operative/ML Convenience and MLCG merger inquiry (19 October 2016), [Phase 1 decision](#), paragraphs 50–54.

applied but set by reference to aggregate performance across the retail estate).

7.109 The Parties submitted that, whilst most competitive elements are set centrally by the Parties, including, in particular, price, many are flexed specifically by reference to local considerations. The Parties submitted that as regards those parameters of competition that are centrally-set and uniformly applied, such as pricing, the Parties factor an aggregate assessment of performance across their entire retail estates into their decision-making.

7.110 In particular, the Parties submitted that when setting PQRS they consider a range of information relating to local store performance, and as such, any significant changes across the local estate will contribute to central decision-making. In this regard, the Parties submitted that:

- (a) Pricing decisions are primarily [redacted]. This data comes from aggregated store performance and is the most important input into determining price changes.
- (b) They receive ongoing feedback from stores to understand how centrally made decisions are impacting store sales. This comes not only from financial performance figures, but also from regular communication with store managers. For example, [redacted].
- (c) Central decisions about quality and service are similarly determined centrally but take into account local and aggregate performance in local stores. Centrally set quality standards for own-brand products and in-store service are tracked and monitored at a local level, with performance at store level feeding into the Parties' positioning and decision-making at a central level.
- (d) Ranging decisions are similarly not determined in a purely 'top down' manner. Whilst decisions on range are taken centrally, no two stores in either Party's estate has the same product range mix on shelves as any other, [redacted].
- (e) Innovation is similarly based on aggregate store performance, as competition to roll out new in-store, services or multi-format offerings, for example, will depend on how those innovations perform locally across stores in an initial trial set of stores (or across all stores if there is no trial on a subset first). The Parties' incentives to innovate depend on the return made from that innovation; the more competition a retailer faces at local level, the greater the incentive to innovate, in order to win share. Therefore, incentives to innovate will depend on the aggregate level of competition across the estate.

(f) Brand perception is simply a composite reflection of more tangible competitive variables such as PQRS and convenience experienced by customers. The Parties submitted that all of these elements are fundamentally local and therefore so is brand.

7.111 In addition, both Parties provided evidence on how local conditions of competition can contribute directly to changes in particular local stores.

7.112 Sainsbury's told us that, while price and quality factors are typically nationally-led (either for brand reputation or practical reasons), range and service factors are 'locally optimised'. For example, in the face of new local competition, Sainsbury's told us that [✂].

7.113 Asda also told us that decisions on competitive parameters (with the exception of price) are based on conditions locally, and how these conditions drive sales locally. Asda said that there are always local variations based on a number of different factors, such as the local population in terms of ethnicity, demographics and adjacencies (ie what else is present in the local area, eg whether the store is next to a football stadium). Asda said that, in general, local managers know their local competition and they will take actions to ensure their particular store is competitive with other stores in that local area (for instance, Asda mentioned that, if in a local area there is a Lidl store with a 'fantastic bakery', the store manager will make sure that Asda's bakery is 'in great shape').

Third parties' views

7.114 We asked third party grocery retailers a number of factual questions about how they operated their businesses. The responses generally suggested that grocery retailers vary some competitive parameters locally (although it was often not clear whether this was directly due to competition or a competitive response to changes in performance or any other factors) and apply other parameters uniformly throughout the estate.

7.115 Some third parties noted that they set certain parameters locally by measuring competition, identifying specific competitors, or reviewing competitive conditions in that particular area:

(a) Morrisons and Lidl told us that store opening hours vary locally considering the competitors in a particular local area. Morrisons also told us that local marketing activity is dependent on two key factors: the proximity of the competitors' stores and the proposition overlap of the competitor.

(b) Aldi submitted that they do occasional local vouchering to support store openings/re-openings or to counter a direct discounter competitor.

7.116 Other evidence received from third parties showed that some competitive parameters may be flexed as a result of store performance, which we note may be the indirect result of local competition. For instance:

(a) [X] told us that it may review trading hours on the basis of store performance relative to equivalent stores.

(b) With respect to staffing levels, Morrisons and [X] submitted that staffing levels differ on a store level depending on sales performance, among other factors. [One of these third parties] noted that, although staffing levels can differ on a store, these are set centrally. M&S told us that stores will be staffed appropriately to meet historical trading patterns.

(c) As regards local vouchering, Morrisons noted that it is initiated usually as a result of a new store opening or refurbishment or a competitor's store opening or refurbishment that could have an impact on their store performance. [X] told us that advertising or vouchering can be used to support underperforming stores.

7.117 Morrisons told us that range is specified based on clustering similar stores together (primarily using demographics and identifying which products reflect the needs of the customer within each cluster). [X] told us that, for larger stores, store managers can add lines not centrally stocked if requested by customers. This procurement is managed through store systems and measured centrally. The amount of local choice is managed to below 5% of the range. For smaller stores, the primary driver of range is customer preference, whereby the range is adjusted to reflect factors such as affluence, regional/local preferences or customer shopping missions. Whilst this leads to variation on a store by store basis, this is determined centrally, by categorising stores into clusters to determine the range applied to stores in local areas.

7.118 Third parties submitted that they set other competitive parameters uniformly throughout the estate:

(a) Aldi, Lidl, M&S, Waitrose, Co-op, Tesco and Morrisons submitted that price is centrally-set and uniformly applied.

(b) Tesco, Aldi and Waitrose submitted that quality is uniform across their stores in the UK.

- (c) Aldi, Lidl and M&S told us that range is set centrally and applied uniformly.¹⁶⁰ Tesco submitted that range decisions are taken centrally on a national basis and do not take into account conditions of local competition.
- (d) Aldi, Lidl, Waitrose and Tesco submitted that they do not vary their local offer in terms of service.

Internal documents and internal performance metrics

7.119 As discussed at paragraph 8.33 onwards, we conducted an extensive review of the Parties' internal documents, a number of which provided evidence relating to the existence of, or potential for, local flexing. This included:

- (a) an email from Sainsbury's that discusses [REDACTED].
- (b) An internal Sainsbury's document entitled '[REDACTED]' discusses [REDACTED].¹⁶¹
- (c) A document provided to the CMA by Sainsbury's wherein Bernstein, an analyst firm, carried out local reviews of competitor stores and suggested it was accepted in the grocery business that staffing, availability and quality were flexed locally in response to competition.¹⁶²

7.120 In addition, we asked the Parties to provide data on store-level Key Performance Indicators (KPIs) on quality, range and service variables over time, to see whether variation in such metrics could be attributable to changes in competition. However, we were unable to perform such analysis, given that we found that the Parties' service-level metrics are measured infrequently, [REDACTED]. It was also not possible for us to conduct margin analysis over time, given that we did not have access to margin analysis over time at a sufficiently granular level to identify the impact of changes in competition (which can happen during a year), as the Parties' [REDACTED]. We did however find evidence of [REDACTED] (see Figures 1 and 2 of Appendix F), which may reflect differences in competitive conditions, or other factors.

¹⁶⁰ Some of these retailers noted that they stock a negligible amount of regional products in some of their stores, and that they offer a slightly reduced range in some of their stores due to store size constraints.

¹⁶¹ [REDACTED].

¹⁶² Bernstein said: 'Perhaps a reaction to high levels of local competition, or perhaps a change in tactics by Asda, this Asda store was well staffed, availability was excellent everywhere and the bakery section had good quality products ...'.

Our assessment

- 7.121 We found that good prices, convenient location and range are key factors for consumers when choosing a grocery retailer.¹⁶³
- 7.122 We consider that even within those broad aspects of PQRS there are a range of ways in which grocery retailers improve their offers, as submitted by the Parties and third parties operating in these markets.
- 7.123 The evidence submitted by the Parties suggested that the Parties:
- (a) vary some parameters locally, although it is often not clear whether this is directly due to competition or a competitive response to changes in performance or any other factors (such as customer demographics) and there appears to be limited evidence that the results of local actions are systematically monitored or assessed by the Parties themselves; and
 - (b) set other parameters uniformly throughout the estate, such as pricing, overall brand positioning, innovations that affect product quality and negotiations with suppliers on promotions.
- 7.124 Based on the above, we consider that there is scope for and sufficient evidence to consider that at least some aspects of PQRS are or would be flexed locally in response to competition. In light of this, we consider the Parties have the ability to respond to competition and, as such, to the extent they have the incentive, we consider they will alter their local offering. It is therefore appropriate to consider the potential effects of the Merger in particular local areas where the Parties overlap. Based on the evidence provided by the Parties, factors such as range and service levels are those which appear most susceptible to local flexing. We address this within our local assessment of in-store groceries in Chapter 8.
- 7.125 However, there are also parameters of competition that the Parties set centrally and apply uniformly across their national estates (in particular pricing, as well as quality factors such as quality of own-label offering). We do not think that the Parties would have the incentive to depart from this practice and to vary them locally post-Merger (ie setting different prices in one store compared to another). As a result, we also need to consider the incentive of the Parties to degrade those elements across all stores in their national store estates, as a result of the loss of overall constraint from the Merger. We

¹⁶³ See paragraph 8.69.

address this within our national assessment of in-store groceries in Chapter 8.

Interactions between business lines

7.126 In this section we consider the interactions between the different areas of the Parties' activities. In particular, we consider whether the Parties' ability to offer additional products and services on the same site as their grocery offering, such as GM and fuel, has an impact in the retail supply of in-store groceries and whether this could make them a more attractive retailer for some consumers (as opposed to other retailers who do not offer these additional services).

Parties' views

7.127 The Parties submitted that it is wrong to take into account apparent differences between business models and in-store offerings as a proxy for customer preferences. In particular, the Parties submitted that additional facilities are not perceived by customers as important drivers of store choice and account for a [X] proportion of the Parties' sales. The Parties submitted that, according to their survey data, non-grocery/GM retail offers are not the predominant or sole driver of store visits for more than a small fraction of customers.

7.128 With respect to fuel, the Parties submitted that PFS customers that also shop in the grocery store are believed to have a positive impact on grocery volumes, which is part of the reason why supermarkets have an incentive to follow a low price, high volume fuel retailing model.¹⁶⁴ However, the Parties also submitted that only a minority of customers buy both groceries and fuel in a single transaction, and that the evidence supports the fact that any 'halo effect' is small.^{165,166} Based on Sainsbury's analysis of Nectar data, only [20–30%] of fuel customers bought groceries in the same visit, and only [10–20%] of groceries customers at stores with a PFS also bought fuel.¹⁶⁷

¹⁶⁴ (along with the natural incentive for such a model which arises due to the nature of supermarket PFS locations): [Parties' response to the Remedies Notice](#), paragraphs 7.4 and 7.5 and footnote 39. In this context, the Parties submitted that they are willing, if required by the CMA, to replicate the effect of the 'halo' contractually by a simple mechanism of a flat pence per litre payment to the new PFS owner.

¹⁶⁵ [Parties' response to the Remedies Notice](#), paragraph 2.7.

¹⁶⁶ By 'halo effect' we refer to the effect whereby the overall performance and profitability of some business lines are strengthened by the Parties being present in the other 'adjacent' business lines (see paragraph 8.236).

¹⁶⁷ [Parties' response to the Issues Statement](#), paragraph 164.

Third parties' views

- 7.129 Aldi, Lidl and Iceland noted that offering GM drives footfall in their stores. [REDACTED]. Similarly, [REDACTED] submitted that GM products complement customers' grocery missions. According to this third party, GM products drive incremental profit as they operate at higher margins than grocery lines and, as such, increase average basket value through the inclusion of additional items in the basket.
- 7.130 M&S submitted that it offers a substantial GM offer as this is what customers are used to and expect in its larger stores.
- 7.131 Tesco noted that additional products and services including fuel, GM, banking facilities or pharmacies are important for attracting customers to large stores. This competitor submitted that, for some customers and missions, these additional products and services may also provide an added incentive to choose its store over other competing food retailers. With respect to fuel, this third party submitted that it sells fuel as customers indicate that PFSs are an important part of the large store offering, and one that they value.
- 7.132 Morrisons submitted that it offers GM to ensure they provide their customers with a wide range of products all under one roof, offering maximum convenience to the customers' shopping trip. This third party noted that GM drives a higher basket spend and can be used as a differentiator.

Internal documents

- 7.133 The Parties' internal documents indicate that they believe that having a PFS on-site or adjacent to a supermarket leads to an increase in groceries sales. For example, one Sainsbury's document estimated that a PFS delivered an increase of [REDACTED]% in groceries sales (a 'sales halo'). Similarly, a 2017 Asda document [REDACTED].¹⁶⁸

Our assessment

- 7.134 Alongside core groceries in their larger stores, the Parties also sell items such as GM, and typically PFSs are located adjacent to these larger grocery stores and are also operated by the Parties. In particular, there is considerable operational integration between in-store groceries, online delivered groceries and fuel. These retail channels are supported by

¹⁶⁸ [REDACTED].

sophisticated distribution and logistics, which are optimised to the current configuration of the Parties' store network.¹⁶⁹ Many of the stores fulfil a dual role of providing in-store shopping and acting as a supply point for online delivered groceries operations.

- 7.135 The available evidence shows that there are some interactions between these different areas of the Parties' activities. In particular, attracting a customer to a store to purchase one of these items increases the probability that they will also make purchases of the other item.
- 7.136 With respect to GM we consider that, by offering these items alongside their grocery proposition, supermarkets are able to fulfil a larger number of customer shopping missions and allow for cross-selling between GM and groceries, as shown by the available evidence:
- (a) according to the CMA store exit survey, 27% of Sainsbury's customers and 29% of Asda's customers said they had just bought non-grocery items (clothing, stationery, electricals, toys, etc) in addition to their grocery shopping; and
 - (b) the Parties' transaction data indicate that for Asda typically [20–30%] of all baskets contain both GM and groceries, and for Sainsbury's [10–20%].¹⁷⁰ GM accounts for [10–20%] of store sales (excluding fuel) for Sainsbury's and [10–20%] for Asda.
- 7.137 With respect to fuel, we consider that supermarkets use their fuel offering as part of their overall proposition to attract customers, and so are often local price-leaders as a result.¹⁷¹ As submitted by the Parties, the PFS customers that also shop in the grocery store have a positive impact on grocery volumes, which is part of the reason why supermarkets choose to operate PFSs adjacent to their stores.
- 7.138 The quantitative available evidence also suggests that there is interaction between this area of the Parties' business and groceries:

¹⁶⁹ According to the available information, Asda has 676 stores employing more than 145,000 people, and 39 distribution centres employing 12,000 people, 4,000 HGVs and 2,000 home delivery vehicles (see Asda's website: [company facts](#)). This meant a spend on retail staff of £[REDACTED] and a spend of £[REDACTED] on staff in warehouse and logistics in the last financial year. Sainsbury's has 33 distribution centres (including Argos) and a spend of c.£ [REDACTED] on staff in warehouse and logistics and £[REDACTED] on retail staff in the last financial year.

¹⁷⁰ [Parties' response to the Issues Statement](#), paragraph 164.

¹⁷¹ For example, the [AA estimated](#) that supermarket prices were 3.5 pence/litre lower than the UK average for unleaded petrol in October 2018.

- (a) according to the CMA store exit survey, 18% of Sainsbury's customers and 15% of Asda's customers at those stores with a PFS had also bought fuel there or were planning to do so; and
- (b) fuel sales account for [20–30%] of store sales ([10–20%] across all stores including those with no PFS) for Sainsbury's and [10–20%] ([5–10%] across all stores including those with no PFS) for Asda.

7.139 In the next chapters, we have taken these interdependencies into account in our investigation and considered how the Parties' activities across all markets in which they operate impact upon how the Merger affects competition in the retail supply of in-store groceries.

8. In-store groceries: unilateral effects

- 8.1 In this chapter we set out our assessment of whether the Merger may give rise to unilateral effects in the retail supply of in-store groceries. We first assess the effect of the Merger on the Parties' supermarkets, and then assess the effect of the Merger on the Parties' convenience stores.
- 8.2 In each case, we start with an assessment of whether the Merger gives rise to competition concerns across the Parties' national store estates. This would be the case if the Parties had an incentive to deteriorate elements of PQRS across all of their stores – for example, through national price rises. This incentive would arise from the accumulation of the loss of competition that the Parties face in every local area where they currently overlap. At the same time, our assessment reflects that many important aspects of the competitive offering (for the Parties and a number of their main competitors) are set uniformly at a national level. Where we find that the Parties would have an incentive to change these nationally-uniform parameters, we would find an SLC in each local market where one or both of the Parties is present (on the basis that harm to consumers would arise in areas where the Parties do not overlap, as well as where they do). By way of shorthand, we refer to this as our 'national assessment'.
- 8.3 We undertake this assessment by considering a range of qualitative and quantitative evidence which provides a view of the competition which the Parties face across their national store estates and which can be expected to inform their conduct at a national level. This includes market share information, internal documents, third party submissions, national switching data, survey responses, and information on the Parties' in-store offering. These sources generally give a national or 'top down' perspective, which is consistent with our understanding of how the Parties monitor and set their competitive offering. Decisions affecting the Parties' national offerings are

driven by trends and competitive pressures at a local level, but centrally-taken decisions are based on a holistic view of the local conditions across all stores, rather than conditions at any particular location. In addition, we take account of the 'bottom up' perspective provided by the aggregated results of our assessment of the upward pricing pressure (as measured by the GUPPI) that the Merger would produce in each local area where the Parties overlap, and which can be expected to inform pricing and other decisions at a national level. These different pieces of evidence draw on different sources but ultimately capture all or part of the same competitive dynamics. Our assessment draws on all of this evidence, to come to a decision in the round.

8.4 We also assess whether the Merger gives rise to competition concerns in certain local markets where the Parties overlap. This would be the case if the Parties had an incentive to deteriorate elements of PQRS only at certain stores – for example, through worsening in-store service levels or stock availability, or reducing range in those stores. In this case, we may find an SLC in each local market where this incentive is likely to arise, but not in others. By way of shorthand, we refer to this as our 'local assessment'. An SLC found on the basis of our local assessment relates to conduct which can vary by store and so is on different grounds to one found on the basis of our national assessment. However, the local assessment reflects the same loss of rivalry as the national assessment.

8.5 For our local assessment, given the very many local areas in which the Parties overlap, and that the competitive pressures in each will vary, it would not have been practicable to assess each of these local areas in turn, using the same range of qualitative and quantitative evidence used for our national assessment. We therefore adopt a methodology (known as the WSS methodology) which allows us to assess, in a consistent way, the potential effect of the Merger in every local market in which the Parties overlap. This methodology captures those characteristics which we found were key drivers of customers' store choice (store size, proximity, and brand) as well as how the competitive strength of a rival store varies with those characteristics (eg how quickly the competitive strength of a store declines over distance, or with reducing store size, and how different brands 'rank' in customers' preferences relative to each other). It uses this information (drawn primarily from the CMA store exit survey, and complemented by evidence from the CMA's entry-exit analysis) to 'weight' the competitive strength of each store relative to all other stores in a local area, which in turn allows us to estimate how (and to what extent) 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 WSS methodology, therefore, more closely reflects how customers actually make their choices (and how stores compete) than a

fascia counting exercise, which simply counts all the brands in a local area, and treats each equally.

- 8.6 We then use the diversion ratios from the WSS, combined with information on the Parties' margins, to produce a measure of how much the Parties would gain from customers switching between them, and therefore the incentive the Parties would have to worsen the in-store offering in each local area post-Merger¹⁷² – referred to as the GUPPI. The higher the GUPPI figure in a local area, the greater the incentive to deteriorate PQRS, and therefore the more likely the merger may be expected to result in an SLC.
- 8.7 Having produced a GUPPI measure for each local area, we then assessed at what GUPPI threshold the Merger may be expected to give rise to competition concerns, and used this as the basis of a decision rule to conclude on which local markets the Merger gives rise to an SLC. In setting our GUPPI threshold, we account for the rivalry-enhancing Merger efficiencies identified, since these can be expected to lead to downward pricing pressure. We also consider what allowance, if any, should be made to account for the requirement that the lessening of competition be substantial, and for any uncertainty in our analysis. Finally, as a cross-check, we consider whether our chosen GUPPI threshold makes sense in light of the wider context of this case and 'real world' factors.

National assessment (supermarkets)

- 8.8 In this section, we examine whether the Merger would give rise to an incentive to degrade PQRS across the Parties' national supermarket estates, resulting in an SLC in each local area where one or more of the Parties' supermarkets is present.
- 8.9 Many of the Parties' commercial decisions are taken centrally (rather than at the store level), and many competitive parameters are applied uniformly, across the Parties' national supermarket estates. For the Parties, this importantly includes pricing.¹⁷³
- 8.10 If the Merger may be expected to result in competition concerns in local areas representing a significant proportion of the Parties' overall supermarket estates, the Merger may create an incentive to worsen the Parties' offerings across all of their supermarkets. We consider that the most likely way in

¹⁷² We explain how this incentive arises in a merger situation as part of our description of horizontal unilateral effects theories of harm in paragraph 6.7.

¹⁷³ See also paragraphs 7.100 to 7.125.

which this could arise is through a national price rise. This would affect each local area where one or more of the Parties is present, including areas where they do not overlap. Any such deterioration across the Parties' estates would reflect the aggregate effect of the loss in competitive constraints that the Parties face in each of the local areas where they operate.¹⁷⁴

- 8.11 To undertake our national assessment, we have considered a range of qualitative and quantitative evidence which provides a centralised, or aggregate, view of the competition which the Parties face.¹⁷⁵ We have assessed what this evidence shows about the closeness of competition between the Parties, and the constraints they face from other grocery retailers.
- 8.12 Whilst acknowledging that there is 'no generic hierarchy in terms of evidence that is informative for the CMA's assessment', the Parties submitted that the CMA's national assessment should not focus unduly on qualitative evidence, in contrast to the local analysis, which relies primarily on the quantitative measure of the GUPPI. The Parties submitted that a consideration of the national weighted-average GUPPI is the most appropriate way of assessing whether the Merger may give rise to an incentive by the Parties to deteriorate centrally-set PQRS, and that it is inconsistent for the CMA to 'place decisive "decision rule" weight on GUPPI at local level, where competition fundamentally takes place, and then accord GUPPI at best supplemental weight in the national analysis'.¹⁷⁶
- 8.13 We agree that there is 'no generic hierarchy in terms of evidence that is informative for the CMA's assessment'. Both qualitative and quantitative evidence can and do provide valuable insights into how competition works in a given industry, and the CMA will typically assess a significant body of both types of evidence in reaching its decisions.
- 8.14 We also consider that where multiple sources of evidence are available, and where it is practical within the constraints of the investigation to combine or

¹⁷⁴ [CMA62](#), paragraphs 1.13-1.17. The Parties argue that there can be no residual national theory of harm (where that theory of harm is based on an aggregation of local effects) if all local SLCs are comprehensively remedied: [Parties' response to the Provisional Findings](#), paragraphs 471-474. The Act requires that we must first identify whether the Merger may be expected, on the balance of probabilities, to give rise to an SLC in any market or markets in the UK. Only after having concluded that an SLC is likely, must we turn to the question of what remedial action would comprehensively address that SLC. This chapter therefore considers only our SLC finding; we address remedies in Chapter 18.

¹⁷⁵ Some of this evidence provides an indication of the relative strength or positioning of individual competitors (but does not necessarily take into account the extent to which these competitors overlap with the Parties, in aggregate, across their estates), while other evidence takes into account both the strength of competitors and the extent to which they overlap with the Parties.

¹⁷⁶ [Parties' response to the Provisional Findings](#), paragraphs 364-367.

take account of those multiple sources of evidence within the assessment, it is appropriate (and indeed preferable) to do so.

- 8.15 In this respect, there are important differences between our national and local assessments, with implications for the evidence that we rely upon for each.
- 8.16 As discussed further at paragraphs 8.112 onwards, our local assessment requires assessing how the Merger may affect conditions of competition in each of hundreds of local areas. Given the scale of this assessment, relying on a GUPPI-based decision rule allows us to analyse, in a consistent way, the impact of the Merger on the Parties' incentives in each local overlap area without requiring a further individual analysis of each area in turn. Reviewing a range of evidence (such as internal documents, third party views, local in-store offerings, entry-exit data, etc) on an area-by-area basis in around 1,000 local areas would clearly be impracticable in the time available for our enquiry, even if such evidence existed.
- 8.17 For the purposes of our national assessment, on the other hand, there are multiple sources of evidence available to us which provide insights on the Parties' competitive position across their national supermarket estates. It is appropriate for us to take into account these different sources of evidence in the round in reaching our decision on whether the Merger gives rise to concerns at a national level. Many pieces of evidence corroborate or support other pieces of evidence, because the competitive dynamics which they capture are similar.¹⁷⁷
- 8.18 Taking into account this range of evidence is also consistent with our understanding of how the Parties monitor and set their competitive offering at a national level. Whilst the markets for the retail supply of in-store groceries are local, the Parties are large, nation-wide players, as are most of their effective competitors. As set out in paragraph 7.1, they operate under national brands; they advertise nationally; and important elements of their offering are set centrally and applied across their national store estates. While our national assessment considers the aggregate effect of any loss of competition across each of the local areas in which the Parties overlap, we consider that taking only a 'bottom up' approach of considering the aggregated GUPPIs, and not also a 'top down' approach of considering

¹⁷⁷ For example, the fact that the Parties monitor one another in their internal documents reflects that they are competing with one another for customers; this is in turn reflected in the switching patterns that we identify in the Kantar data, and the diversions that we observe in the CMA exit survey. The diversions themselves then feed into the weighted-average GUPPI figures, which provide a further, quantitative measure of the closeness of competition between the Parties.

evidence on the Parties' position overall, would exclude evidence relevant to understanding the effect of the Merger.

8.19 In the following sections, we first set out the Parties' submissions and those made by third parties, before reviewing in turn the following:

- (a) evidence on shares of supply;
- (b) evidence from the Parties' internal documents;
- (c) customer switching patterns, on an aggregated national basis, based on Kantar data;
- (d) views from other grocery retailers;
- (e) responses from the CMA store exit survey;
- (f) evidence on the Parties' and rivals' in-store offering;
- (g) for each Party, the national weighted-average GUPPI,¹⁷⁸ including evidence on the scale of the geographic overlaps between the Parties; and
- (h) other evidence, including on customer demographics and cross-shop data.

Parties' views

8.20 The Parties submitted that the Merger would not result in an incentive to worsen parameters of competition which are set centrally and applied uniformly across the Parties' respective store estates for the following reasons:

- (a) There are no discrete 'national' parameters of competition that exist in isolation from, and are not economically determined by, individual or aggregate local competition pressures. To the extent that certain competitive variables, notably pricing but equally brand factors or innovation, are set centrally across stores, these are based on the aggregated pressure of local competition across the estate.
- (b) The aggregate incentives of the Parties will not change post-Merger as there will be no substantial reduction in aggregate competitive pressure. The national weighted-average GUPPI for both Parties (on the Parties'

¹⁷⁸ This is an index measure calculated from combining diversion ratios and margin information, to provide an indication of the upward pricing pressure incentive at the national level that is expected to result from the Merger.

calculations) is less than 3% and hence suggests insufficient upward pricing pressure to be consistent with an expectation of a material adverse effect.

- (c) The Merger will result in a low combined market share (between 23% and 26.2% by value), and the Parties' market share has been declining over recent years (whilst Aldi and Lidl have been expanding and have stated they will continue to do so in future). The Parties submitted that these shares would be lower if considered on a volume basis, or if online sales were excluded. The Parties submitted that these shares are well below the level which the UK competition authorities normally associate with prima facie unilateral effects concerns, submitting that past decisions and the CMA's Retail Mergers Commentary acknowledge that combined market shares of less than 40% will not often give the CMA cause for concern over unilateral effects.¹⁷⁹
- (d) In recent years there have been changes in consumer demand and in the supply-side options available to meet these demands that have resulted in a transformation of how customers shop for groceries. In particular, the Parties submitted that the 'big weekly shop' at a traditional grocery retailer and the popularity of large stores is in decline. According to the Parties, customers in aggregate are now more likely to purchase food for dinner on the way home from work, do smaller 'main' shopping trips for key items topping-up with (fresh) items as needed throughout the week, and use online home delivery to buy bulk or heavy items several times a month. As such, the distinction between shopping missions of 'main shop' and 'top up' are increasingly obsolete. The Parties also submitted that the brand loyalty to traditional retailers has decreased, as shown by market research.
- (e) The Parties face significant competition from rivals that are as close or closer competitors to the Parties than they are to each other. The Parties submitted that each of them faces significant individual constraint from each of at least eight grocery retailers (Tesco, Morrisons, the other Party, Waitrose, M&S, Co-op, Aldi and Lidl).
- (f) Aldi and Lidl particularly have had a profound impact on the UK retail market in recent years, moving from niche players to mainstream rivals. The Parties submitted that these grocery retailers provide strong offerings in both quality and price and that there is no significant difference in the

¹⁷⁹ Parties' response to the Provisional Findings, paragraphs 395–402.

type of 'baskets' their customers purchase, or the proportion of 'main shops' they serve compared the Parties and other 'traditional retailers'.¹⁸⁰

- (g) The Parties face competition from other grocery retailers such as Iceland, bargain stores, and many strong smaller and regional operators (amongst other constraints).
- (h) Meanwhile, the Parties are not particularly close competitors to each other. The Parties submitted that customer perception data shows that customers perceive the Parties' brands as significantly different and each of the Parties appeals to different consumer demographics. They state that switching data indicates that both Parties experience [X] losses to Aldi and Lidl combined than they do to each other, and that cross-shopping data shows that a higher proportion of each Party's customers also shopped in Tesco, Morrisons, Aldi and Lidl than also shopped at the other Party.
- (i) The Parties submitted that the CMA store exit survey generally supports the submissions made by the Parties – particularly regarding the constraint on the Parties from Aldi and Lidl. The Parties submitted that the survey supported that there is significant diversion of the Parties' customers to Aldi and Lidl (with diversion of Asda customers to Aldi and Lidl 'combined' higher than diversion to Sainsbury's);¹⁸¹ that, particularly for Sainsbury's customers, diversions to Waitrose, M&S and Co-op (each between 3% and 6%) were also 'high';¹⁸² that Medium stores, including those of Aldi and Lidl, exert a constraint on the Parties' stores (including Large stores); that having a wide range of products is only an important determinant for a very small proportion of customers; and that customers who would divert to Aldi and Lidl are on average more likely to increase the number of items they would buy from the discounters (showing that customers are not switching only a small proportion of their baskets in light of more limited range).
- (j) The 'Big 4' is not a homogenous group, and the CMA should not downplay the fact that the offerings of the Parties (and other members of the 'Big 4') are differentiated from each other, and importantly that Tesco is a materially stronger constraint on each Party than they are on each other.¹⁸³ The Parties dispute that they perceive the Big 4 as a 'distinct

¹⁸⁰ By which the Parties meant in this case the Parties, Tesco and Morrisons. The Parties use 'traditional retailers' to mean other groupings of retailers in other contexts.

¹⁸¹ [Parties' response to the Provisional Findings](#), paragraph 409.

¹⁸² [Parties' response to the Provisional Findings](#), paragraph 409.

¹⁸³ [Parties' response to the Provisional Findings](#), paragraph 356.

group',¹⁸⁴ or that the 'Big 4' feature 'most prominently' in their internal documents.

- (k) Overall, the CMA's assessment should take account of the dynamic nature of the groceries market. This includes, on the supply-side, competitors' repositioning to improve and upgrade their offer, and future entry beyond planned store openings – in particular by Aldi and Lidl, but also developments in online groceries. On the demand-side, the CMA should take into account that its diversion ratio estimates do not account for changing customer preferences, assuming these are 'locked in' as at the date of the survey, and failing to capture how closely customers consider their third or fourth preferences, or what they would do if Aldi or Lidl opened more stores or repositioned further.¹⁸⁵

Third parties' views

- 8.21 We received a range of views from other grocery retailers on the relative positioning of the Parties and their competitors.
- 8.22 As noted in paragraph 7.22, we acknowledge that different grocery retailers will have different incentives when engaging with the CMA, and that views submitted by third parties (as with all evidence, including that of the Parties) should be carefully evaluated in light of all of the available evidence. We have taken this into account when considering the views of third parties and the weight that can be placed on them.
- 8.23 In general, grocery retailers agreed that there was a degree of differentiation in the market, with different grocery retailers (or groups of retailers) positioned to serve different types of customers and shopping trips or 'missions'. Some third parties also indicated that different groceries retailers competed more or less closely depending on the customer 'mission' (eg whether the customer is undertaking a 'main shop' or just purchasing a few items for dinner), product category (eg fresh, packaged) and product tier (eg 'entry level' vs 'finest').
- 8.24 A number of third parties identified the 'Big 4' retailers as overall having similar business models, customer offerings, and brand positioning. For example, Tesco submitted that, while its core competitors varied depending on the customer and the mission, for many missions the rest of the 'Big 4' retailers were its closest competitors given their comparable breadth of

¹⁸⁴ [Parties' response to the Provisional Findings](#), paragraph 439.

¹⁸⁵ [Parties' response to the Provisional Findings](#), paragraphs 112–113.

range, offer and pricing. Tesco submitted that the 'Big 4' are the closest in terms of offering similar pricing, the same breadth of range, stores of the same size, and the most comparable in-store offer (in terms of meat and fish counters,¹⁸⁶ general merchandise and additional products like fuel).

Morrisons submitted that there were a limited number of grocery retailers that operated 'one-stop' shops in the way operated by Tesco, Morrisons and the Parties and identified these retailers as its closest competitors. M&S also noted that it groups Tesco, Sainsbury's, Asda and Morrisons as having 'similar associations' and therefore perceived as performing broadly similar roles for consumers.

8.25 Some third parties nevertheless perceived some differences between Tesco, Morrisons, Sainsbury's and Asda, with Asda generally perceived as the price leader and Sainsbury's generally perceived as having a higher quality of service and products. For example, Aldi submitted that Asda's and Sainsbury's current strategies had each sought to differentiate themselves from other 'Big 4' retailers: Sainsbury's through becoming 'more premium' and Asda through strengthening its position as a value retailer.

8.26 With respect to discounters, while third parties generally noted a degree of competition between the 'Big 4' (or 'typical supermarket' retailers) and discounters, they indicated that the constraint from discounters on such retailers is more limited than the constraint of the 'Big 4' on one another. Various reasons were given for this, including: the different offering and more limited range of discounters, differences in store environment, breadth of range and level of customer service. Some third parties nevertheless noted the direct impact of discounters on the Parties' competitive offering and commercial strategy. A more detailed description of third parties' views on discounters is included in paragraphs 7.24 to 7.29.

8.27 With respect to other grocery retailers:

- (a) In general, third parties identified M&S and Waitrose as high-priced retailers with a higher perceived level of quality and service (see paragraph 7.34);
- (b) generally, few third-party grocery retailers who responded to the CMA's investigation listed the bargain stores as amongst their main competitors (see paragraph 7.31); and

¹⁸⁶ On 28 January 2019, Tesco announced that it would be closing counters at around 90 stores, with the remaining 700 stores trading with either a full or flexible counter offer: Tesco news release, *Building a simpler, more sustainable business*, 28 January 2019. See further paragraph 8.85.

- (c) a number of third parties differentiated Co-op from other retailers on the basis of its focus on convenience missions (in which it was perceived as a strong competitor) or its store locations while one third party (Tesco) submitted that Iceland targets specific categories, missions and customer demographics (see paragraphs 7.33 to 7.34).

Our assessment

Shares of supply

- 8.28 As set out in paragraph 4.1, the Parties are the second and third largest grocery retailers in the UK. Together, we estimate that the Parties' combined share is 29% of sales on a UK-wide basis.^{187,188} Post-Merger, the Parties would be the largest grocery retailer by share of sales, overtaking Tesco (with a current estimated share of supply of c.27%) and nearly three times the size of the next largest grocery retailer, Morrisons, with an estimated share of c.10%.¹⁸⁹
- 8.29 The Parties' statement that the Retail mergers commentary (which in turn references the Guidelines) acknowledges that combined market share of less than 40% will not often given cause for concern omits the fact that this statement is made specifically with respect to undifferentiated product markets.¹⁹⁰ In a differentiated market such as the retail supply of in-store groceries, while shares of supply may act as a useful starting point, we consider that they are only one indicator of potential competitive constraint, and must be considered alongside the body of evidence on the closeness of competition between the Parties, and the nature of competition in the market as a whole, as set out in the remainder of this chapter.¹⁹¹

¹⁸⁷ See paragraph 4.27 and footnote 73 in Chapter 4. The Parties submitted that their combined share is lower than this, at no more than 26.2%. This is based on Kantar market share estimates which include all groceries sales, including those by 'non-grocers' (which includes retailers such as Boots). As we consider groceries sales by non-grocers to be 'out-of-market' constraints in our competitive assessment, we consider that it is appropriate to exclude these sales from our market share estimates. Our estimates are therefore based on including only those retailers that Kantar classifies as grocers, but with the addition of M&S, which Kantar classifies as a non-grocer but which we consider a grocery retailer for the purposes of our analysis.

¹⁸⁸ We consider that shares of supply by value remain the most meaningful measure of shares of supply for our analysis: this is consistent with *CC2 Revised*, paragraph 5.3.3, which states that 'when products differ in quality it may be appropriate to use sales revenue as the basis' for share of supply calculations. We note that excluding online grocery sales makes only a negligible difference to these shares of supply (reflecting the fact that online sales account for a much smaller proportion of the Parties' sales than in-store sales), reducing Sainsbury's share of supply by 0.1%, and Asda's by 0.2%.

¹⁸⁹ All market shares are as estimated in Figure 4.3.

¹⁹⁰ 'Previous CMA decisions in mergers in markets where products are undifferentiated suggest that combined market shares of less than 40% will not often give the CMA cause for concern over unilateral effects.' *CMA62*, paragraph 3.36 (emphasis added); *CC2 Revised*, paragraph 5.3.5.

¹⁹¹ The Parties also reference in support of their arguments that these shares are presumptively non-problematic in EU merger decisions and case law and 'past decisions' of UK authorities ([Parties' response to the Provisional](#)

- 8.30 We recognise that the Parties' shares of supply have been falling in recent years. However, we note that this reduction in share amounts to less than four percentage points (on the Parties' estimates), in total across both Parties, over the seven years from 2011 and 2018. We consider that this does not represent such a significant change as to alter our overall findings, based on the remaining evidence set out in this chapter, that the Parties are close competitors to one another.
- 8.31 We recognise that Aldi and Lidl have grown in the same period (by six percentage points, combined, in the same seven year period) and the increasing prominence of these grocery retailers is reflected in other evidence examined in this chapter, such as the focus these retailers receive in the Parties' internal documents and the diversions they achieve in the CMA's store exit survey (reflected in the weights they are given in the WSS). Even taking into account this growth however (and considering the constraint imposed by the discounters on the Parties), we still find that the Parties remain sufficiently close competitors to one another such as to raise concerns that the loss of competition between them as a result of the Merger would be significant.
- 8.32 We also recognise that the discounters are expected to expand further and have taken this into account directly in our assessment. As set out in paragraphs 8.363 to 8.364 where we have found evidence that any rival grocery retailer, including Aldi and Lidl, is likely to open a new supermarket in a timely fashion (for which we use, consistent with past practice and our guidance, a two year time horizon),¹⁹² we have included these in our analysis as an additional competitive constraint in the local area where they plan to open. In the case of Aldi and Lidl, this has resulted in the inclusion of around an additional [X] stores within the next two years. However, to account for any further, unspecified and uncertain changes in the groceries market, would not be appropriate.

[Findings](#), paragraphs 400–401 and footnotes 225 and 227). With respect to the former, we note that the cases cited were decided under the previous version of the EU Merger Regulation, which used a different legal test to that applied under the Act and which are not relevant to our assessment. With respect to the latter, the Parties reference a single case, which confirms the position set out in the Guidelines that 'Shares of supply are generally a useful tool to start to assess market power. However, [...] these shares are less conclusive as services are highly differentiated.' Anticipated acquisition by Pearson Professional Assessments Limited of the computer-based testing business of learndirect Limited (ME/6562/15), 2 December 2015, [Phase 1 decision](#), paragraph 64 (emphasis added).

¹⁹² [CC2 Revised](#), paragraph 5.8.11.

Internal documents

- 8.33 The Parties provided a large number of internal documents to the CMA in response to information requests. These included:
- (a) documents presented at a number of key commercial boards and committees of each Party, dating between 2015 to mid-2018 (the 'Board and Committee documents', around 2,650 documents); and
 - (b) internal email files selected on the basis of keyword searches across the email files of identified key custodians of each Party, dating between 2015 and mid-2018 (the 'internal email files', around 136,000 documents).
- 8.34 The Board and Committee documents were individually reviewed by the CMA, while the internal email files were reviewed on the basis of further keyword searches using a specialist document review software platform. The findings summarised in this section are informed by all the above documents, but focus particularly on the documents of certain commercial boards and committees which we found to be most relevant for our assessment.
- 8.35 Based on this review we found that:
- (a) Both Parties regularly monitor a broad range of grocery competitors. While the precise competitor set varies between documents, and some competitors feature more prominently in one Party's documents than the other, overall the group of competitors each Party monitors is similar. For both, at a minimum this typically includes Tesco, the other Party, Morrisons, Aldi and to a lesser extent Lidl. For Sainsbury's, Waitrose, M&S and Coop also feature prominently (for Asda, to a lesser extent). Other competitors, including Iceland and the bargain stores (eg B&M and Home Bargains), appear, albeit with less frequency or prominence.
 - (b) Both Parties recognise the 'Big 4' (a term used in both Parties' documents as a shorthand term)¹⁹³ as a distinct group, and regularly refer to their own performance relative to this group. In Sainsbury's documents, the performance of [X]. For both, performance against the 'Big 4' is an important strategic focus.
 - (c) Aldi and Lidl are a clear focus in both Parties' documents. Each Party frequently compares its own performance (or that of the 'Big 4' generally)

¹⁹³ In Asda's documents, 'Big 3' rather than 'Big 4' is also frequently used when Asda refers to Tesco, Sainsbury's and Morrisons as a group.

to that of the discounters (with Aldi discussed more frequently than Lidl) and ensuring competitiveness against these retailers is a strategic focus.

8.36 The Parties argue that their internal documents show that the Parties monitor a wide range of competitors, with Aldi and Lidl being a clear focus. The Parties use a simple counting measure to record the number of competitor mentions. According to the Parties, this shows that, within a subset of the Asda Board and Committee documents, [REDACTED]. In a subset of Sainsbury's Board and Committee documents, [REDACTED].

8.37 We note that there are shortcomings to using a simple count of competitor mentions, particularly where an in-depth review of the documents has been possible. This approach fails to account for the context in which a term is used, or the reasons why some terms may appear more frequently than others. First, it counts all mentions as 'equal', whereas a mention that appears as the titular, or first, point on a slide/page may tell us something about its relative importance. Second, it does not account for the fact that, where competitors are used as a benchmark or proxy, they will be cited more frequently. One recent Asda internal document indicates that [REDACTED],¹⁹⁴ and Sainsbury's has submitted that, [REDACTED]. [REDACTED], and we would expect that the use of [REDACTED]. Similarly, where collective terms are used for groups of retailers, this will reduce mentions of individual retailer names (both Parties frequently use the terms 'Big 4' and 'discounters', as well as 'traditional retailers' and 'premium retailers'); but this does not undermine the fact that each reference to the 'Big 4' (which, as noted above, is a term used frequently in both Parties' documents, and as set out below acts as an important benchmark/comparator) is equivalent to a reference to each of Tesco, Morrisons, Sainsbury's and Asda. Finally, new developments and rising competitors may receive more focus (and therefore get more mentions) than established patterns or players. As set out in paragraph 4.8 to 4.10, the growth of the discounters (and their increasing importance within UK grocery retailing) is a major recent development and we would expect these players to therefore be monitored closely. However, high frequency of mentions will not necessarily mean that these are the retailers which the Parties consider to be their closest competitors.

8.38 While a competitor count may be a useful measure in some contexts (including where it is possible to take into account the relative importance of mentions),¹⁹⁵ we consider that an overall assessment of the documents

¹⁹⁴ One chart reads [REDACTED].

¹⁹⁵ For example, in *Electro Rent/Microlease*, the CMA was able to take into account when counting competitor mentions that several mentions of a competitor may nevertheless all relate to a single point, and in these cases

based on our in-depth review is more informative than using a simple counting measure across the total document population in the circumstances of this particular case.

Parties monitor a wide range of competitors

8.39 With regard to our review of Sainsbury's internal documents:

- (a) Some Sainsbury's documents identify a 'wider market' that comprises a broad range of food and non-food offerings, including supermarkets, discounters, online grocers, bargain stores, wholesalers, convenience stores, home and beauty, beer, wine and spirits retailers, and restaurants.
- (b) However, Sainsbury's regular reporting typically monitors a subset of competitors, comprising [REDACTED].¹⁹⁶
- (c) Sainsbury's monitors its position via a 'Value Index', which tracks Sainsbury's price positioning relative to its competitors. The Value Index currently tracks against a wide set of competitors, [REDACTED].¹⁹⁷
- (d) Under its [REDACTED].
- (e) On a periodic basis, the commercial and pricing strategies of certain competitors may receive added focus through 'deep dive' assessments ([REDACTED]). Other competitors are commented upon on a more ad hoc basis in regular reporting.

8.40 With respect to our review of Asda's internal documents:

- (a) Asda, too, monitors a range of competitors. Asda's regular reporting focuses on a subset of competitors which in some cases is slightly narrower than Sainsbury's, although the competitor set chosen varies [REDACTED]. For example:
 - (i) Recent editions of the Asda Customer Board reproduce charts on grocery spend growth, switching trends, and performance against factors such as growth in number of shoppers, frequency of visit and basket size, against [REDACTED].

did not count these references more than once: Completed acquisition by Electro Rent Corporation of Microlease, Inc. and Test Equipment Asset Management Limited (17 May 2018), *Final report*, footnote 306.

¹⁹⁶ [REDACTED].

¹⁹⁷ These wider competitors are shown in [REDACTED].

- (ii) In Asda Customer Board and Commercial Board packs, a slightly narrower competitor set of [REDACTED].
 - (iii) On a more ad hoc basis, charts compare Asda's position against a narrower or wider competitor set (which may additionally include eg [REDACTED] appear consistently, and [REDACTED].
- (b) The Parties submitted that the more limited set of competitors shown in some of these charts is a function of the fact that Asda chooses to reduce the number of lines (ie retailers) to make them more readable. The Parties submitted that senior management also receive Kantar data containing information on a much wider set of competitors, showing that the competitors shown in Asda's documents should not be considered a 'more typical' set of comparators. However, we consider that where certain retailers have been specifically chosen for inclusion in Asda's internal documents, this is likely to be informative of which competitors Asda considers important from within any wider set.

'Big 4' identified as an important comparator and members of Big 4 (and especially Tesco) featuring more prominently than other retailers

8.41 With respect to our review of Sainsbury's internal documents:

- (a) While Sainsbury's typically monitors a wider set of retailers, its documents identify the 'Big 4' (a term used frequently) as an important reference group within this wider competitor set. [REDACTED].¹⁹⁸
- (b) In some analyses, Sainsbury's relative position to Tesco, Asda and Morrisons is discussed first, ahead of other competitors. [REDACTED] (the most recent edition reviewed), [REDACTED].
- (c) Tesco tends to receive additional focus. [REDACTED].
- (d) A focus on the 'Big 4' and Tesco is also visible in Sainsbury's commercial target setting and price benchmarking, as discussed in paragraph 8.49 below.
- (e) Asda and Morrisons do not individually receive more prominence in regular reporting compared to other retailers (outside of the extensive references to the 'Big 4'), [REDACTED].

¹⁹⁸ [REDACTED].

- (f) Finally, some documents indicate that, while Sainsbury's recognises differences within the 'Big 4' retailers, it nevertheless perceives the 'Big 4' to be distinguishable from other 'more distinctive' offers. [REDACTED].

8.42 With respect to our review of Asda's internal documents:

- (a) Asda's documents also identify the 'Big 4' (sometimes referred to as the 'Big 3', excluding Asda) as an important reference group within its wider competitor set. For example, the [REDACTED]. Performance against the 'Big 4' is cited frequently in regular reporting.¹⁹⁹
- (b) As noted in paragraph 8.40(a)(iii), when presenting charts tracking performance of a number of retailers, [REDACTED] appear consistently in all charts, sometimes as the only competitors. [REDACTED].

Discounters

8.43 Both Parties' documents demonstrate a clear focus on Aldi and Lidl. In strategic overviews, the 'threat' of the discounters is a common theme, and in regular reporting, both Parties compare their performance relative to these competitors. Aldi is mentioned more frequently than Lidl.

8.44 With respect to our review of Sainsbury's internal documents:

- (a) In Sainsbury's strategic documents, discounters are presented as a key competitive threat to Sainsbury's and other members of the Big 4, offering a strong customer proposition across both price and quality to rival traditional retailers. In [REDACTED].
- (b) Strategic and board level documents discuss strategies to counter the discounters both in general terms and [REDACTED].²⁰⁰ [REDACTED].
- (c) Comparisons of Sainsbury's performance against the discounters also appear frequently in regular reporting.²⁰¹ [REDACTED].

8.45 With respect to our review of Asda's internal documents:

- (a) [REDACTED].
- (b) [REDACTED].

¹⁹⁹ [REDACTED].

²⁰⁰ [REDACTED].

²⁰¹ [REDACTED].

Competitor benchmarking

- 8.46 The Parties submitted that the CMA fails to consider the relative importance of different retailers in the Parties' approach to setting PQRs (or strategic decision-making generally). For instance, the Parties submitted that [REDACTED]. The Parties submitted that [REDACTED].²⁰²
- 8.47 We have considered the role of different retailers in the Parties' commercial targets and other KPIs in our review of the Parties' internal documents.
- 8.48 With respect to Asda:
- (a) As set out above, Asda [REDACTED]. However, also as set out above,²⁰³ a recent Asda internal document indicates that [REDACTED];²⁰⁴
- (b) Further, [REDACTED] feature in Asda's KPIs. [REDACTED].
- 8.49 As regards Sainsbury's:
- (a) [REDACTED].²⁰⁵

Conclusion on internal documents

- 8.50 In conclusion, the evidence from the Parties' internal documents shows that while each Party monitors a wide range of competitors (which includes one another, other traditional retailers, the discounters, and others), both Parties recognise the 'Big 4' (a term which both use frequently in their internal documents) as a distinct group, against whom they regularly measure their own competitive performance, indicating that these retailers act as important competitors to both Parties.
- 8.51 Whilst we recognise that there is some differentiation between the Parties in terms of their competitive positioning, our assessment is not concerned with identifying whether each Party is the other's closest competitor (the evidence we have considered generally suggests that Large Tesco supermarkets provide the greatest competitive constraint to both Parties), but instead whether they are sufficiently close competitors to each other that the loss of constraint they impose on each other following the Merger would amount to a substantial lessening of competition.

²⁰² Parties' response to the Provisional Findings, paragraph 425.

²⁰³ See paragraph 8.37.

²⁰⁴ One chart reads [REDACTED].

²⁰⁵ [REDACTED].

8.52 Tesco features [X] in both Parties' documents, indicating that it acts as the most important constraint on each Party. While the other Party and Morrisons tend not to individually receive more prominence compared to other retailers (outside of the extensive references to the 'Big 4'), we note that the Parties' use of [X] will reduce references to Morrisons and the other Party in the documents reviewed. As such, the [X] of Tesco may in fact misrepresent the extent to which Morrisons and the other Party are viewed as important competitors.

8.53 Both Parties' internal documents also show a clear competitive focus on the discount retailers. That being the case, a mere competitor count is likely to overstate the extent to which these retailers impose a constraint on the Parties, given that we would naturally expect more frequent mentions to be made to rising competitors such as these, over more established (and potentially closer) rivals.

Kantar Worldpanel switching data

8.54 We have analysed data on customer switching habits, compiled by the third-party data provider Kantar. This information is gathered from a panel of 30,000 households who scan in the barcode of the grocery products they purchase. As the same households are tracked over time, this allows Kantar to establish whether households are shifting some grocery spend from one retailer to another, as well as whether they are increasing or decreasing spend in total.

8.55 We consider that, for the purposes of assessing closeness of competition, information on customer diversion (that is, the extent to which customers would switch in response to a small change in PQRS) is generally more informative than customer switching data (which does not account for the reason for changes in customer purchasing habits, which may be unrelated to competition). For this reason, we place considerable weight on customer diversion ratios²⁰⁶ calculated from the CMA store exit survey, as discussed in the context of our local assessment (paragraphs 8.136 to 8.145 below). Nevertheless, we consider that the Kantar switching data may also provide a useful indication of the degree of competition between the Parties, and between each Party and other grocery retailers. It provides data on real observed customer behaviour; many grocery retailers use the data in their

²⁰⁶ The diversion ratio from Store A to Store B is the proportion of customers that would switch to Store B in response to a worsening of Store A's competitive offering, as a proportion of all customers that would switch away from Store A. In other words, if Store A raises its price and 100 customers switch away from Store A and, of those 100 customers, 20 choose Store B, the diversion ratio from Store A to Store B would be 20%.

own businesses; and the sample size is large, so we consider the results to be robust.

- 8.56 However, in order to interpret the data correctly for the purposes of our assessment, we consider that it is important to make some adjustments to account for the fact that some of the switching recorded in the Kantar data may represent migration of customers; eg, customers moving to a preferred retailer that has opened in a new area. Where customers migrate in this way, they may be less likely to switch back, even if the 'losing' retailer improved its PQRS (as we are most interested in how customers would respond to changes in PQRS, this is relevant). We consider that this is particularly important in this case, given that Aldi and Lidl are growing quickly through store openings. While the opening of an Aldi or Lidl store may result in an initial migration of customers, subsequent small changes in PQRS, by Aldi/Lidl or the Parties, may have much less impact on these customers. As such, the level of switching between the Parties and each of Aldi and Lidl as shown through the Kantar data may not accurately represent the ongoing constraint from those retailers.
- 8.57 We note this is supported by a Tesco internal document reviewed as part of the investigation, which observed that (i) switching to the discounters is heavily driven by new store openings and (ii) Tesco perceived these customer losses as less 'influenceable' (ie possible to respond to) than switching to the other 'Big 4'. As a result, the internal document indicated Tesco focused its price investment on specific product categories, reflecting where switching to the 'Big 4' was more significant.
- 8.58 The appropriateness of distinguishing between these categories of growth when interpreting the Kantar switching data is also supported by a Sainsbury's internal document which includes analysis which attempts to quantify the extent of switching driven by store openings versus switching on a 'like-for-like' basis.
- 8.59 We have adjusted the Kantar data to disaggregate switching driven by new store growth from switching driven by like-for-like sales growth, using the analysis in this internal document, which suggested that like-for-like growth as a proportion of all growth was [X] % for Aldi and [X] % for Lidl.
- 8.60 The Parties submitted that this adjustment to the Kantar data 'results in an inconsistent approach to entry by Aldi and Lidl': on the one hand Aldi and Lidl are weighted down 'on account of their rapid growth'; on the other hand, the CMA's overall analysis of national unilateral effects 'ignores this rapid growth'. The Parties submitted further that the adjustment amounts to a

'novel methodological approach', 'substantiated by a single Sainsbury's internal document'.²⁰⁷

- 8.61 We disagree with this characterisation. As set out above, the adjustment is not made 'on account of' the growth by Aldi and Lidl, but because we consider that switching to these retailers following new store openings may not accurately represent the ongoing constraint from those retailers. As set out above, the appropriateness of adjusting the Kantar switching data to reflect the conditions of competition in this case is supported not only by a Sainsbury's internal document which distinguishes between like-for-like and new store growth, but also by a Tesco internal document, which additionally indicates that Tesco perceives competition from discounter new store growth differently. We also disagree with the Parties' submission that the CMA's analysis fails to account for the growth of Aldi and Lidl; we address this in paragraphs 8.31 to 8.32 above.
- 8.62 Having initially adjusted the switching losses using analysis set out in a Sainsbury's internal document, we consulted the Parties on this approach. We then adjusted the analysis following submissions from the Parties.²⁰⁸ The results are shown in Figures 8.1 and 8.2. We have focused on switching losses as the measure that we consider most closely proxies for diversion and is most informative about closeness of competition.²⁰⁹
- 8.63 This shows that Tesco (which does not have significant planned store openings) acts as an important constraint on both Parties, accounting for approximately [25–30%] of switching losses. For both Parties, Morrisons and the other Party (none of which have significant store openings either) are the next most important constraints, each accounting for 10–15% of switching losses. For Asda, this is followed by Aldi, Lidl and Co-op (5–10% each), and then Iceland, Waitrose, M&S and the bargain stores (each [0–5%]). For Sainsbury's, the picture is similar, although Waitrose is a more important constraint (5–10%) compared with Aldi, Lidl, Co-op and M&S, who are slightly less important ([5–10%] each).²¹⁰

²⁰⁷ [Parties' response to the Provisional Findings](#), paragraphs 404 and 405.

²⁰⁸ The Parties submitted in response to working papers that our initial calculations had not applied the adjustment to Aldi's and Lidl's switching losses correctly, on the basis that we had excluded all sales to new stores, and applied the reduction directly to switching losses, rather than net switching. We applied the Parties' suggested amendments, with a small adaptation. We explain the Kantar switching data and our methodology for the adjustment in Appendix D.

²⁰⁹ The Parties argue that we should be looking at net switching because this measures exactly how much sales they are losing to competitors. We disagree, given that net switching masks competitive interaction (as two retailers that lose large, but very similar, amounts of sales to each other will look the same as two competitors which lose very few sales to each other).

²¹⁰ When comparing the constraint on the Parties of different retailers, the Parties note that switching to Aldi and Lidl 'combined' is greater than switching to Sainsbury's for Asda, and similar to switching to Asda for Sainsbury's.

Figure 8.1: Adjusted switching losses from Asda: Proportion of value lost to each retailer



Source: CMA analysis of Kantar WorldPanel 52 week switching 2015,2016,2017,2018 (provided by Asda)

Figure 8.2: Adjusted switching losses from Sainsbury's: Proportion of value lost to each retailer



Source: CMA analysis of Kantar WorldPanel 52 week switching 2015,2016,2017,2018 (provided by Asda)

8.64 We consider the results from this Kantar switching analysis support a finding that, for both Parties, Tesco is the most important constraint, with Morrisons and the other Party the next most important constraints. It also supports a finding that Aldi and Lidl are a constraint to some degree on both Parties and particularly on Asda, but not to the extent of Tesco, Morrisons and the other Party (and for Sainsbury's, also not to the extent of Waitrose). For Sainsbury's, Waitrose is a material constraint (but much less so for Asda). Co-op, M&S and Iceland also impose a smaller constraint than Tesco, Morrisons and the other Party.

Survey responses

8.65 The CMA store exit survey was a substantial evidence-gathering exercise, interviewing over 20,000 of the Parties' in-store customers across the UK. The Parties also submitted a number of their own surveys. We discuss these further in the context of our local assessment, in paragraph 8.136 onwards and in Appendix B.

8.66 The CMA store exit survey asked Asda and Sainsbury's customers a range of questions about where they would have done their shopping had they not been able to shop at the Party's store (diversion questions). We use the results of these questions in the local assessment. Other questions asked which elements of a grocery retailer's offering were most important to customers (choice attributes), which helps inform our understanding of the parameters on which each of the Parties compete with other grocery retailers. Further questions asked about what items or services customers purchased, to understand how customer purchases interact across the Parties' businesses. We review the results of these questions in aggregate, across the surveyed sample.

This does not detract from our finding that each Party is an important constraint on the other (and a more important constraint than either of the discounters individually). Other retailers which the Parties submit are 'significant' constraints based on this analysis (M&S, Co-op and Waitrose) each account for materially smaller shares of switching than the other Party. [Parties' response to the Provisional Findings](#), paragraph 407.

- 8.67 The Parties submitted concerns regarding the representativeness of the CMA store exit survey. These concerns are described more fully in paragraph 8.168 onwards. As discussed in our local assessment and Appendix B, we consider that the survey produces robust results across the sampled stores and that, when analysed and interpreted appropriately, it is a robust source of evidence for the purposes of our assessment.
- 8.68 Regarding the diversion questions, we note that, as the CMA store exit survey focused primarily on areas of overlap between the Parties, while the diversion patterns across surveyed overlaps may be expected to be broadly representative of overlap areas, they may not be fully representative of all areas.²¹¹ We therefore do not take into account the aggregate diversion patterns as part of our national assessment (although the survey results do contribute to calculating the WSS, and therefore the national weighted-average GUPPI, as discussed at paragraph 8.92 below). Nevertheless, even taking the Parties' submissions regarding these aggregate diversion patterns on their face, we consider that they support a finding that the Parties are close competitors in the surveyed areas. For both Parties, after Tesco (which receives the greatest diversion at c.28-30%), the other Party receives the next highest diversion: 18% for Sainsbury's customers, 17% for Asda customers. The share of diversion to Aldi is higher for Asda customers (13%) than for Sainsbury's customers (6%) but, for both Parties, Lidl receives substantially less diversion (4-6%), approximately one third of the diversion received by the other Party. Co-op and M&S receive even smaller shares of diversion (0-3%).²¹²
- 8.69 Regarding the choice attribute questions, the first set of questions was 'unprompted' (ie the questions did not suggest any particular reasons for shopping at that store), while the second set was prompted (ie the questions asked customers to say how important four attributes were in their decision to shop at that store: 'good special offers', 'wide choice of products', 'having well-known brands' and 'short waiting times at checkout'). In response to the unprompted questions, over two-thirds of respondents mentioned convenient location as a reason for their choice of store (68% of Sainsbury's respondents/71% of Asda respondents), with good prices (9%/35%), familiarity with the store (19%/14%) and a wide range of products (15%/15%) being the attributes next most frequently referenced. In response to the

²¹¹ For example, the aggregate diversion figures will not take into account that not every retailer will be present in every surveyed area, nor that even where present, the store size or proximity of those retailers' stores will not be constant. On the other hand, the WSS used in the local assessment to calculate diversion does take into account brand, store size and distance.

²¹² [Kantar Report](#), page 34.

prompted questions, over two-thirds of respondents said that having ‘a wide choice of products’ was essential or very important (68% of Sainsbury’s respondents/71% of Asda’s respondents), around half said good special offers was essential or very important (45%/56%) and two-fifths said ‘having well-known brands’ was essential or very important (38%/41%).²¹³ Contrary to the Parties’ submission that ‘the CMA’s store exit survey shows that only a small proportion of respondents listed these factors [range and branded products] as important drivers (relative to location and price)’,²¹⁴ we note that for Sainsbury’s customers ‘wide range’ was in fact mentioned by more customers than ‘good prices’ (both when considering the first-mentioned reason for choice, and all drivers of choice).²¹⁵

- 8.70 Considering respondents’ purchasing decisions, 27% of Sainsbury’s customers and 29% of Asda’s customers said they had just bought non-grocery items (clothing, stationery, electricals, toys, etc) in addition to their grocery shopping. 18% of Sainsbury’s customers and 15% of Asda’s customers at those stores with a PFS had also bought fuel there or were planning to do so.
- 8.71 We consider that these results show that while location is the most important attribute for the Parties’ supermarket customers, followed for Asda customers by price, for both Parties’ customers a wide range of products and the availability of brands are important factors for some customers’ purchasing choices (and are factors which, as discussed in the following section, not all grocery retailers offer to the same degree). Further, a material proportion of customers purchase GM and/or fuel together with their groceries. Again, as discussed in the following section, this option is only available to customers of certain retailers who, like the Parties, offer a full range of products across groceries, GM and fuel.

In-store offering

- 8.72 We have considered whether differences in the in-store offering, range and product offering, in-store amenities and additional services of different grocery retailers are informative of the closeness of competition between the Parties and between the Parties and other grocery retailers. We note that,

²¹³ Unless otherwise specified, results quoted here from the CMA store exit survey are taken from the [Kantar Report](#) and are unweighted.

²¹⁴ [Parties’ response to the Provisional Findings](#), paragraph 380 and 450.

²¹⁵ In their response to the Provisional Findings, the Parties referred only to the proportion of respondents that listed this as the ‘main’ reason, which they note is ‘no more than 5%’: [Parties’ response to the Provisional Findings](#), paragraph 450. We note that, even on this basis, this is a higher proportion than the proportion of Sainsbury’s respondents who mentioned ‘good prices’ as their main reason for shopping at the store, which was just 2%.

while the precise in-store offering will vary to some extent between stores, many of the overarching features of the offer are centrally-set and uniform across most or all of a brand's supermarkets.

- 8.73 Further, the fact that the Parties are large national players influences this in-store offering in every local store, contributing to their ability to act as effective competitors in every local area in which they operate: for example, their national scale allows them to achieve better prices from suppliers; while their nationally-recognised brands mean that many customers will have an affinity with those brands, and an expectation of what that brand's offering is, that goes beyond the experience in their local store.
- 8.74 While we consider that evidence on customer preferences (whether revealed, as in the switching data discussed above, or stated, as in the survey diversions discussed in detail as part of our local assessment) is particularly valuable evidence for the purposes of our assessment, we consider that differences in in-store offerings are also informative,²¹⁶ particularly given that the results of the CMA store exit survey show that, for both Parties' customers, a wide range of products, and the availability of brands, are important factors for some customers' purchasing choices, and given that a significant proportion of respondents also purchased their groceries in combination with non-grocery items.
- 8.75 With respect to the in-store offering of different grocery retailers, the Parties submitted in particular that:
- (a) Aldi and Lidl offer a range that covers the majority of the grocery shopping requirements of customers. This is shown by the fact that Kantar data shows that the proportion of spend at Aldi characterised as a 'main shop' exceeds that for traditional retailers, whilst the proportion of 'main shop' spend at Lidl is similar. [✂]. This shows that even though Aldi and Lidl stock fewer SKUs, they carry a sufficient range to cater to customers' main shopping needs.
 - (b) In any event, having a wide product range is not a key driver for customers, as demonstrated by the CMA store exit survey and supported by industry surveys undertaken by YouGov and IGD (all of which show convenience is the most important driver).

²¹⁶ This is supported by the Guidelines, which state that evidence used to assess the closeness of substitution between products may include evidence on product characteristics and price points: [CC2 Revised](#), paragraph 5.2.15(a).

- (c) The fact that Aldi and Lidl stock fewer branded products does not detract from their ability to compete with the Parties, nor detract from the fact that the Parties compete closely with a wider range of retailers:²¹⁷ Kantar data shows that customers regularly substitute own-branded goods for branded goods; the CMA store exit survey shows that the availability of branded goods is not an important driver of choice for consumers; and customers are in any event able to purchase a select number of favourite branded products from a range of retailers beyond the Medium and Large stores of the traditional retailers (including Aldi and Lidl themselves, who have both increased the number of branded SKUs they offer).²¹⁸
- (d) There is no significant difference in the type of ‘baskets’ of customers of Aldi or Lidl compared to traditional retailers and the proportion of spend, frequency of visit and items per trip are not significantly different at Aldi/Lidl versus the traditional retailers (with the number of items per basket higher for Aldi and Lidl). The proportion of cross-shop for main baskets²¹⁹ at Aldi and Lidl is similar to that for the traditional retailers, indicating that the discounters are not used disproportionately for specific products that are complementary to those offered by the traditional retailers (we address this evidence under ‘Other evidence’ below).
- (e) Additional services are not perceived by customers as important drivers of store choice and account for a [~~3%~~] proportion of the Parties’ sales. The Parties submitted that, according to their internal survey data, cafés, concessions or non-grocery/GM retail offers are a reason for choosing a store for only a small fraction of customers. Specialist food counters are similarly not intrinsic to a store’s success and their popularity is in decline (as evidenced by Tesco’s decision to withdraw counters from some stores).

8.76 As regards third parties, the more limited range of the discounters, in terms of number of SKUs, lack of choice within particular product categories (including both grocery and non-grocery products), and lack of branded products, was mentioned by a number of third parties in their submissions to the CMA. Some third parties also highlighted that discounters do not offer the full range of amenities (such as cafes, food counters, pharmacies, ATM machines, PFS or large car parks) that are often provided by the ‘Big 4’. As set out in paragraph 8.26, some third parties noted that this had implications for the degree to which the discounters compete with the ‘Big 4’ retailers. Morrisons submitted that the ‘Big 4’ compete closely in terms of level of in-store service,

²¹⁷ Parties’ response to the Provisional Findings, paragraph 464.

²¹⁸ Parties’ response to the Provisional Findings, paragraph 464.

²¹⁹ That is, the proportion of customers that also shop at other retailers.

including in relation to store cleanliness, product availability, staff helpfulness, check out queues and facilities.

- 8.77 We note that there are important differences in the in-store offering of the Parties compared to some other grocery retailers, including the discounters. This includes in relation to: the range and types of grocery products sold; the overall pricing level; the extent of in-store services and amenities provided; and the offer of additional products and services on-site such as GM and fuel. In these respects, the Parties (together with Tesco and Morrisons) share certain similarities, which a number of other retailers do not share, such that for customers that value these aspects of the offering the Parties are likely to be close substitutes (while other grocery retailers, including the discounters, are likely to be less close substitutes).

Range and product offering

- 8.78 The Parties submitted that the ‘big weekly shop’ at a traditional grocery retailer and the popularity of large stores is in decline. However, as noted in Chapter 4, there remains a substantial proportion of shoppers (89%) that continue to conduct a main weekly shop where they get all or most of their grocery shopping in one go. For some of these consumers, this is likely to necessitate shopping at a grocery store of a certain size, and with a certain range, that allows them to get ‘all or most of their grocery shopping’. The Parties (like Tesco and Morrisons, but unlike some other grocery retailers that the Parties cite as close competitors, such as the discounters or Co-op) tend to have Large stores with a wide range that allow customers to conduct this ‘one-stop shop’.
- 8.79 Contrary to the Parties’ submission that the CMA store exit survey shows that the availability of branded goods is not an important driver of choice for consumers, as set out in paragraph 8.69 above, in response to the prompted choice attribute questions, 38% of Sainsbury’s customers and 41% of Asda customers said ‘having well-known brands’ was essential or very important to their choice of store. As set out in that paragraph, ‘wide range of products’ was listed (unprompted) as a driver of choice for 15% of respondents at both Parties’ stores (for Sainsbury’s customers, this was mentioned by more customers than ‘good prices’). When prompted, over two-thirds of respondents said that this was essential or very important.
- 8.80 In terms of range, a Large store of the Parties (similarly to Tesco and Morrisons) will typically stock around [20,000–30,000] SKUs, offer an extensive own-label offering (including a good/better/best range hierarchy aiming to cater for all customer budgets), and a wide range of well-known brands. By comparison, discounters (which primarily operate Medium stores)

offer a limited range of circa 1,800-2,000 SKUs, and the majority of this range is own-label, offering fewer branded goods than any other supermarket: approximately [90–100%] of Aldi's product range consists of own-label brands, and approximately [90–100%] of Lidl's product range. Meanwhile, [40–50%] and [50–60%] of Sainsbury's and Asda's sales respectively come from branded products. Whilst the Parties have submitted data which they submit evidences significant net switching from branded to own brand goods, we note that the fact that the Parties (and Tesco and Morrisons) continue to offer this broad range of goods, including branded goods (despite the fact that discounters are able to save cost by having a more limited range and higher proportion of own-branded goods) indicates that this is an important part of their offering to customers. While the Parties submit that the discounters have increased the number of branded SKUs they offer, this still remains very limited in comparison to the Parties (around one-fifteenth the size). There is a substantial difference between offering a minority of branded SKUs and a full range of branded items: treating this in a binary way ignores the substantial differences between the branded range offered by discounters versus that offered by the Parties.

- 8.81 The Parties submitted that even despite these differences in range, there is no significant difference in the product mix of 'baskets' of customers of Aldi or Lidl compared to those of the 'Big 4' retailers, as shown by Kantar data on the proportion of 'main shop' missions served by those retailers. We acknowledge that this data shows that many customers do use Aldi and Lidl for their 'main shop'. Nevertheless, we also note that the 'profile' of different grocery retailers in terms of the proportion of spend by customer 'mission' served (Kantar distinguishes between four customer missions: 'for tonight', 'main shop', 'replenishment' and 'specific journey') shows significantly more similarities between the Parties, Tesco and Morrisons, than it does between the Parties and other retailers. The proportion of spend on each of these four missions is almost identical for Tesco, Asda, Sainsbury's and Morrisons across all missions, while Aldi caters for a smaller proportion of 'specific journeys' and Lidl a greater proportion of 'replenishment'.²²⁰ More generally, the differences are particularly marked between the Parties (and Tesco and Morrisons) and Co-op, Waitrose and Iceland, with Co-op and Iceland serving substantially more 'for tonight' missions and Co-op in particular serving substantially fewer 'main shops'. Moreover, even if customers exhibit similar

²²⁰ The Parties state that Aldi and Lidl have submitted to the CMA that they 'aim to fulfil all or the vast majority of 'main shop' products': [Parties' response to the Provisional Findings](#), paragraph 463. The reference provided is the Summary of hearing with Lidl held on 6 November 2018. During this hearing, while Lidl stated that they 'try to offer every product required for a full weekly shop', the Parties omit that Lidl also stated that 'the majority of shoppers in the UK do not consider them as their first destination, but they use them as a top-up shop, or as the shop to buy basic products and then top-up somewhere else.' [Summary of hearing with Lidl](#) (6 November 2018).

patterns in terms of frequency of shopping trip and size of basket across two supermarkets, this does not necessarily imply that their ranges are similar or that customers of each type of supermarket considers the other to be a good substitute.

Pricing level

- 8.82 In terms of overall pricing level, the discounters operate at a substantially lower price point than the Parties: Aldi has stated publicly that it aims to be at least 15% cheaper than the 'Big 4' retailers on a comparable basket of goods.²²¹ While we have seen evidence in the Parties' internal documents that [redacted], there remains a significant difference between their relative pricing levels.
- 8.83 The Parties submitted that the fact that Aldi and Lidl are more price-competitive cannot be used as a reason to argue that these retailers impose less of a constraint on the Parties. While competitors can exert a competitive constraint even if they have a different price level, having a similar price level (and corresponding similar level of QRS) increases the likelihood that customers will perceive the offerings as similar and good substitutes for each other. Indeed, we note that the different price point at which Aldi and Lidl operate itself reflects their lower-cost model (driven by their more limited range, predominantly own-brand offer, lack of additional services, etc), which, for the reasons set out above and in the remainder of this section, does not offer certain features that the Parties do, and which some customers value.

In-store amenities and services

- 8.84 In terms of in-store amenities and services, as noted by some third parties (see paragraph 8.24 above), the Parties (together with Tesco, Morrisons and Waitrose) are differentiated from some other grocery retailers (in particular the discounters). Particularly in Large stores, these retailers offer amenities such as food counters, cafés and pharmacies, and services such as toilets and ATMs, that many other grocery retailers do not offer. The Parties submit these services are not the main driver of customer choice,²²² and [redacted]. However, we note that, even on the Parties' own submissions, [redacted] identified store facilities [redacted]. Further, we consider that the fact that the Parties choose to offer these services (despite [redacted]) indicates they believe it to be a valuable part of their customer offering. Indeed, the Parties submitted that both

²²¹ See paragraph 4.43(d).

²²² Citing the Asda tracker survey, which identifies store facilities as [redacted].

Sainsbury's and Asda Large stores offer third party concessions (eg Lloyds Pharmacies and Timpson for Sainsbury's, and Timpson and McDonalds for Asda) to give customers 'the convenience of a wider range of in-store amenities'.²²³ In the Groceries market investigation, the CC found that range and extent of in-store facilities were correlated with store size, ie larger stores tended to offer a wider range of products and a wider offering of facilities (such as food counters, parking, toilets, ATMs, cafés, photo processing, pharmacies and adjacent PFS), and that larger stores also tended to be more attractive as an alternative for customers.²²⁴

- 8.85 The Parties submit that the diminishing importance of counters is evidenced by Tesco's recent decision to discontinue specialist food counters in some of its stores, [redacted], and Asda's [redacted].²²⁵ However, notwithstanding the costs of operating food counters (and evident pressures to make food counters commercially viable), the Parties' internal documents nevertheless indicate that they consider food counters provide an important point of differentiation, and an important driver of customer choice. [redacted].

Additional products and services on-site (GM, fuel)

- 8.86 Finally, in terms of additional goods and services sold alongside their groceries offering, particularly in Large stores, both Parties offer a consistent year-round GM offering. This is similar to the offering of some retailers, like Tesco, Morrisons and Waitrose, but differs from the 'when-it's-gone-it's-gone' model that Aldi and Lidl operate, where particular lines of GM may be offered at different points of the year, with limited stocks which are not restocked once depleted. As set out in paragraph 8.70, 27% of Sainsbury's customers and 29% of Asda's customers responding to the CMA store exit survey said they had just bought non-grocery items (clothing, stationery, electricals, toys, etc) in addition to their grocery shopping.²²⁶ As described further in 8.235, there is evidence that a GM offering drives customer footfall, and produces a 'halo' effect on grocery store profits. We consider that this demonstrates that having a stable GM offering is an important point of competitive differentiation for those grocery retailers that have one, as demonstrated by the fact that Sainsbury's have sought to expand its supermarket GM offering with Argos

²²³ The Parties also described 'in-store aspects of the retail food offer beyond the core aisles, such as fresh food counters (bakery, meat, fish) and food to go counters (eg roast chicken, pizza, sushi), and concession partners' as '[redacted] [which] are central to the customer's shopping experience'.

²²⁴ Groceries market investigation (30 April 2008), *Final report*, paragraphs 4.25 to 4.32.

²²⁵ *Parties' response to the Provisional Findings*, paragraphs 455-456.

²²⁶ As set out in paragraph 4.54, the Parties' transaction data shows that [redacted]% of Asda grocery baskets and [redacted]% of Sainsbury's grocery baskets contain GM.

'infills' (ie concessions) (and the Parties have stated they would seek to do the same at Asda stores following the Merger).

- 8.87 As discussed further in Chapter 14, the Parties also operate PFSs adjacent to some of their stores; something which is unique amongst grocery retailers to Tesco, Morrisons, the Parties and (to a much lesser extent) Waitrose.²²⁷ As discussed in paragraph 14.78, the Parties have analysed internally how having a PFS on-site or adjacent to a supermarket leads to an increase in groceries sales, producing a 'halo' effect on the grocery stores profits. We consider that this demonstrates that operating PFSs is an important point of competitive differentiation for those grocery retailers that operate them. This is further supported by the fact that the Parties are continuing to open new PFSs.²²⁸

Conclusion on in-store offering

- 8.88 We consider that the factors above indicate that the Parties (together with Tesco and Morrisons, and Waitrose to some extent) are close alternatives for customers in terms of their in-store offering, providing a range of products, in-store amenities and additional services which meet particular customer needs that other retailers (including the discounters) do not serve, or at least not to the same extent.

Extent of geographic overlap and national weighted-average GUPPIs

- 8.89 The Parties' store estates overlap to a very significant degree. The Parties submitted that they overlap geographically with each other less often than each Party overlaps with Tesco and Morrisons (and for Asda, also with Aldi). They also submitted that they overlap at around the same level of frequency as they overlap with Lidl (and for Sainsbury's, also with Aldi).²²⁹ However, we consider that the extent of the overlap between the Parties is nevertheless very substantial: the Merger gives rise to [redacted] overlaps between the Parties' supermarkets (when taking into account pipeline stores), which represents [80–90]% of Asda's estate and [70–80]% of Sainsbury's estate.²³⁰

²²⁷ Waitrose partners with Shell at 29 PFS. [redacted]. Whilst Co-op also operates PFSs, for the reasons set out in Appendix K, there are important differences between Co-op's PFSs and PFSs operated by other grocery retailers which mean that we do not treat Co-op's PFSs as supermarket PFSs.

²²⁸ The Parties have a number of pipeline PFSs, which are taken into account as part of our assessment with respect to the supply of fuel in Chapter 14.

²²⁹ [Parties' response to the Provisional Findings](#), paragraph 413.

²³⁰ In Table 11 of the [Parties' response to the Provisional Findings](#), the Parties list the number of brands that would remain (pre- and post-Merger) in each area in which the Parties overlap (counting only Tesco, Morrisons, Aldi and Lidl, 'for the sake of pragmatic illustration'). We consider that this analysis, which is akin to a fascia counting exercise, is not informative for our analysis given that it does not take into account the relative weight of

- 8.90 Further, the findings of our local assessment (discussed at paragraph 8.112 onwards below) are that the Merger will result in an SLC in over five hundred (537) local markets centred on their supermarkets. This represents approximately 40% of Sainsbury's supermarkets and 50% of Asda's supermarkets. We note further that there are many more local areas which have GUPPIs which, although not exceeding the GUPPI threshold used in our decision rule for the local assessment, are nevertheless material. As set out in paragraph 8.10, if the Merger may be expected to result in competition concerns in local areas representing a significant proportion of the Parties' overall supermarket estates (which our local assessment indicates it would), the Merger may create an incentive to worsen the national aspects of their offerings across all of their supermarkets.
- 8.91 As noted in paragraphs 8.7 and 8.16 (and discussed further in paragraph 8.113 onwards), we use GUPPI as the basis of our decision rule for the purposes of our local assessment. We therefore discuss in detail how we have calculated the GUPPI for each local area in our local assessment of the Parties' supermarket overlaps.
- 8.92 For the purposes of our national assessment of the Parties' supermarket overlaps, we have used the GUPPIs calculated for each local area to calculate two national weighted-average GUPPIs (one for each Party), which we use as one category of evidence assessed as part of our overall national assessment.²³¹ As discussed in our local assessment, the GUPPI calculation itself incorporates inputs drawn from a range of evidence, including the CMA store exit survey, the entry/exit analysis and margin information submitted by the Parties.

each of these retailers' stores (due to brand, store size and proximity) in each local area, in the way achieved through our WSS analysis (discussed further in the context of our local assessment of the Parties' supermarket overlaps, below).

²³¹ The national weighted-average GUPPIs presented here are based on local GUPPIs which rely on survey respondents' answers to a forced diversion question. Based on the reasoning set out in paragraphs 8.141 to 8.145, we consider that diversion ratios based on forced diversion questions will represent the best evidence on the Parties' incentives to implement cost-saving degradations to QRS parameters (ie parameters other than price) that are set uniformly across their supermarket estates at the national level. With respect to the merged entity's incentives to raise prices, we noted that price-marginal customers of Sainsbury's were more likely to choose Asda than the average customer in the survey (20% compared to 18%). Price-marginal customers of Asda on the other hand were less likely to choose Sainsbury's than the average customer in the survey (12% compared to 17%). However, this does not change our findings as set out in this section, as we consider that degradation of QRS parameters remain an important cause of concern.

- 8.93 Our calculations (described in Appendix E) produce a national weighted-average GUPPI for Sainsbury's of 2.5% and for Asda of 3.3%.^{232,233}
- 8.94 We have taken into account the same factors described in our local assessment (paragraphs 8.275 to 8.295) when interpreting the national weighted-average GUPPI figures, including that merger-specific efficiencies may offset upward pricing pressure, that any lessening of competition must be substantial, and that there may be uncertainty or bias in the estimates.²³⁴ As set out further in that section, we consider that the evidence used to underpin the GUPPI calculation is the best available evidence, and that the GUPPI is a reliable indicator of the likelihood of an SLC on the basis of the balance of probabilities. We further consider that uncertainty around the national weighted-average GUPPI figures is lower than for each individual local GUPPI figure.²³⁵ As a result, we consider that national weighted-average GUPPIs of the level we have calculated support a finding that the Merger gives rise to an incentive to degrade PQRS across the Parties' national supermarket estates.
- 8.95 The Parties submitted that they presumed, given the inferences drawn from the local assessment, that if the national weighted-average GUPPI figures were lower than the CMA's local GUPPI threshold, these national figures would not contribute to an SLC finding in the national assessment.²³⁶ We disagree. A threshold is necessary in the context of using a decision rule to identify local SLCs. The threshold is determinative of a local SLC finding (ie a GUPPI above the threshold indicates that an SLC in this area is more likely than not), and the value of the threshold is set with that in mind. The national

²³² For some aspects of PQRS of the Parties' competitive offerings that are set uniformly at the national brand level, notably including price, the level of PQRS set by the Parties for their supermarkets is the same as the level set for their online grocery store. As such, for these parameters, it would be appropriate for the national weighted-average GUPPI for these aspects of PQRS to be based on a weighted average of the GUPPI values for the Parties' supermarkets and the GUPPI values for their online business together. We have not made this adjustment as (i) there are likely to be some national, uniform parameters of competition for the Parties' supermarkets that are not set consistently across their supermarket and online businesses, for which the supermarket-only GUPPI would be an appropriate indicator; (ii) more than [X]% of the Parties' revenue is supermarket revenue, implying that any adjustment resulting from including online in the weighted average would be small, and (iii) the national weighted-average GUPPI is one piece of evidence taken into account in the round alongside other pieces of evidence, and therefore small adjustments to its value would not significantly influence the assessment.

²³³ In the case of Asda, as discussed in paragraph 8.317, pricing is uniform across the supermarket and convenience store estates. We have not adjusted the national supermarket GUPPI given the very small number of convenience stores, and the relatively small weight each of these would receive.

²³⁴ As we have taken into account efficiencies directly when interpreting the level of the GUPPI as part of our national assessment, we have not separately considered efficiencies in the countervailing factors section of this chapter.

²³⁵ This is because the national averages do not rely on any given GUPPI estimate, and so effectively the sample size is larger and the statistical error correspondingly lower. For example, while idiosyncratic factors may contribute to overestimates or underestimates in individual local areas, these errors would be expected to balance each other out to a large extent. We also consider our estimates of national margins to be more reliably estimated than local margin figures.

²³⁶ [Parties' response to the Provisional Findings](#), paragraph 390, footnote 219.

weighted-average GUPPI on the other hand is used in the national assessment as just one piece of evidence in our thinking, which is assessed in conjunction with the other evidence in order to come to a view in the round about whether the Merger is likely to give rise to an incentive on the part of the Parties to degrade their offering in every local area. As already noted in paragraph 8.94 and footnote 235, we consider that uncertainty around the national weighted-average GUPPI figures is lower than for each individual local GUPPI figure. As such, it would not be inconsistent to find that the Merger gives rise to an SLC on the basis of our national assessment even if the national weighted-average GUPPI figures were lower than the GUPPI threshold used in the local analysis (indeed, in this case, the national weighted-average GUPPI for Sainsburys is below our local GUPPI threshold, and the national weighted-average GUPPI for Asda is above it). The national assessment reflects an aggregation of local effects, but it is not an aggregation of the SLCs found through our local assessment, which are assessed differently.

Other evidence

- 8.96 The Parties referred in their submissions to a number of further sources of evidence which they considered relevant in assessing closeness of competition between the Parties, and the constraint from other grocery retailers. This includes evidence from the Parties' entry-exit and impacts analyses, and from their internal gravity model, all of which are discussed further in the local assessment. The Parties also cite:
- (a) Data on customer demographics, which they submitted shows that they are not particularly close competitors: Asda generally over indexes (ie performs higher than average) on consumer groups in which Sainsbury's under indexes, and vice-versa; and Asda is much closer to Aldi and Lidl in terms of consumer profile than to Sainsbury's (which, in turn, has the most in common with Waitrose).²³⁷
 - (b) The OC&C Index of customer perception, which they submit shows a significant 'gap' between the Parties, with Tesco and Morrisons situated between them, and Aldi and Lidl positioned most closely to Asda.
 - (c) Cross-shop data from GlobalData, which shows that in the past year: a higher proportion of Sainsbury's food and grocery shoppers also shopped in Tesco, Aldi, Lidl and Morrisons than also shopped at Asda; and a

²³⁷ [Parties response to Issues statement](#), paragraph 113.

higher proportion of Asda food and grocery shoppers also shopped at Aldi, Tesco, Morrisons and Lidl than also shopped at Sainsbury's.

- 8.97 Regarding the data on customer demographics, we note that, while customers' differing demographic characteristics may affect their purchasing choices, this does not exclude the fact that there may remain a significant proportion of customers who see the Parties as close substitutes. We therefore consider that the diversion ratios estimated by the CMA store exit survey (as discussed in our local assessment) and the Kantar switching data discussed in paragraphs 8.54 to 8.64 above are more informative on how closely customers perceive the Parties to compete. Further, we note that this data demonstrates important differences between the demographic profile of all grocery retailers, and not just the Parties. While we agree that this data shows that Asda and Aldi have a broadly similar index levels in many demographic categories, it also shows very significant differences between Sainsbury's customers and a number of competitors that the Parties have submitted are close competitors to it: including the discounters, Co-op and Waitrose (while both may over or under-index in particular categories, the index levels of each is very different). We acknowledge that Tesco and Morrisons appear situated broadly between the Parties.
- 8.98 Regarding the OC&C Index of customer perception, we note that this has similar limitations to the demographic data, in so far as it does not provide any information on whether there remains a significant proportion of customers by whom the Parties are seen as close substitutes. Similarly to the demographic data, we acknowledge that this shows Asda as most closely positioned to Aldi and Lidl. However, this again reinforces the gap between Sainsbury's and the discounters, which the Parties have submitted are 'close competitors' to it. Again, we acknowledge that Tesco and Morrisons appear situated broadly at the 'midpoint' between the Parties.
- 8.99 Regarding the GlobalData cross-shop data, we note that data on cross-shopping does not necessarily provide information on the extent to which consumers are switching between different retailers, and a significant proportion of 'cross-shopping' may relate to customers complementing their purchases across retailers, rather than substituting between them. Where we have available data on diversion ratios and switching patterns, we therefore consider this to be more informative for our assessment.
- 8.100 For the reasons above, we have placed very limited weight on these additional sources of evidence, and have instead placed greater weight on the sources of evidence set out in previous sections (including the Parties' internal documents, the Kantar switching data, the CMA store exit survey

responses, the national weighted-average GUPPI estimates, and the qualitative evidence regarding the differences in the Parties' in-store offering).

Conclusion on national assessment

- 8.101 Based on the evidence set out above, we find that the Parties are two of a small number of significant national players in in-store groceries, and overlap across their national stores estates to a very significant degree (across c.80% of their estates). Post-Merger, the Parties would have a combined share of supply of 29%, making the Merged entity the largest grocery retailer by share of sales, overtaking Tesco (with a current estimated share of supply of c.27%) and growing to nearly three times the size of the next largest grocery retailer (Morrisons, with an estimated share of c.10%).
- 8.102 Based on the evidence set out in the preceding sections, we find further that the Parties are close competitors to each other. While the Parties face varying degrees of competitive pressures from a range of other groceries retailers, including Aldi and Lidl, who we find provide a material constraint on the Parties, we find that these constraints would not be sufficient to offset the substantial loss of competition between the Parties post-Merger.
- 8.103 We consider that there is an important competitive interaction between the 'Big 4' grocery retailers (of which the Parties are two) and that, after Tesco, each Party generally acts as the other's next closest competitor (together with Morrisons).
- 8.104 The evidence from the Parties' internal documents shows that, while each Party monitors a wide range of competitors (which includes one another, other traditional retailers, the discounters, and others), both Parties recognise the 'Big 4' (a term which both use frequently in their internal documents) as a distinct group, against which they regularly measure their own competitive performance. Tesco features [redacted] in both Parties' documents, but [redacted] leads us to believe that the [redacted] of Tesco may in fact misrepresent the extent to which Morrisons and the other Party are viewed as important competitors. Both Parties' internal documents also show a clear competitive focus on the discounters, although we would naturally expect more frequent mentions for rising competitors such as these, over more established (and potentially closer) rivals.
- 8.105 Once the Kantar switching data is adjusted to reflect switching driven only by like-for-like growth, this shows that, for both Parties, Tesco is the most important constraint, with Morrisons and the other Party the next most important constraints. It also supports a finding that Aldi and Lidl are a

constraint to some degree on both Parties, but not to the extent of the other Party, Tesco, or Morrisons.

- 8.106 Third party submissions support a degree of distinction between the 'Big 4' retailers and other grocery retailers, albeit also recognising certain differences within this group. These third parties highlighted important points of difference between the 'Big 4' retailers and the discounters, which some submitted reduced the extent to which they competed closely (although we took into account the potential for particular interests of third parties to have motivated these submissions).
- 8.107 Our review of the in-store offering of the Parties and other retailers (in terms of amenities and services, product range and offering) supports some of these points of difference, including on factors (wide range of products, availability of brands, offering of GM/fuel) which the CMA store exit survey demonstrates are important for some customers' purchasing choices. We consider that these factors indicate that the Parties (together with the other 'Big 4' retailers) are close alternatives for customers in terms of their in-store offering.
- 8.108 As a result, we find that the discounters provide a degree of competitive constraint on the Parties, but that this constraint varies between Sainsbury's and Asda and is generally less important than that provided by Tesco, the other Party and Morrisons.
- 8.109 The closeness of competition between the Parties and the absence of sufficient post-Merger constraints (as supported by the evidence set out above, as well as the degree of geographic overlap between the Parties' estates and the scale of the SLCs identified as part of our local assessment), is consistent with our national weighted average GUPPI calculations. At 2.5% (for Sainsbury's) and 3.3% (for Asda), these GUPPI values 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 are expected to arise from the Merger.
- 8.110 Although the national assessment does not rely on the number of SLCs that have been found as a result of the local assessment, we note that our finding of over five hundred such SLCs is consistent with Parties having incentives to raise prices or degrade QRS at the national level.
- 8.111 As a result, we find, on the balance of probabilities, that the loss of competition between the Parties as a result of the Merger would give rise to an incentive to degrade PQRS across the Parties' national supermarket

estates, which may be expected to result in an SLC in each local area where one or more of the Parties' supermarkets is present.

Local assessment (supermarkets)

- 8.112 Having found through our national assessment SLCs in every local market in which either or both Parties are present, this section separately considers whether there are SLCs in any of those same local markets arising from an incentive on the part of the Parties to deteriorate locally-set parameters of competition (eg a worsening of in-store service levels or stock availability, or a reduction of range in those stores) in some local areas but not others.
- 8.113 Given the very many local areas in which the Parties overlap, it would not have been possible to assess each of these local areas in turn, using the same range of qualitative and quantitative evidence used for our national assessment (nor would similar information have necessarily been available on an individual local-area basis). We therefore adopted a methodology which allows us to assess, in a consistent way, the potential effect of the Merger in every local market.
- 8.114 In designing the methodology for our local assessment, our aim was to estimate, in each local area, how closely a store operated by one of the Parties competes with all other stores in its local area, including the stores of the other Party. To do this, we first gathered evidence of those characteristics which appeared to most affect customers' choice of store. Based on a range of evidence (including the CMA store exit survey, the CMA's entry-exit analysis, and findings from past investigations),²³⁸ and in line with the Parties' submissions, we found that these included:
- (a) the store size (generally correlated with product range and range of in-store services);
 - (b) proximity (and therefore distance for the customer to travel); and
 - (c) brand of the store (which covers many aspects associated with the in-store offer, including price, quality of goods, etc).
- 8.115 We also studied how the competitive strength of a rival store varies with those characteristics – eg how quickly the competitive constraint exercised by one store on another declines over distance, or with reducing store size, and how different brands 'rank' in customers' preferences relative to each of the Parties (and the Parties relative to each other). Drawing on all of this

²³⁸ Summarised in paragraphs 8.125 to 8.128.

information, we developed a methodology which ‘weights’ stores according to their size, distance and brand, rather than treating all rival stores in a local area as equally attractive to a customer, in the way that a simple ‘fascia count’²³⁹ would do. The methodology is referred to as a weighted share of shops, or WSS.

- 8.116 The WSS methodology allows us to calculate estimated diversion ratios (that is, the proportion of customers that would switch from one Party’s store to each other store in the local area) in every local area where the Parties operate a store. In turn, this allows us to produce a measure known as the gross upward pricing pressure index, or GUPPI, for each local area. The GUPPI is a metric that describes merging parties’ incentives to raise prices and/or degrade the quality of their offering, their product range or their service levels (ie worsen their PQRS) post-merger. It does this by combining the information on diversion ratios (to measure the proportion of customers that would switch from one Party to the other if one worsened their offer) and margins (to measure the additional profit the Parties would retain from these customers switching between them).²⁴⁰ These are profits which would be retained after the Merger but would have been lost by one Party to the other prior to the Merger. The higher the GUPPI figure, the greater the incentive to deteriorate PQRS after the Merger, and therefore the more likely the Merger may be expected to result in an SLC. The GUPPI is not a prediction of the level of expected price rise (or other deterioration of offer) from the Merger but is instead a measure of the expected pressure (or incentive) on the Parties to increase prices or degrade some other aspect of their customer proposition.
- 8.117 For the purposes of our local assessment, having produced a GUPPI measure for each local area, we assessed at what GUPPI threshold the Merger may be expected to give rise to competition concerns, and used this as the basis of a decision rule to conclude on which local markets the Merger gives rise to an SLC.

Parties’ views

- 8.118 The Parties submitted that the assessment of competition is appropriately carried out at the local level and proposed that the CMA should use a WSS methodology to assess the Parties’ incentives in each local area.

²³⁹ A ‘fascia count’ simply counts the number of brands in a local area and assumes they all exercise a similar level of competitive constraint and will all receive an equal share of customer diversion.

²⁴⁰ The GUPPI calculation also takes into account the ratio between the Parties’ prices (ie the extent to which one Party’s prices are higher or lower than the other). We discuss the price ratio in footnote 313.

- 8.119 The Parties submitted that the relevant parameters for the competitive constraints faced by a supermarket were (i) geographic location and distance, (ii) store size, (iii) brand, and (iv) other constraints such as online, convenience stores, bargain stores, independent and specialist stores and constraints from stores located outside the geographic catchment. The Parties made submissions on each of these parameters.
- 8.120 As discussed in paragraph 7.73, with respect to geographic location and distance, the Parties submitted that a range of evidence supported their view that the geographic catchment areas should be more inclusive than those used by the CC and CMA in past investigations, and in particular that the Parties' stores are constrained by Large stores up to 15 minutes' drive away and Medium stores located up to 10 minutes' drive away. These drive times should be 5 minutes longer where the Parties' supermarkets are located in rural areas.
- 8.121 As discussed in paragraphs 7.12 to 7.14, with respect to store size, the Parties submitted that there was no 'step change' in the constraint from different supermarkets once they pass any specific threshold of store size. However, they submitted that larger supermarkets exert stronger constraints (although on a per square metre basis Medium Stores exert a stronger constraint on Large Stores than other Large Stores), and that it would be pragmatic to adopt the approach used by UK competition authorities in past cases involving grocery retailing to define two size categories, considering separately the constraint from Medium stores and the constraint from Large stores, with appropriate weight.
- 8.122 With respect to brand, the Parties submitted that each brand exerts a different strength of constraint on the Parties. As a result, each should be analysed separately and, where possible, assigned a brand-specific weight. In particular, as set out in paragraphs 7.15 to 8.20, the Parties submit that Aldi and Lidl exert a strong constraint on the Parties' stores and that the weights given to those brands should reflect this. The Parties also submitted that Tesco imposes a materially larger constraint on the Parties than Morrisons or either of the Parties impose on each other. In the Parties' view, Aldi imposes a larger constraint on the Parties than Lidl, and the effect of M&S, Waitrose, and Co-op differs (ie some of the brands exert a larger constraint than others) and that these effects differ between the Parties (ie they exert a different constraint on Sainsbury's than Asda). The Parties submitted specific suggestions for the weights to be assigned to each competitor brand. The Parties also submitted that one would ideally analyse the constraints of each rival separately for each of the Parties, although they

noted that the available data may not allow this to be done in a very reliable fashion.²⁴¹

8.123 With respect to other constraints, the Parties submitted that, on average, 25% of all diversion is to retailers other than Medium stores within 10 minutes' drive and Large stores within 15 minutes' drive. These other constraints include bargain stores, convenience stores, specialist stores (such as independent butchers or bakeries), supermarkets located more than 10-15 minutes' drive away, online delivered grocery retailers, and online delivery specialists.

8.124 We have considered these submissions and the supporting evidence in our assessment, which is set out in the following section.

Our assessment

8.125 As set out in paragraph 8.114, in designing the methodology for our local assessment, we have sought to capture those factors which most affect a customer's choice of store, and therefore which are the most important drivers of competition (and diversion) between supermarkets. Our findings are as follows.

8.126 First, the location (ie proximity) of a store is a key driver of choice for customers. As such, the greater the number of stores a given brand has in a local area, and the closer those stores are located to the Parties' stores, the more likely it is that a large proportion of customers of the Parties would consider that brand to represent a good substitute. This is supported by the large proportion of customers that identify convenient location as a key driver of choice in the CMA store exit survey, with over 50% of respondents mentioning this as their main reason for choice of store.²⁴² The CMA's entry-exit analysis (discussed further at paragraph 8.170 onwards) indicates that a small incremental increase in the distance between two supermarkets can materially reduce the impact they have on each other's sales.

²⁴¹ The Parties also submitted that the Provisional Findings found that the Merger would lead to an SLC in 629 local areas, that this is substantially higher than the 463 SLCs that were identified under the CMA's phase 1 decision, and that this is despite the fact that in the phase 1 decision the CMA excluded Aldi and Lidl as effective competitors ([Parties' response to the Provisional Findings](#), paragraph 343). We note that in the phase 1 decision, the CMA adopted a filtering approach using a fascia counting methodology in light of the Parties' fast-track request. However, as explained in paragraphs 8.115 to 8.131, we consider that a fascia counting exercise is not informative for our analysis in phase 2, and that the WSS analysis is more appropriate. In addition, the phase 1 decision made clear that the nature of the fast-track meant that the local areas identified in the phase 1 decision were not intended to act as the starting point from which the phase 2 analysis will develop ([Phase 1 decision](#), paragraph 82).

²⁴² See [Kantar Report](#), page 25.

- 8.127 Second, when choosing where to shop, respondents to the CMA store exit survey frequently cited factors that are commonly set by retailers uniformly at the national level, such as price, aspects of product quality, and brand reputation.²⁴³ Different brands are therefore likely to exert different levels of competitive constraint on the Parties, depending on their perceived substitutability for the Parties' offerings. Given the national dimension to the overall brand positioning, there is likely to be a degree of consistency in the perceived substitutability between stores of specific brands.
- 8.128 Third, store size plays an important role in customer choice. Customers frequently describe product choice and range of facilities (such as specialist food counters, cafés, concessions or car parking) as important factors affecting their choice of supermarket. In the CMA's store exit survey, almost 30% of customers mentioned the wide choice of products as a reason for their choice of store when asked unprompted. When prompted on the importance of choice of products, around 70% of customers said that range was very important or essential when they decided where to do their shopping. In the Groceries Market Investigation, the CC found that these factors were correlated with store size, ie larger stores tended to offer a wider range of products and a wider offering of facilities, and that larger stores also tended to be more attractive as an alternative for customers.²⁴⁴ As discussed in later sections analysing diversions from the CMA store exit survey (see paragraphs 8.155 to 8.161) and concluding on the relative weights (paragraphs 8.196 to 8.205), we find that Large stores consistently receive greater diversion than Medium stores.
- 8.129 In designing the methodology for the local assessment, we therefore sought to capture the brand, size and distance of all stores in the local areas surrounding each of the Parties stores. As noted in paragraph 8.119, the Parties agreed that these were the most important factors that should be taken into account in our local assessment methodology.²⁴⁵
- 8.130 We also sought to capture the number of stores each brand has in a local area, as we recognise that this will increase the share of diversion that brand wins from other brands.

²⁴³ Good prices were mentioned as a reason for choice of store by 9% and 35% of Sainsbury's and Asda respondents respectively; quality of fresh products by 15%/6% of Sainsbury's/Asda respondents respectively; quality of other products by 9%/4% of Sainsbury's/Asda respondents respectively; and reputation of supermarket brand by 9%/13% of Sainsbury's/Asda respondents respectively. See [Kantar Report](#), page 26.

²⁴⁴ Groceries market investigation (30 April 2008), [Final report](#), paragraphs 4.55.

²⁴⁵ In addition to certain 'out of market' constraints. We discuss these out of market constraints in paragraph 8.206 to 8.214.

8.131 The WSS allows us to capture and reflect these factors. The main premise of the WSS methodology is that, unlike a standard ‘share of shops’ methodology, or a simple fascia count, where each store within a catchment area receives an equal weight of one, each store will receive a different weight depending on its specific characteristics. In particular, in our WSS methodology a store will receive a higher weight if, all else being equal, it is a Large Store (rather than a Medium Store), if it is located closer to the store from which diversion is measured from (which we refer to as the centroid store), or if it belongs to a brand that is perceived to be a stronger competitive constraint to the Parties, based on its offering.²⁴⁶ We consider that such a model better reflects how customers choose between stores, and therefore the degree of competitive constraint between different rival stores, than other models such as a simple fascia count, which only counts the number of brands in a local area, but does not allow for the number of shops of each brand, and assumes that all stores exercise a similar level of competitive constraint and will all receive an equal share of customer diversion.

8.132 The main steps we took in implementing the WSS methodology as part of our local assessment are as follows:

- (a) First, we analysed different types of evidence to decide which weight to attach to stores depending on their store characteristics (brand, size, distance). We discuss this in paragraphs 8.134 to 8.205.
- (b) Second, we considered the appropriate allocation for ‘out-of-market constraints’, discussed in paragraphs 8.206 to 8.214. We used the weights determined in the first step, as well as this ‘out-of-market allocation’, to generate our best estimate of the likely diversion between the Parties in each local market and, therefore, the likely extent to which the Merged entity would recapture a substantial proportion of any sales lost in the event that one of the Parties degraded its competitive offering.²⁴⁷ We discuss this in paragraphs 8.215 to 8.224.
- (c) Third, we assessed the economic value of sales we considered likely to be recaptured. We did this by using data on the Parties’ margins, combined with the diversion ratios to calculate a GUPPI for each of the Parties’ overlapping stores, to help us assess the extent to which it would

²⁴⁶ For example, in a hypothetical scenario: a Large Store may obtain a weight of 1, but a Medium Store of the same brand may obtain a weight of 0.5; a rival store right next to the Parties may obtain a weight of 1, but a rival store that is far away from the Parties may obtain a weight of 0; a store that belongs to a brand that is perceived to be a stronger competitive constraint to the Parties may obtain a weight of 1, whereas a store that belongs to a brand that exerts a weaker competitive constraint may obtain a weight of 0.5.

²⁴⁷ We did this by applying our weights to all stores identified in a store dataset of the Parties’ and their competitors’ stores in each local area of the UK where the Parties are present as set out from paragraph 8.215. We included all active stores as well as new stores likely to open in future.

be profitable for the Merged entity to degrade PQRS in individual local markets. We discuss this at paragraphs 8.225 to 8.244.

- (d) Finally, we considered carefully at what level to set the threshold for a GUPPI decision rule, such that we could be satisfied, on the balance of probabilities, that in each area failing the decision rule, the Merger would give rise to an SLC in the circumstances of this particular case. As a cross-check, we considered whether our chosen GUPPI threshold made sense in light of the wider context of this case and 'real world' factors. We discuss this at paragraph 8.245 to 8.308.

8.133 We applied our WSS approach to each of the Parties' existing and pipeline stores.²⁴⁸

Evidence on weights for different competitors

8.134 We considered a range of evidence related to closeness of competition between stores with different characteristics (ie brand, size and distance), including evidence from customer surveys, the analysis of competitor entry and exit events, and internal modelling performed by the Parties.

8.135 We discuss this evidence below, together with the implications it has for the relative weight assigned to different types of stores, and considerations affecting the weight we can attach to different pieces of evidence. By way of overview:

- (a) we relied on the CMA store exit survey as our primary source of evidence for the relative weights that should be attached to stores of different types;
- (b) we then used the entry-exit analysis as a complementary source of evidence to cross-check these weights and, in certain cases (where the entry-exit data was statistically significant, and where to do so would not in our view produce counter-intuitive results) adjust the weights; and
- (c) we sense-checked the weights we produced using qualitative evidence on the similarity between the Parties' businesses and those of their rivals and other qualitative evidence such as internal documents and evidence on the Parties' monitoring and benchmarking, as already discussed in the context of our national assessment of the Parties' supermarket overlaps.

²⁴⁸ We also took into account the pipeline stores of competitors in each overlap area.

Survey evidence

- *CMA store exit survey*

- 8.136 To gather evidence on how closely the Parties compete with each other and with other brands, the CMA commissioned a large survey of customers who had just shopped at one of the Parties' supermarkets (the CMA store exit survey). This survey covered 100 supermarkets (50 Sainsbury's and 50 Asda supermarkets) across the UK and is the largest exit survey the CMA has ever undertaken. The survey generated over 20,500 responses, with at least 150 at any one supermarket.
- 8.137 The survey was conducted as an exit survey, meaning that respondents were sampled by approaching customers who were leaving a supermarket, having just completed a shopping trip. Those respondents were asked questions relating to their choice of supermarket and their next-best alternative. An important benefit of conducting an exit survey is that consumers have just completed their shopping trip and can easily recall the broad contents and value of their basket, which factors drove their choice of store, and the circumstances in which they made their choice of store when answering the survey questions. The survey methodology for the CMA store exit survey is described in greater detail in the Kantar Report and we discuss aspects of it further in Appendix B.
- 8.138 The sample of supermarkets we surveyed was selected at random.²⁴⁹ It was predominantly made up of supermarkets in relatively concentrated overlap areas (3-to-2s and 4-to-3s), but also included some supermarkets in the most concentrated overlap areas (2-to-1s), in less concentrated overlap areas (5-to-4s or more) and in non-overlap areas.²⁵⁰ We therefore collected more evidence for local areas likely to be of most interest to our inquiry (ie those where the Parties were likely to face the least amount of competition post-Merger), while making sure that we were able to complement this with evidence from a wider range of types of local areas. The Parties submitted that this approach had consequences for the representativeness of the CMA store exit survey. We discuss these submissions in paragraph 8.168 onwards.
- 8.139 We consider that the CMA store exit survey has several strengths that mean it provides a robust way of assessing the level of diversion to different types

²⁴⁹ Using a stratified random sample specified by Party, type of overlap area, and London/Northern Ireland/Other UK, as described in Appendix B.

²⁵⁰ As described in Appendix B, footnote 2, the classification of overlap areas as 4-to-3s, 3-to-2s, etc was based on the CMA's precedent fascia counting methodology. For these purposes, only the following brands were included in the fascia count: Tesco, Sainsbury's, Asda, Morrisons, Waitrose, M&S and Co-op.

of store and thus establishing relative weights in our analysis. In particular, we designed the survey and questionnaire specifically with the evidential needs of our inquiry in mind; the sample of stores surveyed was large and we ensured we collected sufficient responses at each store to provide robust estimates; and we required that considerable effort was invested in interviewer briefing and monitoring of fieldwork to ensure the survey was conducted to a high quality standard. We provide our fuller assessment of the CMA store exit survey in Appendix B.

8.140 For these reasons, we conclude that the CMA store exit survey findings provide a robust source of evidence for our analysis.

- *Assessing diversion*

8.141 The central questions in the CMA store exit survey focused on gathering evidence on customers' views on the closest alternative to the Parties' supermarkets. Customers were asked to consider what they would have done if, prior to deciding to come to the supermarket, they had heard that it was closed.²⁵¹ Asking customers about what they would do in the hypothetical situation where a store is closed is known as a 'forced diversion question'.

8.142 The CMA store exit survey also asked what customers would have done if prices at the store had increased by 5%.²⁵² Customers who responded that they would have switched away from the store in response to such a price increase are referred to as 'price marginal' customers.

8.143 The advantage of using forced diversion questions is that it ensures we learn about the next-best alternative from all respondents (rather than just the marginal customers). Gathering this evidence from all respondents ensures a large enough sample size for analysis of results at each individual surveyed store. However, a drawback of this approach is that the average response of all customers may differ from the average response of marginal customers, and it is marginal customers – ie those that would 'vote with their feet' – that affect the Parties' incentives to change PQRS.

8.144 For the estimation of weights for the purposes of our analysis we use the results from the forced diversion questions as this ensures that at store level

²⁵¹ This question was as follows: Now imagine that, before deciding to come here today, you knew that this store was closed for six months. Looking at card 2/3, how would you have made today's purchases instead?

²⁵² This question was as follows: Now imagine that, before deciding to come here today, you knew that this [Sainsbury's/Asda] store had increased its prices by 5%. This would mean that the items you have bought today would have cost you an extra £[5% OF AMOUNT FROM Q2]. Would you still have done your shopping here today or not?

there are sufficient observations to provide robust estimates of customers' next-best alternatives. If we were to restrict our analysis to the diversion choices of those customers who said that they would switch away in response to a 5% change in price, we would not have robust estimates in individual local areas as on average, only [20-30]% of Sainsbury's respondents and about [20-30]% of Asda respondents were price marginal (based on the survey responses).

8.145 An important purpose of our analysis is to assess the Parties' incentives to make cost-saving degradations to the quality, range or service levels they offer to customers at specific local supermarkets (rather than price, which is set uniformly at a national level). The responses of price-marginal customers to diversion questions may differ from the responses of customers that would switch in response to a change in quality, range or service. In considering diversion patterns in response to degradations of quality, range and service, the best available evidence is the response to the forced diversion question.²⁵³

- *The Parties' surveys conducted pre-notification*

8.146 The Parties commissioned three surveys prior to notification of the Merger in connection with their in-store offering:²⁵⁴

- (a) A face-to-face exit survey at 14 of Sainsbury's Large Stores in areas where it competes with Asda within a 15-minute drive-time (the Sainsbury's exit survey).
- (b) An online survey of Sainsbury's Nectar Card customers who shopped in-store at the same 14 stores as in the exit survey and at an additional 11 Sainsbury's stores, totalling 25 Sainsbury's stores (the Sainsbury's online survey of in-store customers).
- (c) A face-to-face exit-survey at Asda's 13 Large Stores, in the same local areas as the face-to-face exit survey in the Sainsbury's stores (the Asda exit survey).

8.147 As discussed in more detail in Appendix B, we consider that these surveys have a number of limitations which affect their evidential value for the purposes of our analysis. In summary, the Parties surveyed a limited number

²⁵³ We did not ask customers what they would do in response to a small but significant change in QRS, because - unlike price - quality, range and service cover many different aspects of the Parties' offerings and are hard to quantify. It is therefore difficult to formulate an effective survey question (or questions) to identify Q-, R-, S- or 'QRS'-marginal customers in a useful way.

²⁵⁴ A more detailed description of these surveys is provided in Appendix B, together with our assessment of them.

of stores that were not selected on a random basis; the diversion questions relied on fixed, prompted brand and store lists that we consider less appropriate than the unprompted lists used for the CMA store exit survey; we were not able to observe fieldwork or otherwise assess survey quality; and fieldwork for these surveys took place some time ago. In addition, the Sainsbury's online survey of in-store customers, by virtue of being conducted online, excludes those in-store shoppers that do not use the internet; we consider that this results in serious limitations when the purpose of the survey is to ask in-store shoppers about their next-best alternatives for their recent in-store shopping visit.

8.148 In addition to these limitations, we note that it would not be methodologically robust for us to combine the Parties' survey response dataset with the CMA store exit survey response dataset, given they are based on two different questionnaires.

8.149 For the reasons set out above and in Appendix B, and given we have access to the CMA store exit survey, with a methodology designed specifically with the needs of our inquiry in mind, we have not placed any weight on the Parties' pre-notification surveys in our local assessment analysis.

- *The Parties' New Surveys*

8.150 The Parties submitted the results of two further surveys in the course of the inquiry. The first (the Parties' new exit survey) surveyed 20 Sainsbury's and 20 Asda stores that were a sub-sample of the CMA's initial sample of 80 stores (that is, those 80 stores on which our early analysis had been based). The second (the Parties' new online survey) included all of the 50 Sainsbury's stores contained in the CMA's full sample; this survey was sent to Nectar Card customers of Sainsbury's who had visited one of these stores over the last four weeks.²⁵⁵

8.151 The CMA's published Survey Good Practice, recommends that merging parties engage with us in advance of conducting surveys they wish to submit as evidence and notes that we may wish to monitor quality aspects, for example by observing fieldwork.²⁵⁶ However, the Parties did not engage with us in relation to the above surveys, despite the fact that the Parties were already aware of our views on, and concerns about, the surveys they conducted pre-notification.

²⁵⁵ A more detailed description of these surveys is included in Appendix B.

²⁵⁶ [Good practice in the design and presentation of customer survey evidence in merger cases \(CMA78\)](#), paragraphs 1.23 to 1.25.

8.152 Our detailed assessment of the Parties' new surveys is at Appendix B. In summary, we consider these surveys have the following limitations:

- (a) The Parties used the questionnaire for the CMA store exit survey as a starting point, but made some modifications to it. In our view, these modifications are not inconsequential and mean that the Parties' results are not directly comparable with ours in a number of key respects. We consider that the changes, in combination, may be expected to create a framing bias for some respondents in favour of certain brands or types of stores as next-best alternatives, for example, discounters such as Aldi or Lidl, or stores that have a more limited offering than the Parties' stores. For the CMA store exit survey, we considered the wording of our own questionnaire very carefully in light of the evidential needs of our inquiry; this included specifically deciding against some options the Parties have implemented in their questionnaire.
- (b) As with the Parties' exit surveys conducted during pre-notification, we were not given the opportunity to assess or monitor the quality of the fieldwork for the Parties' new exit survey and were therefore unable to make an assessment of the level of rigour with which the survey was conducted.
- (c) In addition to having these limitations, the Parties' new exit survey in any event only sampled stores the CMA had already surveyed. It therefore does not add much new information to evidence our inquiry.
- (d) For the Parties' new online survey, by virtue of being conducted online it excludes those in-store shoppers who do not use the internet and who may not respond in the same way as online respondents. We consider this to be a serious limitation when the purpose of the survey is to ask a random sample of in-store shoppers about their next-best alternatives for their recent in-store shopping visit. Additionally, it was only able to survey Sainsbury's customers, and only those who hold a Nectar Card who, as loyalty-card customers, may not be representative of shoppers as a whole.

8.153 In summary, we have carefully considered the Parties' new surveys and their submissions concerning them and the extent to which we consider we can place weight on them in our inquiry. In respect of the Parties' new exit survey, we consider that it cannot be considered comparable to the CMA store exit survey, due to the differences in the questionnaire used and the fact that we were not given the opportunity to assess the quality of the survey and, consequently, the robustness of the results. We also consider that it adds little new information in terms of the stores surveyed. Given this, we do not

consider that it would be appropriate, or methodologically robust, to incorporate the results from the Parties' new exit survey into our quantitative analysis. In respect of the Parties' new online survey, as explained above, we don't consider that it would be appropriate to incorporate the results from an online-only survey into our local in-store assessment.

8.154 For the reasons set out above, and given that we have access to a robust survey of our own with a methodology designed specifically to meet the needs of our inquiry, we have not placed any weight on the Parties' new surveys in our local assessment analysis.

- *Analysis of diversion from CMA store exit survey*

8.155 In order to analyse the strength of constraint exerted by stores of different sizes and brands, we sought to classify different competitor supermarkets into 'brand-size' categories,²⁵⁷ and analysed the frequency with which respondents to the CMA store exit survey named stores in each of those categories as their preferred alternative should their current choice be unavailable. We then also analysed how this frequency varied with distance from the surveyed store. We carried out a separate analysis for Sainsbury's and Asda customers, given that the results of our analysis showed that the next-best alternatives for customers of each of Sainsbury's and Asda differed in some respects.

8.156 With respect to the size categories we used, we agreed with the Parties that there was not necessarily a 'step change' in the constraint exerted by Medium stores and Large stores, but that a pragmatic way to carry out the analysis would be to categorise stores as 'Medium' or 'Large' and analyse the strength of constraint from stores belonging to those respective groups.

8.157 To illustrate the approach, Figure 8.3 shows the diversion ratios from surveyed Sainsbury's stores to various Large Tesco stores located within 15 minutes' drive of those surveyed stores, based on responses to our forced diversion question. Each 'dot' on Figure 8.3 represents a single Large Tesco store.²⁵⁸ The higher the dot, the more often it was named by respondents surveyed at a given Sainsbury's supermarket. The further to the right the dot, the further away the store was located from the surveyed Sainsbury's store.

²⁵⁷ As discussed further from paragraph 8.164, the available data did not allow for all competitors' stores to be classified with the same level of granularity (ie both by brand and by size category). Therefore, for some competitors, a weight was assigned for the brand without further disaggregation by size category. Accordingly, the following brand-size categories were adopted: Large Tesco, Medium Tesco, Large/Medium Morrisons, Large Asda, Medium Asda, Large Sainsbury's, Medium Sainsbury's, Large/Medium Waitrose, Large/Medium Aldi, Large/Medium Lidl, Large/Medium M&S, Large/Medium Co-Op and Iceland.

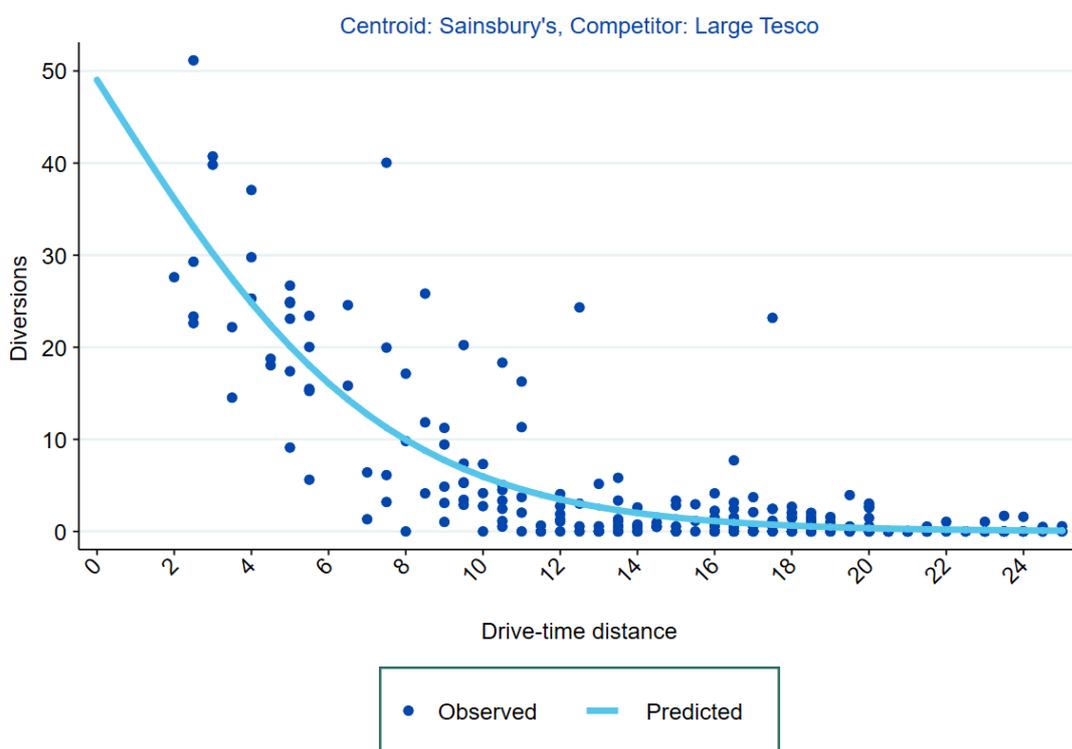
²⁵⁸ If a Tesco's store is a competitor (ie it is within the catchment area) for more than one centroid store, this store will appear more than once in the chart.

The downward slope suggests that stores that were located further away tended to be named less frequently. For example, Figure 8.3 shows that one particular Tesco store was chosen by more than 50% of respondents at a given Sainsbury's store (see the highest 'dot' on Figure 8.3 below). Several Tesco stores (all of which were located at least 8 minutes' drive away from the centroid Sainsbury's (ie the Sainsbury's store from which diversion is measured)) were not mentioned by any of the respondents surveyed at that store.

8.158 We then plotted a line between these dots (as shown by the light blue line), to provide a continuous picture of the average levels of diversion at each drive-time distance, based on the survey observations. We adjusted the economic model used to plot this line following submissions from the Parties, which we agreed produced a better fit for the data.²⁵⁹

²⁵⁹ In response to the Provisional Findings, the Parties submitted that using a 'fractional response estimator' methodology, which takes into account the bounded nature of the diversion ratio (which must be less than or equal to 100% and greater than or equal to 0%), produces a line of best fit that better fits the data than the line of best fit produced by a quadratic ordinary least squares (OLS) regression (which does not take account of the bounded nature of diversion ratio), [Parties' response to the Provisional Findings](#), Schedule 3.1, and paragraphs 28, 130 and 131.

Figure 8.3: Proportion of Sainsbury's customers that chose a given Tesco Large store as their next-best alternative to Sainsbury's, by distance

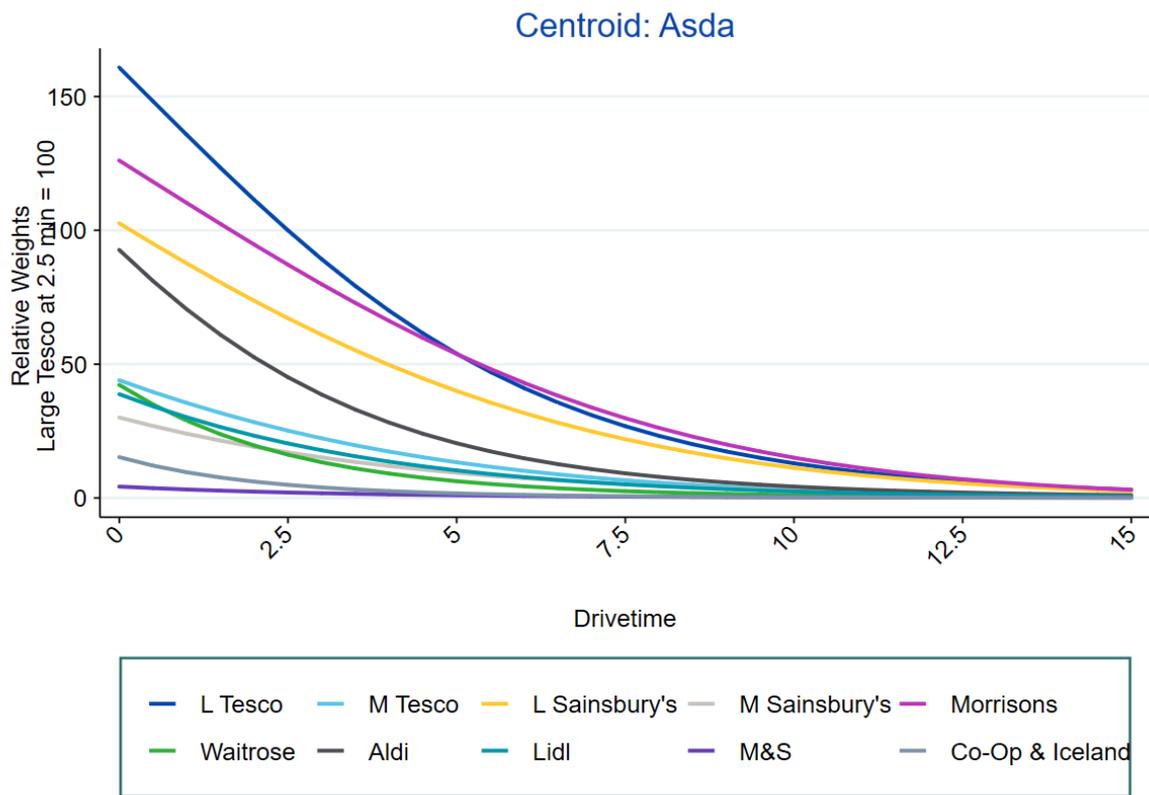


Source: CMA analysis of responses to the CMA store exit survey

8.159 We carried out an equivalent analysis of diversion to each of the brand-size categories, separately for Sainsbury's and Asda stores. We then compared the average diversions of these brands and sizes, at different distances, to the average diversion of a Large Tesco located 2.5 minutes' drive away, which was given a weight of 1.²⁶⁰ In practice, this means that if a brand-size category of supermarket was mentioned more frequently than a Large Tesco located 2.5 minutes' drive away, it would receive a weight of more than 1, in proportion to the higher frequency it was mentioned by survey respondents. If mentioned less frequently, it would receive a proportionally lower weight. Figure 8.4 and Figure 8.5 show the estimated relative weights we calculated for each brand-size category (in the chart, L denotes Large and M denotes Medium).

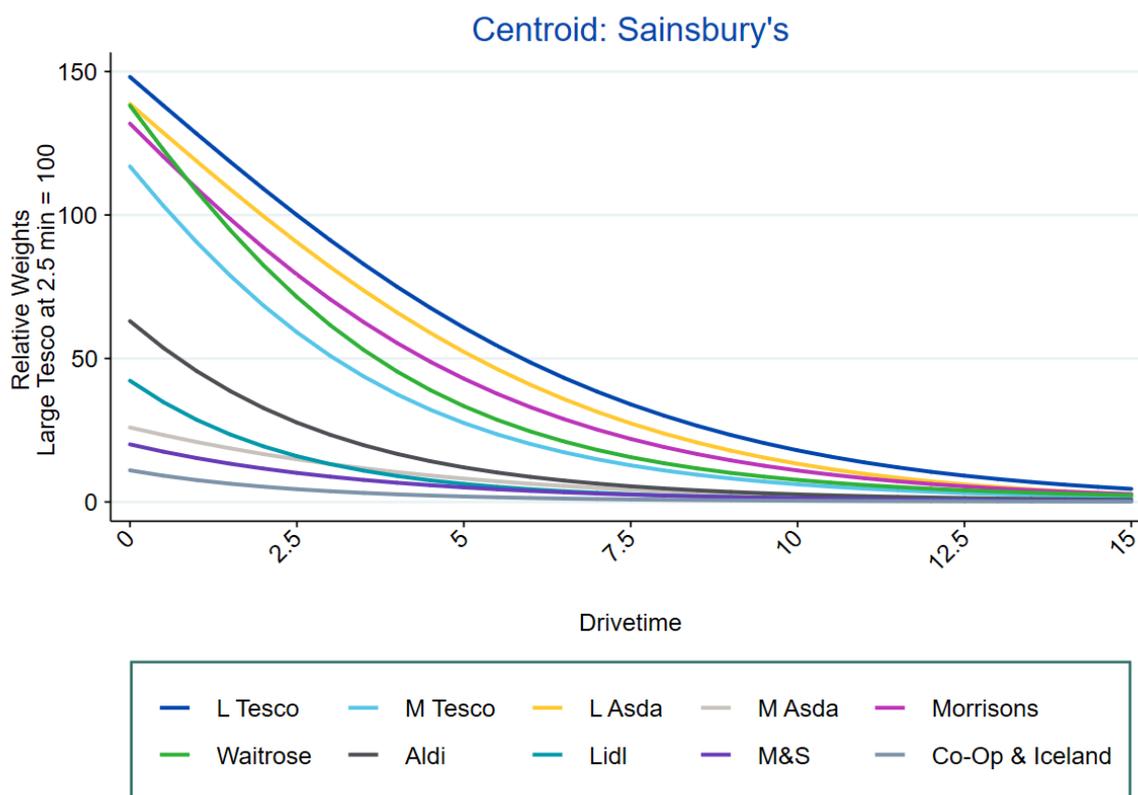
²⁶⁰ Large Tesco stores within 2.5 minutes were chosen as the benchmark category because there are many stores of this brand-size-distance category in the survey data, meaning diversion to Large Tesco stores is relatively well-estimated, and because Tesco is a well-recognised and familiar brand which makes it a familiar reference point, ensuring our weights are transparent.

Figure 8.4: Relative weights of supermarket brand-size categories derived from the CMA store exit survey



Source: CMA analysis of CMA store exit survey responses.

Figure 8.5: Relative weights of supermarket brand-size categories derived from the CMA store exit survey



Source: CMA analysis of CMA store exit survey responses.

- 8.160 As shown in the figures above, Large Tesco stores receive the highest weights for both Asda and Sainsbury's centroid stores. For Sainsbury's centroids, the next highest weight is for Large Asda stores, whereas for Asda it is Morrisons. Overall, Large stores receive higher weights than Medium stores, for the same brands, but the weights of Medium stores are not insignificant.
- 8.161 The figures also show that Aldi and Lidl have been attributed a significant weight. This is in contrast the approach taken by the CMA and its predecessors in to previous mergers involving the supply of groceries through supermarkets, where Aldi and Lidl have not typically been included within the 'competitor set' (although they have in some cases been taken into account when assessing competition in particular local areas).²⁶¹ The weight for Aldi is higher than for Lidl, and Aldi in particular receives a higher weight for Asda centroids than for Sainsbury's centroids (for Asda, Aldi is a stronger competitor than Medium (but not Large) Tesco stores). In contrast, Waitrose

²⁶¹ See paragraph 7.44.

(and to a lesser extent M&S) have higher weights for Sainsbury's centroids than for Asda centroids.

- *Catchment area*

8.162 The analysis in Figure 8.4 and Figure 8.5 suggests that the weights tended to decline to zero after approximately 15 minutes' drive-time. This was the case for both Large and Medium stores. On this basis, we used the survey analysis to assign weights to supermarkets up to 15 minutes' drive away for both Large and Medium stores (adopting the same approach for both urban and rural stores, for the reasons discussed in paragraph 8.167(d)). The treatment of supermarkets located more than 15 minutes' drive away is discussed in conjunction with other out-of-market constraints from paragraph 8.206.²⁶²

8.163 We note that our approach expands the overall catchment area compared to the practice used in previous cases concerning the retail supply of groceries through supermarkets, although importantly the WSS also allows us to take account of the fact that the constraint from rivals declines with distance across this catchment area. The catchment used is also generally in line with the catchment proposed by the Parties (which was to assign a weight to Large stores up to 15/20 minutes' drive away in urban/rural areas, and Medium stores up to 10/15 minutes' drive away in urban/rural), except that it is larger for Medium stores in urban areas, and smaller for Large stores in rural areas.

- *Disaggregation of fascia*

8.164 We considered whether any further disaggregation of weights of the chosen brand-size categories was appropriate, or whether some of these weights should be aggregated together.

8.165 The benefit of disaggregation is that it results in more 'tailored' weights for more specific categories of competitor store. The drawback is that those weights will be estimated with a smaller sample size, and therefore are less

²⁶² Given that we observed some diversion beyond 15 minutes' drive, we also conducted a sensitivity analysis whereby we increased the catchment area by 5 minutes and therefore generated weights for all stores located within 20 minutes' drive and reduced out-of-market diversion accordingly. We found that the GUPPI analysis was not very sensitive to this adjustment. Had we used a catchment area of 20 minutes, the national average-weighted GUPPI would have increased by 0.1 percentage points for Sainsbury's and by 0.2 percentage points for Asda.

robust. We took this trade-off into account when deciding the appropriate level of disaggregation for the weights.

8.166 The Parties submitted that:

- (a) The evidence shows that differentiation is an important part of competition in the grocery sector and it was important that the weights for different brands be disaggregated, given evidence that the constraints exerted by different brands were substantially different;²⁶³
- (b) there is evidence to group M&S and Waitrose together, but it may also be possible to group Co-op and Iceland together. The weights for the other major retailers should be calculated separately.
- (c) categorisation of store size into Medium and Large is pragmatic as this allows for the effect of store size to be captured by calculating separate diversions for each brand's Large and Medium stores. The Parties submitted that it may make sense to combine Medium and Large weights for those main rivals with a limited Large store estate such as M&S, Waitrose, Aldi, Lidl, Iceland and Co-op.
- (d) one should calculate diversions separately for both Parties, however the Parties recognise that the available data may not allow this to be done in a very reliable fashion. Therefore, a pragmatic approach may be to pool the Parties' data whilst splitting the groups into individual brands.
- (e) in estimating separate weights for Large and Medium centroids the CMA is forced to rely on very small sample sizes for medium centroids. As such it may make sense for the CMA to investigate further whether the data supports there being a significant difference between the brand-size-distance weights depending on the size of the centroid. To the extent that it does not, it may make sense to use the Large store results for both Medium and Large centroids – on the basis that the Medium store results are imprecisely estimated.

8.167 As explained in more detail in Appendix E, taking into account the trade-off between having less 'tailored' weights and having the weights estimated less robustly due to low sample size, our approach to estimating weights for individual brand-size categories was as follows:

²⁶³ This was because it could cause the diversion between the Parties to be overstated and the constraint of rivals to be understated. By way of example, the Parties submitted that grouping Tesco with weaker brands would cause Tesco's weight to be understated (and other rivals in the group to be overstated), which would cause the overall constraint on the Parties to be understated in part because Tesco stores are relatively numerous.

- (a) We estimated separate weights for each brand except for Co-op and Iceland, which have been assigned the same weights, given the limited number of observations for these competitors in the survey results. This reflects our agreement with the Parties that there is value in disaggregating brand weights where the data allow.
- (b) We agreed with the Parties that aggregating the size categories of stores for certain brands is a pragmatic approach to increasing sample size where the brand's store estate is largely concentrated in one size category, or where there were few observations for a particular size category of that brand. We therefore split the weights by size (ie Large vs Medium) for Tesco, Sainsbury's and Asda, but did not differentiate between Medium and Large Stores for Morrisons, Aldi, Lidl, Co-op/Iceland, M&S and Waitrose stores.
- (c) We estimated separate weights for Asda centroids and Sainsbury's centroids. However, the constraints were modelled in the same fashion regardless of whether the centroid was a Medium or a Large store.
- (d) We treated rural stores in the same way as urban stores, due to limited evidence on rural stores. We note that past cases in the retail supply of groceries through supermarkets have found that rural supermarkets compete over longer distances than urban stores.²⁶⁴ We note that our approach of using a consistent catchment for urban and rural may therefore underestimate the true catchment area for rural stores. We note that this would have two effects: firstly, some diversion between the Parties' rural stores located further apart will be excluded, causing diversion between the Parties to be underestimated; secondly, some diversion to competitors located further away from the Parties' rural stores will also be excluded, causing diversion between the Parties to be overestimated. As there are typically more rival stores than stores of the other merging Party in any given local area, we consider that the net effect will usually be that diversion between the Parties is overestimated in rural areas. Conversely, by generating average weights based on evidence from urban areas and rural areas, diversion between the Parties may be underestimated in urban areas. Overall, we would expect this to have a small impact on our assessment, given that the vast majority of the Parties' stores are in urban areas.

²⁶⁴ See paragraph 7.76, which notes that catchment areas for Large and Medium stores have typically been 5 minutes longer for rural stores.

- *Representativeness of CMA store exit survey*

8.168 The Parties submitted that the sampling methodology used to decide which stores to survey in the CMA store exit survey means that our results would tend to overstate the diversion between the Parties and understate the diversion from the Parties to other competitors. This was because (i) the average diversion to a given store will be lower if there are more competitors and (ii) in our sample, the Parties tend to be present in areas with fewer competitors (leading to higher diversion estimates) and (iii) in our sample, other competitors, such as Aldi and Lidl, tend to be present in areas with more competitors (leading to lower diversion estimates).

8.169 We consider this in Appendix B. In our view, the sampling approach oversamples all competitors' stores in relatively concentrated areas in a way that means there will be limited impact on the relative weights assigned to different brand-size categories. We have taken into account small differences in the level of concentration faced by different brands in our sample when choosing an appropriate GUPPI threshold.

Entry-exit analysis

- *CMA analysis*

8.170 Entry and exit analysis is used to assess whether and how the entry and exit (ie closure or sale to another brand) of competitors' stores affect the Parties' grocery sales. It allows us to estimate the average impact of one additional (or one fewer) competitor store on the Parties' sales. The more customers consider an opening or closing store a good substitute to the Parties' stores, the larger the impact of the entry or exit of the competitor on the Parties' sales at those stores.

8.171 This type of analysis can be used to compare the relative strength of constraint exerted by stores of different brands, sizes and distances.²⁶⁵

8.172 There are certain caveats to this analysis. Entry-exit analysis does not directly measure diversion. Rather, it examines how customers respond to a store opening or closing. This may not be the same as how customers would

²⁶⁵ For example, imagine that when a new Tesco opens within 5 minutes' drive of one store, Sainsbury's sales fall by 6%, but when a new Tesco opens within 20 minutes' drive of an otherwise similar store, Sainsbury's sales do not show a statistically significant reduction in sales. This might suggest that we should consider Sainsbury's stores to be constrained by stores within 5 minutes' drive but not by stores within 20 minutes' drive.

respond to small changes in PQRS.²⁶⁶ Evidence on entry-exit also may understate the actual impact of store entry, because competitive responses to expected or recent entry can dampen the effect on revenues.²⁶⁷ In addition, in the context of store exit events, it is more likely that poorly performing stores will exit, and this will cause their impact on sales to be smaller than might be expected if an 'average' store were removed. Nevertheless, we think entry/exit is still informative of the relative constraint exerted by stores, especially when considered in the context of other evidence.

8.173 We analysed a dataset provided by the Parties on entry and exit events by competitor supermarkets over the period 2014 to 2017. Considering an area of a 15-minute drive-time from each of the Parties stores, this dataset contained:

- (a) 488 instances in which an Asda's store was affected by a Large store entering or exiting;²⁶⁸
- (b) 638 instances in which a Sainsbury's store was affected by a Large store entering or exiting;
- (c) 3,222 instances in which an Asda's store was affected by a Medium store entering or exiting;
- (d) 3,106 instances in which a Sainsbury's store was affected by a Medium store entering or exiting.

8.174 Our econometric approach in conducting this entry-exit analysis and the results of the analysis are described in detail in Appendix C.

8.175 Similar to our approach described above with respect to the diversions estimated from the CMA store exit survey, we use the results from the entry-exit analysis to calculate relative weights for each brand-size-distance category. As we did when calculating the weights derived from the CMA store exit survey, we used Tesco as a benchmark. Therefore, all weights were calculated relative to the weight assigned to a Large Tesco store located 0-5 minutes' drive away, which was given a weight of 1.

²⁶⁶ This may be because, for example, some customers make their choice purely on the basis of location, and the new store is closer to their home or, alternatively, some customers have a strong preference for a particular brand, and the new store is the first and only store of that brand in their local area.

²⁶⁷ This is discussed in greater detail in Appendix C.

²⁶⁸ An entering or exiting store may affect more than one centroid store.

8.176 The key results are shown in the tables in Appendix C, paragraph 19. These show that:

- (a) The impact of entry-exit on a store's revenues overall decreases with distance. We interpret this as indicative evidence of a weakening competitive constraint with distance.
- (b) Aldi and Lidl stores have a smaller yet meaningful impact relative to Large Tesco stores on revenues, in particular within 0-5 minutes' drive from a Sainsbury's or Asda centroid. Overall, we take this as evidence that Aldi and Lidl pose some competitive constraint on the Parties' stores.
- (c) The impact of Large stores is, broadly speaking, stronger compared to the constraint from Medium stores. We therefore interpret this as supporting evidence that Large stores exert a stronger competitive constraint than Medium stores.
- (d) Some of the estimated weights are unexpectedly negative. This might be because we are not fully able to account for confounding factors at the local level, specifically factors that change over time (see Appendix C).²⁶⁹

8.177 We describe at paragraphs 8.196 onwards how we have used the results of this entry-exit analysis in combination with the evidence from the CMA store exit survey to construct the weights used in the WSS.

- *Parties' analysis ('impacts analysis')*

8.178 Similarly to an entry-exit analysis, the Parties' internal impacts analysis ('impacts analysis') evaluates what happens to the Parties' sales after a competitor enters or exits. The Parties submitted that they generate impacts analyses during the normal course of business in order to estimate the impact of store entry on individual stores.

8.179 To measure the impact of an entry or exit event, one would want to compare the revenue of an affected store with and without the impact. However, it is difficult to establish the revenue pattern of a store in the absence of the entry/exit event. To establish this, the Parties [✂].²⁷⁰

²⁶⁹ Confounding factors are factors that may cause a false association between the store revenue and exit/entry events.

²⁷⁰ [✂].

- 8.180 We considered the relative merits of the CMA's entry-exit analysis, and the Parties' impacts analysis for the purposes of our assessment. In this respect, we noted several points.
- 8.181 First, the entry-exit analysis is conceptually similar to the impacts analysis in the sense that they both evaluate the impact on the Parties' revenues after a competitor enters/exits. Indeed, the Parties' impacts analysis is based on the same entry and exit events as our entry-exit analysis.
- 8.182 Second, the advantage of the fixed effects approach of the entry-exit analysis (described in Appendix C) is that we can systematically account for factors that affect outcomes in the local market. In contrast, the impacts analysis does not allow us to directly account for those factors.
- 8.183 The Parties submitted that they use the impacts analysis during the normal course of business and try to make it as robust as possible, including accounting for factors specific to some local markets (for example, the Parties exclude weeks where another impact occurred, and Sainsbury's excludes Christmas weeks from all impact measurements).²⁷¹
- 8.184 However, the above suggests that, in contrast to the entry-exit analysis, the Parties' approach to accounting for factors specific to local markets in the impacts analysis is non-systematic and may be based on manual adjustments in some local areas that rely on judgement, which are not fully observable by the CMA.²⁷² While this approach may be appropriate with regards to assessing whether an *individual* event had an impact (or not), we consider that the systematic approach reflected by the entry-exit allows for a more accurate reflection of the *average* impact of entries/exits for each brand-size combination.
- 8.185 Third, in the entry-exit analysis we are able to identify potential biases and their direction, which is not possible in the impacts analysis (see Appendix C for discussion).
- 8.186 The Parties submitted that they do not consider the impacts data to be biased as it is contemporary data on which business decisions on a day to day basis are made.²⁷³
- 8.187 In the CMA's view, the biases in analysis related to entry or exit events arise through the lack of suitable ways to account for confounding factors, ie

²⁷¹ [Parties' response to the Provisional Findings](#), Schedule 3.1, paragraph 99.

²⁷² As regards impacts on Sainsbury's, Schedule 2 to the merger notice states that: "[~~]"~~ (*emphasis added*)

²⁷³ [Parties' response to the Provisional Findings](#), Schedule 3.1 and paragraph 99.

factors that may result in an inaccurate estimate of the relationship between revenues and entry/exit events.²⁷⁴ The fact that the data for the impacts analysis are contemporary data and are used in business decisions, does not mean that the analysis is not biased. Moreover, we explain in the section on the entry-exit analysis, there are circumstances in which the approach is not fully able to account for potential confounding factors. For the CMA's purpose, it is thus important to be able to assess the direction of the bias and the possible extent of such bias. While the source and direction of these biases are understood in the entry-exit analysis, we do not consider it possible to gain the same understanding for the impacts analysis. However, identifying the biases is not possible for the impacts analysis as there is no approach to measuring them.²⁷⁵ For this, and other reasons outlined above, we consider the entry-exit analysis as more reliable for the CMA's purpose.

- 8.188 In light of the factors above, we have not attached weight to the impacts analysis in our assessment but note that the data on which it relies is incorporated into our assessment through the entry-exit analysis.

Gravity models

- 8.189 Another source of potential evidence, which the CMA investigated, is the Parties' gravity models. According to the Parties' initial submissions, these models are used to forecast sales for new supermarket sites, and on an ad hoc basis to measure performance, particularly of newly opened stores.²⁷⁶ The Parties' initial submissions referred to usage of these models as being 'low' (at least for the Sainsbury's model) and highlighted what they considered to be 'significant variations within the accuracy' of the predictions that both Parties' models provided stating that for this reason they were used as only one component in forecasting sales for new supermarket sites.²⁷⁷
- 8.190 We sent the Parties several detailed information requests to understand the gravity models and assess their potential relevance as a source of evidence. Following these requests, the Parties provided to the CMA the main parameters of the gravity model, including 'attractiveness weights' applied to stores of different brands and different sizes. The CMA assessed the data relating to the Sainsbury's model²⁷⁸ as far as possible and performed an

²⁷⁴ This could be factors that relate to changing profitability in a local market, which triggers entry or exit.

²⁷⁵ In contrast, for the entry-exit analysis we can apply the standard formula for bias.

²⁷⁶ [REDACTED]

²⁷⁷ [REDACTED]

²⁷⁸ Due to prioritisation of resources, we did not conduct the same analysis on the data relating to the Asda model.

initial analysis which incorporated some of the information provided on the gravity models.

- 8.191 In response to the CMA's working papers, the Parties also presented a new simulation of the gravity model. This was produced for the purposes of our inquiry and is therefore not used by the Parties in the ordinary course of business. This simulated the closure of the Parties' stores and identified to which rival stores the lost sales of the closed stores would be predicted to divert. The Parties submitted that that this was relevant evidence that should be taken into account in calibrating the WSS. We asked a series of detailed questions following the submission of this evidence to understand its importance and potential relevance for our inquiry.
- 8.192 The Parties were unable to provide us with sufficient information (in the form of the raw data, and code linking that raw data to the outputs produced by the models) to enable us to reproduce the results of either the original gravity models or the simulation or to assess how the input data were processed to arrive at the output.²⁷⁹ Sainsbury's offered to provide the CMA with a laptop containing 'a relatively static version' of its model, together with a member of Sainsbury's staff to assist in reviewing it. The Parties submitted that this would 'allow the CMA to run sensitivities by changing the settings or by making simple changes to the code. However, the model will not be fully flexible as certain more material changes or sensitivities may require the model to be fully calibrated or may need input from other departments'. The Parties submitted that if the CMA wished to run specific scenarios, Sainsbury's would prepare the required inputs and share them with the CMA. The CMA declined this offer for the reasons set out below. The Parties did not make an equivalent offer regarding Asda's gravity model.
- 8.193 Subsequently, in their response to our Provisional Findings, the Parties submitted that 'the gravity models are used and frequently relied on by the Parties in their day-to-day business to assess local conditions of competition and produce local market forecasts' and that 'the gravity models are, not only accurate in their own right, but are also more accurate at predicting the CMA's own survey diversions than the WSS model'.²⁸⁰
- 8.194 Whilst we have carefully considered the Parties' submission on this issue, we continue to have the following concerns:

²⁷⁹ The guidance on submission of economic analysis, 'Suggested best practice for submission of technical economic analysis from Parties to the Competition Commission', which has been adopted by the CMA Board, provides that the CMA's economists may wish to replicate the results produced by any analysis that has been submitted.

²⁸⁰ [Parties' response to the Provisional Findings](#), paragraph 20.

- (a) We have not been able to independently investigate the gravity models to a sufficient level to enable us to understand what is driving their results. The Parties have not been able to provide us with all the data files necessary to reproduce the outputs of the gravity model simulations (and therefore the results presented in the Parties' submission), and the Parties' gravity models are coded in a programming language that is not accessible to the CMA.²⁸¹ The CMA has therefore not been able to review the steps taken to convert the raw data of the gravity model into the Parties' proposed brand weights, or to fully interrogate the gravity model simulation and therefore rely upon it.²⁸² The Parties' offer to provide a static version of the Sainsbury's model on a laptop with the assistance of a Sainsbury's member of staff would have been insufficient to allow us to interrogate that Party's model independently to the standard required for us to fully understand and validate its results, perform the required adjustments to make those results comparable to our other evidence, and attribute material weight to this evidence.
- (b) The importance of being able to fully interrogate this model (and all underlying assumptions) is reinforced by the fact that the gravity model simulation produced some results that are materially out of line with the results from other pieces of reliable evidence (particularly the CMA store exit survey, which was designed for the purpose of this inquiry and subject to significant amounts of quality assurance, as described in paragraph 8.136 to 8.140 and Appendix B), such as an out-of-market diversion value of [50-60]%. The Parties stated that this was to be expected because the results of the gravity model are not comparable without adjustment.²⁸³ We reviewed the Parties' submissions on this issue²⁸⁴ and considered that this was likely to relate to the fact that some of the modelling assumptions were inconsistent with our market definition. The fact that adjustments were needed to the results to make them comparable to our survey reinforces the need for the CMA to understand fully how such results are produced.

²⁸¹ We note that the Parties' economic advisers were also reliant on the Parties to effect the modifications needed to produce the gravity model simulation. 'CRA discussed the analysis separately with each Party and the instructions were given verbally as follows [...].'

²⁸² The CC's *Suggested best practice for submissions of technical economic analysis from parties to the Competition Commission* (which has been adopted by the CMA) explains at paragraph 8 that '*In a number of cases, the CC will want to replicate the results of the analysis that has been submitted. This means that parties should be prepared to respond to a CC request, at very short notice, for all relevant computer code and data files necessary for the CC's economists to reproduce the results presented in the parties' submission.*' Where the CMA is unable to reproduce the analysis in this way, this clearly undermines the CMA's ability to verify it and, consequently, to rely upon it.

²⁸³ [Parties' response to the Provisional Findings](#), Schedule 3.1, paragraph 78.

²⁸⁴ [Parties' response to the Provisional Findings](#), Schedule 3.1 at 2.3.2.

- (c) We received differing submissions on the frequency of usage of the gravity models, which made us less certain about the robustness of the models and the extent to which they provide reliable evidence in the context of our investigation. Sainsbury's initially submitted that the absence of new supermarket openings means that its usage of the model has been low in recent years. The Parties subsequently (following the release of our Provisional Findings) stated that usage of the gravity models was 'extensive' and provided figures showing that Asda had used its model over 700 times in the last five years whilst Sainsbury's had used its model over 200 times in the last four years.²⁸⁵ We noted that this evidence showed that the usage had declined significantly in recent years with each Party having used the model 30 times in the last year.²⁸⁶
- (d) Further, we had concerns about the accuracy of the models. Both Parties originally submitted that there were 'significant variations' in the accuracy of the model when compared to actual sales of stores.²⁸⁷ In their response to Provisional Findings, the Parties stated that the gravity models are accurate in their own right and also more accurate at predicting the CMA's own survey diversions than the WSS model on which the CMA bases its local SLC findings.²⁸⁸ However, the comparison of correlation coefficients presented by the Parties was not performed on a like-for-like basis.²⁸⁹ In addition, the Parties' assessment of the fit of the gravity model for survey diversion is based on visual consideration of the fit of the data for a subset of points below 15% survey diversion. When considering the full range of points, it is not clear that the fit of the data is better than the WSS.
- (e) The gravity model is based on the same logic as entry-exit in the sense that it seeks to assess, based on historical customer behaviour, where sales would go in the event that a store closes. The gravity model simulation assesses this by considering the change in the Parties' sales forecasts (as compared to entry-exit analysis which directly considers the historical change in actual sales). Given that we have considered evidence from entry-exit analysis in this case, the incremental value of the

²⁸⁵ [Parties' response to the Provisional Findings](#), Schedule 3.1, paragraphs 7 and 78.

²⁸⁶ [Parties' response to the Provisional Findings](#), Schedule 3.1, paragraphs 83 and 87, Tables 3 and 4.

²⁸⁷ This concern regarding the accuracy of the model was raised in response to the CMA's requests to better understand the inputs to the model, in particular the 'attractiveness weights', and how these might be assessed as part of the CMA's investigation. The Parties did not repeat these concerns when later submitting their simulation on the gravity models, on which they submitted we should rely.

²⁸⁸ [Parties' response to the Provisional Findings](#), paragraphs 20 and 463.

²⁸⁹ In particular, the Parties compared the correlation coefficient of the gravity model when predicting store sales to the correlation coefficient of the WSS for predicting survey diversion. A like-for-like comparison would have considered the correlation coefficient of each of the models for predicting the same thing, e.g. survey diversion.

gravity model simulation is lower than in a scenario where similar evidence were unavailable.

- (f) As regards the gravity model simulation, this was produced during our investigation, is not performed routinely by the Parties, and simulates a scenario different to the one for which the gravity model was built, which makes us less inclined to place weight upon it.²⁹⁰

8.195 Therefore, having considered the results of the gravity model, and gravity model simulation, we have concerns about the reliability of the results they produce, and given the nature of the models, could not further interrogate them. Taking these factors together, in particular that adjustments were required to make the results comparable with our analysis and we were unable to fully understand what was driving these results, we did not consider it would be appropriate to place weight on the gravity models in the context of this investigation. We also took into account that this is a large merger investigation with a tight statutory deadline where we already have a large amount of reliable evidence on which to base our decisions.

Combining evidence on relative weights

8.196 We considered the weight to attach to the different pieces of evidence in calculating weights for our WSS and associated GUPPI analysis.

8.197 For the reasons set out above, we consider that the CMA store exit survey provides robust evidence to use for the purposes of calculating weights for each brand-size category, across the 15 minutes' drive-time catchment. We also consider the CMA entry-exit analysis provides useful complementary evidence to the findings from the CMA store exit survey. We further considered our weights in the light of qualitative evidence on the relative strength of the Parties' rivals. For the reasons set out above, we have not put weight on the Parties' impacts analysis or gravity models in our assessment.

8.198 In order to take into account the evidence from both the CMA store exit survey and the entry-exit evidence in constructing our survey weights, we took the following approach.

- (a) First, we plotted the weights derived from the entry-exit analysis (which are calculated in brackets of 5 minutes' drive-time) against the weights derived from our analysis of the CMA store exit survey (which are shown in a 'curve' that plots the weights for all drive-time distances up to 15

²⁹⁰ Although the Parties submit that the same assumptions were applied to the simulation as are applied when the gravity model is used in the ordinary course.

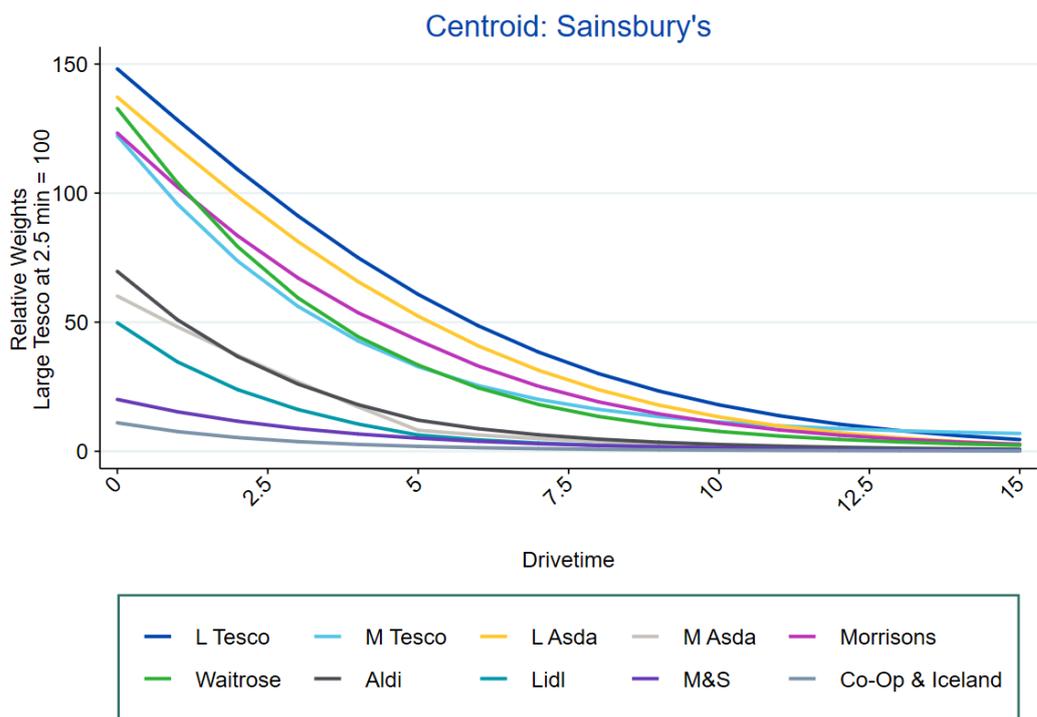
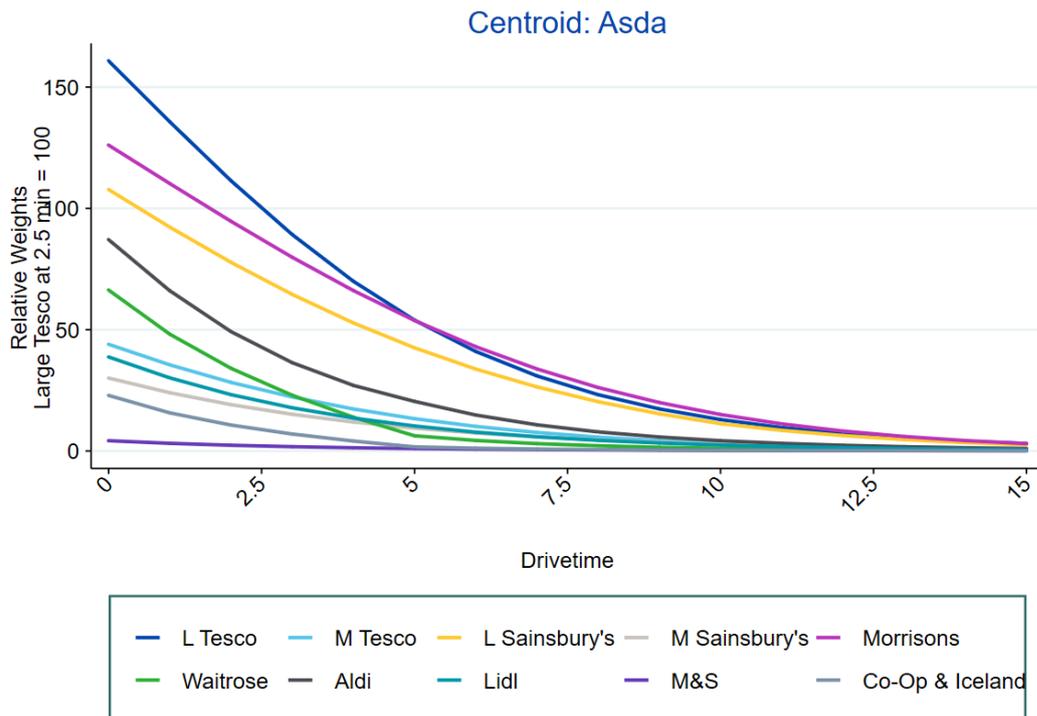
minutes). These comparisons of the relative weights suggested by the survey and the entry-exit analysis are presented in Appendix E.

- (b) Second, where the entry-exit analysis was statistically significant, we made adjustments to the weight from the survey in order to reflect both pieces of evidence.²⁹¹ In a minority of cases, we considered that, in our judgement, the adjustments would produce counterintuitive results (such as relative weights becoming stronger with distance) and therefore made no adjustment. The approach to adjusting the survey curves is also discussed in Appendix E.

8.199 The final weights we applied in our analysis are summarised in Figure 8.6.

²⁹¹ The Parties submitted that the CMA did not provide an explanation of what it considers to be material, when deciding whether or not the difference between the entry-exit and survey evidence was substantial enough to warrant an adjustment. See Parties' response to the Provisional Findings, Schedule 3.1, paragraph 34. In order to address this concern, we have systematically made an adjustment even where the difference between the two pieces of evidence is very small.

Figure 8.6: Summary of weights applied



Source: CMA analysis of CMA store exit survey responses and entry-exit analysis.
 Note: Aldi, Co-op, Iceland, Lidl, M&S, Morrisons and Waitrose include Medium and Large stores.
 Note: Co-op and Iceland have been assigned the same weights due to the small number of respondents that would divert to a store from Co-op or Iceland in the CMA store exit survey.

8.200 We make a number of observations in relation to the final weights applied in our analysis (as illustrated by the curves above).

- 8.201 First, for both Sainsbury's and Asda centroids, Large Tesco stores generally have the highest weight (for Asda centroids, particularly over shorter distances).²⁹² For Asda centroids, this is followed by Morrisons stores (for which the weight is similar to Large Tesco stores at further distances) and Large Sainsbury's stores. For Sainsbury's centroids, this is followed by Large Asda, and then by Morrisons, Medium Tesco and Waitrose stores (the relative position of which vary to some degree depending on the distance of the rival store).
- 8.202 Second, we note that Aldi and Lidl supermarkets receive material weights (with Aldi's weight generally higher than Lidl's). This is true for both Parties, although Aldi's weight in particular is higher for Asda centroids than it is for Sainsbury's centroids. This is consistent with the Parties' submissions regarding the strength of constraint exerted by discounters. Nevertheless, for both Parties, the weights for Aldi and Lidl remain smaller than those for Large Tesco, Large Sainsbury's, Large Asda and Morrisons stores (and for Sainsbury's centroids, also smaller than Medium Tesco and Waitrose stores).
- 8.203 Third, we note that Medium stores receive a positive weight. In previous cases concerning the supply of groceries through supermarkets, Medium stores were not considered to constrain Large stores. The CMA store exit survey and entry-exit evidence suggest that Medium stores do constrain Large stores, albeit to a lesser extent than Large stores constrain Large stores. This may be driven by changing shopping habits as a greater proportion of consumers are willing to make smaller and more frequent shopping trips, or place additional value on convenience, as described at paragraphs 4.11 to 4.14. Again, this is consistent with the Parties' submissions on the constraint exerted by Medium stores.
- 8.204 More generally, we have considered the extent to which the weights indicated by these analyses are consistent with qualitative evidence on the relative constraints imposed on the Parties by different competitor brands. This evidence is described as part of our national assessment, in paragraphs 8.28 to 8.111 above, and includes evidence from the Parties' internal documents and evidence regarding differences in in-store offerings between different competitors. Based on this evidence, we found (amongst other things) that: the Parties are close competitors to each other; that there is an important competitive interaction between the 'Big 4' grocery retailers (of which the Parties are two); that after Tesco, the other Party and Morrisons generally act as each Party's next-closest competitor; and that the discounters provide a

²⁹² We note that it is not inherently problematic for the relative weights of different fascia to change with distance, to the extent those changes are driven by the data rather than by assumption.

degree of competitive constraint on the Parties, but that this constraint is less important than that provided by Tesco, Morrisons and the other Party (albeit that the strength of this constraint also differs between the Parties). We consider that the relative weights as illustrated by the curves in Figure 8.6 above are consistent with this evidence.

8.205 As such, the weights derived from our WSS rely on both the CMA store exit survey and the entry-exit analysis, and are also consistent with the qualitative evidence on the relative constraints imposed on the Parties by different competitor brands, as discussed in our national assessment.²⁹³

Weight for 'out-of-market' constraints

8.206 The Parties submitted that their Medium and Large supermarkets are constrained by a range of competitors other than other supermarkets located in the immediate local area of the Parties. This includes:

- (a) types of store other than supermarkets, such as bargain stores, specialist stores (such as butcher shops and bakeries) and convenience stores;
- (b) stores belonging to brands other than the 10 main brands considered in our analysis;
- (c) online grocery retailers; and
- (d) supermarkets located outside the immediate local areas of the Parties (ie more than 10-15 minutes' drive away).

8.207 The Parties submitted that an overall allocation for 'out-of-market' diversion should be made for alternatives in these categories.

8.208 We estimated this constraint to be 25%, on the basis of aggregating diversion to these alternatives in the CMA store exit survey (using a 15-minute drive-time catchment area).

²⁹³ As a robustness check, we conducted a sensitivity analysis to assess the impact of using just the CMA store exit survey to calculate the weights that feed into our WSS, rather than combining evidence from the CMA store exit survey and the CMA entry-exit analysis. We found that the GUPPI analysis was not sensitive to the approach taken, as the national average-weighted GUPPIs of both Parties did not change to at least one decimal place if we used just the CMA store exit survey.

Table 8.2: Out-of-market diversion based on CMA store exit survey

<i>Category</i>	<i>CMA analysis of CMA store exit survey</i>
Stores outside 15 minutes' drive-time, stores excluded from the relevant product market	18.3
Online	4.7
I would not have made the purchases	2.4
Total	25.3

Source: CMA analysis, Parties (15 minute drive-time catchment area, full survey sample). Diversion online includes own-brand diversion.

- 8.209 In addition, the results of our entry-exit analysis broadly suggest that the geographic market is no larger than 15 minutes' drive-time, since there is a lack of statistically significant coefficients beyond this level. Therefore, it is unlikely that there is a strong out-of-market constraint from stores that are further than 15 minutes' drive from a given store.
- 8.210 The Parties submitted that, by comparing the WSS to the surveyed diversion to stores within the market, it is possible to estimate the total out-of-market constraint. Applying the Parties' proposed method to our WSS suggests that the out-of-market constraint should be 27%, which is consistent with our approach.²⁹⁴
- 8.211 Based on the above, we considered an out-of-market constraint of 25% to be appropriate.
- 8.212 The Parties submitted that amongst other reasons,²⁹⁵ the CMA's approach to own brand within in-store out-of-market is not consistent with its approach to the out-of-market constraint in the online survey, where own-brand other channel alternatives were included. Where own-brand diversions are to another channel, then like on-line, it is appropriate to include them in the diversion calculation.²⁹⁶ However, this is incorrect, as our analysis included own-brand diversion to online grocery shopping.
- 8.213 The Parties submitted that, when calculating out-of-market diversion, we used unweighted responses to the survey (in a departure from the CMA's Survey Good Practice), whereas weighted responses produce a higher estimate.²⁹⁷ As discussed more generally in Appendix B, we consider using

²⁹⁴ The Parties submit that the survey diversions contain all constraints, whilst the WSS diversion only includes diversions to those retail competitors explicitly modelled and physically within the catchment area, and that therefore the average difference between the two provides an estimate of the importance of the additional constraints. We calculated the line of best fit between the WSS diversions and the survey diversions. We estimated that the line of best fit has a slope coefficient of 0.73, and therefore a 100% WSS diversion corresponds to a 73% survey diversion. Based on the Parties' arguments, this would be equivalent of there being a 27% uplift for additional constraints.

²⁹⁵ Parties' response to the Provisional Findings, Schedule 3.1, paragraph 50.

²⁹⁶ Parties' response to the Provisional Findings, Schedule 3.1, paragraph 49.

²⁹⁷ Parties' response to the Provisional Findings, Schedule 3.1, paragraph 51.

unweighted survey responses to be appropriate for our local assessment, and that this is not inconsistent with the CMA's Survey Good Practice.²⁹⁸ Further, we note that the difference between the weighted and unweighted estimates for out-of-market diversion is not material (0.03 percentage points).

8.214 The Parties submitted that we should not round our estimate of the proportion of out-of-market diversion that is recaptured by the other Party to the closest percentage point because this was material relative to the GUPPI threshold.²⁹⁹ We agree and reflect this in our analysis.

Diversion ratios

Converting weights to diversion ratios

8.215 Having established the weights for different competitors, we use these to construct diversion ratios to the existing and pipeline stores of the Parties and their competitors.³⁰⁰ We did this by:

- (a) applying a weight to each store in the local area according to its brand, size and distance from the Parties' stores;
- (b) adjusting those weights upwards or downwards such that they add to 75% without changing the *relative* weight between them; and
- (c) allocating the remaining 25% to out-of-market diversion, of which 1.68 percentage points was attributed as out-of-market diversion between the Parties, as a result of sales diverting to the other Party's brand through some combination of their convenience stores, online groceries business or supermarkets located more than 15 minutes' drive away.³⁰¹

8.216 The resulting proportions were used as the diversion ratios.

8.217 We considered whether, in areas where we had direct evidence from the CMA store exit survey, we should use the survey estimate of diversion rather than the estimate extrapolated from the WSS.

²⁹⁸ As we have assessed that weight may increase overall error (that is, increase sampling error without materially reducing bias).

²⁹⁹ Parties' response to the Provisional Findings, Schedule 3.1, paragraph 53.

³⁰⁰ We have also excluded any Party or competitor stores that are expected to close in the next two years.

³⁰¹ The 1.68% was the average diversion to Convenience stores, Online and out-of-catchment stores of the merging Party across the surveyed areas. We allocated 1.68 percentage points of diversion to the Parties in this way only in cases where they overlapped locally. For areas where they did not overlap within 15 minutes' drive, we made no such allocation, which means that the local GUPPIs of non-overlapping stores are set to zero. This would tend to understate diversion between the Parties and, while unlikely to influence the local GUPPI assessment, it would cause the overall national weighted-average GUPPI to be understated.

- 8.218 The Parties submitted that direct survey results should not be used in local areas, because the survey estimates of diversion will have some degree of noise around them and do not take account of imminent new store openings. However, they submitted that we should use survey diversions as an additional screen to assess whether the WSS diversion and survey diversion were consistent.
- 8.219 We consider that all sources of evidence on diversion (whether calculated directly from the CMA store exit survey, or from the WSS) will be subject to some noise. We have made an allowance for this in our assessment and have considered in particular to what extent any noise is biased, making it more likely that the diversions will be over- or underestimated. However, for areas where we carried out a direct survey of the local area and we identified no plans for stores to open in the area,³⁰² we considered it appropriate to use the diversion ratio between the Parties indicated by that survey evidence, rather than using our WSS methodology.³⁰³ We consider the WSS is a robust methodology by which to estimate diversion between the Parties in the large number of overlaps in which they compete. It also has the advantage of drawing on survey evidence from across local areas, which will tend to reduce any effect of sampling error on the estimated diversion ratio for a given local area. However, a direct survey of a local area has the advantage that it takes into account not only brand, size and distance, but a wide range of specific local factors that influence diversion between the Parties in that local area and which is not captured in our WSS.³⁰⁴
- 8.220 As a robustness check, we conducted a sensitivity analysis to assess the impact of calculating diversion between the Parties using the WSS in all areas as described above, rather than using the survey diversion as set out

³⁰² Stores opening in a local area would mean that the contemporaneous responses to a survey would no longer be fully reflective of the competitive environment in that local area.

³⁰³ In addition to the above, we used the lower of the diversions from the survey and the WSS in areas in which there were third-party pipeline stores and no pipeline stores from the Parties. Given that adding a pipeline competitor stores should reduce the diversion between the Parties compared to the level of diversion found in the survey, this adjustment prevents the WSS from increasing the estimated diversion between the Parties relative to the survey in these areas. In a similar fashion, if there were Party pipeline stores and no pipeline stores from third parties, we used the higher of the diversions from the survey and the WSS.

³⁰⁴ The Parties calculated confidence intervals for each survey store diversion between the Parties' stores in the surveyed areas and then presented the proportion of stores where the estimated WSS diversion was outside the 90% confidence interval of the corresponding survey store ratio (see [Parties' response to the Provisional Findings](#), paragraph 128 and Table 7). We note that we expect the WSS diversions to be different from the survey diversion because the latter accounts for idiosyncratic local factors that the WSS does not account for. We note that this means that idiosyncratic local factors may result in the WSS producing some false positives and false negatives, but we considered this in coming to a view on the appropriate GUPPI threshold (see paragraphs 8.293 to 8.295 and Appendix E). We also note that the Parties, when commenting on numbers in Table 7, refer to the Wald intervals when the Wilson intervals are more appropriate, and they also apply a 90% confidence interval threshold rather than the more conventional 95%; they therefore overstate the proportion of times that the WSS estimates fall outside standard sampling intervals of the corresponding survey estimates.

in paragraph 8.219. We found that the GUPPI analysis was not very sensitive to the approach taken.³⁰⁵

Treatment of own-brand diversion

- 8.221 Some respondents to the CMA store exit survey indicated that, in the event the store they had just shopped at was closed, they would switch to another supermarket of the same brand (whether in the same local area, or further away), a convenience store of that brand, or the brand's online delivered groceries business.
- 8.222 Including these 'own-brand diversion' responses may cause the extent of diversion between the Parties to be understated for a number of reasons. We have set these out in Appendix E.
- 8.223 In light of factors considered in Appendix E, we have excluded own-brand diversion to the Parties' supermarkets in our assessment.³⁰⁶ We recognise that excluding all own-brand diversion to the Parties' supermarkets may cause us to overstate the extent of diversion between the merging Parties (whilst including all own-brand diversion would be likely to understate it).³⁰⁷ However, for the reasons set out in Appendix E, we consider that the risk of overstatement (by excluding own-brand diversion) is smaller than the risk of understatement (by including own-brand diversion). We have taken into account this source of possible overestimation of diversion between the Parties in setting an appropriate threshold for our GUPPI decision rule.
- 8.224 For the purposes of the assessment of the Parties' incentives to degrade aspects of PQRS that are set uniformly at the national level, the correct approach is to exclude own-brand diversion.³⁰⁸

³⁰⁵ Using the WSS in all local areas does not change the national weighted-average GUPPI for both Parties to at least one decimal place.

³⁰⁶ We included own-brand diversion to the Parties' online groceries business. However, we recognize that this will tend to understate diversion between the Parties in light of the finding of SLCs in online groceries (Chapter 11). We included own-brand diversion to the Parties' convenience business in light of our assessment that convenience stores face a wider range of constraints compared to supermarkets, as set out in our assessment of the effect of the Merger on the Parties convenience stores (see paragraphs 8.312).

³⁰⁷ We note that this concern only applies to the local assessment.

³⁰⁸ This is acknowledged by the Parties in Schedule 10 to the Merger Notice. This is also discussed in the [Retail Mergers Commentary](#), Technical Box 4, which explains that if the CMA is investigating a theory of harm based on the aggregation of local concerns, the right approach is to 'disallow' own-brand diversion. The intuition for this is that a customer who decides to leave a shop of one party in response to a deterioration in a nationally-uniform aspect of PQRS (eg a price increase) is very unlikely to go to a different shop of the same party, as this will have also experienced the same deterioration in PQRS.

Value of recaptured sales

- 8.225 In the previous sections, we discussed our analysis of different types of evidence to decide which weights to attach to different stores depending on their characteristics, as well as the weight to attach to out-of-market constraints.
- 8.226 On this basis we generated our best estimate of the likely diversion between the Parties in each local area. That is, we have estimated the proportion of customers that would treat Sainsbury's as their next-best alternative in the event that Asda raised its prices and/or worsened QRS in the local area, and vice versa. This estimate takes into account the number of supermarkets in the local area, the profile of those supermarkets brands, the sizes of those supermarkets, and their relative location.
- 8.227 In this section, we discuss how the extent of expected diversion by customers between the Parties (and the recapture of that diversion post-Merger) might make it profitable for the Parties to degrade their offer. As part of this assessment, we have considered the value of recaptured sales.
- 8.228 The value of recaptured sales refers to the economic value to each of the Parties of the sales they would lose if they degraded PQRs that would be recaptured by the other merging Party. The greater the value of recaptured sales relative to current prices, the greater the importance of those recaptured sales when deciding whether to raise price. If their value is high (ie if margins are high) then small amounts of sales recaptured by the other Party are more likely to put substantial upwards pressure on prices.

Variable margins

- 8.229 To assess the value of recaptured sales in the retail supply of groceries, we have taken as a starting point the Parties' variable margins.
- 8.230 The Parties provided estimates of their grocery margins and the variability of individual cost items at a national level. We have used these figures as the basis for calculating a national average in-store grocery margin for each of the Parties.
- 8.231 The Parties also provided their local-level management/impairment accounts, which we used to develop estimates for local variable margins. In a number of places, the national and local accounts were not directly comparable because of different splits of cost lines, or did not exactly reconcile as a result of not all relevant costs being allocated to a local level. Moreover, the Parties did not have the split of certain cost lines between groceries and GM. In these circumstances, we have made a best estimate of an adjustment or

allocation methodology. For recently opened stores, where cost data is not available, or where the local data may not be fully reflective of local conditions, we have used the respective average national margin for each of the Parties.

- 8.232 Certain cost synergies arising from the Merger would impact the variable margin figures. For example, procurement savings would reduce the Parties' cost of goods sold, and hence increase the gross margin and any associated variable margins. We have discussed the likelihood of procurement savings in more detail in Chapter 16, where we conclude that the Merger is likely to result in £500 million of rivalry-enhancing efficiencies. For the purposes of calculating the post-Merger margins, we have allocated these efficiencies equally between the Parties.
- 8.233 Additional details on the specifics of the local variable margin calculations are included in Appendix F, including an assessment of the additional evidence submitted by the Parties.
- 8.234 As noted above, in order to calculate the in-store variable grocery margins we have used the variability of individual cost lines submitted by the Parties. However, in doing so, we note that there are a number of reasons to consider that the resulting variable margins may be underestimated, which would result in the GUPPI estimate also being underestimated. These reasons are discussed below.

Halo effect

- 8.235 In assessing the value of recaptured sales, we have sought to take into account interactions between the Parties' businesses. As set out in paragraphs 7.126 to 7.139, there are important interactions between the Parties' business areas, including between the sale of in-store groceries, GM, online delivered groceries and fuel. In particular, attracting customers to a store to purchase one of these items gives rise to a probability that they will also make purchases of the other item. This may be to take advantage of increased convenience, reduced transport costs or lower search costs (the 'one-stop shopping principle') or may also arise because each transaction increases loyalty (either through explicit loyalty schemes or for non-financial reasons, such as increased familiarity with the store and its product range).
- 8.236 Overall, this results in a 'halo effect', whereby the overall performance and profitability of some business lines are strengthened by the Parties being present in the other 'adjacent' business lines. We have considered whether our assessment of the effect of the Merger on the retail supply of in-store groceries should take into account the Parties' margins on sales from their

other business areas, by accounting in our GUPPI calculation for the expected GM and fuel sales that would also divert with any diverting in-store groceries sales.

8.237 We discuss this in more detail in Appendix E. We conclude that there is clear evidence that a halo effect exists. We calculate that incorporating the halo effect would increase Sainsbury's national groceries margin from [X]% to [X]% (a [X]percentage point increase), and Asda's national groceries margin from [X]% to [X]% ([X] percentage point increase). We have correspondingly increased Sainsbury's and Asda's margin by an equivalent proportional increase in each local area.

Conclusion on margins

8.238 The margins used in our analysis are set out in Table 8.3.

Table 8.3: Average post-efficiencies variable margins

%		
	<i>Asda</i>	<i>Sainsbury's</i>
In-store groceries, ex. halo effect	[X]	[X]
GM	[X]	[X]
In-store groceries, incl. halo effect	[X]	[X]

Source: CMA analysis.

8.239 We consider that in adopting the cost variability estimates provided by the Parties for in-store groceries, the variable margins we have calculated are likely underestimated and, as a result, the value of recaptured sales is likely also underestimated. This is because:

- (a) Since the Parties' online groceries accounts [X], their in-store groceries costs are likely bearing an overallocation of costs. We note that in-store groceries margins would increase if the online accounts include [X].
- (b) Sainsbury's [X].³⁰⁹
- (c) We have concerns about the specifics of the bottom-up analysis and the econometrics submitted by the Parties, which shows high variability of cost resulting in lower margins, as discussed in paragraph 17 of Appendix F.
- (d) As a sense-check we note that the difference between our estimates of gross and variable margins for both Parties (which would represent the

³⁰⁹ [X]

variability of cost lines) are at the top end of the values quoted in Tesco/Booker.³¹⁰

8.240 In addition, we note that the variable cost estimates are based on volume changes which are sufficiently large to result in certain operational cost changes (eg adjusting the number of staff, and logistics costs). However, smaller price changes could still be profitable, and would be associated with higher variable margin estimates, closer to the gross margin of the Parties. This suggests that our variable margin (and therefore GUPPI) estimates may be underestimated, potentially by a large amount.³¹¹

GUPPI

Calculating local GUPPIs

8.241 We calculated a GUPPI measure for each local area in which the Parties overlap, combining information on local diversion ratios (taken from the CMA store exit survey where the store was surveyed³¹²) or, in non-surveyed areas, the CMA's WSS methodology, which additionally incorporates evidence from an entry/exit analysis) and local margins.³¹³

8.242 The distribution of the GUPPIs for Asda's and Sainsbury's stores are presented in Figure 8.7 and Figure 8.8 below.

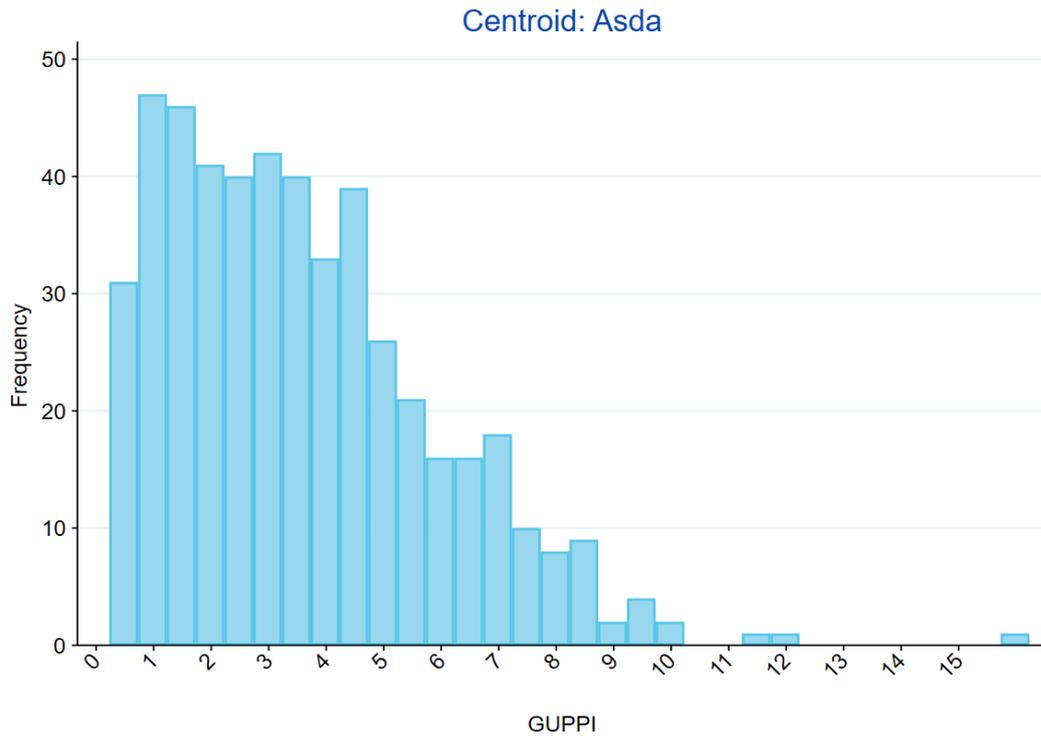
³¹⁰ 'The variability percentages described above generally results in an observed decrease from gross margin to variable margin of around a quarter to a third' (Tesco/Booker merger inquiry (20 December 2017), Final report, [Appendix C](#), paragraph 70). The figure for the Parties' in-store grocery are around [X%] for Asda and [X%] for Sainsbury's (before the effect of efficiencies).

³¹¹ Using gross margins would lead to an increase in the national weighted-average GUPPI for Asda and Sainsbury's by [X] and [X] respectively. We note that Tesco/Booker included a sensitivity based on using gross margins, partly to reflect the fact that the true variable margins may be closer to the gross margins; Tesco/Booker merger inquiry (20 December 2017), Final report, [Appendix C](#), paragraph 75.

³¹² Provided there were no pipeline stores. In surveyed areas in which there were pipeline stores, as discussed in paragraph 8.219, we generally used WSS. The following caveats applied: a) we used the lower of the diversions from the survey and the WSS in areas in which there were third-party pipeline stores and no pipeline stores from the Parties, b) if there were Party pipeline stores and no pipeline stores from third parties, we used the higher of the diversions from the survey and the WSS. See discussion in footnote 303.

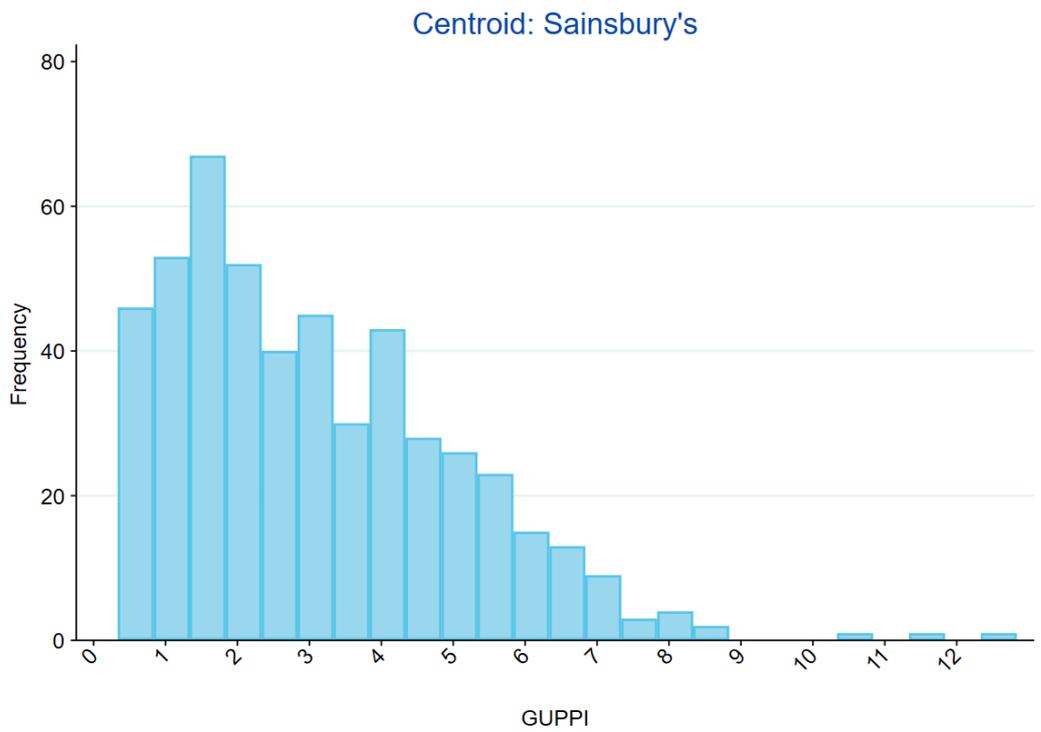
³¹³ In addition to diversion and margins, GUPPI takes into account the ratio between prices at the Parties' stores (referred to as the price ratio). This ratio affects the value of the potentially recaptured sales. The higher this ratio, the greater the value of recaptured sales relative to the current price, and therefore, the greater the incentive to increase prices. The magnitude of the price ratio used in the local assessment of supermarkets and the GUPPI formula are provided in Appendix E.

Figure 8.7: Distribution of the GUPPI for Asda's stores that overlap with Sainsbury's stores



Source: CMA analysis.

Figure 8.8: Distribution of the GUPPI for Sainsbury's stores that overlap with Asda stores



Source: CMA analysis.

Purported bias in the WSS and the GUPPI

- 8.243 The Parties submitted that comparing the estimated WSS diversions between the Parties' stores with the diversion ratios between the Parties' stores found in the CMA's survey, shows that when the survey diversion is less than 15%, the WSS estimate is larger than the corresponding survey estimate for the vast majority of the Parties' stores in the CMA's survey. They also submitted that when the Parties have multiple stores in a local area, this overestimation of individual stores' diversions results in the overestimation of the aggregate diversion ratio between the Parties in local areas when the aggregate diversion ratio is less than 25%.³¹⁴ The Parties argue that this implies that the WSS is systematically upwardly biased at lower levels of diversion. The Parties illustrated their argument with charts showing the WSS diversions and survey diversions for areas in the CMA store exit survey sample, highlighting that for the vast majority of the Parties' stores with a survey diversion to the other Party of less than 15%, the WSS was larger than the survey diversion.
- 8.244 As set out in detail in Appendix E, we consider that the Parties' approach to comparing the WSS diversion with survey diversion risks confusing normal unexplained variation in the survey (ie variation in diversion ratios that is driven by factors other than size, brand and distance, which the WSS methodology does not seek to explain, as well as survey error) with a systematic directional bias. We consider that the Parties' comparison of the WSS to the survey does not imply that there is bias in the WSS estimates of diversion, as the same relationship would be likely to arise naturally in the presence of idiosyncratic factors that affect the level of diversion between the Parties in the specific local areas in which the survey was conducted, which the WSS methodology seeks to abstract from.

Using GUPPI as the basis of a decision rule

- 8.245 As described in paragraph 8.92 above, for the purposes of our national assessment of in-store groceries, we have used a national weighted average GUPPI as one category of evidence (itself derived from a number of other sources of evidence as set out in 8.247 below), in combination with the range of qualitative and quantitative evidence set out in that section, to conclude whether, in the round, the Merger gives rise to competition concerns at a national level in relation to the supply of in-store groceries.

³¹⁴ Parties' response to the Provisional Findings, Schedule 3.1, paragraph 4.

- 8.246 For the purposes of our local assessment, given the very many local areas in which the Parties' stores overlap (around 1,000 local areas), it would not be practicable to perform a specific assessment of each local area in turn within the timeframe of a phase 2 merger inquiry. Accordingly, we considered it necessary to devise a decision rule to establish whether the Merger is, on the balance of probabilities, likely to give rise to an SLC on any local markets for the retail supply of in-store groceries.
- 8.247 Given this context, we consider that the GUPPI framework and the underlying analysis that it relies upon provide an appropriate and reliable measure for assessing the competitive effects of the Merger, which can be used as the basis for our decision rule:
- (a) It relies on evidence that we consider to be robust, and which has been the subject of careful scrutiny. This includes the extensive CMA store exit survey (which was the subject of careful planning, and high-quality fieldwork) and the entry/exit analysis and margin information submitted by the Parties, which we have carefully assessed (as discussed in greater detail in Appendices C and F).
 - (b) It allows us to effectively combine these pieces of information in a single measure, in a way that incorporates and reflects the fullest evidence available to us, including on brand, store size and distance, which our investigation has confirmed are key factors affecting competitive strength. The Parties submit, and we agree, that the GUPPI captures more information on closeness of competition (diversion ratios) and the significance for pricing incentives (variable margins), than other potential measures, such as concentration measures.
 - (c) We carefully assessed the assumptions underlying each of the components of the GUPPI (as detailed above and in Appendix E).
 - (d) Finally, it allows us to directly factor into a GUPPI-based decision rule an allowance for rivalry-enhancing efficiencies. The Parties have also highlighted this as a benefit of the GUPPI approach.
- 8.248 For these reasons, we consider that the GUPPI incorporates the best available evidence, and is a good predictor of upward pricing pressure in this case, such that it provides an appropriate and robust measure to use as the basis of our decision rule. We have therefore proceeded to assess the appropriate threshold at which a GUPPI-based decision rule should be set.

Setting an appropriate GUPPI threshold

8.249 In the following sections, we first set out the Parties' submissions regarding the use of GUPPI in our local assessment. We then describe the use of GUPPI (and similar measures) by UK competition authorities in past cases. Finally, we describe the factors we have taken into account in deciding on the appropriate threshold for concern, before concluding on our decision rule.

Before turning to these issues, we note two preliminary points:

- (a) First, while the GUPPI expresses the incentives of the Parties to raise prices, we note that, for the purposes of our local assessment (given that prices are set nationally, rather than locally), we have also taken into account what any given GUPPI figure may indicate about the Parties' incentives to degrade other non-price factors of their offering.
- (b) Second, we have also used GUPPI as part of our assessment of the Parties' overlapping activities in the supply of online delivered groceries and fuel. While the ways in which GUPPI has been used as part of each of these assessments has varied to take account of specific features of each assessment, some of the issues discussed in the following sections will also be relevant to our use of GUPPI in those other parts of our assessment, and we therefore refer back to these issues, as relevant, in later chapters.

- *Parties' views*

8.250 The Parties submitted that, for the purpose of the local assessment of in-store groceries, a GUPPI threshold should be used as an initial screen, with local areas failing this screen then subject to further inquiry through the application of additional screens (such as margin sensitivities for local areas with 'outlying' margins, or the use of survey diversions rather than the WSS-calculated diversions).³¹⁵

8.251 The Parties submitted that there is no basis for adopting a threshold lower than 5% for this initial screen, consistent with what the Parties submit is an established practice of UK competition authorities ruling out concerns where the GUPPI is less than 5%, which the Parties characterise as a 'safe

³¹⁵ As set out in paragraph 8.218, the Parties submitted that for all local areas (including surveyed areas) diversion ratios should be calculated using the WSS. We have instead taken the approach that where a local area was surveyed, diversion ratios directly taken from the survey (rather than WSS) are used given some advantages over the WSS.

harbour'.³¹⁶ The Parties refer particularly to the use of 5% GUPPI threshold in Tesco/Booker and Co-op/Nisa, which they submit are highly analogous and recent examples of the use of GUPPI in the groceries sector. The Parties submit that these cases show that a 5% GUPPI threshold is itself conservative, with in both cases the CMA subsequently finding local markets with GUPPIs of 5-10% to be unproblematic on further inspection.

8.252 Where the CMA instead chooses to use the GUPPI as part of a determinative decision rule (rather than as an initial screen), the Parties argue that the chosen GUPPI threshold should be a 'step change' higher than 5%, to avoid the risk of 'false positive' results, that is, finding an SLC in a local area where no such SLC exists. The Parties submit that in *Ladbroke's/Coral*, the only UK case where the CMA has used a GUPPI threshold as a definitive decision rule, this threshold was [10–20%], which reflects such a 'step change'.

8.253 Against these past cases, the Parties submit that the CMA's GUPPI threshold (at Provisional Findings) of 1.5% absent efficiencies, and 2.5% including efficiencies, is exceptionally low. The Parties submit this is particularly so given that neither the standard GUPPI measure nor past decisional practice on the GUPPI threshold capture any assumed efficiencies 'credit', whilst in the current case the CMA has allowed for such a credit.³¹⁷

8.254 Regarding the CMA's calculation of the GUPPI and the appropriate level at which to set the GUPPI threshold in this case, the Parties submitted that:

(a) While it is for the CMA to form an overall judgment on whether the Merger results in an SLC on the balance of probabilities, where the inputs relied upon to form this judgment were statistical inputs, the CMA should be satisfied that each of those inputs is statistically significant when applying appropriate confidence intervals (with the Parties' submissions typically referring to confidence intervals of 90%).³¹⁸

(b) Applying such confidence intervals showed that the level of uncertainty around the CMA's GUPPI estimates is particularly high in this case. This is because the GUPPI calculation uses the surveyed diversion ratio and

³¹⁶ The Parties also referred to a public statement by senior US antitrust agency staff in 2010 relating to GUPPI safe harbours. The US Horizontal Merger Guidelines state that 'if the value of diverted sales is proportionately small, significant unilateral price effects are unlikely'. The DOJ statement said that a 5% increase in price was considered 'small but significant' and therefore that a 5% GUPPI could also be considered proportionately small. We note however that in a retail merger in 2015, Family Dollar/Dollar Tree, the FTC explicitly rejected using a 5% GUPPI threshold as a safe harbour (ie as a threshold below which local areas would be identified as unproblematic and given no further consideration). In that case, 27 of the 330 divestment stores had GUPPIs of less than 5%.

³¹⁷ [Parties' response to the Provisional Findings](#), paragraph 43.

³¹⁸ [Parties' response to the Provisional Findings](#), paragraph 20.

the estimated WSS diversion ratio, both of which have significant uncertainty (or variance) associated with them.³¹⁹

- (c) This GUPPI threshold adopted was, furthermore, inconsistent with a finding of an SLC when considered against (i) the number of fascia in the local areas which fail the threshold, and (ii) the circumstances in which the Parties respond to competitive entries in their usual business practice, both of which the Parties submit are good sense checks for the level of WSS/GUPPI threshold that would be appropriate.³²⁰
- (d) Other factors which might be argued to affect the GUPPI calculation (or the threshold of concern), such as feedback effects, pass-through rates, and costs of implementing any deterioration in the Parties' offering post-Merger, had only been postulated, rather than proven, in this case. The Parties submitted that their economic modelling showed that feedback effects are likely to be small relative to first-order effects, and only large when first-order effects would already identify a potential problem, such that they did not form a good basis for changing the GUPPI threshold (as they presumed the CMA had done in this case, given their view that a low GUPPI threshold had been adopted). They submitted further that (i) the CMA's presumption of high pass-through was based on the assumption of isoelastic demand in Somerfield/Morrisons, and it had not been shown that such a demand assumption was also appropriate in this case,³²¹ and (ii) that there were costs associated with deteriorating range and service parameters at the local level and therefore it could not be assumed that very small pricing pressure would translate into actual price increases.³²²
- (e) Meanwhile, the CMA's assessment failed to account for dynamism in the groceries market – both in terms of competitors' repositioning (by improving and upgrading their offer) and future entry, and in terms of changing customer preferences.³²³
- (f) Finally, in setting the GUPPI threshold, the CMA had taken into account the size and 'importance' to households of the UK grocery market to justify a more cautious standard of proof in this case. Even if 'market importance' were relevant to the 'substantial' element of the SLC test, it does not follow that market importance can in this case justify an upward price pressure 'buffer' for uncertainty and substantiality as low as 1.5%

³¹⁹ [Parties' response to the Provisional Findings](#), paragraph 87.

³²⁰ [Parties' response to the Provisional Findings](#), paragraphs 49 and 57.

³²¹ [Parties' response to the Provisional Findings](#), paragraph 117.

³²² [Parties' response to the Provisional Findings](#), paragraphs 118 and 119.

³²³ [Parties' response to the Provisional Findings](#), paragraphs 111–114.

given that, for the reasons set out above, the CMA's GUPPI analysis in this case does not allow any confidence in predicting the risk of adverse effects.³²⁴

8.255 The Parties also submitted an analysis of the relationship between GUPPI thresholds of different levels and the likelihood of finding 'false positives' and 'false negatives'. This analysis involved applying a threshold of 2.5% to the survey and to the WSS and counting the number of false positives and false negatives.³²⁵ The thresholds for both the survey and the WSS were then adjusted upwards in increments of 0.1 percentage points, and the Parties assessed at what point the total number of errors was minimised, subject to those errors being symmetric. On the basis of this analysis, the Parties submitted that the GUPPI threshold should be, at a minimum, 4.5% (absent efficiencies).

8.256 We address the Parties' arguments regarding the use of GUPPI in past cases, and the presumption of efficiencies in the standard GUPPI measure, in paragraphs 8.258 to 8.269 below. We address the Parties' arguments regarding uncertainty in the estimates (including the validity of using statistical confidence intervals as part of our SLC assessment) in paragraphs 8.294 to 8.295. We address the Parties' proposed sense checks (against the number of fascia, and the Parties' impacts data) in paragraphs 8.297 to 8.306. We address feedback effects, pass-through and costs of implementing any deterioration, and the Parties' arguments regarding 'dynamism' in paragraphs 8.288 to 8.289. We deal with the Parties' arguments regarding market importance as a relevant factor in the SLC assessment in paragraph 8.282 to 8.283. Finally, we assess the Parties' analysis of 'false positives' and 'false negatives' in Appendix E.

- *Third parties' views*

8.257 The only other response we received on the appropriate GUPPI threshold was from AlixPartners UK LLP.³²⁶ It submitted that the GUPPI thresholds used by the CMA at Provisional Findings (of 2.5% for groceries, and 1.5% for fuel) were too low to correctly identify SLCs. In particular, it stated that these levels of GUPPI threshold were too low to ensure that any lessening of

³²⁴ [Parties' response to the Provisional Findings](#), paragraphs 34–37 and 165–168.

³²⁵ False positives, in this context, refer to instances where the WSS diversion implies a GUPPI that exceeds the threshold but the survey diversion does not. False negatives refer to instances where the survey diversion implies a GUPPI that exceeds the threshold but the WSS diversion does not.

³²⁶ AlixPartners submitted that it is not acting for either of the Parties nor any third party in this case. ([AlixPartners' response to the Provisional Findings](#), paragraph 1.1).

competition was substantial, and did not correctly allow for the uncertainties associated with GUPPI.³²⁷

- *Past cases*

8.258 The CMA and its predecessors have used GUPPI in merger assessments on many occasions.³²⁸ In some past cases (discussed below), UK competition authorities have alternatively calculated a measure known as an illustrative price rise (IPR), which is similar to the GUPPI in that it measures the post-merger upward pricing pressure using diversion ratios and profit margins, but differs in that it seeks more directly to measure the expected price rise flowing from a merger. Calculating an IPR requires additional information about the degree to which pricing pressure will translate into higher prices for consumers ('pass-through').³²⁹ We have not sought to calculate IPRs in this case. Nevertheless, to aid interpretation of previous cases that have used IPR, we discuss below how GUPPI and IPR measures may be compared.

8.259 While the precedents discussed below may be informative to our assessment, our position is that we are required to determine whether the evidence supports an SLC finding on the facts of the present case. While we have had regard to the approach taken in past cases, our use and interpretation of GUPPI has therefore been assessed afresh in this case, based on the available evidence.

8.260 When considering any read-across from past cases, it is important to take account of the case-specific nature of merger control, and the different ways in which GUPPI and IPR have been used (eg, whether as a filtering tool to exclude concerns in certain areas/markets, as one piece of evidence assessed in combination with others, or as a decision rule to decide upon the existence or otherwise of an SLC). It is also important to bear in mind that merger investigations will vary widely in the extent and quality of the available data, which will affect the accuracy with which it is possible to estimate the GUPPI.³³⁰ The CMA's guidance does not provide any GUPPI or IPR figure that may be considered to give rise to concern (nor to any assumption of a 'safe harbour'), and (as discussed in the remainder of this section) a review

³²⁷ [AlixPartners' response to the Provisional Findings](#), paragraphs 1.4 and 5.4.

³²⁸ Including the Co-op/Nisa merger inquiry (2018); Tesco/Booker merger inquiry (2017); Anticipated merger between Ladbroke's plc and certain businesses of Gala Coral Group Limited (2016) and MRH/Eso merger inquiry (2015), to name a few. Further cases which have used GUPPIs are listed in paragraph 8.265.

³²⁹ This is in turn determined by the shape of the demand curve. A demand curve shows how the demand for a given product or service varies with changes in its price.

³³⁰ In this case, we have had access to extensive and robust data, including plentiful industry data, the results of three extensive consumer surveys, and the results of detailed econometric analyses undertaken by the Parties, which we have carefully critiqued.

of previous cases shows that a variety of approaches have been taken and there has not been convergence on a single figure.

- 8.261 The Parties submitted that UK competition authorities have always, or consistently, used a 5% GUPPI threshold as a means of excluding areas as non-problematic. In fact, the use of GUPPI and IPR in past cases demonstrates a range of approaches, including implied GUPPIs below 5% giving rise to potential concern. We also note that a review of these cases demonstrates the fact-specific nature of the assessment in deciding whether a given GUPPI figure was or was not supportive of an SLC finding.
- 8.262 We consider that there are important differences between the current case and the Tesco/Booker and Coop/Nisa precedents on which the Parties rely. In both Tesco/Booker and Coop/Nisa, the primary (and in Coop/Nisa, sole) focus of the CMA's investigation was the vertical relationship between the Parties' activities. The index measure used in those cases was therefore primarily a vertical GUPPI measure (or vGUPPI). Vertical mergers are generally more efficiency-driving than horizontal mergers (eg due to the reduction or removal of double marginalisation between levels of the supply chain) and there may be a lower likelihood that any upstream price rises will be passed on to end-consumers.³³¹ We disagree with the Parties' assertion that the CMA 'expressly turned its mind to, and developed a 5% GUPPI safe harbour for horizontal overlaps' in the Tesco/Booker case.³³² The use of a 5% GUPPI as a filter (and the absence of concerns at 5-10% GUPPI) must be considered in the context of that case. Nothing in that decision indicates that the use of a 5% GUPPI threshold was intended to constitute a safe harbour which should be applied generally to horizontal overlaps in future cases. Whilst the Parties are correct to note that the fact that horizontal overlaps were a very minor part of the case is not determinative,³³³ it is a relevant factor which the CMA is entitled to take into account in taking its decisions in the round.
- 8.263 The Parties also state that the CMA has not explained how the 'retail to wholesale' theory considered in the Tesco/Booker case is any different to a horizontal retail overlap for GUPPI threshold purposes given that, as the CMA stated in Tesco/Booker, 'Tesco controls its own stores. Any

³³¹ The Parties submitted that the Act does not discriminate between different customer types, and does not accord more weight to end-customers than other customers. However, the CMA's statutory duty explicitly prioritises consumers: 'The CMA must seek to promote competition, both within and outside the UK, for the benefit of consumers' (Enterprise and Regulatory Reform Act (ERRA) s25(3), emphasis added).

³³² Parties' response to the Provisional Findings, paragraph 130.

³³³ Parties' response to the Provisional Findings, paragraph 131-133.

deterioration will therefore be passed through, fully, to shoppers.’³³⁴ We consider it to be clear from the Tesco/Booker decision that several aspects of the retail to wholesale vertical theory of harm made it inherently more complex than a horizontal unilateral effects theory, in particular the fact that the potential price increase and profit recapture are at different levels of the supply chain. The Tesco/Booker decision highlights associated risks and costs which would tend to reduce the likelihood of the strategy underlying the theory of harm being pursued.³³⁵ The CMA found in that decision that these factors meant that the merged entity could only be expected to engage in such a strategy if the expected gains were high.³³⁶ We consider this supports the use of a higher GUPPI threshold in that case.

8.264 In previous horizontal merger investigations in the groceries sector, an IPR measure has been used more frequently than GUPPI. This stems particularly from the CC’s approach in Somerfield/Morrisons,³³⁷ subsequently adopted in a number of phase 1 investigations (Morrisons/Co-op,³³⁸ Asda/Netto,³³⁹ One Stop/Alfred Jones,³⁴⁰ Midcounties/Tuffin,³⁴¹ and Asda/Co-op³⁴²). In these cases, the CC and OFT’s starting point was that an IPR at 5% or above gave rise to prima facie concerns, although it was made clear that this was merely a guide as opposed to a definitive threshold.³⁴³ Further, it was noted that in Somerfield/Morrisons the CC performed sensitivity checks at 1% and 2% IPR, while in Midcounties/Tuffin the OFT found concerns in one area where the IPR was below 5%. While it is not possible to definitively translate IPR into GUPPI, we note that where demand is isoelastic³⁴⁴ (as the CC assumed for the supply of groceries in Somerfield/Morrisons, and as applied in many subsequent groceries cases) and in a market with a margin of [~~%~~]%, a 5%

³³⁴ [Parties’ response to the Provisional Findings](#), paragraph 135-136.

³³⁵ Tesco/Booker merger inquiry (2017). The retail to wholesale theory anticipated Tesco degrading the offer in its retail stores (which, as the parties correctly pointed out, would be passed through fully to customers) in the expectation that customers would divert in sufficient numbers to stores supplied by Booker such that profit would be recaptured by Tesco/Booker through the wholesale sales made to those stores. As noted in the decision, under this theory of harm, Tesco would be seeking to recapture sales via a store that the merged entity does not own – and which could therefore choose to move volumes away from the merged entity’s wholesale arm and towards other wholesalers (Final Report, paragraph 10.20).

³³⁶ Tesco/Booker merger inquiry (20 December 2017), [Final Report](#), paragraph 10.21.

³³⁷ [Somerfield/Morrisons merger inquiry](#) (2005).

³³⁸ [Completed acquisition by WM Morrison Supermarkets plc of 30 stores from Co-operative Group Limited](#) (2009).

³³⁹ [Asda/Netto merger inquiry](#) (2010).

³⁴⁰ [Anticipated acquisition by One Stop Stores Limited of 33 stores from Alfred Jones \(Warrington\) Limited, trading as Spar](#) (ME/6131/13).

³⁴¹ [Completed acquisition by Midcounties Co-operative Limited of Tuffin Investments Limited](#) (ME/5452/12) (2012).

³⁴² [Anticipated acquisition by Asda Stores Limited of five stores from Co-operative Group Limited](#) (ME/6466/14) (2014).

³⁴³ [One Stop/Alfred Jones merger inquiry](#) (2012), paragraph 36. Also noted in [Asda/Netto merger inquiry](#) (2010).

³⁴⁴ An isoelastic demand curve has the same elasticity across all price levels – visually, it appears convex to the origin in price/quantity space.

IPR would equate to a 3.2% GUPPI.³⁴⁵ The Parties submit that the CMA is wrong to rely heavily on Somerfield/Morrisons given the test in that case was not a GUPPI test, had two limbs which related to the critical diversion ratio and the IPR and in any case does not support the CMA's 1.5% net GUPPI.³⁴⁶ We do not rely heavily on this case, although we note that, whilst it dates from 2005, it is the most recent phase 2 investigation of a horizontal merger in the groceries sector involving overlaps in supermarkets.³⁴⁷ Further, whilst our position remains that it is appropriate to focus on the specific context of each case in interpreting GUPPI estimates and setting any necessary threshold for competition concerns, it is a relevant consideration that in our view Somerfield/Morrisons points to a lower threshold than Tesco/Booker.³⁴⁸

8.265 Cases in other sectors where GUPPI has been assessed in the round with other evidence have found concerns at GUPPI levels both above 5% (eg 7% in bowling,³⁴⁹ 5-6% in cinemas³⁵⁰) and below 5% (eg in petrol stations³⁵¹ and building supplies³⁵²). The Parties submit that the cases in which GUPPIs of below 5% were found to give rise to an SLC are phase 1 cases applying a different legal standard, did not use a GUPPI as low as 2.5% or 1.5% or less, were not decision-rule cases and are all older and outside the grocery sector.³⁵³ We do not dispute this but note that these cases show a wide variety of approaches have been taken to interpreting GUPPIs in fairly recent history and support the proposition that this is a matter of judgment in the specific context of each case.

8.266 With respect to the use of GUPPI as part of a decision rule in Ladbrokes/Coral, we note that there are differences between that case and the present case. The decision rule adopted in that case was based on the diversion ratios implied by the WSS and, while the decision translated these diversion ratios into GUPPIs to aid with interpretation, there was no

³⁴⁵ Where demand is linear, a 5% IPR will equate to an 8% GUPPI.

³⁴⁶ [Parties' response to the Provisional Findings](#), paragraphs 148-151.

³⁴⁷ Whilst Tesco/Booker gave rise to a small number of horizontal overlaps, it was not a horizontal merger in that Tesco and Booker were primarily active in different levels of the supply chain whereas Somerfield and Morrisons were both active primarily at the same level.

³⁴⁸ The Parties highlighted concerns around the use of isoelastic IPR in Somerfield/Morrisons. They submit that the use of isoelastic demand in that case was an unproven assumption ([Parties' response to the Provisional Findings](#), paragraph 190). Our reference to Somerfield/Morrisons relates to the Parties' submission that UK competition authorities have always used a 5% GUPPI threshold as a means of excluding areas as non-problematic. Although the Parties may not agree with the approach taken to implement the IPR in that case, we consider that this nevertheless represents an instance where the UK authorities have used a threshold that corresponds to a GUPPI threshold of less than 5%.

³⁴⁹ [Anticipated acquisition by The Original Bowling Company Ltd of Bowlplex Ltd](#) (ME/6528/15), 17 August 2015, Phase 1 decision, paragraph 81.

³⁵⁰ [Completed acquisition by Cineworld plc of City Screen Limited](#) (2013).

³⁵¹ MRH/Eso merger inquiry (2015); [Anticipated acquisition by Shell UK Limited of 253 petrol stations from Consortium Rontec Investments LLP](#) (ME/5191/11) (2012).

³⁵² [Completed acquisition by Saint-Gobain of Build Center](#) (ME/5252/11) (2012).

³⁵³ [Parties' response to the Provisional Findings](#), paragraph 147.

discussion in the decision as to the threshold at which a given GUPPI would or would not support the finding of an SLC (a point to which we have given careful consideration in this case). The extract from this case cited by the Parties to contradict this point does not actually display any reasoning for the use of a particular level of GUPPI other than its correspondence to a chosen level of diversion.³⁵⁴ Further, we note that the case involved a very different market context, and that case-specific evidence (eg on the circumstances in which new entry in the betting industry prompts a refurbishment and when concessions are offered) played an important role in setting the WSS threshold used.³⁵⁵ In any case, regardless of the differing potential interpretations of this decision, it highlights the importance of considering each case on its facts.

8.267 The Parties do not suggest that previous cases are binding on the CMA although, in their opinion, they strongly imply a starting point.³⁵⁶ We have had regard to previous cases and we consider that it is reasonable and appropriate for us to take an approach based on the evidence in this case as to the level at which competition concerns may arise. The fact that differing approaches have been taken in EU and US cases³⁵⁷ only supports the CMA's position that a case-specific approach should be adopted.

8.268 Furthermore, a key element of any interpretation of GUPPI estimates is the consideration of efficiencies. Whilst we accept that most previous cases which have used GUPPI do not refer to any explicit allowance for efficiencies, we do not accept the implication that this means we should apply a higher threshold in this case. Indeed, when the GUPPI measure was first used in the assessment of competition cases in the United States, targeted merger-specific efficiencies formed part of the reasoning as to where any GUPPI threshold should be set.³⁵⁸ While GUPPI is indeed a gross measure (ie of

³⁵⁴ Parties' response to the Provisional Findings, paragraph 141.

³⁵⁵ Ladbrokes/Coral merger inquiry (26 July 2016), *Final report*, paragraph 28.

³⁵⁶ Parties' response to the Provisional Findings, paragraph 144.

³⁵⁷ In footnote 132 of the Provisional Findings, we had referred to the decision of the US Federal Trade Commission in the Dollar Tree/Family Dollar matter. In Schedule 1.1 of the Parties' response to the Provisional Findings, the Parties submitted that the analysis of the FTC in the 2015 Dollar Tree/Family Dollar matter does not support – and in fact contradicts – the CMA's automated decision rule approach based on a GUPPI threshold of 1.5% absent efficiencies. We do not consider it necessary to respond to all of these points as we had simply referred to this case to demonstrate the absence of a GUPPI safe harbour in US practice and had noted that competition concerns were found in numerous local areas where the GUPPI was below 5%.

³⁵⁸ In 2010 Farrell and Shapiro who had then recently been appointed Director, Bureau of Economics at the FTC, and Deputy Assistant Attorney General for Economics in the Antitrust Division of the US Department of Justice respectively; wrote an article in the CPI Antitrust Journal which responded to academic comment on their original GUPPI paper, Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition. This took place in the context of the then ongoing review of the US Horizontal Merger Guidelines. The purpose of the CPI paper was expressed to be to 'respond to two of the papers in the release directed specifically at papers we wrote before taking our current positions at the FTC and DoJ'. Responding to the critique of Schmalensee, Farrell and Shapiro explain, 'In our paper we did not mean to focus very much on just how to quantify marginal-cost efficiencies; the important point is to introduce some credit for efficiencies from the beginning and to weigh it

upwards pricing pressure), we have sought to incorporate any offsetting downwards pricing pressure arising from efficiencies in our threshold, in order to facilitate the use of GUPPI in a decision rule. We have explicitly assessed the efficiencies that may be expected to occur and made an appropriate allowance for substantiality and uncertainty in the context of this case.

8.269 Finally, we disagree with the Parties' apparent suggestion that it would be appropriate to add an additional 'allowance' to the threshold of concern in this case, to account for the fact we are using the GUPPI as a decision rule (whereas in many previous cases it was an initial filter). The Parties submit that greater confidence in 'more likely than not' determinations is required when using GUPPI as a decision rule.³⁵⁹ To the extent that this implies an increase in the standard of proof for decision rule cases, we do not consider that this is correct. For the reasons set out in paragraphs 8.113 to 8.117, we consider that a decision rule approach is reasonable in the context of the case. Although we are using a decision rule, we approach the statutory question (ie deciding whether the Merger will, on the balance of probabilities, give rise to an SLC in any market) with the same rigour that we would relying on any methodology or evidence base. As set out further below, we are confident that our GUPPI estimates, which are derived from a combination of different sources of evidence on diversions and margins, are a reliable measure of the potential harm arising from the Merger in each local area, and that we have appropriately reflected our assessment of efficiencies and of substantiality and uncertainty when determining the threshold at which we would expect an SLC to arise.

Our assessment

8.270 Using a 'filtering' approach involves choosing a set of conditions to identify areas where the likelihood of an SLC is sufficiently low that it can be ruled out for further assessment. In some cases, applying such an approach will result in a number of potential SLC areas that is sufficiently small that each can then be assessed one-by-one, taking into account a range of idiosyncratic factors and specific local evidence (including qualitative evidence), to identify those in which an SLC is more likely than not. However, in this case, we consider that applying a filter that is sufficiently cautious not to rule out areas

against the gross UPP or similar measure. We argued relatively briefly, and with a focus on keeping the screening enquiry transparent and manageable, that a natural way to do this is with a broad default efficiency allowance ("standard deduction"). Perhaps we made it sound too much as if that was a key part of our proposal. Responding perhaps to such a perception, Schmalensee states: "While I recognize that efficiencies are difficult to estimate in practice, it is hard to see the merit in deciding in advance to ignore any relevant case-specific information that might be present." He goes on to say: "It would seem to be preferable to begin with a default value for efficiencies but to depart from it if the merging parties can convincingly argue that they will do better or if they fail to make a credible showing that there will be any significant efficiencies at all. We can only agree."

³⁵⁹ Parties' response to the Provisional Findings, paragraph 125,

where an SLC may be more likely than not would result in hundreds of remaining local areas. It would not be practicable to assess each of these one-by-one within the statutory timetable; a 'decision rule' approach is therefore required in these circumstances.

- 8.271 With respect to the Parties' submission that our analysis should use GUPPI only as an initial filter, and then subject the remaining areas to further assessment using additional filters, we believe that the evidence which the Parties suggest should be incorporated through these additional screens (local margins, and local surveyed diversion ratios) is already incorporated in the GUPPI calculations. It is not necessary to review these inputs again separately from the GUPPI, although in setting our GUPPI threshold we have had regard to the critical diversion ratio that a particular level of GUPPI threshold would represent.³⁶⁰
- 8.272 We consider that applying a consistent GUPPI-based decision rule is the most appropriate approach in this case. In setting the appropriate threshold for the decision rule, we must be satisfied that in each local area captured by the decision rule, the Merger would, on the balance of probabilities, result in an SLC. We consider that this is achieved by assessing at what level we consider a given GUPPI, calculated using reliable evidence, would, on the balance of probabilities, translate into a price rise or other degradation of PQRS (that is, would represent a substantial lessening of competition), after accounting for any downward pricing pressure resulting from efficiencies.
- 8.273 We note that the GUPPI calculates only the expected upward pricing pressure. This is proportionate to the increased profits which can be achieved by the merging parties from a small price rise, on the assumption that other firms do not respond. The GUPPI does not offer an answer to the question of how large that initial increase in price (or deterioration in QRS) would actually be, nor does it consider the price levels which might be expected once the competing firms settle down to a new higher-price equilibrium. Thus the GUPPI does not calculate the price rise (or other deterioration) by the Parties that may be expected to result from the Merger. It also does not take into account the potential for any so-called 'second order' or 'feedback effects', that is, any knock-on price rises (or other deterioration) by competitors which may flow from this, and indeed further upward price moves by the Parties in response to these knock-on effects, and so on. We have considered these issues when setting a threshold of concern.

³⁶⁰ See paragraph 8.302 below.

- 8.274 We have incorporated into our GUPPI figures any relevant evidence about entry and expansion by competitors, reducing the GUPPI figures for some local areas as a result. It is therefore not necessary to raise the GUPPI threshold to take account of entry and expansion.³⁶¹
- 8.275 When interpreting the GUPPI figures resulting from our assessment in this case, and subsequently in deciding the appropriate threshold at which to set our GUPPI decision rule, we account for (i) efficiencies and (ii) substantiality and uncertainty. We consider these factors in turn. Having taken account of these factors, the GUPPI threshold we have used for our local area analysis of supermarkets is 2.75%.
- *Efficiencies*
- 8.276 Mergers can give rise to rivalry-enhancing efficiencies, which introduce downward pressure on prices. Where this downward pressure is sufficient, it may eliminate (or even surpass) any expected upward pricing pressure indicated by the GUPPI calculation.
- 8.277 The Parties submitted that the Merger would give rise to rivalry-enhancing efficiencies of at least £1 billion.³⁶² They stated that they expect to achieve at least £1.2 billion from purchasing synergies, which would all be rivalry-enhancing,³⁶³ and an additional £400 million of non-purchasing synergies, which should also be given an appropriate credit in the analysis.³⁶⁴ In their latest submission on the GUPPI threshold, the Parties referred to an efficiencies allowance of £729 million for use in deciding the threshold. We have carefully examined the Parties' various efficiencies claims and thoroughly tested the estimates produced by the Parties, as set out in detail in Chapter 16.
- 8.278 For the reasons explained in Chapter 16, we have found that, for the purposes of our assessment, it is appropriate to assume that the Merger will give rise to £500 million of rivalry-enhancing efficiencies within the Parties' groceries and GM operations (excluding Argos).³⁶⁵

³⁶¹ We note that we could have taken one of two approaches to account for entry and expansion by competitors in our GUPPI analysis. In particular, we could reduce the GUPPI, or we could increase the GUPPI threshold – these are mathematically equivalent to each other. We took the former approach because adjusting the GUPPI threshold for entry and expansion in individual local areas would result in different thresholds for each local area, which would make discussion of other aspects of the GUPPI threshold more complex.

³⁶² [Parties' response to the Provisional Findings](#), paragraphs 210 and 215.

³⁶³ [Parties' response to the Provisional Findings](#), paragraph 228, and Annex_001V.2_003, slide 4.

³⁶⁴ Merger Notice, paragraph 43.

³⁶⁵ This figure excludes any rivalry-enhancing efficiencies which might arise in Argos. This approach is consistent with the rest of the incentives analysis for in-store groceries, which does not include any effects from Argos.

8.279 For the purposes of the GUPPI assessment, £500 million efficiencies would translate into a downward pressure of around 1.25% in a GUPPI analysis.³⁶⁶ This downward pressure is equivalent to the upward pressure represented by GUPPI figures because neither accounts for the extent of pass-through, so they can be offset directly against each other. Having satisfied ourselves that efficiencies of this level may be expected to arise from the Merger, we consequently do not consider that a GUPPI of around 1.25% or below would be supportive of an SLC finding.³⁶⁷

- *Substantiality and uncertainty*

8.280 Having excluded concerns below a 1.25% GUPPI, we must satisfy ourselves that, on the balance of probabilities, any lessening of competition (as indicated by the GUPPI figure) will be substantial.

8.281 The term ‘substantial’ is not defined in the Act, nor in the CMA’s guidance. Whether a lessening of competition may be considered ‘substantial’ is a question of judgement in each case.

8.282 In response to our Provisional Findings, the Parties submitted that market size and importance is not a relevant factor for the purposes of the SLC assessment; and that even if it were, it cannot be used to justify a more cautious standard of proof in this case.³⁶⁸ In the case of ‘importance’ we disagree. In our judgment, a market can be important if it forms a critical part of consumers’ purchases and is not readily circumvented. This clearly applies to food which is a necessary purchase for all consumers, and so market importance is a relevant factor for the purposes of the SLC assessment in this case.³⁶⁹ We also disagree that the standard of proof being applied in this case is ‘more cautious’, or that we are applying a ‘different test’ because the Merger takes place in the retail sector.

8.283 In assessing what may constitute ‘substantial’ for the purposes of our local assessment of in-store groceries, we have had regard to the fact that groceries are a non-discretionary expenditure that accounts for a significant share of household spend, proportionally more so for low income

³⁶⁶ Downward pricing pressure is equal to the level of efficiencies divided by the Parties’ total combined revenue. If efficiencies are equal to £500 million, and the combined groceries and general merchandise revenues of the Parties (excluding Argos) are approximately [£40 billion], this equates to 1.25%.

³⁶⁷ As we have taken into account efficiencies directly when setting the threshold for the GUPPI-based decision rule for our local assessment, we have not separately considered efficiencies in the countervailing factors section of this chapter.

³⁶⁸ [Parties’ response to the Provisional Findings](#), paragraphs 34 to 37 and 169 to 171.

³⁶⁹ We do not refer in our assessment to market size and agree with the Parties that the Act does not distinguish between markets of different sizes ([Parties’ response to the Provisional Findings](#), paragraph 174).

households. Government estimates are that UK households' expenditure share on food and non-alcoholic drinks is around 11%,³⁷⁰ increasing to over 14%³⁷¹ for those on lower incomes (households with incomes in the lowest 20%). As a result, even a small percentage increase in the price of groceries (or equivalent worsening of QRS) would have a significant adverse impact on UK consumers. As explained in the Guidelines, a merger that gives rise to an SLC will be expected to lead to an adverse effect for customers and evidence on likely adverse effects will therefore play a key role in assessing mergers.³⁷²

8.284 The Parties acknowledge that where the UK competition authorities have ruled out concerns at a given GUPPI level, this should not be interpreted to mean that the authorities have concluded that such a figure represents only a small price increase which is somehow 'tolerable'. Rather, the Parties submit that previous cases have ruled out concerns at low levels of GUPPI on the basis that, at such levels, authorities cannot be satisfied (on the balance of probabilities) that *any* harm will arise to consumers; ie there cannot be sufficient certainty that the pricing pressure indicated by the GUPPI calculation would translate into harm to consumers.³⁷³

8.285 There are a number of reasons why small (but positive) levels of pricing pressure might not translate into price increases (or other deterioration in QRS) that would be consistent with an SLC. In addition to the downward pressure exerted by efficiencies (discussed above), this may arise where: there was expected to be little or no pass-through to consumers; there would be a cost to the merged entity of implementing the price rise or QRS degradation (eg because of operational difficulty); and/or the size of the gain is somehow insufficient to motivate the merged entity to take action, even if potentially profitable.

8.286 However, none of these factors apply in this case:

³⁷⁰ ONS (24 January 2019), Family spending in the UK: April 2017 to March 2018
: <https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/expenditure/bulletins/familyspendingintheuk/financialyearending2018>

³⁷¹ ONS (24 January 2019), Household expenditure as a percentage of total expenditure by gross income decile group for financial year 2017/18:
<https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/expenditure/datasets/householdexpenditureasapercentageoftotalexpenditurebygrossincomededilegroupuktablea5>

³⁷² Merger Assessment Guidelines, paragraph 4.1.3. We do not accept the Parties' submission that in referring to the scale of harm that could be caused by a particular percentage price rise we are using a standard of risk that is more cautious due to market size ([Parties' response to the Provisional Findings](#), paragraphs 169-171) or adopting a different test because the market is large ([Parties' response to the Provisional Findings](#), paragraphs 173 to 176). We are simply taking into account the likely adverse effects on customers, which are always market-specific, and which, as our guidance states, should play a key role in our assessment.

³⁷³ [Parties' response to the Provisional Findings](#), paragraphs 158 to 164.

- (a) the Parties are sophisticated industry players and their argument, made repeatedly throughout the case, that Merger-specific cost savings will be passed on to customers is reliant on an assumption that pass-through will be high;
- (b) Pass-through in the groceries sector has previously been considered likely to be over 100%;³⁷⁴
- (c) the potential degradations of the Parties' PQRS we have considered are not predicated on the Parties changing their approach to how they set aspects of PQRS, so no operational adjustment would be required to effect a change in PQRS;³⁷⁵ and
- (d) given the scale of the Parties' groceries businesses, even a small percentage price increase (or cost-saving degradation of QRS) would lead to a substantial uplift in revenue and, potentially, a significant increase in profits.

8.287 Furthermore, as discussed above, any GUPPI must be interpreted in light of the fact that it accounts for only the individual first-order incentives of each merging party and therefore considers neither feedback effects between merging parties nor second order effects from third parties, both of which will naturally follow from an initial price increase or cost saving degradation in QRS. We note that as the markets under discussion involve competition in prices, or other variables altering the quality of the consumer's experience, and as such variables are strategic complements, second order effects will augment the initial price increases or QRS degradation, exacerbating the initial effect. If it were shown that these effects were unusually limited in a particular case (for any given first-order price increase), this would also reduce the likelihood that a relatively low GUPPI would translate into a price increase consistent with an SLC.³⁷⁶ We consider that there is no reason to

³⁷⁴ As shown eg by the fact that in the [Somerville/Morrisons merger inquiry \(2005\)](#) isoelastic demand was assumed.

³⁷⁵ While the Parties submitted that there would be costs to significantly changing range or deteriorating service levels (including reputational), which are unlikely to be surmounted given the low level of pricing pressure found by the CMA ([Parties' response to the Provisional Findings](#), paragraphs 118 and 119), we note that the Parties have provided several examples of local flexing of range and service levels which would not appear to carry such costs (see paragraph 7.112 to 7.113 and 7.119). We note that a worsening of range and service levels may involve the Parties choosing not to improve their offer where they would otherwise have done so absent the Merger, because of the competition they face from rivals; it need not involve actively deteriorating their existing offer.

³⁷⁶ The Parties have submitted that second-order effects "are only substantial when first order effects are large" ([Parties' response to the Provisional Findings](#), paragraph 110). We agree that second-order effects are generally smaller than first-order effects. However, the fact that second-order effects are not captured in the GUPPI is nonetheless relevant for the assessment of whether a given GUPPI gives rise to competition concerns.

think that feedback effects would be particularly low relative to the first-order effect identified in the GUPPI in this case.³⁷⁷

8.288 The Parties submitted that dynamic factors (namely future repositioning and new entry by rivals, and changing customer preferences) must also be assessed and factored appropriately into the threshold, given that the GUPPI model is static, insofar as it uses snapshot diversion estimates based on customers' responses to hypothetical questions as at the date of the survey.³⁷⁸

8.289 While merger control is forward looking, it is not speculative. Our assessment must be based on the best available evidence at the time. Whilst we therefore factor into our assessment a significant pipeline of new store openings which are expected in the next two years (described in paragraphs 8.363 to 8.364) in calculating local GUPPIs, thus reducing the GUPPI figures in certain local areas, we consider that accounting for any further, unspecified and uncertain changes in the groceries market would not be appropriate.

8.290 Finally, although we have in our analysis taken care to avoid unnecessary bias and uncertainty in our estimates, we have considered whether it would be appropriate, when setting our GUPPI threshold, to take account of any remaining uncertainty and/or bias around the accuracy of our GUPPI figures or our efficiencies allowance:

(a) We may be aware that certain assumptions will tend to result in our analyses underestimating or overestimating the true level of pricing pressure, albeit with some uncertainty as to the magnitude of the effect. In such instances we may find it appropriate to lower or raise the GUPPI threshold.

(b) In some instances, there will inevitably be some uncertainty around elements of our evidence but where, in contrast to (a) above, we have no reason to consider that this would bias the analysis in any particular direction. In such instances, we may find it appropriate to raise the threshold in order to be confident that each SLC identified has been proved to be more likely than not in the context of the decision rule approach and the specific context of this case (albeit this would increase

³⁷⁷ Although we disagree with the Parties' assumption that such feedback effects have 'presumably led to a significant reduction in the otherwise applicable threshold' in this case: [Parties' response to the Provisional Findings](#), paragraph 147. For completeness, we note that we have not found that feedback effects would be particularly high relative to the first-order effect identified in the GUPPI in this case.

³⁷⁸ [Parties' response to the Provisional Findings](#), paragraphs 111 to 114.

the risk that we would wrongly decide that there was no SLC in some areas).

- 8.291 With respect to (a), we note that there are assumptions underlying our analysis that individually may cause us to overestimate or underestimate the pricing pressure in certain local areas. For example, we exclude own-brand diversion to supermarkets in our analysis of diversion, which will tend to lead to diversion between the Parties being overstated (see paragraphs 8.221 to 8.224). However, we include own-brand diversion to convenience stores and online offerings, which will tend to lead to diversion between the Parties being understated (see Appendix E). We use variable margins rather than gross margins in our GUPPI calculations, which will tend to lead to our GUPPIs being underestimated (see paragraph 8.240). Overall, after careful analysis and taking into account the difficulty of quantifying the potential impact of these, and other previously detailed, assumptions, the estimates of pricing pressure represent, in our judgement, a good estimate of the relevant variables.³⁷⁹
- 8.292 With respect to (b), we have undertaken a significant amount of analysis to calculate the local GUPPIs, as described fully in the paragraphs above and in Appendix E. As set out in paragraph 8.247, our calculations rely on evidence that has been the subject of careful scrutiny. This includes the extensive CMA store exit survey (which was the subject of careful planning, and high-quality fieldwork) and the entry/exit analysis and margin information submitted by the Parties, which we have carefully assessed and incorporated as appropriate (as discussed in greater detail in Appendices C and F). Furthermore, our assessment of the expected rivalry-enhancing efficiencies arising from the Merger has also been the product of extensive information gathering and scrutiny.
- 8.293 Nevertheless, there is inevitably some uncertainty around any estimates.³⁸⁰ In order to reduce the risk of ‘false positives’ (ie the incorrect finding of an SLC in a local area), we consider it would be appropriate to account for this in the GUPPI threshold.
- 8.294 However, we disagree with the Parties’ submission that we must be confident, to within a certain statistical confidence interval, that the final output of the GUPPI analysis is indicative of upward pricing pressure after efficiencies have been accounted for, or that we should include an additional

³⁷⁹ We consider that, if anything, diversion ratios between the Parties may be understated.

³⁸⁰ Uncertainty is to an extent more significant at the local level given that the WSS methodology does not capture all sources of local variation in competition. This is not the same at the national level where such sources of variation are averaged out.

'buffer' above the allowance already made for substantiality and uncertainty in our threshold where this is not the case.³⁸¹ This approach would inappropriately subject quantitative evidence to a higher hurdle than could be applied to qualitative evidence. In this case, we consider that the evidence used to underpin the GUPPI calculation is the best available evidence, and that the GUPPI is a reliable indicator of the likelihood of an SLC on the basis of the balance of probabilities. Further analysis on this point is contained in Appendix E.

8.295 We also disagree with the Parties' arguments in relation to balancing 'false positives' and 'false negatives'. The appropriate GUPPI threshold (and hence whether an SLC arises in a given area) is a matter of judgment for the Group. In any case, the analysis presented by the Parties is subject to two methodological flaws both of which cause the number and proportion of false positives to be overstated. Even if we were to accept the Parties' argument that the GUPPI threshold could be determined by this type of technical analysis, we consider that this analysis may have been supportive of our threshold once the flaws had been corrected. However, given the timing of the Parties' submission, we have not been able to confirm if this is the case. Further analysis on this point is contained in Appendix E.

- *Conclusion on threshold for GUPPI decision rule*

8.296 In light of the above, we decided to allow an additional margin of 1.5% above the efficiencies allowance of 1.25% for us to be satisfied, on the balance of probabilities, that in each area failing the decision rule, the Merger gives rise to an SLC in the circumstances of this particular case. This takes into account the need for any lessening of competition to be substantial, and allows for uncertainty. It leaves a sufficient allowance such that our GUPPI figure in a local area would need to mis-estimate the 'true' GUPPI figure by a significant amount for us to incorrectly find an SLC in that area. This in our judgement is unlikely to be the case. Taking the relevant factors in the round, we therefore decided to set the threshold for the GUPPI decision rule for our local assessment of in-store supermarkets at 2.75%.

- *Wider context for the GUPPI threshold*

8.297 As a cross-check, we have considered carefully whether this threshold makes sense in light of the wider context of this case and 'real world' factors.

³⁸¹ See Appendix E.

○ *Comparison of impacts analysis and GUPPI*

8.298 We note the Parties' submission that a GUPPI threshold of a similar level to the one used in our decision rule leads to SLC findings at a level of diversion between the Parties that would not give rise to a competitive response according to the Parties' policies on changing store budgets in response to competitor entry.³⁸²

8.299 In their submission, the Parties presented tables showing the proportion of local areas that would be classified as SLCs using a 1.5% GUPPI threshold by a) number of rival stores (either weighted or unweighted) within 7.5 minutes and b) drivetime to the closest Large store of the other Party.³⁸³ The Parties compared these with equivalent tables showing the proportion of local areas for which the impacts analysis showed an impact above [X] % (i.e. [X]) on a similar basis.³⁸⁴ Based on the above, the Parties conclude that 'the level at which the CMA presumes there is competitive harm to store revenues is far lower than the level which the Parties consider to be impactful'.³⁸⁵

8.300 We noted several methodological flaws in the Parties' analysis of the correspondence between our GUPPI threshold and competitive responses implied by their impacts analysis. These are discussed in Appendix E.

8.301 We sought to correct for these methodological flaws. The results of the adjusted analysis, which are also presented in Appendix E, suggest that there would frequently be a competitive response following entry by a competitor whose significance is broadly equivalent to the other merging Party in areas where the other merging Party receives a GUPPI equal to our threshold (excluding efficiencies).

○ *Relationship between concentration and GUPPI thresholds*

8.302 We consider that, in general, comparisons between SLC findings that result from a given GUPPI threshold and hypothetical fascia counting are of limited value, since fascia counts ignore important market features, such as the location and varying strength of constraint from different stores. However, we have noted that our GUPPI threshold of 2.75% is consistent with a critical diversion ratio of approximately 13%.³⁸⁶ We do not consider that comparing

³⁸² [Parties' response to the Provisional Findings](#), paragraphs 10 to 13.

³⁸³ [Parties' response to the Provisional Findings](#), Tables 1 and 2.

³⁸⁴ [Parties' response to the Provisional Findings](#), Tables 3 and 4.

³⁸⁵ [Parties' response to the Provisional Findings](#), paragraph 65. Schedule 1.3 to [Parties' response to the Provisional Findings](#) provides the same tables using Asda's [X] threshold.

³⁸⁶ The precise critical diversion ratio varies between the Parties. For Sainsbury's it is 14.3%; for Asda it is 11.5%. These critical diversions differ given that the Parties' average margin and relative prices differ.

this diversion ratio to the diversion that would be expected in a market with a certain number of symmetric local competitors would be a useful metric.³⁸⁷ The finding of a diversion ratio of 13% between the Parties would imply that the ‘cost’ of increasing prices, in terms of lost sales, would be 13% lower post-Merger than pre-Merger. Note that pre-Merger prices are set so that the gains from increasing prices slightly are closely balanced by the losses caused by lost sales. Post-Merger, if 13% of the losses are now re-captured via diversion to the other merging party, then in the presence of margins of the order of [X]%, and given the level of timely, likely and merger-specific rivalry-enhancing efficiencies for which we have found evidence, this is in our view sufficient to give rise to upward pricing pressure consistent with an SLC.³⁸⁸

- 8.303 The Parties submitted that a GUPPI threshold of a similar level to the threshold used in our decision rule leads to counterintuitive SLC findings. The Parties presented a table showing the proportion of SLCs using a 1.5% GUPPI threshold by a) number of weighted rival stores within 7.5 minutes (excluding the Parties) and b) drivetime to the closest Large store of the other Party.³⁸⁹ Based on this table, the Parties submit that the CMA finds that 99% of all areas within seven minutes, regardless of the number of rival competitors, are SLCs, and that an SLC threshold that is essentially independent of the level of competition for much of the catchment, such as this one, cannot be appropriate.³⁹⁰
- 8.304 However, first, this analysis uses an incorrect GUPPI threshold. The Parties also presented an equivalent table with a 2.5% GUPPI threshold, which is closer to the GUPPI threshold of 2.75% which we adopted in our decision rule.

³⁸⁷ However, we consider that, should one perform this analysis in this case, it would not be likely to be inconsistent with an SLC finding.

³⁸⁸ The Parties also submitted a series of maps to the CMA with markers for the locations of the Parties’ supermarkets and those of their rivals in the local areas. The Parties argued that the areas were identified as SLCs in our analysis despite the areas being competitive and, therefore, that the GUPPI threshold used in our Provisional Findings was too low. We note that one of the areas was, in fact, not an SLC, as the GUPPI was below our threshold. We do not consider that it is appropriate to assess whether a given threshold is reasonable by reviewing a map. It is not possible to visualise efficiencies or to account for margins or price ratios when reviewing a map. The manual review of a map also risks losing the richness of the analysis which accounts for the brand strength of different rivals, the size of store, and the relative distance (by drive-time) at which they were located. Most importantly, we did not consider that analysis of maps would have added relevant information to our systematic analysis of competition in local areas implied by the GUPPI. To the extent the arguments the Parties sought to make by presenting these maps related to the number of competitors (or competitor stores) in the local area, we have considered the relevance of fascia counts.

³⁸⁹ Parties’ response to the Provisional Findings, Tables 1 and 2.

³⁹⁰ Parties’ response to the Provisional Findings, paragraphs 55 and 56.

Table 8.5: Proportion of Large SLCs on a 2.5% GUPPI by weighted number of competing stores and Parties' overlap drive times

Weighted number of competitors within 7.5 minutes	Drive time band (minutes)							
	0-1	1-3	3-5	5-7	7-9	9-11	11-13	13-15
0-1	100%	100%	95%	100%	100%	75%	41%	11%
1-2	100%	100%	100%	89%	77%	51%	13%	0%
2-3	100%	100%	98%	87%	57%	13%	0%	0%
3-4		100%	96%	81%	35%	13%	0%	0%
4-5		100%	85%	67%	15%	0%	0%	0%
5-6		100%	100%	100%	0%	0%		0%
6-7			100%	50%		0%		0%
7-8								
8-9				0%				

Source: CRA analysis, [Parties' response to the Provisional Findings](#), Schedule 1.3. Weighted store count excludes the Parties. The drive time bands in the column heading are the drive times between the centroid and the closest Large store of the other Party. The red box was added by the CMA. Weighted number of competitors is expressed relative to a Large Tesco, which would be assigned a weight of 1. A weaker brand would be assigned a lower weight (for example 0.4).³⁹¹

8.305 This table shows that when the other Party's closest supermarket is within 3 minutes, all areas are SLCs. When the other Party's closest supermarket is within 3-5 minutes, a large majority of areas are SLCs. (These cases are shown with the red box above.) Outside the red box the number of SLCs gradually decreases as (i) the number of rivals increases and (ii) distance between the merging party increases. This is consistent with an overall tendency towards increasing competition from rivals and decreasing competition between the Parties.

8.306 We note that the Parties' analysis ignores several factors important to determining the level of competitive constraint in the local area, which are captured by the WSS. For example, the analysis ignores the Parties' share of shops. It only accounts for the distance to the closest shop of the other Party, and ignores all subsequent stores in the local area. In fact, almost a quarter of areas in the first four columns of Table 8.5 have at least two stores of the other Party present within 7.5 minute drivetime.³⁹²

³⁹¹In order to arrive at these weights, the Parties expressed for each brand-size category its weight relative to Large Tesco at each drivetime and then took an average of these ratios across all drive-times.

³⁹²In addition, the Parties' analysis ignores: competitors beyond 7.5 minutes; distance of competitors (the Parties analysis only provides the number of competitors within 7.5 minutes, and these weights are independent of the distance from the centroid store); and relative distance of Parties' stores relative to competitors.

- 8.307 For the reasons set out above, we do not consider that the Parties' analysis implies the GUPPI threshold is inappropriate.
- 8.308 We note the Parties' argument that our adjustment of 1.5 percentage points to allow for substantiality and uncertainty in our GUPPI threshold implies that, in the absence of any efficiencies, our decision rule would give rise to SLC findings even in the presence of large numbers of competitors.³⁹³ However, we note that in the absence of efficiencies, there would be no downward pricing pressure to offset the upward pricing pressure caused by the elimination of competition between the Parties. In such scenarios, smaller degrees of diversion between the Parties would give rise to net upward pricing pressure.

Conclusion on local assessment

- 8.309 Having taken into account all the above, we consider that a GUPPI threshold of 2.75% correctly identifies those local areas where, on the balance of probabilities, the Merger gives rise to an SLC based on our local assessment.
- 8.310 Each of the local areas where the GUPPI exceeds this threshold are set out in Appendix N.
- 8.311 On this basis and subject to our assessment of any countervailing factors, we find that the loss of competition between the Parties as a result of the Merger may be expected to give rise to an incentive to degrade those parameters of PQRS that can be locally flexed at certain supermarkets, resulting in an SLC, in 537 local areas. We note this is consistent with the results of our national assessment, which found an incentive for the Parties to degrade their offerings across their store estates.

National assessment (convenience)

- 8.312 The preceding sections discussed our assessment of the effect of the Merger which results from the overlap between each of the Parties' supermarket estates (ie Large and Medium stores). In addition, Sainsbury's operates a large convenience store estate (with 781 convenience stores).³⁹⁴ While Asda

³⁹³ [Parties' response to the Provisional Findings](#), paragraphs 49 to 51.

³⁹⁴ In addition, Sainsbury's plans to open around [X] convenience stores per annum which we have included for the purposes of our assessment as if they were existing stores – see paragraph 8.365.

does not operate any standalone convenience stores, it operates convenience stores at 59 of its PFSs.³⁹⁵

- 8.313 Given Asda's limited convenience store estate, the Merger gives rise to significantly fewer overlaps between the Parties' stores when considering only their convenience stores. Nevertheless, as set out in paragraph 7.93, given that each Party's convenience stores will not only be constrained by other convenience stores, but also by any Medium and Large stores, the Merger has the potential to also give rise to competition concerns if the constraint on one of the Party's convenience stores is substantially lessened as a result of the loss of competition from the other Party's Large, Medium and convenience stores.
- 8.314 As set out in paragraph 7.98, we consider that the relevant market for the retail supply of in-store groceries through convenience stores is local.
- 8.315 Nevertheless, as set out in paragraph 8.10, if the Merger may be expected to result in competition concerns in local areas representing a significant proportion of the Parties' overall convenience estates, the Merger may create an incentive to worsen the Parties' offerings across all of their convenience stores, including aspects of their offerings that are set centrally and applied uniformly across all of their convenience stores.
- 8.316 Earlier in this chapter, in our national assessment of the Parties' supermarket estates, we have found that, on the balance of probabilities, the Merger would give rise to an incentive for the Parties to degrade PQRS across the Parties' national supermarket estates, including in particular by increasing prices. We note that Sainsbury's operates a separate (uniform) national price file for their convenience stores, with prices being higher at its convenience stores than at its supermarkets for the majority of, but not all, products.³⁹⁶ As a result, our finding of competition concerns as part of our national assessment of the Parties' supermarket estates, would not necessarily equate to us also finding competition concerns as part of a national assessment of the effect of the Merger on Sainsbury's convenience store estate, as prices could conceivably be increased at Sainsbury's supermarkets without also being increased at Sainsbury's convenience stores.

³⁹⁵ Asda submitted that they have [redacted]. Asda informed the CMA on 23 April 2019 that one of its convenience stores had closed on 18 April 2019 because the PFS was converted to an unmanned PFS, and another would close for the same reason on 26 June 2019. Accordingly, these two stores are excluded from our findings. Their exclusion does not affect the findings arising from the local assessments of convenience stores.

³⁹⁶ The difference in pricing between its supermarkets and convenience stores is confirmed on Sainsbury's website: <https://help.sainsburys.co.uk/help/prices-payment/convenience-store-prices>.

- 8.317 The same does not hold true for Asda, as Asda operates consistent pricing across its supermarkets and its convenience stores (all of which are attached to PFSs).
- 8.318 According to the Parties, the CMA's national assessment in relation to supermarkets is not supported by the quantitative evidence in this case and relies on an unreasonable assessment of the available qualitative evidence. In light of this, the Parties submitted that there can be no national SLC in relation to in-store groceries for supermarkets, and thus no SLC to transfer to convenience stores.³⁹⁷
- 8.319 We disagree. Based on the reasons explained in our national assessment of the Parties' supermarket estates, we have found, on the balance of probabilities, that the loss of competition between the Parties as a result of the Merger would give rise to an incentive for the Parties to degrade PQRS across the Parties' national supermarket estates, resulting in an SLC in each local area where one or more of the Parties' supermarkets is present. As a result, and considering that Asda operates consistent pricing across its supermarkets and its convenience stores, we consider that our finding that the Merger may be expected to result in an SLC in each local area where one or more of the Parties' supermarkets is present would also mean that the Merger may be expected to result in an SLC in each local area where an Asda convenience store is present.³⁹⁸ We have no evidence to suggest that Asda would de-couple its convenience pricing from its supermarket pricing post-Merger, or that it considers its convenience pricing separately, and in our judgment it is unlikely it would do so (and even if it did, it would be unlikely to charge lower prices in its convenience stores than its supermarkets, which would be contrary to the approach taken by all other grocery retailers).
- 8.320 We focus in the rest of this section on whether the Merger gives rise to competition concerns at a national level with respect to Sainsbury's convenience store estate.
- 8.321 We did not receive any specific submissions from the Parties on this point. We also did not receive any concerns from third parties regarding the potential for an SLC with respect to the Parties' convenience stores.
- 8.322 We find that the Merger would not create an incentive to worsen the offering across all Sainsbury's convenience stores, including aspects of their offerings

³⁹⁷ [Parties' response to the Provisional Findings](#), paragraph 478.

³⁹⁸ We are not aware of any other parameters of competition that are set centrally and applied uniformly on a national basis, across Asda's store estate, that are unique to convenience stores, and which would therefore not already be captured by our national assessment of Asda's supermarkets.

that are set centrally and applied uniformly on a national basis, such as national convenience store pricing. In general, we note that the Parties compete with a wider range of competitors in respect of their convenience stores than in respect of their Medium and Large stores. In addition to the Medium and Large stores of retailers such as Tesco, Morrisons, Aldi, Lidl, Waitrose, M&S and Co-op (each assigned WSS weights for the purposes of our local assessment of the Parties' supermarket overlaps), this also includes: the convenience stores of these same retailers (to the extent they operate convenience stores – this excludes Aldi and Lidl); the convenience stores of a number of largely convenience-only chains (eg McColls, Spar, Costcutter); and a large number of independently owned convenience stores. While we do not consider that each of these retailers exerts an equal constraint on the Parties' convenience stores (as discussed further in paragraph 8.339 to 8.341 below) we nevertheless note that this represents a wide pool of potential competitors which would continue to exert a constraint on the Parties post-Merger.

- 8.323 Further, for Sainsbury's, our local assessment of the Parties' convenience store overlaps (discussed at paragraph 8.325 onwards below) found that the local markets which give rise to an incentive to increase prices (or degrade QRS) represent a small part of Sainsbury's overall convenience estate, such that we do not consider that Sainsbury's would have an incentive to degrade convenience store pricing across all of its convenience stores.
- 8.324 On this basis, we find that the Merger would not create an incentive to worsen Sainsbury's offerings across all Sainsbury's convenience stores, and as such the Merger does not give rise to an SLC in each local area where one or more of Sainsbury's convenience stores is present.

Local assessment (convenience)

- 8.325 Having found through our national assessment SLCs in every local market in which Asda operates convenience stores, this section separately consider whether there are SLCs in any of those same local markets, or in any local markets where Sainsbury's operates convenience stores overlap with Asda stores, arising from an incentive on the part of the Parties to deteriorate locally-set parameters of competition in some local areas but not others.

Approach to competitive assessment

- 8.326 We consider that there are important differences between convenience stores on one hand, and Large and Medium stores on the other, which mean it is appropriate to conduct a separate assessment with respect to the effect

of the Merger on the Parties' convenience stores despite this sector not being a core focus of the Merger.³⁹⁹

- 8.327 As set out in Chapter 7, the scope of the geographic market for convenience stores differs from that for Large and Medium stores, which is in turn reflective of evidence gathered in past cases that customers at convenience stores tend to travel much shorter distances (and choose from available options within a much smaller geographic area) than customers of larger stores.⁴⁰⁰ Further, the range of retailers that operate convenience stores, and therefore that have the potential to act as effective competitors to the Parties' convenience stores, is substantially wider than those that operate Large and Medium stores. In addition to the convenience stores of many traditional retailers, this includes convenience stores operated by Symbol group retailers⁴⁰¹ and independent retailers.⁴⁰² In addition, the factors that the average customer considers, and the weight that they attach to those different factors, may be different when shopping at a convenience store as compared to a supermarket. In particular, customers may attach greater value to convenience or location and lesser value on other factors, such as price and range.
- 8.328 We consider that it is appropriate to take a similar analytical approach to our local assessment of the Parties' convenience store overlaps as we took in our assessment of the Parties' supermarket overlaps. That is, adopting a WSS methodology that allows us to calculate weights (which proxy for diversion ratios) for each local overlap, and using these, together with information on local margins, to produce GUPPIs for each overlapping convenience store. We also consider that it is appropriate to again use a GUPPI-based decision rule to then determine in which local markets the Merger gives rise to an SLC. We discuss our reasons for this further below.
- 8.329 However, we note that it would not be appropriate to apply the same weights used in the supermarkets WSS for the purposes of our convenience assessment, given the differences between these different markets, as set

³⁹⁹ Conducting a separate assessment is also consistent with previous CMA and OFT cases having defined convenience stores as a separate product market to larger grocery stores (see paragraph 7.7 and its accompanying footnote).

⁴⁰⁰For example, [Tesco/Booker merger inquiry \(20 December 2017\), Final report, paragraph 6.25](#).

⁴⁰¹ Symbol group retailers are grocery retailers which operate stores under a common brand (or symbol) and undertake common marketing activities. Stores within a Symbol group may be independently owned and use the common brand under a franchise or membership agreement or, alternatively, may be directly owned by the Symbol group or affiliated wholesalers. Symbol group retailers generally source supplies through affiliated wholesalers. The central organisation of the Symbol group undertakes joint marketing and advertising, co-ordinates promotions, arranges for the provision of own-label products using the Symbol group brand, and supplies support services (eg staff training, financial management and merchandising).

⁴⁰² We use independent retailers to mean grocery retailers that are not part of a national or regional retail chain and are not part of a Symbol group.

out in paragraph 8.326. Indeed, the WSS used for our supermarket assessment classifies other convenience stores (of all brands) as ‘out of market’ constraints, and affords these (and a wide range of other constraints) a collective weight of 25%. It is not appropriate to take a similar approach when the focal store is itself a convenience store.

- 8.330 As noted above, the direct overlaps arising between Sainsbury’s and Asda convenience stores represent a small proportion of the total number of overlaps, across the Parties’ national store estates. The focus of our investigation of in-store groceries has therefore been on the potential loss of constraint from each of the Parties’ Medium and Large stores and our evidence gathering and analysis in relation to the retail supply of in-store groceries has therefore equally focused on the Parties’ supermarket estates. For example, the CMA store exit survey (which forms a key source of evidence for the assessment of supermarkets) interviewed only customers of the Parties’ Large and Medium stores (as did the Parties’ surveys). Other analysis relied upon for constructing the WSS used in our supermarkets assessment, such as the entry/exit analysis, similarly focused on the constraints imposed by Medium and Large stores.
- 8.331 In determining our approach to the competitive assessment of the Parties’ convenience store overlaps, we have therefore drawn on the evidence and analytical approach adopted in the recent CMA phase 2 investigation of Tesco/Booker.
- 8.332 We consider that Tesco/Booker provides a good starting point for our own analysis, given that it represents a recent,⁴⁰³ in-depth investigation in the convenience sector (including the overlap arising between Tesco’s convenience stores and the Symbol group and independent convenience stores supplied by Booker). In view of this recent investigation into convenience stores, and the fact that the convenience sector is not a core focus of the Merger, and taking into account the CMA’s discretion to prioritise the use of its resources within the confines of the statutory timetable, we did not consider it necessary to conduct a large-scale evidence gathering exercise (of the type conducted in Tesco/Booker, or in our supermarkets assessment in this case) to assess the conditions of competition with respect to convenience stores. Instead, we satisfied ourselves that the Tesco/Booker methodology was appropriate for this case; we have assessed whether assumptions and inputs underlying the analysis used in Tesco/Booker remain

⁴⁰³ The CMA published the Final Report on Tesco/Booker on 20 December 2017, so just over a year from the time of assessment of this Merger and publication of this Final Report.

relevant in the particular circumstances of this case and have departed from them where appropriate.

Parties' views

8.333 The Parties submitted that:

- (a) Regarding the CMA's proposal to adopt the approach used in the Tesco/Booker investigation:
- (i) Given the UK grocery market is rapidly changing and highly competitive, it is unrealistic to assume that a decision based on evidence which would be at least two years old adequately captures the Merger's potential impact on convenience stores. Moreover, according to the Parties, the Tesco/Booker and (later) Co-op/Nisa mergers may themselves have had a significant impact on competitive dynamics in the convenience sector.⁴⁰⁴
 - (ii) They could not comment meaningfully on the appropriateness for the present case of using the weights calculated in Tesco/Booker (having not had sight of the full evidence available to the CMA in that case). However, in any event, these weights reflect the CMA's view of the constraint that different brands exert on Tesco convenience stores, and it is not clear that these constraints would be the same for Sainsbury's and Asda.
 - (iii) With respect to the Sainsbury's stores, the Parties submitted that the CMA cannot assume that the Tesco/Booker approach would apply equally with respect to assessing the constraint on Sainsbury's, and that this undermines the CMA's approach to the assessment.⁴⁰⁵ With respect to Asda's stores, the Parties submitted that the CMA's approach disregards the differentiated nature of the Asda convenience offering; all of the Asda stores are attached to its PFSs unlike standard convenience stores, which tend to be situated in high streets and other convenient locations. Moreover, Asda stores are particularly small and carry a narrower range of products relative to an average convenience store.⁴⁰⁶ The Parties submitted that Asda's stores are therefore not 'convenience stores' in the sense commonly understood.⁴⁰⁷ The Parties submitted that the proper competitive set

⁴⁰⁴ [Parties' Response to the Provisional Findings Report](#), paragraph 487.

⁴⁰⁵ [Parties' Response to the Provisional Findings Report](#), paragraph 493.

⁴⁰⁶ [Parties' Response to the Provisional Findings Report](#), paragraph 488.

⁴⁰⁷ [Parties' Response to the Provisional Findings Report](#), paragraph 489.

by which the impact of the Merger on Asda's stores should be assessed at local level must include local PFS shops, which the Parties submitted played no role in the Tesco/Booker analysis and are, as a result of the CMA's reliance on that case, excluded from the competitive analysis in the present case.⁴⁰⁸

- (iv) With regards to assessing whether the Merger gives rise to an incentive for Asda to degrade PQRS at its convenience stores, the competitive set should include local PFS shops, because these are the primary source of competitive constraint for Asda's PFS shops. According to the Parties, PFS shops played no role in the Tesco/Booker analysis and are therefore excluded from the competitive analysis in the present case.⁴⁰⁹

(b) Regarding the GUPPI threshold adopted by the CMA:

- (i) It is inappropriately low. Whilst the Parties consider that it would be inappropriate to uncritically adopt the approach used in Tesco/Booker, they do not consider that the CMA has provided an adequate justification to depart from the GUPPI threshold adopted in Tesco/Booker.⁴¹⁰ In Tesco/Booker, the CMA ruled out concerns in local markets where the GUPPI was less than 5%, and subjected those above 5% to a 'second screen' fascia count. The CMA should equally exclude concerns in local markets where the GUPPI was under 5% in this case.
- (ii) Having determined that an appropriate approach is the one adopted in Tesco/Booker, the CMA is incorrect to then depart from the Tesco/Booker threshold in order to be consistent with its approach in relation to supermarkets, as this is just focused on Medium and Large stores, and not convenience stores.⁴¹¹ The Parties also submitted that, if the evidence in the Tesco/Booker investigation warranted a 'safe harbour' GUPPI threshold of 5%, it cannot at the same time warrant a determinative GUPPI of less than half of that.⁴¹²

⁴⁰⁸ [Parties' Response to the Provisional Findings Report](#), paragraph 490.

⁴⁰⁹ [Parties' Response to the Provisional Findings Report](#), paragraph 490.

⁴¹⁰ [Parties' Response to the Provisional Findings Report](#), paragraph 494.

⁴¹¹ [Parties' Response to the Provisional Findings Report](#), paragraph 495.

⁴¹² [Parties' Response to the Provisional Findings Report](#), paragraph 496.

- (iii) In Tesco/Booker, the CMA applied both a 10% and a 20% out-of-market constraint, and acknowledged that 10% was likely to be conservative.
 - (iv) The CMA's GUPPI threshold purports to take account of a number of factors applicable to the present case when it does not, in fact, do so. These factors relate to the inclusion or exclusion of own-brand diversion, the greater relative price difference between the Parties for their convenience stores and the approach to margins.⁴¹³
 - (v) The CMA makes no attempt to determine the extent to which the assumptions to its analysis might overestimate or underestimate pricing pressure or to balance those factors against each other.⁴¹⁴
- (c) The CMA's proposed approach for the convenience store analysis differs from that proposed for the supermarkets analysis in a number of material respects (including in terms of the treatment of own-brand diversion), where there was no clear reason for it to do so.
- (d) The CMA fails to take account of entry and expansion in convenience. According to the Parties, the barriers to entry in the market for smaller stores, in particular for convenience stores, are far lower than for supermarkets, as operators require far less by way of supply network, brand and marketing, the provision of car parks and associated facilities, etc;⁴¹⁵ this is evidenced by recent examples of expansion.⁴¹⁶ The Parties also submitted that the CMA has only considered new store openings of supermarkets, but has not taken into account the new store openings of convenience stores, despite the large number of operators present in this market.⁴¹⁷

Our assessment

Preliminary

8.334 The Parties submitted that the CMA has provided none of the data, methodology or assumptions underlying the decision in Tesco/Booker,

⁴¹³ [Parties' Response to the Provisional Findings Report](#), paragraph 497.

⁴¹⁴ [Parties' Response to the Provisional Findings Report](#), paragraph 498.

⁴¹⁵ [Parties' Response to the Provisional Findings Report](#), paragraph 506.

⁴¹⁶ [Parties' Response to the Provisional Findings Report](#), paragraph 508.

⁴¹⁷ [Parties' Response to the Provisional Findings Report](#), paragraph 507.

meaning the Parties were given no opportunity to comment meaningfully on the CMA's proposed approach.⁴¹⁸

8.335 This is incorrect. At the time of publishing our provisional findings, we disclosed to the Parties' advisers unredacted versions of the relevant sections of the Tesco/Booker final report along with the unredacted appendices which detailed the methodology, and the relevant underlying and unpublished working paper. These materials would have enabled the Parties' advisers to understand the methodology used to assess horizontal convenience store overlaps in that case, including underlying assumptions and the reasons why that methodology was used.

WSS

8.336 As set out in paragraph 8.328 above, we consider that it is appropriate to use a WSS methodology. As with our assessment of the Parties' supermarket overlaps, this involved:

- (a) applying a weight to each store in the catchment area of the centroid convenience store;
- (b) adjusting those weights upwards or downwards such that they sum to a particular percentage of 'in market' constraints, without changing the relative weight between them; and
- (c) allocating a remaining percentage to out-of-market diversion.

Relative weights

8.337 Consistent with the approach taken in Tesco/Booker,⁴¹⁹ we derive the weight for each competitor store based on two factors:

- (a) *Distance*. Stores next to the Parties' store received a weight of one, and stores at the very edge of the catchment area received a weight of zero. Between these points, the weights of stores decline from one to zero in a linear way.⁴²⁰
- (b) *Brand*. Each brand is given a weight to reflect the competitive constraint it poses.

⁴¹⁸ [Parties' Response to the Provisional Findings Report](#), paragraph 483.

⁴¹⁹ Tesco/Booker merger inquiry (20 December 2017), Final report, [Appendix C](#), paragraphs 40–42.

⁴²⁰ For example, if a competing store is located 0.75 miles away (ie 75% of the way to the edge of the geographic market, in the case of convenience stores), the store's weight is reduced by 75%.

8.338 With respect to distance, we note that using a weight which declines with distance is consistent with the approach taken in our assessment of the Parties' supermarket overlaps, which reflected the evidence gathered in this case that competitive constraint for Large and Medium stores declines with distance.⁴²¹ It is also consistent with the findings of the CMA in Tesco/Booker (based on its analysis of the Parties' internal documents, survey evidence from market research companies, its entry/exit analysis, and third party submissions) that distance is particularly important in convenience grocery retailing. We think it is appropriate to adopt the same approach in this case.

8.339 With respect to brand, in Tesco/Booker, when considering the constraints on Tesco conveniences stores, the following weights were employed:

- (a) a weight of 1 was given to each brand listed in the 'effective competitor set' adopted by the CMA and its predecessors in previous cases concerning the supply of groceries, with the following exceptions:
 - (i) Aldi, Lidl and M&S were given a weight of 0.8 (when considering the constraint on Tesco convenience stores or Booker Symbol group stores), to reflect the fact that these retailers do not stock tobacco products, which the CMA's investigation in that case showed were an important product category in convenience stores.⁴²² For Aldi and Lidl, this also reflected their lack of convenience focus, and the CMA's findings (based on the results of its review of the Parties' internal documents, survey evidence, its entry/exit analysis, and third party submissions)⁴²³ that these retailers did not exert as strong a competitive constraint on Tesco convenience stores or Booker-supplied Symbol group stores as did other retailers.
 - (ii) Symbol stores were given a weight of 0.8 (when considering the constraints on Tesco convenience stores), to reflect the evidence found in that case (based on the results of the CMA's review of the Parties' internal documents, survey evidence, its entry/exit analysis, and information on the range and services available in such stores)⁴²⁴ that Symbol stores do not exert as strong a competitive constraint on Tesco convenience stores as did stores of major grocery retailers.

⁴²¹ Although this decline is not modelled in a linear way in our supermarkets assessment.

⁴²² Tesco/Booker merger inquiry (20 December 2017), [Final report](#), paragraph 7.44.

⁴²³ Tesco/Booker merger inquiry (20 December 2017), [Final report](#), paragraph 7.37-7.44.

⁴²⁴ Tesco/Booker merger inquiry (20 December 2017), [Final report](#), paragraph 7.23-7.30 (particularly with respect to the constraint as between Tesco and Booker-supplied Symbol group retailers); paragraph 7.45-7.49 (regarding the constraint on Tesco of Symbol group retailers more generally).

- (iii) Independent retailers were given a weight of 0.5 (when considering the constraints on Tesco convenience stores or Booker-supplier Symbol group stores), to reflect the evidence found in that case (based on survey evidence, third party views and information on the range and services available in such stores)⁴²⁵ that independents exert a weaker competitive constraint on Tesco convenience stores than Symbol groups do.
- (iv) Iceland was not given a weight in the CMA's base case, on the basis that the CMA's investigation found (based on the Parties' internal documents, survey evidence, entry/exit analysis and third-party submissions)⁴²⁶ that Iceland may not be an effective convenience store competitor. Like with Aldi and Lidl, this reflected the fact that Iceland does not sell tobacco products and its lack of convenience focus. However, the CMA also applied a sensitivity to assess the incremental impact on the assessment if Iceland stores were treated as effective competitors.⁴²⁷

Table 8.4: Retail brands deemed effective competitors for local analysis of convenience store overlaps in Tesco/Booker

<i>Retailers</i>	<i>Symbol groups/fascia operated by wholesalers</i>
Aldi [^]	Bargain Booze ^{^*}
Asda	Best-One [^]
Booths	Budgens [^]
Co-op	Centra [^]
Dunnes	Costcutter
Iceland [*]	Key Store/Key Shop [^]
Lidl [^]	Lifestyle Express ^{^*}
M&S [^]	Londis [^]
McColls	Mace [^]
Morrisons	Nisa [^]
Sainsbury's	P&H Retail ^{^†}
Tesco	Premier [^]
Waitrose	Spar [^]
Whole Foods	Supervalu [^]
	Today's [^]
	VG/Vivo [^]

Source: CMA analysis: [Tesco/Booker merger inquiry](#), Table 5.

[^] These competitors received a reduced weight of 0.8 (compared to a weight of 1 for all other listed fascia).

^{*} These stores were included in a sensitivity test only in the Tesco/Booker analysis.

[†] At the time of publishing the Tesco/Booker decision, it was noted that P&H Retail (via its operating company, WS Retail Limited) had not been placed in administration.

Costcutter was not included in this list in Tesco/Booker. However, this was an omission in the published version of the report. It has therefore been added above.

8.340 For the purposes of the present case we note that:

- (a) With respect to the down-weights (or absence of weights) applied in Tesco/Booker as listed in paragraph 8.339 above, these were based on

⁴²⁵ Tesco/Booker merger inquiry (20 December 2017), [Final report](#), paragraph 7.47-7.49.

⁴²⁶ Tesco/Booker merger inquiry (20 December 2017), [Final report](#), paragraph 7.37-7.44.

⁴²⁷ This was also the case for two further Symbol group chains: Bargain Booze and Lifestyle Express.

significant evidence gathering and analysis conducted in the context of that case. Given the recent nature of that case, we consider it unlikely that the conditions of competition which led to those weights have materially changed. We have not received any evidence to suggest that the Tesco/Booker or subsequent Co-op/Nisa transactions have substantially changed the nature of competition within convenience retailing in a way that would lead us to question the appropriateness of using these weights. We note that it continues to be the case that Aldi, Lidl and M&S do not offer tobacco products.

- (b) With respect to Iceland, as in Tesco/Booker, we have performed a sensitivity check where we have included Iceland as a competitor, with a weight of 0.8. We note that this did not make a significant difference to our analysis. With respect to Bargain stores, consistent with Tesco/Booker (which did not give any weight to Bargain stores) and our supermarket assessment, (where we treat Bargain stores as part of the out-of-market constraint), we think it appropriate that these stores are not given a specific weight in our assessment of the Parties' convenience overlaps.
- (c) With respect to the Parties' arguments that there is no evidence to support the assumption that the constraints on Tesco stores would apply equally to Sainsbury's convenience stores, we note that in Tesco/Booker the competitor weights given were the same whether or not the centroid store was a Tesco store or a Booker Symbol group retailer (with the exception of the Symbol group retailer weight). The weights were also consistent for all major competitor convenience chains (ie excluding those under Symbol groups or independently owned) that sold tobacco. This consistency of weighting (which is consistent with the finding in Tesco/Booker that distance is particularly important in convenience grocery retailing, and therefore brand comparatively less important) supports a finding that the constraints on Tesco's convenience stores are likely to be comparable to the constraints on Sainsbury's and Asda convenience stores. This is particularly so when considered in light of the evidence, discussed in the context of our assessment of the Parties' supermarket overlaps, which suggests that (at least with respect to Large and Medium stores and in the online delivered groceries market) Tesco is each Party's closest competitor.
- (d) With respect to the Parties' arguments that the CMA's approach disregards the differentiated nature of the Asda convenience offering, as discussed in Chapter 7, the OFT and CMA considered in a number of cases whether it was appropriate to distinguish stores attached to PFSs (also referred to as kiosks) from other types of convenience stores, on the basis of their smaller size and more limited offering, but either did not

conclude or concluded that no such distinction was appropriate on the basis of the available evidence. We have taken the same approach in this case.⁴²⁸ As such we have treated both Sainsbury's and Asda convenience stores as competing with each other, and with all other convenience stores (regardless of whether they are attached to PFSs or not). We note that this is also the approach taken in Tesco/Booker (where a number of the merging parties' convenience stores were located at PFSs). The Parties' submission that convenience stores located at PFSs have been excluded from our analysis is therefore incorrect: the store dataset provided by the Parties includes a number of competitor convenience stores located on PFSs and we have included these in our assessment. We have however considered the Parties' arguments regarding the differences in size and product offering of the Asda convenience stores and the effect that this may have on competition between the Asda convenience stores and other competitor convenience stores (including Sainsbury's convenience stores). In the absence of evidence on the precise effect that this would have on diversion between these stores and each of the other competitor stores, we have taken this into account as source of uncertainty in the analysis when considering the threshold at which we set our GUPPI decision rule (see paragraph 8.353). We have also taken into account the potential that some competitor stores (including those located at PFSs) may not be reflected in the store dataset provided by the Parties (see paragraph 8.354).

8.341 For the reasons set out above, we consider that it is appropriate to apply the same brand weights as used in Tesco/Booker.⁴²⁹

Out-of-market

8.342 In Tesco/Booker, the CMA incorporated an out-of-market constraint of 10% in its base case, while also using 20% as a sensitivity.⁴³⁰ In that case, the CMA noted that survey evidence from the Association of Convenience Stores (ACS) suggested that 20% of customers travelled more than a mile (the geographic catchment for convenience stores used in the CMA's analysis) to carry out shopping. However, it also noted that the ACS survey included some mid-sized stores and therefore may have overstated the degree of out-of-market diversion from convenience stores. It was however noted that a 10% figure may be cautious in some local areas.⁴³¹ Taking this into account,

⁴²⁸ See paragraph 7.93.

⁴²⁹ Although we note that a small number of the brands listed in Table 8.4 did not appear in the store dataset provided by the Parties, and were therefore not included in the analysis.

⁴³⁰ Tesco/Booker merger inquiry (20 December 2017), Final report, [Appendix C](#), paragraphs 59-62.

⁴³¹ Tesco/Booker merger inquiry (20 December 2017), [Final report](#), paragraph 10.19 and 11.14.

in our judgment it is appropriate to adopt an out-of-market diversion figure of 15% in this case.

Treatment of own brand diversion

8.343 The Parties' views on own-brand diversion are discussed in the *Treatment of own-brand diversion* section of Appendix E.

8.344 Consistent with the approach for supermarkets, and for the same reasons, we took the approach of excluding all own-brand diversion when the overlapping Party store is a Large/Medium store (given the greater prevalence of SLCs centred on Large/Medium stores) and including own-brand diversion when the overlapping Party store is a convenience store.⁴³² We note that including own-brand diversion when the overlapping store is a convenience store may understate the GUPPIs figures calculated, whereas the exclusion of own-brand diversion when the overlapping store is a supermarket may overstate the GUPPI figures. We take this into account when considering the threshold at which we set our GUPPI decision rule.

Local GUPPIs

8.345 As with our assessment of the Parties' supermarket overlaps, we used the weights set out in paragraph 8.339 above (as a proxy for diversion ratios), in combination with the following information, to produce a GUPPI value for each of the Parties' convenience overlaps:

- (a) Margins: we have used store-specific local margins for each convenience store. On this point, we make the following observations:
 - (i) As set out in paragraphs 8.239 and 8.240, we consider that the margins used in our assessment (for all of the Parties' stores, including their convenience stores) are likely to be understated and, therefore, that the GUPPIs are also understated. In our view, the same considerations apply in respect of the use of margins in the Parties' convenience stores.
 - (ii) Unlike our assessment of the Parties' supermarket overlaps, we have not included an adjustment to the margins to account for the so-called 'halo effect', that is, the fact that some customers also purchase GM when purchasing groceries. We note that GM is particularly stocked

⁴³² This reflects an update to the approach taken at provisional findings. This also addresses the Parties' concern (set out at paragraph 8.333(c) above) that the CMA's approach is inconsistent in this respect as between its supermarkets and convenience stores assessments.

at the Parties' Medium and Large stores and so we have not made this adjustment when considering the Parties' convenience store overlaps. However, we note that, to the extent that some GM sales are made in convenience stores, this would lead to the GUPPIs being understated.

(iii) The Parties submit that there is no evidence that convenience margins have been understated and, in fact, submit that the evidence shows that the margins used by the CMA are in fact overstated.⁴³³ The Parties cross-refer to evidence submitted as part of their submissions regarding our assessment of the Parties' supermarket overlaps. As these submissions relate to the calculation of the halo effect, which is not reflected in the margins used in our convenience store assessment, we do not consider this evidence to be relevant to this part of the assessment.

(b) Price ratios: the magnitude of the price ratio used in the local assessment of convenience stores is provided in Appendix E. The price ratios reflects evidence submitted by the Parties following provisional findings regarding the relative price differences between their convenience stores and supermarkets.⁴³⁴

8.346 In response to submissions made by the Parties at provisional findings, we also corrected two calculation errors, including the inclusion of Asda Living stores in the convenience store dataset used for the analysis.⁴³⁵

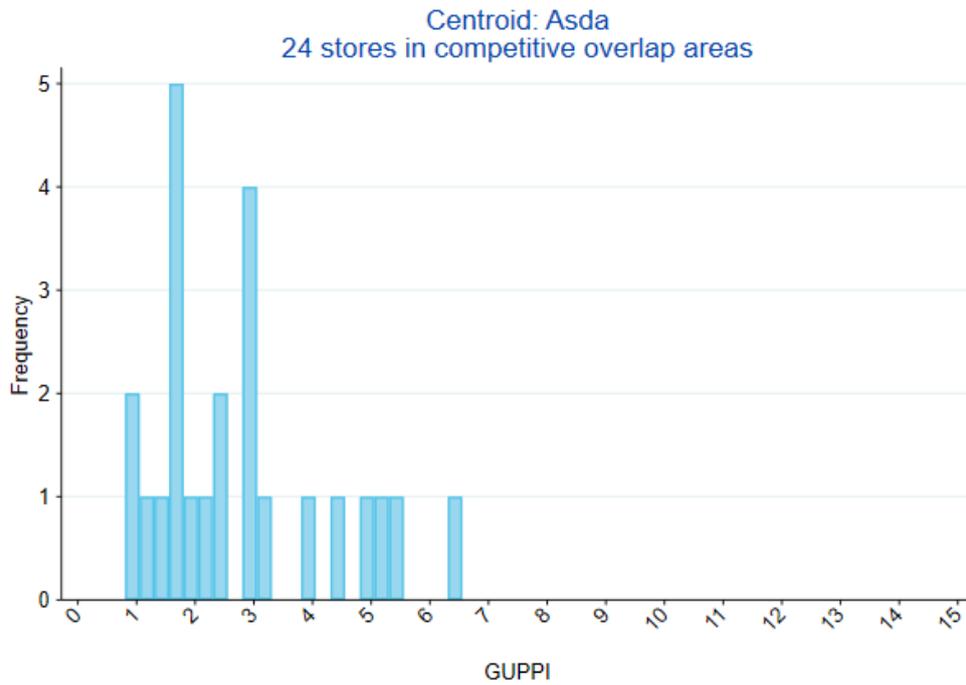
8.347 The distribution of the GUPPI figures produced for each of Asda and Sainsbury's convenience stores are presented in Figure 8.11 and Figure 8.12 below.

⁴³³ [Parties' Response to the Provisional Findings Report](#), paragraph 499.

⁴³⁴ There is also some uncertainty regarding the price ratio used for overlaps specifically between Sainsbury's convenience stores and Asda convenience stores (this does not apply to overlaps between Sainsbury's convenience stores and Asda supermarkets, or between Asda convenience stores and Sainsbury's supermarkets). See Appendix E. We also account for this uncertainty when setting the GUPPI threshold.

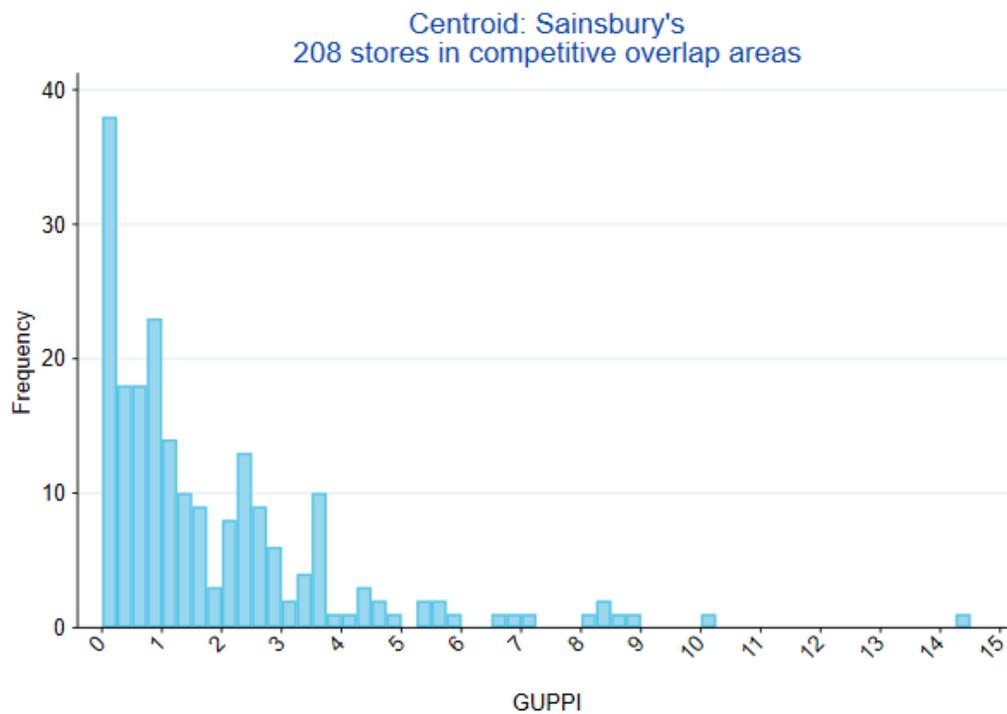
⁴³⁵ The Parties also submitted that the CMA's analysis contained two calculation errors: one related to the duplication of Asda's stores and another one with respect to overlapping competitors that have the same latitude and longitude of the centroid being dropped ([Parties' Response to the Provisional Findings Report](#), paragraphs 501–503). These have been corrected in the analysis conducted for this report.

Figure 8.11: Distribution of the GUPPI for Asda's stores that overlap with Sainsbury's stores



Source: CMA analysis.

Figure 8.12: Distribution of the GUPPI for Sainsbury's stores that overlap with Asda's stores



Source: CMA analysis.

GUPPI decision rule

- 8.348 While the number of overlaps arising from the Parties' convenience stores is smaller than for their Large and Medium stores ([X]), compared to around [X]), the number of overlaps is still such that it would not be practicable to perform an assessment of each local area in turn within the timeframe of a phase 2 merger inquiry. As such, consistent with our assessment of the Parties' supermarket overlaps, we considered that it was necessary to devise a decision rule to establish whether the Merger is, on the balance of probabilities, likely to give rise to an SLC on any local markets for the retail supply of in-store groceries through convenience stores. In determining the appropriate threshold for concern for this decision rule, we have considered the same factors as considered for the purposes of our assessment of the Parties' supermarket overlaps. These are (i) efficiencies and (ii) substantiality and uncertainty. We consider these factors in turn.
- 8.349 With respect to efficiencies, for the reasons set out in paragraphs 8.276 to 8.279, we found that we can rule out concerns below a 1.25% GUPPI, given that we consider that the rivalry-enhancing efficiencies evidenced in this case accruing to the Parties' grocery businesses (which would include groceries sold through their convenience stores) would have a downward effect on pricing pressure commensurate with a GUPPI of that level. We therefore consider that the GUPPI threshold should be above 1.25%.⁴³⁶ As with our supermarkets assessment, we note that our assessment of the expected rivalry-enhancing efficiencies arising from the Merger has been the product of extensive information gathering and scrutiny.
- 8.350 With respect to substantiality and uncertainty, for the reasons set out in paragraphs 8.280 to 8.295, which we consider would apply equally to our assessment of the Parties' convenience store overlaps, we consider that it is appropriate to add an allowance above a 1.25% GUPPI. As regards substantiality, we consider that the same factors set out in paragraphs 8.281 to 8.289 (in relation to our assessment of the Parties' supermarket overlaps), apply equally to our assessment of the Parties' convenience store overlaps.
- 8.351 As regards any uncertainty or bias, in our GUPPI figures, we note that there are certain biases in our convenience store assessment that also applied in our supermarkets assessment (as noted in paragraph 8.291 above). For example, excluding own-brand diversion to overlapping supermarkets and including own-brand diversion to overlapping convenience stores will tend to

⁴³⁶ As we have taken into account efficiencies directly when setting the threshold for the GUPPI-based decision rule for our local assessment, we have not separately considered efficiencies in the countervailing factors section of this chapter.

lead to diversion between the Parties being overstated in some areas, and understated in others (see paragraph 8.344). Our use of variable margins rather than gross margins in our calculations will also tend to lead to our GUPPIs being underestimated (see paragraph 8.345(a)).

- 8.352 There are however certain elements of uncertainty in our GUPPI estimates which apply in our convenience store assessment which did not apply in our supermarkets assessment. Most significantly, we note the following.⁴³⁷
- 8.353 First, there may be greater uncertainty regarding the weights used in the WSS. The weights used to proxy for diversion ratios in the GUPPI calculation are based on substantial evidence gathering in the context of the Tesco/Booker merger investigation, which, as set out above, we consider provide a good basis for our analysis. However, we note that the evidence for these weights has not been subject to the same scrutiny in this investigation as the evidence underlying the weights calculated for our assessment of the Parties' supermarkets overlaps. We have not, for example, assessed whether the different size and product offering of the Asda convenience stores may affect competition between them and other convenience stores (although, as noted above, the weights calculated in Tesco/Booker were also applied in that case to convenience stores which, like the Asda stores, were located at PFSs). Whilst it is therefore reasonable for us to adopt the weights applied in Tesco/Booker (both when considering the constraints on Sainsbury's convenience stores, and those on Asda convenience stores) as an efficient approach to the assessment of the convenience store overlaps, given that they are of a lower order of magnitude in the context of this case, we consider it is appropriate to take account of the greater uncertainty that results from using evidence gathered in the context of another case in setting the threshold for our decision rule.
- 8.354 Second, there may be greater uncertainty in the store dataset used for the analysis. We have relied primarily on a dataset of competitor convenience stores provided by the Parties. We have supplemented this dataset with information provided by the following grocery retailers regarding their existing and planned convenience stores: Tesco, Morrisons, Aldi, Lidl, Waitrose, M&S, Co-op and Iceland. Given the large number of convenience store retailers operating in the UK, we considered that it was not practical to approach all other convenience retailers to confirm their store locations (both

⁴³⁷ As noted in footnote 434, there is also some uncertainty regarding the price ratio used for overlaps specifically between Sainsbury's convenience stores and Asda convenience stores (this does not apply to overlaps between Sainsbury's convenience stores and Asda supermarkets, or between Asda convenience stores and Sainsbury's supermarkets). We also account for this uncertainty when setting the GUPPI threshold.

existing and planned) and have therefore relied on the data submitted by the Parties regarding the location of such stores. To the extent that certain competitor stores are not reflected in the store dataset provided by the Parties (which the Parties submissions imply include some convenience stores located PFSs), they will not be reflected in the analysis.⁴³⁸ For this reason, we note that our current approach may overstate the likelihood of the Merger giving rise to an SLC in some local markets, to the extent it does not account for specific competitor stores in those local areas. We consider it is appropriate to take account of this element of uncertainty in setting the threshold for our decision rule.

8.355 Taking the factors above in the round, we have decided to set the threshold for the GUPPI decision rule for our local assessment of convenience stores at 3.25%, which is 0.5 percentage points higher than for supermarkets. We consider this allows a sufficient margin above the lower bound of 1.25% (which accounts for efficiencies) for us to be satisfied, on the balance of probabilities, that in each area failing the decision rule, the Merger gives rise to an SLC in the circumstances of this particular case. This takes into account the need for any lessening of competition to be substantial, and reflects the greater degree of uncertainty in the evidence base.

Conclusion on local assessment

8.356 Having taken into account all the above, we consider that a GUPPI threshold of 3.25% correctly identifies those local areas where, on the balance of probabilities, the Merger gives rise to an SLC based on our local assessment. Each of the local areas where the GUPPI exceeds this threshold are set out in Appendix N.

8.357 On this basis and subject to our assessment of entry and expansion, we find 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 PQRS that can be locally flexed at certain convenience stores, resulting in an SLC, in 18 local markets.

8.358 As set out above, the decision-rule threshold for the local convenience store assessment takes into account any uncertainty over the completeness of the competitor set. However, following the Parties' submissions specifically regarding convenience stores located at PFSs, we have checked whether there are any PFS convenience stores in the six local areas where SLCs are found for Asda convenience stores, which are not included in the competitor

⁴³⁸ Although we note that some competitor stores included in the Parties' dataset may equally have since closed.

set provided by the Parties. Having done so, in each of the six local areas, we remain satisfied that there is an SLC either because we have not identified any PFS convenience store that is not already in the competitor set, or because the GUPPI figures are sufficiently high that the additional PFS convenience stores, given their distance from the centroid store, do not negate the finding of an SLC on the balance of probabilities.

Countervailing factors

Entry and expansion

- 8.359 As set out in our guidance, any analysis of a possible SLC should take into account the responses of others, including rivals. We need to consider whether the entry of new firms or the expansion of operations by existing firms would mitigate the initial effect of the Merger on competition, such that no SLC would arise. In assessing whether entry or expansion might prevent an SLC, we consider whether it would be timely, likely and sufficient. This also involves a consideration of any barriers to entry which may give incumbent firms advantages over potential competitors.⁴³⁹
- 8.360 The Guidance suggests that entry or expansion may be considered timely where it takes place within less than two years but this needs to be assessed on a case by case basis. The assessment of likelihood takes into account whether there are any factors in addition to the scale of entry barriers that would impact on the ability and incentive of firms to enter the markets. Finally, entry should be of a sufficient scope to deter or defeat any attempt by the merged firm to exploit any lessening of competition resulting from the merger.
- 8.361 The Parties submitted that barriers to entry for smaller stores, in particular for convenience stores, are far lower than for supermarkets,⁴⁴⁰ and that this is evidenced by recent examples of expansion.⁴⁴¹ Further, the Parties submitted that the CMA has only considered new store openings of supermarkets, but has not taken into account the new store openings of convenience stores, despite the large number of operators present in this market.⁴⁴²
- 8.362 The UK competition authorities have previously found that there are barriers to entry and expansion in certain relevant markets for groceries retailing. In the Groceries market investigation, the CC found that barriers to entry or

⁴³⁹ [CC2 Revised](#), paragraphs 5.8.1 to 5.8.15.

⁴⁴⁰ [Parties' response to the Provisional Findings Report](#), paragraph 506.

⁴⁴¹ [Parties' response to the Provisional Findings Report](#), paragraph 508.

⁴⁴² [Parties' response to the Provisional Findings Report](#), paragraph 507.

expansion constrained competition by impeding the emergence of competitors able to challenge the existing offer of grocery retailers. In particular, the planning system was found to constrain entry by new Large stores but only placed limited constraints on entry or expansion by Medium grocery stores and convenience stores.⁴⁴³ Some evidence in our inquiry confirmed the existence of barriers to entry for Large stores and the generally reduced number of openings by the Parties, Tesco and Morrisons in recent years.⁴⁴⁴ With respect to convenience stores, we note that previous precedents noted that barriers to entry for convenience stores are more limited than for Large stores and that this may be also the case for this investigation, as we have not received any evidence on the contrary.

8.363 For our assessment of the Parties' supermarket overlaps, we have gathered evidence on all planned new store openings of the Parties and of those competitors receiving a positive weight in the analysis (ie Tesco, Morrisons, Aldi, Lidl, Waitrose, M&S, Co-op and Iceland). In order to consider only those new store openings that were likely to open in a timely manner, we requested confirmation of whether the relevant planned store had received board approval or the relevant contract had completed and only took into account those stores where the expected opening date was in the next two years.⁴⁴⁵

8.364 For each of the planned store openings, we identified its location, its size and its brand, and assigned it a weight accordingly in the WSS analysis. As such, in our local assessment of the Parties' supermarket overlaps, this future expansion is accounted for directly in the calculation of the local GUPPIs, reducing the GUPPI figures in certain local areas. Where such timely and likely entry by rivals in a local area reduces the diversion ratio between the Parties to a point where the relevant GUPPI no longer meets the threshold used in our decision rule, the implication is that this entry would be sufficient to countervail an SLC. In our national assessment of the Parties' supermarket overlaps, these pipeline stores are reflected in the national weighted-average GUPPI (which is calculated from the local GUPPIs). Further, the growth of competitors more broadly is reflected in qualitative evidence reviewed, such as the Parties' internal documents.⁴⁴⁶

⁴⁴³ Groceries market investigation (30 April 2008), [Final report](#), paragraphs 7.114-7.122; Also referred to in [Asda/Netto merger inquiry](#) (2010); [Anticipated acquisition by Co-operative Group Limited of Somerfield Limited \(ME/3777/08\)](#) (2008).

⁴⁴⁴ The Parties' entry-exit dataset showed a far higher number of entries by Medium stores as compared to Large stores, see discussion at paragraph 8.173 above; Morrisons referred to significant barriers to entry in grocery retailing in its [Response to the Issues Statement](#), paras 3.63-3.67; M&S also referred to a general reduction in openings by the Big 4 in recent times in its response to our questionnaire; Tesco also referred to the fall in the number of new large stores in recent years in its response to our questionnaire.

⁴⁴⁵ Using a cut-off date of December 2020. The dataset has around 400 pipeline stores.

⁴⁴⁶ For example, the internal document discussed at paragraph 8.44(a) specifically refers to the discounters 'laying down space fast'.

8.365 In our assessment of the Parties' convenience store overlaps, we have taken into account planned new store openings of convenience stores operated by the Parties and the grocery retailers discussed in paragraph 8.363. We have also taken into account planned new store openings of convenience stores of other competitors, to the extent the Parties were aware of them. As with our assessment of the Parties' supermarket overlaps, these stores were included in our analysis as an additional constraint in the relevant local area, and therefore accounted for directly when calculating local GUPPIs. However, we recognise that our analysis may not capture all pipeline convenience store entry of competitors other than those listed above, to the extent the Parties were not aware of them. For this reason, we note that our current approach may overstate the likelihood of the Merger giving rise to an SLC in some local markets. As discussed in paragraph 8.354 above, we take this into account as an area of uncertainty when considering the threshold at which we set our GUPPI decision rule.

8.366 We considered whether there was other evidence of plans to enter or expand in the relevant markets for the retail supply of in-store groceries that we should take into account. Whilst there have been some reports of potential entry or expansion in the relevant markets, we consider that any specific stores which are part of these plans and which would be likely to provide a competitive constraint on the Merged entity have already been taken into account as explained above.⁴⁴⁷ More general plans for entry or expansion would not meet our criteria and therefore would not affect our findings in relation to our national assessment or our local assessment. As set out in paragraphs 8.32 and 8.289, we consider that accounting in our local or national assessments for any further, unspecified and uncertain changes in the groceries market would therefore not be appropriate.

9. In-store groceries: coordinated effects

9.1 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 outcome if they coordinate, or align their behaviour, to limit their rivalry.⁴⁴⁸ Concerns regarding coordinated effects arise when a merger makes coordination more likely to emerge or makes pre-existing coordination more stable or effective.⁴⁴⁹ Coordination can be explicit or tacit. Explicit

⁴⁴⁷ Except for any planned convenience store openings of certain brands, which for the reasons in paragraph 8.365 have not been taken into account.

⁴⁴⁸ [CC2 Revised](#), paragraph 5.5.1.

⁴⁴⁹ More stable or sustainable coordination would be more likely to continue whereas more effective coordination would result in an outcome closer to that a monopolist would achieve.

coordination is achieved through communication and agreement between the parties involved. Tacit coordination is achieved through implicit understanding between the parties, but without any formal arrangements.⁴⁵⁰ We have only considered the scope for tacit coordination in this investigation.

- 9.2 Our focus was on whether the Merger would make it easier for grocery retailers to coordinate or align their behaviour in a way which limits the rivalry between them without entering into any express agreement or direct communication. In concentrated markets where firms recognise their interdependence, repeated interaction between firms can lead them to refrain from competitive behaviours, such as initiating price cuts (as this is likely to provoke a matching price cut from competitors), or to initiate price rises (as competitors may recognise that following the price rise is the most profitable approach) without the need for any active collusion between them. This would result in prices above the counterfactual level, ie where they would be without the aligned behaviour.
- 9.3 The Guidelines set out that the CMA will first analyse the characteristics of the market that could be conducive to coordination. The CMA will then examine whether there is evidence that firms in the market were coordinating pre-merger and if so, whether the merger would make coordination more stable or effective. If there is no evidence of pre-merger coordination, the CMA will examine whether the merger makes it more likely that firms in the market will start to coordinate.⁴⁵¹
- 9.4 The Guidelines set out that all three of the following conditions must be satisfied for coordination to be possible:⁴⁵²
- (a) Firms need to be able to reach and monitor the terms of coordination.
 - (b) Coordination needs to be internally sustainable among the coordinating group, ie firms find it in their individual interests to adhere to the coordinated outcome.
 - (c) Coordination needs to be externally sustainable, in that the coordination is not undermined by competition from outside the coordinating group.
- 9.5 We assessed whether the Merger might be expected to give rise to an SLC in in-store grocery markets through coordinated effects, using the framework set out in the Guidelines. As part of our assessment, we examined the extent to which the conditions set out in the Guidelines are met in the current

⁴⁵⁰ [CC2 Revised](#), paragraph 5.5.3.

⁴⁵¹ [CC2 Revised](#), paragraph 5.5.4.

⁴⁵² [CC2 Revised](#), paragraph 5.5.9.

market, and the extent to which they would be met following the Merger. We conducted our analysis with a form of hypothetical coordination in mind which takes into account the characteristics of the market and considers all the available evidence in the round.

Parties' views

9.6 The Parties consider that no concerns can, on the evidence, arise in relation to coordinated effects in relation to the retail supply of in-store groceries.⁴⁵³

The Parties contend that the UK grocery market is not conducive to coordination and the Merger will not make coordination more likely. The Parties argue this is a result of:

- (a) strong pre-Merger competition and no evidence of coordination;
- (b) at least nine (and post-Merger, eight) significant grocery players with diverse business models and therefore misaligned incentives; and
- (c) competition encompassing the entire 'retail offer', covering a wide variety of products, quality, ranges, price points and other 'customer satisfaction' propositions, making finding a focal point for coordination extremely unlikely.⁴⁵⁴

9.7 The Parties consider that the conditions for coordination are not met in relation to the retail supply of in-store groceries, even in relation to coordination on price between the 'Big 4' retailers. They submitted that it would not be feasible to reach alignment on the terms of coordination, nor would such coordination be either internally or externally sustainable given the complexity of competitive parameters, very significant differences in position and incentives of the so-called 'Big 4' retailers, and the key disruptive constraints posed by other grocery retailers.

Third parties' views

9.8 Some competitors noted that the Merger would increase the likelihood of and opportunity for coordinated effects in relation to the retail supply of in-store groceries. According to these third parties, the Merger will leave two very large grocery retailers at the national level (the Merged entity and Tesco), which will face very limited competition. Morrisons noted that there is a

⁴⁵³ [Parties' response to the Provisional Findings](#), Executive Summary, paragraph 4.

⁴⁵⁴ [Parties' response to the Issues Statement](#), paragraphs 217–230.

significant amount of transparency and competitor monitoring in the market.⁴⁵⁵

- 9.9 Morrisons said that the Merger will result in the creation of an effective duopoly formed by Tesco and the Merged entity and as a result prices may increase between these two companies. Morrisons mentioned that it would be possible for Tesco and the Merged entity to compete less fiercely and sustain this position, as they will be controlling the majority of the market.⁴⁵⁶ Waitrose was also of the view that if the Merger were to go ahead, the likelihood of coordination would increase. Waitrose submitted that the market would focus not only on price, but also on the range that the Merged entity and Tesco would offer, resulting in increased prices over time.⁴⁵⁷
- 9.10 Lidl considered that if the 'Big 4' were to raise prices, sales would not be diverted to their business, as the 'Big 4' would increase prices in those ranges where they do not compete with discounters such as Lidl.⁴⁵⁸
- 9.11 Two suppliers considered that a merger between the second and third largest grocery retailers would be likely to lead to coordinated effects.⁴⁵⁹ [One supplier] submitted that the UK retail grocery market was already concentrated and transparent and the increased market consolidation would make it even easier for grocery retailers to coordinate their behaviour without the need for express agreement. This supplier pointed to the fact that three out of the 'Big 4' supermarket retailers had dropped their low price guarantees to customers in the last year and submitted that this showed that the market was already characterised by conditions that facilitate collusive behaviour. It was submitted that post-Merger competitor monitoring and anticipation of competitor responses would be facilitated.

Our assessment

Possible forms of coordination

- 9.12 It is appropriate to conduct our assessment of the potential for coordinated effects with a specific hypothetical form of coordination in mind. Based on our assessment of the characteristics of in-store groceries and the evidence set out below in paragraphs 9.14 to 9.60, we considered that were tacit coordination (ie alignment without any explicit agreement among the

⁴⁵⁵ [Morrisons response to the Issues Statement](#), paragraph 1.5(c).

⁴⁵⁶ [Summary of hearing with Morrisons](#) (9 November 2018), paragraph 39.

⁴⁵⁷ [Summary of hearing with Waitrose](#) (7 November 2018), paragraph 9.

⁴⁵⁸ [Summary of hearing with Lidl](#) (7 November 2018), paragraph 8.

⁴⁵⁹ [redacted].

coordinating group) to occur pre-Merger, it would most likely have the following characteristics:

- (a) Pre-Merger the coordinating group would include Asda, Morrisons, Sainsbury's and Tesco. These are the four largest grocery retailers and they are sufficiently similar such that we consider they would recognise their mutual interdependence and would likely have a shared incentive to price above the counterfactual level.
- (b) Price would be the most likely focus of coordination and would cover either all products or a subset of products not sold by Aldi and Lidl. We considered price to be the most likely focus of coordination due to the greater transparency around price. As price is set nationally, we considered the most likely form of coordination would also be national.
- (c) The terms of coordination would be most likely to emerge over time through repeated interaction in the market. One or more members of the hypothetical coordinating group would either refrain from initiating price cuts or they would initiate price increases in anticipation of the other members doing the same. The responses of the other members would influence the reactions of each of the other group members so that members of the coordinating group come to the view that it is more profitable to forgo short-term market share gains in anticipation of greater profits from longer term more elevated market prices. Thereby the scope of the coordination would be defined. This mechanism would result in a price above the counterfactual level.

Pre-existing coordination

- 9.13 While pre-existing coordination is not required for a merger to lead to coordinated effects, in general, a merger in a market already showing coordinated outcomes would be likely to make coordination more sustainable or more effective, unless the structure and scale of the merged firm is so different from those of its predecessors that the incentive to coordinate has been removed.⁴⁶⁰

Parties' views

- 9.14 The Parties submitted that the evidence in this case demonstrates clearly that the markets for in-store groceries are not subject to coordination. The Parties considered that the CMA's pricing data analysis showed that there

⁴⁶⁰ [CC2 Revised](#), paragraph 5.5.8.

was no pre-existing coordination and that this was also consistent with the Parties' and third parties' internal documents.

Our assessment

- 9.15 To assess whether there was evidence of pre-existing coordination, we considered:
- (a) past mergers and market investigations;
 - (b) findings of past competition investigations;
 - (c) internal documents;
 - (d) pricing analysis;
 - (e) analyst reports; and
 - (f) past observed outcomes.

Past mergers and market investigations

- 9.16 Concerns have been raised in previous inquiries in the groceries sector about the potential for coordinated effects. In 2003, the CC found that the acquisition of Safeway by Asda, Sainsbury's or Tesco might be expected over time to lead to coordinated behaviour.⁴⁶¹ The Groceries market investigation concluded that the conditions necessary for tacit coordination to arise and be sustainable may be present in the groceries market.⁴⁶² However, neither found evidence of pre-existing coordination.

Findings of past competition investigations

- 9.17 We note that past proven or suspected cartel actions in the market(s) for the retail supply of in-store groceries may indicate that the conditions for coordination were met in that market, although this inference cannot automatically be drawn.⁴⁶³ Any such evidence must be assessed alongside the current market characteristics. There have been two Competition Act cases in this sector which both involved behaviour in the early 2000s.⁴⁶⁴

⁴⁶¹ Safeway merger inquiry (18 August 2003), [Final report](#).

⁴⁶² Groceries market investigation (30 April 2008), [Final report](#).

⁴⁶³ [CC2 Revised](#), paragraph 5.5.7.

⁴⁶⁴ In 2010, the OFT found that two tobacco manufacturers and ten retailers, including Asda and Sainsbury's, engaged in unlawful practices in relation to retail prices for tobacco products between 2000 and 2003. A number of parties, including Asda, challenged the decision and it was overturned on appeal (see [Imperial Tobacco Group](#)

9.18 We did not place weight on these cases because of the following factors:

- (a) the behaviour concerned occurred many years ago (most recently 2002/03);
- (b) the cases concerned actual exchanges of information between grocery retailers and suppliers rather than the form of tacit coordination which we consider to be most plausible; and
- (c) there were successful appeals covering some of the findings of anti-competitive behaviour in relation to both cases.

Internal documents

9.19 We examined internal documents from the Parties and their competitors for evidence of behaviour that could be consistent, or inconsistent, with coordination.

9.20 In the internal documents we found evidence of the following:

- (a) While the Parties constantly analyse and attempt to anticipate their competitors' behaviour, they often appear to have a high degree of uncertainty around what their competitors will do. For example, the minutes of a Sainsbury's strategy conference state that: '[redacted]'. If there was pre-existing coordination, we would expect the Parties to be able to predict to some extent how their competitors would respond to their initiatives. As such, we considered this evidence to be more consistent with competition than pre-existing coordination.
- (b) Sainsbury's considering the messages it wants to send to the market about pricing. For example, Sainsbury's [redacted] stated that Sainsbury's 'should signal that [redacted]'. We considered that such signalling could be an attempt to influence the pricing decisions of competitors and coordinate on higher prices. However, Sainsbury's submitted that the example given above was targeted at investors rather than competitors and should be read in the context of [redacted]. We took this into account and, on balance, considered this form of communication to be consistent with competition.

[plc and Imperial Tobacco Limited v OFT](#), and related cases [2011] CAT 41); In 2011, the OFT issued an infringement decision finding that four supermarkets (including Asda and Sainsbury's) and five dairy processors had coordinated price increases for certain dairy products through indirect exchange of retail pricing intentions in 2002 and/or 2003. Each of the infringements involved an indirect information exchange whereby the supermarkets exchanged retail pricing intentions with each other via the dairy processors. All of the addressees of the OFT's decision, apart from Tesco, entered into early resolution agreements with the OFT, whereby the OFT granted a reduction in the fine in return for an admission of liability. Tesco appealed the decision and was partially successful (see: [Dairy retail price initiatives](#), (CE/3094-03), OFT, decision dated 26 July 2011).

(c) The Parties carrying out actions designed to (adversely) surprise competitors, for example taking ‘the competition off guard’ or giving ‘competitors a headache’. These actions appear inconsistent with coordination, where we would expect competitors to attempt to make their conduct more predictable. The Parties submitted that these documents were clear examples of pricing conduct in the cyclical dynamic of the grocery market with some retailers doing better than others before the latter recover and reverse the position.

9.21 The internal documents we have reviewed show that the Parties closely monitor and attempt to anticipate their competitors’ behaviour. However, we did not find evidence that the current extent of anticipation was inconsistent with competition. Furthermore, we found evidence of the Parties taking actions designed to hurt competitors that we considered to be inconsistent with pre-existing coordination.

Pricing analysis

9.22 We examined price movements at product level for any movements that may be consistent, or inconsistent, with pre-existing coordination. We consider that evidence of price rises by grocery retailers being consistently followed by other grocery retailers within a short period of time could, in some situations, be consistent with coordination (eg where they are not a result of common cost shocks).

9.23 Our analysis was based on SKU-level [REDACTED], which allowed us to compare prices between pairs of ‘Big 4’ retailers.⁴⁶⁵ The data comprises weekly price information (either including or excluding temporary promotions) across all product categories for the last two years (from 24 October 2016 to 15 October 2018). In the data we reviewed, we found that the members of the hypothetical coordinating group had not consistently changed their prices following price changes made by their competitors.⁴⁶⁶ For example, when [REDACTED] increased its price, [REDACTED] only increased its price within two weeks 7% of the time. We found comparable results for an assessment of higher revenue products,⁴⁶⁷ branded products and for a general analysis of price decreases.⁴⁶⁸ The low rate in the accommodating response to price movements between the ‘Big 4’ was also consistent across the following scenarios: (i) allowing for simultaneous price movements (ie within the same

⁴⁶⁵ [REDACTED].

⁴⁶⁶ [REDACTED].

⁴⁶⁷ [REDACTED].

⁴⁶⁸ For higher revenue products, we found that [REDACTED] increased its price within two weeks 15% of the time. For price decreases, the proportion of responses from [REDACTED] within two weeks was lower.

week); (ii) extending the time window allowed for competitors to adjust their price from two weeks to three or four weeks; (iii) [redacted]; (iv) including temporary promotions; and (v) disregarding price changes smaller than 5%. These do not significantly alter the response rate (see further results in Appendix G).

- 9.24 We also considered that price increases having been reversed within a short period of time in the absence of a response by competitors could be consistent with attempted coordination. As a starting point, we looked for instances where a member of the 'Big 4', increased its price and then reduced it again within six weeks. However, this type of price movement was rare (for example, for [redacted] we only saw this behaviour on 400 occasions over the last two years across over 14,000 products) and is significantly less frequent than instances where a retailer dropped its (non-promotional) price and then increased it again within six weeks (for example, for [redacted] we saw this 900 times for the same time period and products). We therefore did not consider whether these price movements were influenced by competitor behaviour.
- 9.25 Although we consider that the pricing analysis is sufficiently robust to take into account in our assessment of pre-existing coordination, there were certain limitations to our analysis. For example, we did not have cost data on the products meaning we could not identify price increases caused by increased costs. As such, while we consider that the pricing analysis does not support a finding of pre-existing coordination, we have considered it alongside other evidence.

Analyst reports

- 9.26 We examined whether there is evidence of signalling of pricing intentions through statements made publicly or to financial analysts. We considered that such signals may be consistent with coordination: for example, if such signals could be used as a means to reach a common understanding that competitors will compete less intensely.
- 9.27 We found examples of grocery retailers signalling intentions that could be interpreted as dissuading rivals from pro-competitive behaviour, such as reducing prices. For example, following a call with the CEO and CFO of Sainsbury's one analyst reported that 'Sainsbury's (and other retailers') commitment to go toe-to-toe signals to Asda that there is nothing to be gained from starting such a price war'. However, we also found examples where the analysts suggested that the signals point towards increased competition. For example, one analyst reported that they 'believe there are signs that ASDA may be about to fundamentally reposition on price, bringing down sector profits'.

- 9.28 In relation to potential signalling through analysts, the Parties submitted firstly that there was no evidence that the Parties actually engaged analysts specifically to send any pricing signals, the analyst reports were independent and often speculative and should therefore be treated with scepticism; and secondly, that these reports do not play a material role in the Parties' commercial or operational decision making and are predominantly used in the context of investor relations. Finally, the Parties submitted that given the extent of product variation and differentiation between grocery retailers across which a coordinated strategy would have to take place, such vague and high-level speculation would be insufficient to allow retailers to reach a common understanding on the terms of coordination.
- 9.29 We considered that communication through analysts could be used to signal future intentions including intentions that could dissuade rivals from pro-competitive behaviour. However, the examples we found were not consistent with attempting to reach terms of coordination. Furthermore, we considered that these communications with analysts may serve some other legitimate purposes, for example communicating intentions to investors. We did not consider the behaviour we observed to be evidence of pre-existing coordination.

Past observed outcomes

- 9.30 We also analysed relevant market outcomes to assess whether these were consistent, or inconsistent, with pre-existing coordination. In particular, we considered margins, market shares and relative price levels.
- 9.31 Very high margins might be consistent with coordination, if firms are making additional profits as a result of their coordination, whereas very low margins could be inconsistent with (effective) coordination. However, in this case we considered that an assessment of the levels of margins would be of limited value due to the difficulty in assessing the 'competitive' level of margins against which to compare.
- 9.32 Large grocery retailers' margins moving in parallel over a period of time may be consistent with firms coordinating. However, the evidence does not suggest that the margins of different large grocery retailers have consistently moved together over the last few years. For example, Figure 9.1 shows that between 2013/14 and 2014/15 Tesco's margin fell considerably more than Sainsbury's although Tesco's margin may have been affected by the accounting errors and other losses that were revealed during this time

period.⁴⁶⁹ It is therefore difficult to draw any conclusions for the assessment of potential coordination from this data and we did not put much weight on this evidence.

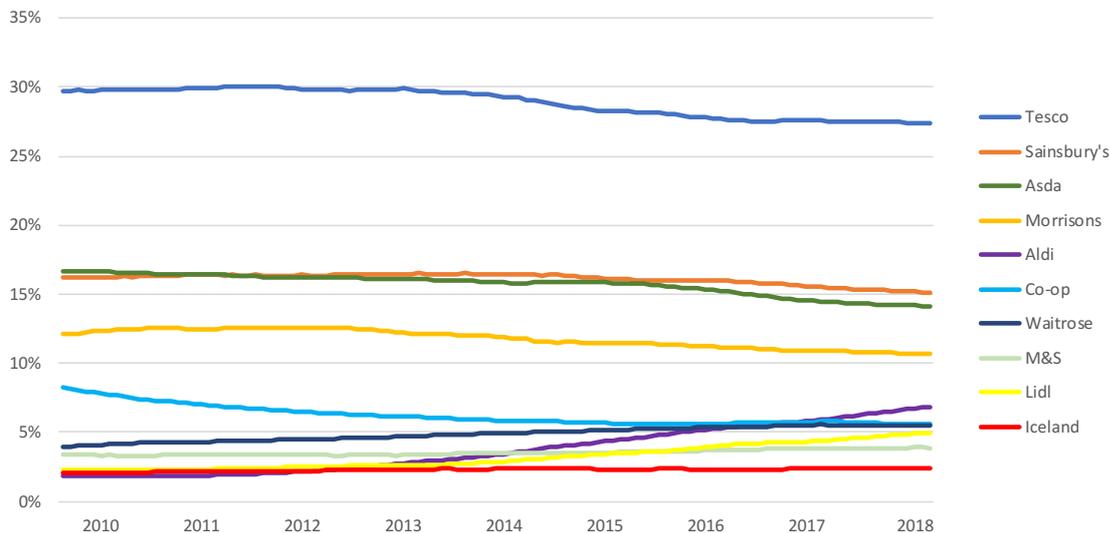
Figure 9.1: Operating Margin/Trading Margin (%) (2008/09 – 2015/16)



Source: Sainsbury's.

9.33 Stable shares of supply over a period of time between grocery retailers may suggest coordination between those firms. As can be seen in Figure 9.2, the shares of supply of the 'Big 4' have been stable over time, particularly relative to each other. The Parties accepted that grocery shares over time 'does not show a large percentage drop in market share over the past five years', but they submitted that percentages alone understate 'stability'. The Parties submitted that small changes in market share in a market of this size give rise to large impacts⁴⁷⁰ and so the changes in market share shown in Figure 9.2 have had a significant impact on the 'stability' of the Parties and their competitors. We took this into account, but we still considered that the level of stability shown in the market shares could be consistent with pre-existing coordination. However, these stable shares of supply may also reflect the outcome of competition between similar competitors each with a mostly fixed set of stores and, we did not put much weight on this as evidence of pre-existing coordination.

Figure 9.2: Total Grocery Shares of Supply 2010 to 2018



Source: The Parties (Kantar).

⁴⁶⁹ The Guardian (22 April 2015), [Tesco results: the five reasons behind Tesco's historic £6.4 billion loss](#).

⁴⁷⁰ The Parties submitted that a 1% drop in market share results (on the basis of Kantar market size data) in a loss of £1.1 billion (equivalent to 1% or 1% of the Parties' total revenues).

9.34 Stable relative price levels over a period of time would be consistent with firms coordinating on price. The evidence from the relative price levels of the 'Big 4' does not appear consistent with pre-existing coordination. As can be seen in Figure 9.3, the relative price levels averaged across their full range of products appear to change frequently including large sustained changes, such as the decline in the price gap between Sainsbury's and Asda in 2014.

Figure 9.3: Price gap to Asda

[✂]

Source: Asda's market volume-weighted pricing gap data (midweek gaps).

9.35 The Parties submitted evidence showing substantial noise in the price gaps between grocery retailers at a product category level. Figure 9.4 below shows the price difference between Sainsbury's and Tesco in each of the main branded product categories.⁴⁷¹

Figure 9.4: Sainsbury's Value Indices for Tesco for branded product categories, March 2015 – January 2018

[✂]

Source: Sainsbury's.
Note: [✂].

Conclusion

9.36 While we found some evidence that could be consistent with pre-existing coordination (significant levels of competitor monitoring and stable shares of supply), this evidence would also be consistent with competition. We have not seen evidence of significant or persistent pricing alignment or stable relative price levels or stable margins between the 'Big 4' for the retail supply of in-store groceries. Overall, we considered the evidence to be more consistent with competition and we therefore find that there is no pre-existing coordination in the markets for in-store groceries.

Conduciveness to coordination

9.37 Notwithstanding our conclusion that there is no evidence of current coordination, we have considered to what extent the characteristics of the markets for the retail supply of in-store groceries are conducive to the hypothetical form of coordination set out in paragraph 9.12. This section considers the pre-Merger situation, with the change resulting from the Merger

⁴⁷¹ Although as noted in paragraph 9.55, different grocery retailers estimate these price indices differently.

considered in the following section. The evidence from the previous section on pre-existing coordination is also relevant to this section.

Condition 1: Ability to reach and monitor the terms of coordination

9.38 For coordination to emerge, the coordinating grocery retailers need to be able to reach a common view on the scope of such coordination. This does not need to involve a precise outcome, but needs to be sufficiently clear to enable their behaviour to be aligned. To sustain coordination, they will also need to be able to observe each other's behaviour sufficiently to ensure that deviation from the coordinated outcome can be detected. If deviation goes undetected then there will be no incentive to sustain a non-competitive outcome.

Parties' views

9.39 The Parties submitted that even when looking at the possibility of coordination amongst just the 'Big 4', the market conditions for reaching alignment on coordinated terms are not present. The Parties submitted that given the underlying changes in the UK groceries market, the essential feature of stability required for coordination was not present. Further, there were key differences between the 'Big 4' which meant that the structural symmetry necessary to reach alignment was absent. The Parties submitted that coordination over price alone would not be possible given the differentiated nature of the market and fact that retailers compete over other parameters of competition (QRS). Finally, there was a lack of transparency over pricing making it difficult to reach any common understanding either over pricing generally or a sub-group of prices or products.

Our assessment

9.40 We considered several factors which could affect the ability of grocery retailers to reach and monitor terms of coordination: (i) stability of market conditions; (ii) symmetry between the coordinating retailers; (iii) the number of firms; (iv) transparency over parameters of competition; and (v) complexity and interactions between grocery retailers. We assessed these factors with the hypothetical form of coordination outlined in paragraph 9.12 above in mind.

- *Stability of market conditions*

9.41 Where market conditions are relatively stable it is generally easier to coordinate behaviour. Continually changing market conditions would

potentially disrupt any common understanding and make it harder for firms to maintain coordination over time.

9.42 We found that shares of supply are relatively stable between the 'Big 4', although the shares of Aldi and Lidl have gradually grown since at least 2010 (see Figure 9.2 above). The Parties did not agree that their market position (or that of the other 'Big 4' retailers) is stable. They submitted that the changes in market share shown in Figure 9.2 have had a significant impact on the stability of the Parties and their competitors.

9.43 We also note that only limited numbers of new Large or Medium stores have been opened by the 'Big 4' in recent years although many Medium stores have been opened by Aldi and Lidl. Demand is relatively stable for the retail supply of in-store groceries although we noted that, as the Parties highlighted, there have been changes in consumer shopping habits such as decreasing basket sizes and own-brand switching. Finally, we have not seen evidence of significant disruption from innovation (which is not to say there is not ongoing innovation).

- *Symmetry*

9.44 The more similar the grocery retailers in the hypothetical coordinating group, the more likely they are to be able to arrive at a common perception of what the terms of coordination should be. However, it may be possible to account for differences between members of the coordinating group in any terms of coordination, for example price coordination does not need to be on the same price level, but could involve maintaining a relative price level with lower cost grocery retailers setting a lower price and higher cost grocery retailers setting a higher price.

9.45 Each of the 'Big 4' operates a national chain of Large and Medium grocery stores and has a long-term commitment to the grocery sector. Whilst there are some differences in their strategies and models, for example Tesco and Sainsbury's are active in the convenience sector whilst Asda and Morrisons are not, in general their customer propositions are somewhat similar. As the Parties highlighted, there are also some structural differences such as the extent of vertical integration of Tesco/Booker (retail, wholesale and international operations) or Morrisons (retail, wholesale and upstream production), Sainsbury's ownership and operation of Argos and Sainsbury's Bank, materially different balance sheet propositions (eg different mixes of freehold vs leasehold properties) and the fact that Tesco now has a separate discounter brand (Jack's). The Parties considered that these differences would each impact on the operational approach and incentives of the grocery retailers. However, we did not consider that these differences would

necessarily affect their incentives to coordinate in relation to their Large and Medium stores operations.

9.46 The hypothetical coordinating group differ in size. Tesco accounts for approximately 27% of total grocery sales with Sainsbury's, Asda and Morrisons each some way behind accounting for approximately 15%, 14% and 10% respectively (see paragraph 4.27). We considered that this market structure means that at present Tesco faces three other members of the hypothetical coordinating group that are all of a similar size and as a result there are multiple relationships of similar importance.

- *Number of firms*

9.47 The lower the number of firms which are coordinating, the easier it will be to reach a tacit understanding.⁴⁷² As a starting point, it will generally be easier for a firm to monitor what its rivals are doing when there are fewer of them and it will therefore be easier to interpret market interactions and reach the terms of coordination between a smaller group of retailers.⁴⁷³

9.48 We considered that the most plausible hypothetical coordinating group in the markets for in-store groceries would consist of four members. This means there would be four sets of incentives that would need to be aligned within any common understanding forming the basis of coordination.

9.49 Potential coordination would be more likely where the hypothetical coordinating group is smaller as it would involve aligning fewer sets of behaviour based on a smaller number of relationships between the members. This could increase the likelihood of any common understanding emerging given the greater likelihood that incentives would be aligned and the smaller number of interactions that may be required to effectively coordinate behaviour. This number of relationships and interactions required are important because participants would need to anticipate and react to the others' responses in the market in order to reach alignment without any direct discussion between the members of the hypothetical coordinating group.

- *Transparency*

9.50 Being able to observe the actions of competitors helps grocery retailers develop mutual awareness that may then help them reach a common

⁴⁷² [CC2 Revised](#), paragraph 5.5.11.

⁴⁷³ [CC2 Revised](#), paragraph 5.5.13.

understanding. The more transparent the market is the easier it will be to monitor any terms of coordination.

- 9.51 We have found that grocery retailers closely monitor other grocery retailers' prices and there is a considerable degree of transparency for prices of individual products. Although it can be complex, grocery retailers are able to match even differentiated products with the equivalent from their competitors' range. However, not all products are matched: as can be seen in Table 9.1, [REDACTED]. In the Parties' internal documents there are also examples of the difficulty of matching products across grocery retailers. For example, [REDACTED]. [REDACTED].

Table 9.1: [REDACTED]

[REDACTED]

Source: [REDACTED]

- *Complexity*

- 9.52 Reaching and monitoring terms of coordination will be harder where the market comprises a larger number of differentiated products.
- 9.53 The overall offer of the grocery retailers covers many products and the multiple parameters of competition, ie PQRS. For example, Sainsbury's master assortment includes approximately [30,000 to 40,000] unique products and in-store service consists of multiple factors, including car park, toilets, colleague performance, availability and technologies, such as self-service checkouts and 'scan as you shop' technologies.
- 9.54 We found that pricing is further complicated by the need for alignment of price changes within the coordinating group to also fit with grocery retailers' other considerations when setting prices. We found the following elements of grocery retailers' pricing that would complicate aligning prices with other members of the hypothetical coordinating group:
- (a) Interdependencies of pricing between products, for example between tiers of own brand, between own brand and branded, between substitute and complementary products.
 - (b) Frequent use of promotions.
 - (c) Grocery retailers' wider priorities for their pricing beyond responding to competition. For example, Sainsbury's 'want to achieve prices that are fair, logical and genuine'. Priorities such as reducing the number of price changes would be likely to conflict with following the price changes of other grocery retailers.

9.55 We found that coordination on the overall price level of all products would be complicated by the need to weight individual prices according to level of sales to reach a view on the overall price level. Different weightings can result in different understandings of price levels and importantly different perceived price movements. The resulting differences in understandings of relative price levels can be seen in Figure 9.5 which plots both Parties' view of the price gap between Sainsbury's and Asda. While the Parties' perceptions of the price gaps are generally correlated, there are periods where they are moving in opposite directions.

Figure 9.5: The Parties' perceived price gaps

[✂]

Source: The Parties.

9.56 Grocery retailers recognise this problem and can use alternative weights, as can be seen in Figure 9.6 below. While these could be used to reach more similar views on overall price movements, problems would remain due to imperfect information on competitors' sales and limited matching.

Figure 9.6: Sainsbury's calculating price index using different weightings

[✂]

Source: Sainsbury's.

9.57 The Parties submitted that Figure 9.6 is not representative of how Sainsbury's conducts price monitoring [✂]. Further, they submitted that Figure 9.6 [✂] thereby showing that it would not be feasible to monitor the terms of any coordination in this way.

9.58 Coordination on any subset of products would also be affected by the challenge of accounting for the relative importance of different products, ie reaching a common understanding of the appropriate weight to use. There would also be the additional complexity of having to reach the common understanding of what is included in the subset. This is a particular challenge where the subset is not readily defined, for example reaching a common understanding of which products are branded would be easier than reaching a common understanding of which products do not have a close substitute stocked by Aldi and Lidl.⁴⁷⁴ A subset of 'known value items' would be easier

⁴⁷⁴ To coordinate on products without a close substitute stocked by Aldi and Lidl, each member of the hypothetical coordinating group would need to monitor the range of Aldi and Lidl (which would not be required if coordination was on branded items) and judge for each of their own products whether any of the products stocked by Aldi and Lidl were sufficiently close substitutes (which would be a more difficult judgement to align than whether a product is branded).

to identify (eg milk, bananas, bread), but there are still extensive interdependencies with multiple types and sizes of each product.

9.59 In summary, we found that there would be significant challenges for the hypothetical coordinating group to reach a common understanding, in spite of the high levels of transparency and sophistication in the market, in relation to each of the different potential focal points for coordination for the following reasons:

- (a) Coordination over individual products and smaller subsets is challenging due to: the volatility of pricing, including from promotions,⁴⁷⁵ interdependencies with other products that differ between grocery retailers; and the need to choose which products are in scope of coordination.
- (b) Coordination on the overall price level of groceries and larger subsets is challenging in terms of the appropriate weights and the risk of divergent understandings in relation to different underlying data on sales.

Interactions between grocery retailers

9.60 Opportunities for members of a hypothetical coordinating group to interact with each other may help that group reach a common understanding of the terms of coordination.

9.61 We examined the following opportunities to interact:

- (a) Communications through suppliers – previous investigations in this sector have found that suppliers have played a role in facilitating anti-competitive behaviour (see paragraph 9.17). However, we have not seen evidence of this type of communication and it is not relevant for the form of coordination we considered most plausible in this case.
- (b) Price leadership – if one supermarket (although which particular one may change over time) makes price changes that are then followed by the others, this price leadership could allow a common understanding to be reached more easily because the understanding could be based on repeated interaction in the market and following the price leader to a supracompetitive price level. While our pricing analysis (see paragraphs 9.22 and 9.23), did not find evidence of this, previous

⁴⁷⁵ We observed this volatility in pricing data referred to in paragraph 9.23.

research has found evidence of price leadership in British supermarkets.⁴⁷⁶

- (c) Signalling through price movements (see paragraph 9.24).
- (d) Price matching schemes, such as Sainsbury's Brand Match⁴⁷⁷ and Asda Price Guarantee (APG)⁴⁷⁸ – when in force, may have allowed grocery retailers to signal the scope for limitation of price competition with other grocery retailers, including over which products and with which competitors.⁴⁷⁹ This would help those grocery retailers reach a common understanding about the potential terms for coordination. Although the Parties' schemes are no longer in place, it is possible that grocery retailers would seek to reintroduce them post-Merger.
- (e) Analyst reports/public statements (see paragraphs 9.26 to 9.29).

Conclusion

9.62 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 within the hypothetical coordinating group. We consider the main barrier to reaching and monitoring a common understanding to be the complexity of pricing across such a wide range of differentiated products. We do not consider the problem posed by this complexity to be entirely intractable; grocery retailers already deal with a high degree of complexity when pricing unilaterally and further advances in technology will likely increase their ability to do so. However, at present we consider this complexity to be a significant barrier. On balance, based on the factors discussed above, we conclude that it is not likely that grocery retailers would be able to reach and monitor terms of coordination over the pricing of in-store groceries at present.

⁴⁷⁶ Seaton and Waterson (2013), *Identifying and characterising price leadership in British supermarkets*.

⁴⁷⁷ Sainsbury's historically operated a brand match scheme between October 2011 and April 2016. At launch a customer's total basket cost of branded items was matched to that of the same basket cost of Tesco and Asda. On 2 October 2014, Sainsbury's removed Tesco from the match and only matched the branded basket cost with Asda. In April 2016, Sainsbury's terminated its Brand Match scheme.

⁴⁷⁸ The APG was available until 3 October 2018. This compared purchases from Asda to Morrisons, Sainsbury's, Tesco and Waitrose. If a customer's grocery basket of comparable items as a whole was not 10% cheaper than the referenced retailer, Asda would refund the difference between the Asda basket and the compared basket through the provision of vouchers for use at a subsequent visit up to 28 days from the comparison.

⁴⁷⁹ Tesco operated the 'Tesco Price Promise' from 2012 which was relaunched as the 'Tesco Brand Guarantee' in 2015. This scheme was withdrawn in June 2018. Morrisons offered a similar scheme called 'Morrisons More' from October 2014 until October 2015. Waitrose offers a price match scheme against Tesco which was launched in October 2012. Ocado offers a 'Low Price Promise' where vouchers are provided if Tesco prices on certain products are cheaper.

Conditions 2 and 3: internal and external sustainability

9.63 Given that all three of the conditions must be satisfied for us to conclude that tacit coordination would be more likely than not,⁴⁸⁰ we considered whether the Merger would have a sufficient impact on this first condition, such that it would be satisfied post-Merger, before considering whether any hypothetical coordination would be internally or externally sustainable. As set out below, as we find that the Merger would not have a sufficient impact to make the first condition likely to be met following the Merger we do not need to conclude on the internal or external sustainability of coordination in the markets for in-store groceries.

Evidence on merger effect

9.64 We have set out below our assessment of whether the Merger would have a sufficient impact on the ability to reach and monitor the terms of coordination such that it would be likely to be satisfied post-Merger.

Impact on the ability to reach and monitor coordination

Parties' views

9.65 The Parties considered that none of the conditions for coordination were currently present on the market. Further they submitted that in light of the nature of competition on the UK groceries market and the evidence before the CMA, it is clear that the Merger will not have a sufficient impact on the three conditions for coordination such that they become satisfied.

Our assessment

9.66 We considered whether the first condition of coordination, the ability to reach and monitor coordination, would be satisfied following the Merger. We examined whether the Merger would strengthen the ability to reach and monitor coordination as a result of:

- (a) there being fewer members of the hypothetical coordinating group – four instead of three; and
- (b) the Merger creating two large entities with similar shares of supply – after the Merger the combined entity would be a similar size to Tesco, with a

⁴⁸⁰ [CC2 Revised](#), paragraph 5.5.9.

share of supply of groceries of 29% compared to Tesco's 27% share (see paragraph 4.27 and Figure 4.3).

- 9.67 As a result of the Merger, the number of grocery retailers in the hypothetical coordinating group would be reduced from four to three. The Parties submitted that their dual brand strategy post-Merger would not make alignment between the Parties and Tesco/Morrisons easier as there would continue to be two separate price files and brand strategies and therefore similar levels of complexity around the competitor response. We considered that whilst the brands may maintain separate pricing in future, these pricing files would be controlled by the same firm (and competitors would be aware of this) and therefore pricing could be more easily aligned post-Merger compared to currently.
- 9.68 Post-Merger, the Merged entity and Tesco would be of similar size in the retail supply of in-store groceries. Although Morrisons would now be an outlier in terms of size, we consider that the symmetry between the Merged entity and Tesco would make reaching a common understanding between those firms easier. Any understanding that emerges between these two firms could then form the basis of a wider understanding including Morrisons. We consider this to be a difference to the pre-Merger situation where Tesco's three largest competitors are all of a similar size and as a result there are multiple relationships of similar importance.
- 9.69 Fewer members of the hypothetical coordinating group would make reaching and monitoring an understanding within that group easier as there are fewer parties that need to share the understanding. Further, the Merger would mean one less set of incentives and one less approach to pricing to consider. However, we consider that the complexity over reaching a common view of the scope of coordination, as set out in paragraphs 9.53 to 9.59 above, would still apply to a coordinating group of three grocery retailers. It would still be difficult for the Merged entity, Tesco and Morrisons to reach an understanding of the products or prices over which to coordinate and navigate the complexity over weighting and pricing rules for monitoring purposes. Whilst interaction between three as opposed to four players would make this easier, we do not consider, on balance and in view of the sheer number of products and prices in these markets, that it would reduce the complexity to an extent that would make reaching and monitoring the terms of coordination more likely than not.
- 9.70 Based on the reasoning set out above, although we considered that, post-Merger it would be easier for the hypothetical coordinating group to potentially reach and monitor terms of coordination, overall, we did not

consider that the Merger would have a sufficient impact to make this condition likely to be met following the Merger.

Internal and external sustainability

9.71 As we considered that the Merger would not have a sufficient impact on the ability of a hypothetical coordinating group to reach and monitor the terms of coordination, we do not need to conclude as to the internal and external sustainability of any potential coordination in these markets either pre- or post-Merger.

Conclusion

9.72 As set out in paragraphs 9.66 to 9.70, we found that the Merger was likely to increase the ability to reach and monitor a common understanding to a certain extent. However, we did not consider that the Merger would make it more likely than not that the coordinating firms would be able to reach and monitor terms of coordination in relation to the retail supply of in-store groceries. We therefore did not need to assess the other conditions for coordination. As a result, we conclude that the Merger is not likely, on a balance of probabilities, to result in an SLC on the basis of coordinated effects in any of the markets for in-store groceries.

10. Online delivered groceries: overview

10.1 According to IGD, sales of online groceries were worth around £11.4 billion in 2018 and represent around 6% of UK groceries sales. It is forecast to be the fastest growing grocery channel and is forecast to grow annually by 9% to £17.3 billion by 2023.⁴⁸¹

10.2 There are two main models used for online delivered groceries:

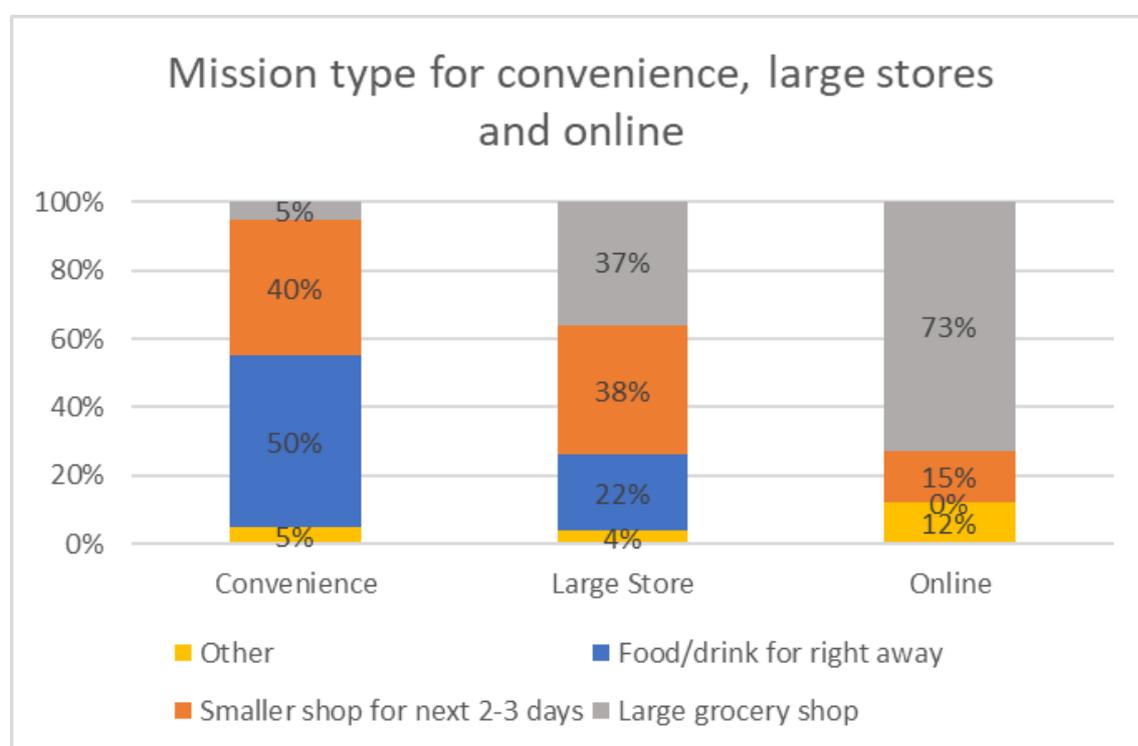
- (a) Store-pick: the retailer's employees walk around the supermarket to 'pick' the orders, and then a driver delivers the groceries to customers.
- (b) CFCs: groceries are picked in a specialised centre which only supports online sales. These centres typically service a larger geographic area than individual local stores. This is the method used by online-only grocery retailers such as Ocado, but other retailers also use CFCs in combination with store-pick.

⁴⁸¹ IGD (5 June 2018), *UK food and grocery market to grow 14.8% by £28.2 billion by 2023*. However, as noted in footnote 59 above there is some indication that this growth may be slower than historically.

Market definition

- 10.3 When assessing the relevant product market for online delivered groceries,⁴⁸² we recognised that consumers shopping for groceries may use a mixture of different shopping missions at different times. For example, they may receive large online grocery deliveries and shop at a local convenience store for perishable items. The fact that consumers engage in different types of grocery shopping missions, however, does not necessarily imply that they are substitutes for the purposes of market definition.
- 10.4 Figure 10.1 below, from a Tesco internal document, shows that 73% of online shopping missions at Tesco were a 'Large grocery shop' and only small proportions are for 'Food/drink for right away' and a 'Smaller shop for next two to three days'.

Figure 10.1: Online shopping missions



Source: CMA based on Tesco internal document.

- 10.5 With this in mind, in the assessment below we focussed on understanding the reasons why consumers shopped online for groceries and what the close substitutes were for those online shopping missions. We first consider the appropriate product market and then the appropriate geographic market.

⁴⁸² We use the term online delivered groceries to refer to groceries which are delivered to the customer's location following an order placed online. Click and Collect is dealt with in our in-store analysis (see paragraph 7.6).

Product market

10.6 Both Sainsbury's and Asda offer online delivered groceries across large parts of the UK.⁴⁸³ The question of whether there is a separate market for online delivered groceries has not been considered in detail by the CMA (or its predecessors) in previous cases and to identify the relevant product market containing online delivered groceries we considered multiple evidence sources.⁴⁸⁴ In this section we first consider demand-side substitution and then supply-side substitution. We then present our conclusions on the relevant product market.

Demand-side substitution

Parties' views

10.7 The Parties told us that online delivered groceries should not be considered a separate market from in-store groceries. They provided multiple pieces of evidence to support their view:

- (a) Kantar online switching data showed that for Asda's sales (including Click and Collect) [70–80%] of switching losses were to in-store options. For Sainsbury's the same metric was [70–80%].
- (b) The Parties submitted online lapsed customer surveys conducted by ABA as part of the Parties' regular course of business. These looked at lapsed online customers: one for customers who were no longer shopping at Asda online (this survey was carried out in August 2016) and one for customers who were no longer shopping at Sainsbury's online (this survey was part of a series of surveys conducted each year for Sainsbury's since 2015). We refer to these surveys as the Lapsed customer surveys. In these surveys, lapsed customers were asked where they were subsequently shopping. [50–60%] of Asda online customers who lapsed or reduced their spend at Asda online said that they did so because they were shopping more in-store and [30–40%] said they were using another online retailer. [60–70%] of Sainsbury's online customers who lapsed or reduced their online spend with Sainsbury's said they were spending more in-store and [30–40%] said they were using another online retailer.

⁴⁸³ In addition to their standard online delivered grocery services, Sainsbury's offers a service called 'Chop Chop', where groceries can be delivered within 60 minutes. Asda does not currently offer this type of service [X]. Therefore, we have not considered this segment further (see [Sainsbury's Chop Chop website](#)).

⁴⁸⁴ In the [Co-op/Nisa merger inquiry](#) (2018), paragraph 125(b), the CMA noted: 'it is not clear how strong a constraint online shopping provides for individual stores, particularly for convenience'.

- (c) The Parties submitted that the CMA should place weight on the key fact that price and quality were common across both online and in-store and the category mix showed relatively similar proportions. For example, sales of multipack beer were split between the online and in-store channels in proportion to the overall channel split.⁴⁸⁵ There was also no distinct 'online only' product offering.
- (d) According to Kantar Worldpanel, 99.4% of online shoppers also bought groceries in store.
- (e) There were also internal documents which showed the constraint from in-store on online delivered groceries, which the Parties submitted the CMA had failed to take into account.⁴⁸⁶
- (f) The Parties submitted additional evidence derived from the Asda and Sainsbury's online customer databases, based on: (i) a customer's entire expenditure switching from one database to another, or (ii) a proportion of this expenditure switching (reduced spend). This analysis showed that [X]% of Sainsbury's online customers switched to Asda online and [X]% of Asda online customers switched to Sainsbury's online. The Parties told us that this evidence showed that their online delivered grocery websites did not strongly compete for the same customers. The Parties also submitted two analyses of customers in Northern Ireland. The analyses showed that, when Sainsbury's delivery prices increased by an average of [X], [X]% to [X]% of Sainsbury's lapsed online customers diverted to Asda online. The Parties undertook additional sensitivity analysis to assess whether the transaction analysis results changed when they considered frequent customers and looked at a shorter period. These sensitivities did not have any material impact on the results.⁴⁸⁷ The Parties also told us that the CMA's concerns about distinguishing between complements and substitutes in these analyses were not clear to the Parties.⁴⁸⁸

10.8 The Parties submitted that the CMA online survey underestimated the importance of the constraint exercised by in-store options for four main reasons:

- (a) First, it was not representative because it was based on customers who ordered within a specific week and included a much higher proportion of

⁴⁸⁵ Parties' response to the Provisional Findings, paragraphs 523 and 525.

⁴⁸⁶ Parties' response to the Provisional Findings, footnote 281 and paragraphs 520 and 521.

⁴⁸⁷ Parties' response to the Provisional Findings, Schedule 6.2, paragraph 3.

⁴⁸⁸ Parties' response to the Provisional Findings, Schedule 6.2, paragraph 2.

heavy online shoppers than would be expected from the Parties' ordinary course of trading.⁴⁸⁹

- (b) Second, the diversion question was ambiguously worded, and it could not be assumed that the proportion of customers diverting in response to price changes would be the same as the forced diversions.⁴⁹⁰
- (c) Third, since the survey was carried out online there could be a framing bias towards online diversion.⁴⁹¹
- (d) Fourth, there was a non-response bias as the survey was carried out online.

10.9 The Parties submitted a report by Professor Sturgis which stated:

‘the CMA online survey is likely to contain a range of random and systematic errors as a result of risk factors arising from the way the survey was designed, implemented, and analysed’ and that, as a result, ‘there is a high risk that key estimates from the CMA online survey cannot be taken as an accurate guide to customer behaviour in the event of a merger between the Parties’.

10.10 Professor Sturgis expressed concerns regarding non-response bias, sampling size and variability, response quality, the rate of ‘don’t knows’ and ambiguity in the price rise question. However, he did not consider there to be a notable risk of framing bias and he also noted positive aspects of the CMA online survey, including that there was no evidence to suggest that the profile of orders during the sample week was different from other weeks, the survey was carried out to a high professional standard and the national estimates were precisely estimated.

10.11 The Parties submitted that the CMA online survey evidence was inconsistent with other evidence sources, including Kantar data, the ABA survey, the Parties' analysis based on Asda and Sainsbury's sales data and Nielsen data. Reweighting the CMA's diversions using the Kantar and Nielsen data produced diversions to in-store of 36% to 41%.⁴⁹²

10.12 The Parties submitted that the CMA had dismissed the evidence of third party online providers (Ocado and Amazon) that they compete in an overall market for groceries, comprising both online and in-store. Furthermore, the Parties

⁴⁸⁹ Parties' response to the Provisional Findings, paragraph 528.

⁴⁹⁰ Parties' response to the Provisional Findings, paragraphs 529.

⁴⁹¹ Parties' response to the Provisional Findings, paragraph 528.

⁴⁹² Parties' response to the Provisional Findings, paragraph 530.

considered that to describe third party views as mixed was an overstatement.⁴⁹³

- 10.13 The Parties considered that the CMA had failed to validate a submission by Morrisons and had used Morrisons data on net switching inappropriately. The CMA's preferred measure, switching losses, showed only 22% of Morrisons losses went to other online competitors.⁴⁹⁴

Third parties' views

- 10.14 Third parties had different views on the constraint exerted by in-store on online delivered groceries. For example:
- (a) Amazon told us that there was a single grocery market segment that encompassed both online and offline and consumers were increasingly switching between the online and the in-store channels on a shop-by-shop basis. Amazon told us that, when it set its online offer, it also considered both online and in-store competitors.⁴⁹⁵
 - (b) Morrisons told us that customers that shop online often had a different shopping mission than customers that shop in-store. In particular, online customers valued the convenience that the online channel brought them. Morrisons therefore considered it unlikely that customers would switch from online shopping to in store grocery shopping in response to small changes in price or quality. Kantar Worldpanel data submitted by Morrisons showed that 99.6% of net switching to its online store came from other online competitors.
 - (c) Ocado, an online only retailer, told us that online delivered groceries and bricks and mortar stores competed for the same customers, so their offering tended to be similar in terms of price and range.
 - (d) Tesco told us that the online delivered groceries model services a particular customer base.⁴⁹⁶
 - (e) Co-op, Iceland and Lidl submitted that online delivered groceries constrain in-store groceries and vice versa to some extent.

⁴⁹³ [Parties' response to the Provisional Findings](#), paragraph 518.

⁴⁹⁴ [Parties' response to the Provisional Findings](#), paragraph 519.

⁴⁹⁵ [Summary of hearing with Amazon](#) (5 November 2018), paragraphs 5 and 6.

⁴⁹⁶ [Summary of hearing with Tesco](#) (9 November 2018), paragraph 23.

Our assessment

10.15 We assessed the evidence provided by the CMA online survey. The CMA commissioned GfK to carry out an online survey of Asda and Sainsbury's online delivered groceries customers (the CMA online survey). A total of 31,404 online interviews were completed (20,032 Sainsbury's and 11,372 Asda).⁴⁹⁷ Table 10.1 below shows that the main reasons for shopping online were: saving time; an inability to transport heavy goods; flexibility over when customers could shop; and that it was not easy to get to or around a physical store.

Table 10.1: Main reasons for buying groceries online

Reason	%	
	Asda Spend	Sainsbury's Spend
Saves time	35	42
Cannot transport a bulky shop myself	17	15
Can do my shopping when I like	14	15
Not easy to get to/around a physical store	13	12
Helps with budgeting	9	5
No physical store close to where I live/work/study	4	3
Better prices	2	0
Better special offers	1	1
Better range of branded products online	1	0
Better availability of products online	1	1
Have a voucher for online shopping	0	2

Source: CMA online survey report, 'Thinking about your spending on grocery shopping, what is the one main reason why you choose to buy your groceries online for home delivery rather than doing the shop yourself in a physical store?'

Note: Percentages are spend weighted. Only responses from online delivered groceries customers are included.

10.16 The results suggest that many customers who have ordered online delivered groceries have done so for specific reasons related to the service provided by online delivered groceries. For these shopping missions, in-store would appear to be a poor alternative for customers who cannot transport bulky items and/or do not find it easy to get around a physical store. Furthermore, in-store shopping may take more time and restrict their ability to shop at a convenient time. There is also likely to be a group of customers for whom in-store shopping is not possible at all and who therefore are reliant on online delivered groceries, possibly because they are unable to get to a store.

10.17 Respondents to the CMA online survey were asked about the balance of online and in-store shopping for groceries over the last three months. About three quarters of online delivery spend was by customers who responded that they had bought all, nearly all or most of their groceries online.⁴⁹⁸

⁴⁹⁷ [GfK research report](#) (CMA online survey report). See Appendix B for a detailed discussion of the CMA online survey.

⁴⁹⁸ Survey results from CMA online survey question ([GfK research report](#)).

- 10.18 The CMA online survey showed limited diversion from the Parties' online delivered groceries offering to in-store. The survey included both a question which asks what a customer would have done if prices had increased slightly and a question that asked what a customer would have done had the website/app they used been unavailable. As discussed in Appendix B, in a merger inquiry our focus is typically on marginal customers and therefore we would typically place more weight on the responses to the price increase question, as it is marginal customers who are first to switch if a retailer changes its offering, and who therefore have more impact on a retailer's competitive offering.⁴⁹⁹ However, we have some concerns regarding whether customers understood clearly that the 5% price increase hypothesised in our price diversion question only related to online delivered groceries, and not in-store groceries as well. Having considered this issue in detail, including the submissions made by the Parties and the report by Professor Sturgis, we considered it appropriate to place no weight on the responses to the price increase question.⁵⁰⁰ We consider diversion estimated from responses to the forced diversion question to be the best estimate of in-store constraints provided by our survey.⁵⁰¹ In response to the forced diversion question, [30–40%] of Asda spend and [30–40%] of Sainsbury's spend would have switched to in-store.⁵⁰²
- 10.19 We have considered whether the CMA online survey is biased towards heavy users of online delivered groceries.⁵⁰³
- 10.20 For the reasons explained in Appendix B, we are confident that the CMA online survey week is not biased towards heavy users of online delivered groceries and we note that Professor Sturgis agrees with this assessment.
- 10.21 In response to the Parties' submissions, we also carried out further analysis and reweighted the CMA online survey responses to take account of frequency of shopping and online spend. This analysis showed that any non-response bias resulting from a higher proportion of frequent online users,⁵⁰⁴ when set against bias from under-representing customers who purchase

⁴⁹⁹ Note that if the change in offering relates to quality, range and/or service, rather than price, then the marginal customers may not be the same as those who are marginal if there is a price increase.

⁵⁰⁰ Appendix B contains a more detailed discussion of this issue.

⁵⁰¹ As discussed in Appendix B, while it is difficult to assess whether marginal and inframarginal customers would choose the same next best alternative, we note that the possibility of harm arising in this Merger includes degradation of elements other than price, which may in any event not be well-captured by a price diversion question.

⁵⁰² Survey results from CMA online survey question ([GfK research report](#)).

⁵⁰³ [Parties' response to the Provisional Findings](#), paragraphs 29 and 528.

⁵⁰⁴ Non-response bias could result from heavy users being more likely to respond to the survey.

more than once a week⁵⁰⁵ and spend truncation,⁵⁰⁶ had not substantially affected our results.⁵⁰⁷

- 10.22 We also assessed the Parties' submissions which reweighted the survey responses on the basis of the Kantar and Nielsen figures on the proportion of groceries bought online, and found in particular that diversion to in-store options was higher when these adjustments were made. However, the questions used in each of the CMA online survey, Kantar Survey and Nielsen Survey are different and both Kantar and Nielsen panels recruit via non-random sampling, while the CMA online survey uses random probability sampling. We agree with Professor Sturgis that this makes comparisons difficult. We further note that adjusting on the basis of the Kantar data made a small change to the figures, while the Nielsen adjustment resulted in a larger change. In the Parties' submission Nielsen caveats its figures heavily.⁵⁰⁸
- 10.23 We have considered all the evidence below and, contrary to the Parties' views, we have not relied on the CMA online survey to the exclusion of other relevant evidence. We have assessed each piece of evidence below and we have identified strengths and weaknesses in each. We have set out our reasons for placing differing weight on individual pieces of evidence according to these strengths and weaknesses and their relevance for the questions we are seeking to answer.
- 10.24 We agreed with the Parties' evidence on competitive parameters: online delivered groceries and in-store groceries do currently share some competitive parameters, such as the quality of the products and the product prices. However, there are other parameters, such as the website/app functionality, delivery prices, delivery pass prices, delivery slot availability and delivery service levels, which are specific to online delivered groceries. In addition, the convenience of the in-store and online offerings are different; in-store provides the ability to purchase groceries immediately, while online delivered groceries avoids the need to make a specific trip to a store.
- 10.25 The Kantar switching data submitted by the Parties looked at switching during a period of 52 weeks ending 17 June 2018. We considered that, over

⁵⁰⁵ The design of the sample may under-represent very heavy users because those customers who bought online delivered groceries with one of the Parties more than once in the survey reference week will not have this multiple usage reflected in the results.

⁵⁰⁶ The CMA online survey responses were spend-weighted. If the relevant transaction value was more than £300 then the value was set to £300. This approach produces more robust estimates by reducing their sensitivity to individual large value transactions.

⁵⁰⁷ Further detail is provided in paragraphs 62 to 67 of Appendix B.

⁵⁰⁸ Nielsen state: '*Note: This data should only be used directionally. Online data in panel has a higher margin of fluctuation compared to our total read, due to panel's sampling methodology. These margins increase with shorter time periods and narrower market selections (eg Sainsbury's online shoppers vs Total online shoppers). Please use with caution'.

these 52 weeks, some customers were likely to be switching from in-store to online shopping and vice versa for reasons other than changes in the Parties' competitive offerings. For example, they may no longer be available at home for deliveries or they may no longer be able to easily get to a grocery store. The Kantar data does not allow us to understand whether customers switched between online and in-store due to changes in circumstances or preference or in response to changes in the offerings of different grocery retailers. When assessing the potential impact of a merger we are concerned about whether the merger could lead to a lessening of competition through the merging parties degrading their offerings. The CMA online survey is more relevant to this question as it asked current online delivered groceries' customers how they would respond to being forced to choose something other than their current online delivered groceries offering, holding their personal circumstances constant.⁵⁰⁹ However, given that this Kantar data is a large, robust survey, the figures refer to sales value rather than customer numbers and we know that retailers use this data in the course of business, we place some weight on this evidence.

- 10.26 The Parties submitted data from their Lapsed customer surveys (described in paragraph 10.7 above). We had some concerns about the relevance of this information for market definition purposes. By their very nature a proportion of lapsed customers are likely to have already decided to stop having online groceries delivered. Therefore, the responses are less informative for market definition purposes than the CMA online survey, which interviewed current users of Asda and Sainsbury's online delivered groceries services. It is also likely that some of the customer choices revealed in the Lapsed customer surveys may be driven by changes in circumstances, rather than changes in the offerings of online delivered groceries retailers. Furthermore, the Lapsed customer surveys focus on customers, rather than sales. Finally, the Asda survey received a low response rate, around 1%, which raises questions regarding the representativeness of the respondents. Having conducted this initial assessment, we therefore consider that it is appropriate to put no weight on the Asda survey, and very little weight on Sainsbury's survey.
- 10.27 The Parties submitted a full switching analysis based on their customer order databases. The switching analysis examined customers that did not order on the Party's websites during 12 week periods and switching ratios were calculated from the proportion of customers, identified by their email addresses, who placed orders on the other Party's website. The Parties excluded from this analysis⁵¹⁰ those customers who placed orders on both

⁵⁰⁹ Further discussion of this evidence is contained in Appendices B and D.

⁵¹⁰ But included in the partial analysis (see following paragraphs).

the Parties' websites in the preceding 12 week period 'to avoid counting customers having used the two websites as complements'. The Parties also looked at a range of sensitivities to the analysis, including the exclusion of one-off orders and looking at 'seasoned' customers.⁵¹¹

- 10.28 The Parties, having used the possibility of customers using both their websites as complements as a reason for eliminating them from the analysis, do not explain why the rest of the analysis is not similarly affected; why customers using different brands, or a combination of online and in-store shopping from the same or different brands may not be using them as complements.
- 10.29 The Parties' reduced spend analysis (where a switch was identified if a proportion of spend moved from one Merging party to the other) followed a similar approach to their 'full-switching' analysis. This also included customers who had shopped on both Parties' websites in the 12 weeks prior to the reduced spend period. The Parties looked at the same sensitivities as the full switching analysis, but also included different definitions for the reduction in the level of spend relative to the 12 weeks prior.
- 10.30 In our view, for both the full switching analysis and the reduced spend analysis, it is difficult to distinguish complements and substitutes. The Parties' updated analysis suggested instances of reduced spend were not driven by the inclusion of infrequent shoppers, or changes in spend during and after the Christmas and New Year periods. However, we consider that it is not possible to determine whether this reduction in spend is due to changes in the competitive offering or triggered by unrelated factors. It is changes in shopping behaviour due to changes in the Parties' competitive offerings that are material in relation to market definition, and as such we consider that it is appropriate to place very little weight on this evidence.
- 10.31 The Parties submitted an analysis of switching from Sainsbury's to Asda's online offerings in Northern Ireland. This analysis looked at the proportion of Sainsbury's online customers who switched to Asda in response to an average Sainsbury's delivery price increase of [X]. We consider that this price change, which would represent around a [0–5%] change if the total delivered price was £60, is too small to have induced many customers to have switched from Sainsbury's to Asda even if they were close competitors. As such, we consider that it is appropriate to place very little weight on this evidence.

⁵¹¹ Seasoned customers are defined as those customers who made five or more shops during the period covered by the data.

- 10.32 The Parties submitted evidence on the product mix between online and in-store shoppers. The Parties told us that whilst there was some over-indexing in certain categories (for example canned and packaged goods represented a higher proportion of online sales compared to in-stores sales), the extent of over-indexing was relatively small. We agree that the category mix and the Parties' evidence⁵¹² on beer multipacks shows relatively similar proportions across online delivered groceries and in-store. However, the fact that customers buy the same things does not necessarily mean they would switch between channels. As noted in paragraph 10.16, customers may purchase online delivered groceries because they cannot transport bulky items or because they are restricted in their ability to shop at a convenient time. Online customers are paying for this convenience through the delivery charge, as opposed to in-store where such a charge does not exist.
- 10.33 The Kantar Worldpanel data⁵¹³ submitted by the Parties showed that many customers used a mixture of online delivered groceries and in-store options. We note that Kantar Worldpanel switching data submitted by Morrisons showed that 99.6% of net switching to its online store came from other online competitors, although the Parties' submission⁵¹⁴ showed that only 22% of Morrisons online losses went to other online grocery providers. Whilst noting the evidence from Kantar, our view is that we should place more weight on the CMA online survey, rather than evidence based on Kantar Worldpanel data (or any other evidence submitted).⁵¹⁵ Unlike Kantar Worldpanel, the CMA survey was a bespoke survey designed specifically to answer questions relevant to the assessment of this Merger.
- 10.34 Based on an assessment of the evidence in the round, taking account of the strengths and weaknesses of the multiple evidence sources, our finding is that demand-side considerations suggest that the relevant product market is the market for online delivered groceries. Nonetheless, we recognise that the available evidence is mixed, and there is evidence that a meaningful number of customers do or would divert to in-store alternatives. We take this into account when assessing out-of-market constraints.

⁵¹² [Parties' response to the Provisional Findings](#), paragraph 525.

⁵¹³ We discuss Kantar Worldpanel in the context of the proportion of groceries bought online, and in the context of switching data, the latter of which is discussed in more detail in Appendix D.

⁵¹⁴ [Parties' response to the Provisional Findings](#), paragraph 519. Data relates to the 12 week period ending 7 October 2018.

⁵¹⁵ See Appendix D for more discussion of the Kantar data.

Supply-side substitution

Parties' views

10.35 As noted in paragraph 10.2 there are two main models used to deliver groceries which have been ordered online – the ‘store-pick’ model and the CFC model. We use the term Supply Point to refer both to stores which are used for store-pick and to CFCs. The evidence submitted by the Parties showed that the investment required for CFCs was around £[redacted] and the timelines from conception to operation were around [redacted]. The Parties told us that grocery retailers with an existing store estate could readily expand into online delivery services, either through the development of their own online fulfilment capabilities, the adoption of third party systems, or the use of third party delivery service providers such as Deliveroo, Grocemanía and Homerun.

Third parties' views

10.36 Third parties provided evidence on the assets, investment and timelines required for entry into online delivered groceries using an existing store portfolio (more detail is provided in Appendix H). The evidence is mixed and is influenced by the operating model adopted. In general, the evidence suggests that it would be quicker and easier to enter online delivered groceries if the grocery retailer already has an existing store portfolio, although there would still be costs and time incurred adapting stores to act as a Supply Point for online delivered groceries. At the other end of the scale, construction of a CFC would entail substantial time and investment.

Our assessment

10.37 As discussed in paragraphs 8.33 to 8.53, the Parties provided a large number of internal documents to the CMA. The evidence from Asda's internal documents [redacted].

10.38 We also assessed the evidence from Sainsbury's internal documents. [redacted]. The Parties stated that we placed no weight on internal strategy documents which discuss online delivered groceries and in-store groceries side-by-side.⁵¹⁶ We did consider these documents, but given that the Parties operate both in-store and online delivered groceries businesses, the mere fact that these are discussed side-by-side in internal strategy documents is neither surprising nor informative for market definition purposes. We also recognise

⁵¹⁶ [Parties' response to the Provisional Findings](#), paragraphs 520 and 521.

that some of the internal documents refer to competition from in-store and this supports our approach of recognising the constraint from in-store in our competitive assessment.

- 10.39 We note that the conditions for using supply-side substitution to widen the relevant market are relatively strict: ‘Supply-side substitution can be thought of as a special case of entry – entry that occurs quickly (eg less than one year), effectively, (eg on a scale large enough to affect prices), and without the need for substantial sunk investments’.⁵¹⁷
- 10.40 We do not consider that the conditions for supply-side substitution are met by entry through the construction of CFCs. Whilst we recognise that entry into the supply of online delivered groceries would be quicker for grocery retailers with an existing store estate, as they would be able to adopt a store-pick model, this would still require investment in a website, associated technological and logistical infrastructure and the adaptation of stores to enable delivery of groceries to customers’ homes. Therefore, we do not think that the conditions are met to use supply-side substitution to widen the relevant market to include all retailers of in-store groceries.

Conclusion on product market definition

- 10.41 In light of all the evidence discussed above (and the more detailed review in Appendix H) we found that the relevant product market is the market for online delivered groceries. In-store groceries provides some level of constraint (which we take into account in our competitive assessment), but the focus of market definition is on the most important constraints on the Parties’ online offering.
- 10.42 The eight retailers currently operating in this product market (ie selling online delivered groceries) are AmazonFresh,⁵¹⁸ Asda, Iceland, Morrisons, Ocado, Sainsbury’s, Tesco and Waitrose. Chapter 11 discusses these retailers in more detail.

⁵¹⁷ OFT (2014), [Market Definition](#), paragraph 3.15.

⁵¹⁸ We have excluded from the market definitions Amazon’s Pantry and Prime Now services as these do not allow consumers to carry out a full online delivered groceries shop. We have also excluded from the market definition the new online service provided by Co-op, and Aldi (which only sells alcohol online). The new Co-op service is discussed in more detail in Appendix H.

Geographic market

10.43 In this section we consider geographic market definition. We first consider demand-side substitution and then supply-side substitution. We then present our findings.

Demand-side substitution

10.44 In this section we present the evidence we have considered on demand-side substitution, covering Parties' views, third parties' views and our assessment.

Parties' views

10.45 The Parties told us that the online channel is inherently local as online is constrained by the in-store channel, which is fundamentally local. Furthermore, online involves physical delivery of products to a customer's address, and for the Parties it typically involves local supply 'picked' from the range in a relevant local store. Therefore, according to the Parties, the relevant geographic market is not national (or regional) in dimension any more than for in-store sales.

Third parties' views

10.46 No third parties expressed a view on the correct geographic market definition for online delivered groceries.

Our assessment

10.47 On the demand side, customers order groceries for delivery to their home or another fixed location such as a workplace. Therefore, based on the basic purpose of the product, there is unlikely to be any demand-side substitution by customers to retailers that do not deliver to their address. This factor would suggest that the geographic markets are local in character from the point of view of the consumer.

Supply-side substitution

10.48 In this section we present evidence we have considered on supply-side substitution, covering Parties' views, third parties' views and our assessment.

Parties' views

10.49 As discussed above, the Parties told us that grocery retailers with an existing store estate could readily expand into online delivery services using this

estate. The Parties also told us that they did not understand the rationale of looking at share of supply by reference to Supply Points as distinct from the delivery area and that the key question should be the amount of retailers that can deliver to an area.

Third parties' views

- 10.50 No third parties expressed a view of the impact of supply-side substitution on geographic market definition.

Our assessment

- 10.51 In relation to supply-side substitution, the evidence on entry and expansion in online delivered groceries discussed in Appendix H is consistent with the view that supply-side constraints, arising from the ability to move production assets from one part of the UK to another part of the UK, are not strong enough to consider the geographic market as being UK wide.
- 10.52 However, we recognise that there does appear to be some scope for relatively quick entry into the supply of online delivered groceries by retailers who already offer in-store groceries and who have already invested in the infrastructure, including a website, required to offer online delivered groceries. Since supply-side substitution is a form of entry, we have taken account of these constraints in our competitive assessment in the section on entry and expansion in paragraphs 11.110 to 11.134 below.
- 10.53 In addition, we note that the Guidelines state:⁵¹⁹

‘The boundaries of the relevant product market are generally determined by reference to demand-side substitution alone. However, there are circumstances where the Authorities may aggregate several narrow relevant markets into one broader one on the basis of considerations about the response of suppliers to changes in prices. They may do so when:

- production assets can be used by firms to supply a range of different products that are not demand-side substitutes, and the firms have the ability and incentive quickly (generally within a year) to shift capacity between these different products depending on demand for each; and

⁵¹⁹ [CC2 Revised](#), paragraph 5.2.17.

- the same firms compete to supply these different products and the conditions of competition between the firms are the same for each product; in this case aggregating the supply of these products and analysing them as one market does not affect the Authorities’ decision on the competitive effect of the merger’.

10.54 The Supply Point’s production assets that can be used to supply an individual address can also be used to supply other addresses within the Supply Point’s delivery area.⁵²⁰ For example, the van and driver used to supply one street can be used to supply other nearby streets. Therefore, rather than analyse the competitive conditions for groups of households at the level of the Postcode Unit or Output Area,⁵²¹ which may be suggested by demand-side substitution, we consider it appropriate to aggregate those households which are served by the same Supply Point. In this way, we are looking at the delivery area of the Supply Point, which we consider is consistent with the approach suggested by the Parties. This aggregation of households surrounding a CFC or store is analogous to the approach used in our in-store analysis. In in-store, the geographic market is delineated by drive-times around each store, while in online delivered groceries the geographic market is delineated by the delivery area of each Supply Point. This approach is also analogous to the approach adopted in many retail merger inquiries.⁵²²

Conclusion on geographic market definition

10.55 In light of the evidence set out above, balancing the evidence on demand-side and supply-side substitution, the nature of online competition, and the appropriate level of aggregation, we found that the appropriate geographic market definition is the delivery area served by each Supply Point. We consider that the conditions of competition within these Supply Point delivery areas are likely to be sufficiently similar such that they form appropriate geographic markets for the purposes of our competitive assessment. For online delivered groceries this led to 286 geographic markets for the Asda online Supply Points and 245⁵²³ geographic markets for the Sainsbury’s online Supply Points.

10.56 However, notwithstanding that the geographic market definition is the delivery area served by each Supply Point, our competitive assessment also takes

⁵²⁰ In general, any given address is supplied by a single Supply Point of any given retailer.

⁵²¹ Postcode Units are the set of addresses sharing the same full postcode. Output Areas are used in the reporting of census data and are described [here](#).

⁵²² For example: Ladbroke’s/Coral merger inquiry (26 July 2016), *Final report*, paragraph 6.106; *Co-op/Nisa merger inquiry* (2018), *Phase 1 decision document*, paragraphs 34 and 35; and Tesco/Booker merger inquiry (2017), *Final report*, paragraph 6.24.

⁵²³ Including the planned new Supply Point at Kendal.

into account that in this sector several elements of the competitive offering are set centrally and applied uniformly across the retailers' Supply Points. In addition, the Parties are large, nation-wide operators operating in a large number of local markets across the UK. We consider that this affects their effectiveness as a competitor in every local area where they operate. In our competitive assessment, we assess the effect of the Merger (and any reduction in competition), on the Parties' conduct at a national level (ie across all the Parties' Supply Points)⁵²⁴ as well as in each local area in which the Parties' Supply Points overlap.

Nature of competition

10.57 In this section we describe the nature of competition in online delivered groceries, describing the competitive parameters (PQRS) and whether these are set uniformly across the UK or varied locally. We cover the Parties' views and third parties' views and our assessment. We then present our findings on the nature of competition.

Parties' views and third parties' views

10.58 We have set out below the Parties' and third parties' views on PQRS in relation to online delivered groceries.

Price

10.59 In this section we discuss product pricing, promotional pricing, delivery prices, delivery passes and vouchering.

Product pricing

10.60 Asda told us that its online product prices were set uniformly and were the same as its in-store prices. Furthermore, it did not [REDACTED].

10.61 Sainsbury's told us that it set product prices uniformly across the UK and it used the same pricing files for both its in-store and online delivered grocery offering. [REDACTED].

10.62 Iceland, Morrisons, Tesco and Waitrose told us that product prices were the same across both online and in-store. Amazon and Ocado told us that their prices were consistent across the UK.

⁵²⁴ [CMA62](#), paragraphs 1.13–1.17.

Promotional pricing

- 10.63 Asda told us that it did not run online-specific product price promotions. However, [REDACTED]. Asda also did not run end-of-line promotions online.
- 10.64 Sainsbury's told us that it used the same promotions online and in-store.
- 10.65 Third parties provided mixed evidence in relation to promotional pricing and examples are provided below.
- (a) Iceland told us that it might run different promotions online and in-store.
 - (b) Morrisons told us that some promotions offered in-store may not be available online for commercial or operational reasons.
 - (c) Tesco told us that promotions were the same online and in-store.

*Delivery prices*⁵²⁵

- 10.66 Asda told us that it varied delivery prices by the time of day and day of the week. Asda set delivery prices based on periodic reviews of the prices charged by [REDACTED]. Delivery prices were also influenced by capacity levels and supply and demand. Asda told us that it rarely varied delivery prices by region, store, or over time. [REDACTED]. Asda did, however, vary the minimum basket sizes for online delivered groceries. In some areas the minimum was £25, while in others it was £40.⁵²⁶ Asda internal documents suggested that Asda added an additional 25 sites to the trial related to changing minimum basket sizes. These included all stores within the M25, excessive mile stores and a selection of high utilisation stores. The Parties told us that Asda's internal strategy was [REDACTED].⁵²⁷
- 10.67 Sainsbury's told us that it operated [REDACTED] pricing clusters across the UK. [REDACTED].
- 10.68 Third parties provided mixed evidence on delivery prices and examples are provided below.
- (a) AmazonFresh, Iceland and Waitrose told us that they charged the same delivery prices across the UK.
 - (b) Morrisons told us that delivery prices varied by [REDACTED].⁵²⁸ [REDACTED].

⁵²⁵ Delivery prices are discussed in more detail in Chapter 12.

⁵²⁶ See: [Asda website: What is the minimum order amount?](#)

⁵²⁷ Parties' response to the Provisional Findings, paragraph 639.

⁵²⁸ [REDACTED].

(c) Tesco told us that it had [redacted] delivery pricing in the UK: [redacted].

Delivery passes

- 10.69 Customers who purchase the Asda delivery pass obtain free delivery if they spend a minimum of £40 per order.⁵²⁹ Asda told us that the price setting approach for the delivery pass was the same as that for delivery prices. An Asda internal document from May 2018 suggested [redacted]% (calculated on a monthly basis) of Asda online customers had a delivery pass.⁵³⁰ Currently Asda offers three national delivery passes: £55 for 12 months, £35 for six months and £24 for a 12 month pass where customers are restricted to midweek deliveries, all payable upfront.⁵³¹ Customers are also able to pay on a monthly basis, £5 per month for a 12 month anytime pass or £6 for a six month anytime pass.
- 10.70 Sainsbury's told us that it offered delivery pass subscriptions and customers using a delivery pass represented [redacted]% of online baskets. The prices were set uniformly nationally and Sainsbury's ensured its prices were competitive through monitoring [redacted]. Currently, Sainsbury's offers three anytime delivery passes: £60 for 12 months, £35 for six months and £20 for three months. It also offers discounted passes which restrict deliveries to Tuesdays, Wednesdays and Thursdays. These cost £30 for 12 months, £18 for six months and £10 for three months.⁵³²
- 10.71 AmazonFresh,⁵³³ Iceland⁵³⁴ and Waitrose⁵³⁵ do not offer delivery passes for online delivered groceries. Morrisons⁵³⁶ and Ocado⁵³⁷ offer annual, six month and monthly delivery passes. Tesco offers monthly and six-month delivery passes.⁵³⁸ Delivery passes were used for around [redacted]% of Tesco online sales.⁵³⁹ All of the retailers that offer delivery passes do not vary delivery pass prices geographically.

⁵²⁹ See: [Asda website: Delivery pass](#).

⁵³⁰ [redacted].

⁵³¹ See: [Asda website: Delivery pass](#).

⁵³² See: [Sainsbury's website: What is a Delivery Pass and how does it work?](#).

⁵³³ See: [Amazon website: Amazon Fresh UK Grocery Shopping](#). Only members of Amazon Prime can use Amazon Fresh.

⁵³⁴ See: [Iceland website](#).

⁵³⁵ See: [Waitrose website: Free delivery on online shopping](#).

⁵³⁶ See: [Morrisons website: Delivery Pass](#).

⁵³⁷ See: [Ocado website: Ocado Smart Pass](#). (Users must create an account to access delivery pass prices).

⁵³⁸ See: [Tesco website: Delivery saver](#).

⁵³⁹ Note that this data relates to a period prior to 2016.

Vouchering

- 10.72 Asda told us that, in financial year 2017, vouchers accounted for just [redacted]% of total transactions and [redacted]% of sales. Asda ran [redacted] campaigns. [redacted].
- 10.73 Sainsbury's told us that [redacted]% of online transactions had a voucher associated with them. Sainsbury's told us that each vouchering campaign was [redacted].
- 10.74 Third parties had different approaches to vouchering and examples are provided below.
- (a) Amazon told us that it used vouchering, but it did not target particular areas or competitors.⁵⁴⁰
 - (b) Morrisons told us that its approach to vouchering depended on the [redacted] circumstances. [redacted].
 - (c) Waitrose told us that it vouchered based on a customer behaviour. While it did not respond to competitors directly, it responded indirectly through responding to customers.⁵⁴¹

Quality of website/app⁵⁴²

- 10.75 Asda told us that it invested in its website and [redacted].
- 10.76 Sainsbury's told us [redacted].
- 10.77 Several third parties told us that they had invested considerable sums in their digital platforms. Iceland told us that it invested millions in its new infrastructure and website to maintain its position. Morrisons told us that the quality of its digital platforms was one of the factors where it competed with online rivals. Ocado told us that the user interface was one of the areas where it competed with online rivals. Tesco told us that it had invested in the online customer experience, focussing on having a simple and easy to use website and app.

Range

- 10.78 Asda told us that [redacted]% of online delivered grocery sales were picked from stores, where the online food range was largely similar to the in-store range.

⁵⁴⁰ [Summary of hearing with Amazon](#) (5 November 2018), paragraph 3.

⁵⁴¹ [Summary of hearing with Waitrose](#) (7 November 2018), paragraph 11.

⁵⁴² In this section we focus on the quality of the websites and apps. Competition on quality of delivery, for example slot availability, is discussed below in the section on service. Product quality is discussed in Chapter 8.

There were some exceptions, for example some variants of build your own pizza were not available on Asda's website. The online range was driven by stock availability in the delivering Supply Point.

- 10.79 Sainsbury's told us that [redacted]% of Sainsbury's online delivered groceries came from stores, with the remaining [redacted]% coming from its Bromley-by-Bow CFC. The online range was driven by stock availability in the delivering Supply Point.
- 10.80 Third parties typically told us that the product range available online depended on the range of the Supply Point used to pick the online delivery. For example, Ocado told us that its ranges were broadly consistent across all geographies to which it delivered. Tesco told us that the range that it had available online was the same as that in-store with the exception of items which it was not able to deliver due to size, safety/security or operational obstacles.

Service

- 10.81 Asda told us that it tracked different KPIs covering different parts of the business, including operational and financial performance and customer satisfaction. Whilst capacity investment decisions were not taken [redacted].
- 10.82 Sainsbury's told us that it tracked many KPIs to assess its online business, including substitutions, rejected substitutions, on time departures and on time deliveries. Capacity investment decisions were based on [redacted]. [redacted], local demand would be a function of competition in the local area.
- 10.83 Third parties provided little information on how service levels varied across the UK. Ocado told us that if its competitors improved their service levels, for example through shorter delivery slots, then it would expect to respond.⁵⁴³ Tesco told us that it monitored performance of its online business through the 'Grocery Customer Recommend Score' (Tesco's internal tracking). Tesco was typically in line with or ahead of [redacted], but behind [redacted].

Our assessment

- 10.84 The evidence provided by the Parties includes multiple examples of the Parties changing their offer across these aspects to respond to competitors.
- (a) Delivery prices. In August 2014 Asda reduced its delivery pricing to match [redacted]. In June 2017 Asda reduced the price of its six-month delivery pass

⁵⁴³ [Summary of hearing with Ocado](#) (6 November 2018), paragraph 11.

to match the price offered by [REDACTED]. In 2016 Sainsbury's reported that it had changed its delivery pricing to bring it into line with [REDACTED].

- (b) Vouchering – In its 2018 Online Grocery Board meeting Asda set out a tactical vouchering plan to target [REDACTED]. Sainsbury's noted that it could use marketing to respond to [REDACTED], but this was not considered a viable option without [REDACTED].
- (c) Quality – Asda internal documents showed it was looking to improve its website and introduce guided searches, similar to [REDACTED]. Sainsbury's said it was developing its website and app to try and [REDACTED].
- (d) Range – Asda noted that its online availability was behind its rivals and, to improve it, aimed to better manage its suppliers and reduce maximum order quantities. Sainsbury's discussed improving its range to compete with [REDACTED].
- (e) Service – Asda noted that its on-time delivery was behind [REDACTED] and aimed to reduce later deliveries to improve customer satisfaction. Sainsbury's stated that it would need to offer same day service as [REDACTED] were trialling this.

10.85 Within this there is some evidence of the Parties flexing their offer in specific local areas in response to local competitors.

- (a) Sainsbury's noted that it would offer [REDACTED] in some key geographical areas and then roll out by region. It would also consider [REDACTED] in some critical locations.
- (b) Sainsbury's aimed to improve its tactical marketing approach to support online grocery operations, [REDACTED].

10.86 We note that Sainsbury's has run [REDACTED] pricing trials [REDACTED]. This suggests that Sainsbury's has the technical ability to flex delivery prices in response to changes in competitive conditions. If this were the more profitable approach to delivery pricing, and the Merger went ahead, we consider that similar pricing policies could be implemented at Asda.

Conclusion on nature of competition

10.87 Considering all the evidence above our conclusion on the nature of the competition is that the Parties and third parties do or can compete based on elements of PQRS at both the national and Supply Point level. For example, some parameters of competition such as the quality of their website and the price of delivery passes are set uniformly across the UK while other

parameters such as the availability and pricing of delivery slots are, or can be, varied by Supply Point. We consider the implications of this for our competitive assessment in the following chapter.

11. Online delivered groceries: unilateral effects

- 11.1 In this chapter we present our assessment of unilateral effects in online delivered groceries,⁵⁴⁴ by assessing whether the Merger would give the Parties the incentive and ability to degrade any aspects of their online delivered groceries competitive offering.
- 11.2 We start with an assessment of whether the Merger gives rise to competition concerns, in aggregate, across the Parties' online delivered groceries businesses. This would be the case if the Parties had an incentive to deteriorate elements of PQRS across all of their Supply Points – for example, through national delivery pass price increases. This incentive would arise from the accumulation of the loss of competition that the Parties face in every local area where they currently overlap. At the same time, our assessment reflects that many important aspects of the competitive offering (for the Parties and a number of their main competitors) are set uniformly at a national level. Where we find that the Parties would have an incentive to change these nationally-uniform parameters, we would find an SLC in each local market where one or both of the Parties is present (on the basis that harm to consumers would arise in areas where the Parties do not overlap, as well as where they do). By way of shorthand, we refer to this as our 'national assessment'.
- 11.3 We undertake this national assessment by considering a range of qualitative and quantitative evidence which provides a centralised, or aggregate, view of the competition which the Parties face across their UK online delivered groceries businesses and which can be expected to inform their conduct at a national level. This includes share of supply information, internal documents, third party submissions, national switching data, and pricing pressure analysis, amongst others. These different pieces of evidence draw on different sources but ultimately capture all or part of the same competitive dynamics. Our assessment draws on all of this evidence, to come to a decision in the round.
- 11.4 We also assess whether the Merger gives rise to competition concerns in certain local markets where the Parties overlap. This would be the case if the

⁵⁴⁴ As noted in Chapter 10, we use the term online delivered groceries to refer to groceries which are delivered to the customer's location following an order placed online. Click and Collect is dealt with in our in-store analysis (see paragraph 7.6).

Parties had an incentive to deteriorate elements of PQRS only at certain Supply Points – for example, through worsening delivery prices, service levels or stock availability, or reducing range in those Supply Points. In this case, we may find an SLC in each local market where this incentive may arise. By way of shorthand, we refer to this as our ‘local assessment’. An SLC found on the basis of our local assessment relates to conduct which can vary by Supply Point and so is on different grounds to one found on the basis of our national assessment. However, the local assessment reflects the same loss of rivalry as the national assessment.

- 11.5 For our local assessment, given the very many local areas in which the Parties overlap, it would not have been practicable to assess each of these areas in turn, using the same range of qualitative and quantitative evidence used for our national assessment. We therefore adopted a method to assess, in a consistent way, the potential effect of the Merger in every local market in which the Parties overlap. This methodology involved constructing diversion ratios and producing a GUPPI for each local area. As noted in Chapter 8, the greater the incentive to raise prices or deteriorate other elements of the offering (signalled by a higher GUPPI figure), the more likely it is that the Merger may be expected to result in an SLC.
- 11.6 For the purposes of our local assessment, having produced a GUPPI measure for each local area, we then assessed at what GUPPI threshold the Merger may be expected to give rise to competition concerns, and used this as the basis of a decision rule to conclude on which local markets the Merger gives rise to an SLC. In setting our GUPPI threshold, we account for the rivalry-enhancing Merger efficiencies identified, since these can be expected to lead to downward pricing pressure. We also consider what allowance, if any, should be made to account for the requirement that the lessening of competition be substantial, and for any uncertainty in our analysis.
- 11.7 As for in-store groceries, the national assessment for online delivered groceries reflects an aggregation of local effects, but it is not an aggregation of the SLCs found through our local assessment, which are assessed differently.

National assessment

- 11.8 Both Parties set product prices, promotional prices, delivery pass prices, the quality of their own-brand products, and the quality of their website and apps at the national level and apply them uniformly across their national online

offering (ie these parameters do not vary by geographic area). Asda also currently sets its delivery prices at the national level.⁵⁴⁵

Parameters that are uniform across online and in-store groceries

- 11.9 The evidence set out in Chapter 10 above indicates that the Parties set product prices, promotional prices and own-brand product quality uniformly across online and in-store grocery sales. We do not consider that this is likely to change post-Merger. We note that, for Asda, online delivered grocery sales represented [5–10%] of total grocery sales in 2017; for Sainsbury's, it was [5–10%]. We therefore consider the incentive to deteriorate these parameters in respect of online sales is captured within our in-store competitive assessment.
- 11.10 In Chapter 8 we found that the Parties would have an incentive post-Merger to degrade PQRS across their national supermarket estates. Our finding is therefore that the Merger may be expected to result in an SLC in each local area where one or more of the Parties' supermarkets is present. In the context of increasing product prices, we consider that this finding means that there is likely to be an equivalent increase in the prices of groceries sold by the Parties to their online delivered customers, as the prices of these products are the same as in-store. This means that the Merger may be expected to result in an SLC in each local area where one or more of the Parties is present in online delivered groceries.⁵⁴⁶

Parameters that are specific to online delivered groceries

- 11.11 We have also considered whether the Merger would result in an incentive for the Parties to degrade elements of PQRS that are nationally uniform and specific to online delivered groceries. The remainder of this national assessment section considers this issue.
- 11.12 Delivery pass prices and the quality of the website and apps for both Asda and Sainsbury's, and Asda's delivery prices, are set nationally and are specific to the Parties' online delivered groceries activities. In particular, delivery passes are used in [30–40%] of Sainsbury's orders and by [20–30%] of Asda customers.⁵⁴⁷ Therefore, we have assessed whether the Merger could lead to a substantial lessening of competition in every local market for

⁵⁴⁵ Asda varies the minimum basket size locally (see [Asda website: What is the minimum order amount?](#)).

⁵⁴⁶ It would be appropriate for the weighted average national GUPPI for these aspects of PQRS to be based on a weighted average of the GUPPI values for the Parties' supermarkets and the GUPPI values for their online business together. We have not made this adjustment, for the reasons described in Chapter 8. See footnote 232.

⁵⁴⁷ See paragraphs 10.69 and 10.70.

online delivered groceries through the deterioration of these nationally uniform competitive parameters.⁵⁴⁸

Parties' views

11.13 With regard to competition in online delivered groceries, the Parties told us that they were not close competitors.⁵⁴⁹ The evidence they presented was as follows.⁵⁵⁰

- (a) Kantar switching data showed [redacted].
- (b) The Lapsed customer surveys showed that customers had most commonly switched to [redacted].
- (c) Nielsen data⁵⁵¹ showed that, of shoppers who had used Sainsbury's online, more was spent at Tesco online than at Asda online. Similarly, of shoppers that had used Asda online, more was spent at Tesco online than at Sainsbury's online.
- (d) The Parties' analysis of transaction data showed that [0–5%] of lapsed Sainsbury's online customers switched to Asda online and [0–5%] of Asda online customers switched to Sainsbury's online.

11.14 The Parties submitted that it is not possible to conclude that they are particularly close competitors, given that the Parties both (i) have closer competitors than each other, and (ii) face strong competition from a large number of other online delivery providers (both cross-channel and pureplay).⁵⁵²

11.15 The Parties also told us that they expected to see continued growth from Amazon Fresh, Ocado, Morrisons and other players. For example, they highlighted Amazon's expanding grocery offer and Iceland's expanded capacity. They also noted that grocery retailers without an online offer could expand by developing their own online fulfilment capabilities, adopting third

⁵⁴⁸ For instance, the Merged entity may increase the price of delivery passes, or decide to save money by not investing in improving the website or app. We note that, in general, the deterioration of parameters need not involve the customer experience becoming worse than it was pre-Merger – instead, there may be fewer or smaller improvements (such as delivery pass price cuts or new website functionalities) than there would have been in the absence of the Merger.

⁵⁴⁹ [Parties' response to the Provisional Findings](#), paragraph 575 to 577.

⁵⁵⁰ The quantitative evidence submitted by the Parties which is listed here and which is relevant to the assessment of unilateral effects is discussed in more detail in Chapter 10 above.

⁵⁵¹ Nielsen share of wallet data shows, for all customers who purchase at least some groceries from each Party's online offering, what proportion of spend was also spent at other retailers. Nielsen collects this information from a panel of consumers who record/scan the purchases they have made (in a similar fashion to Kantar Worldpanel).

⁵⁵² [Parties' response to the Provisional Findings](#), paragraph 540.

party systems, or using third party delivery platforms (such as Deliveroo, Grocemanía and Homerun). Finally, the Parties submitted that there had been a number of recent industry developments, including Co-op selling online groceries for the first time and a joint venture between M&S and Ocado. We discuss each of these in Appendix H and in the section on entry and expansion.

- 11.16 Asda told us that it tracked the delivery prices of [REDACTED].⁵⁵³ Sainsbury's told us that it tracked delivery prices for [REDACTED].
- 11.17 The Parties submitted that there is a single market for in-store and online delivered groceries, and as such they consider there is no potential for competition concerns to arise in relation to online delivered groceries as they would continue to be constrained by in-store grocery retailers. Chapter 10 discusses the Parties' views on the constraint of in-store groceries on each of the Parties' online businesses. As explained in that chapter, we have found that the relevant product market is the market for online delivered groceries, although in-store groceries provides some level of constraint.

Third parties' views

- 11.18 The evidence from third parties showed, in general, that they were focussed on competition from the largest online delivered groceries retailers. For example, the internal documents of Morrisons showed that it benchmarked its online offer against the online offers of Asda, Sainsbury's and Tesco, and Morrisons told us it most closely competed against Asda, Tesco, Sainsbury's and Ocado as the other major online delivered grocery retailers. Ocado told us it aimed to remain competitive against the 'Big 4' (Tesco, Asda, Sainsbury's and Morrisons). Ocado did not list Iceland as a close competitor.
- 11.19 Tesco told us its closest competitors were Asda and Sainsbury's as the only two operators, along with Tesco, which offered almost national coverage. Ocado was the next most significant competitor, with coverage across the Midlands and the south of England. Tesco said that Kantar Worldpanel data showed that it saw the greatest degree of switching to Ocado.

⁵⁵³ [REDACTED].

Our assessment

Competitor offerings – business models and product range

11.20 As set out in Chapter 10 (paragraph 10.42), there are eight retailers of online delivered groceries that we consider to be competitors within the relevant product market: Asda, Sainsbury's, AmazonFresh, Iceland, Morrisons, Ocado, Tesco and Waitrose.

11.21 We set out below a description of third parties' current online delivered grocery offerings, which we consider provides qualitative evidence on the competition between online delivered groceries retailers:⁵⁵⁴

- (a) Amazon told us its AmazonFresh service offered around 20,000 SKUs, including a broad range of fresh food, frozen food and other grocery items. AmazonFresh delivers groceries using a CFC based model.⁵⁵⁵
- (b) Co-op told us that it had launched a trial online offer on 22 March 2019 using one of its stores in London. The trial involved a range of [redacted] SKUs and delivery limited to a maximum [redacted] radius from the store. The trial was to be extended [redacted] by the [redacted] 2019.⁵⁵⁶
- (c) Iceland told us its online range of products was more or less exactly the same as its in-store range (comprising approximately 3,000 SKUs). Iceland predominately uses a store-pick model to deliver groceries, but has one 'pick centre' also.
- (d) M&S currently does not offer online delivered groceries, but in February 2019 announced a 50/50 joint venture deal with Ocado, to take effect from September 2020 at the latest, with M&S acquiring 50% of Ocado's retail business, and M&S taking over from Waitrose as an Ocado supplier.⁵⁵⁷
- (e) Morrisons told us it offered a grocery and general merchandise home delivery service via the Morrisons.com website. Its online product offer was broadly reflective of the range in one of its large format stores. Morrisons has a contract with Ocado whereby Ocado provide fulfilment services and technology to deliver orders placed on Morrisons' website.

⁵⁵⁴ We also identified other smaller grocery operators who offered a more restricted online range or more restricted geographic coverage. For example, Abel and Cole, which focusses on organic food, and Farm Drop, which focusses on local produce.

⁵⁵⁵ [redacted]. We assess this in the section on entry and expansion and in Appendix H.

⁵⁵⁶ See further detail in Appendix H.

⁵⁵⁷ See M&S's website (27 February 2019), [Bringing the best together: transforming UK online grocery shopping M&S and Ocado announce new joint venture](#). See further detail in Appendix H.

[X] % of all Morrisons sales are delivered through Ocado, with the rest being delivered by Morrisons directly through a store-pick model.⁵⁵⁸

- (f) Ocado told us it offered online delivered grocery services and a limited general merchandise range and its strategy was based on its unique operating model of centralised and automated warehouses.
- (g) Tesco told us that in most parts of the country its online delivered grocery orders were picked from one of 346 stores. In some parts of London, customers were served from one of six dedicated grocery fulfilment centres.
- (h) Waitrose told us its main website, waitrose.com, sold its in-store range of grocery lines plus a range of lines for home delivery or pick up in store.⁵⁵⁹

11.22 Aldi,⁵⁶⁰ Booths, Lidl and Southern Co-op told us they did not offer online delivered groceries.

Competitor offerings – geographic coverage

11.23 We also considered the geographic coverage of the different suppliers, using the coverage data supplied to us by the Parties and third parties.⁵⁶¹ This showed that Asda online, Sainsbury's online and Tesco online had the largest coverage areas, with other competitors having more limited coverage of the UK (see Table 11.1 below).⁵⁶²

11.24 For instance, Ocado is focused on the South of England and has no presence in Scotland, Northern Ireland or much of Wales. In these areas the Parties face only Tesco, occasionally Waitrose and/or Iceland, and very occasionally, Morrisons. Morrisons, which is focused on Central and Eastern England has limited coverage in Scotland and in counties that border the South Coast of England. AmazonFresh only operates in London and some of the home counties.

⁵⁵⁸ Morrisons also has a supply contract with Amazon, whereby Morrisons goods can be purchased on AmazonFresh.

⁵⁵⁹ Waitrose also supplies products to Ocado. Waitrose has announced that its commercial arrangement with Ocado will come to an end in September 2020.

⁵⁶⁰ Aldi sells alcohol online, but does not offer other online delivered groceries.

⁵⁶¹ Each Party and third party provided us with details of the postcodes that they deliver to. This is discussed in more detail in Appendix I.

⁵⁶² Taking into account the submissions of the Parties regarding the accuracy of the coverage maps supplied by Tesco, we did not use these in our analysis of the effects of the Merger.

Table 11.1: Percentage of postcode units covered by each online delivered groceries retailer

	Total Postcode units	% of UK Postcode units covered
AmazonFresh	[X]	[10–20]
Asda	[X]	[90–100]
Iceland	[X]	[70–80]
Morrisons	[X]	[70–80]
Ocado	[X]	[70–80]
Sainsburys	[X]	[90–100]
Tesco	[X]	[90–100]
Waitrose	[X]	[80–90]
Total	[X]	

Source: CMA analysis of the Parties and third parties' data on postcodes they deliver to.

Internal documents

11.25 The Parties submitted that their internal documents demonstrate a focus on a wide range of competitors, and that the CMA had recognised in its Provisional Findings that these documents typically refer to at least five other competitors in online groceries.⁵⁶³

11.26 Asda's internal documents suggest that Asda reviews [X], with much less focus on other suppliers.

11.27 Sainsbury's internal documents [X].

The CMA online survey

11.28 The CMA online survey is described briefly in Chapter 10, and in more detail in Appendix B. The Parties expressed concerns about the robustness of the CMA online survey, particularly in relation to the representativeness of the sample with respect to the proportion of customers' total grocery purchases spent online. For the reasons explained in Appendix B we are confident that the CMA online survey week is not biased towards heavy users of online delivered groceries, and we also consider that any non-response bias has not substantially affected our results. Indeed, we consider that the overall results of our survey, as set out below, are particularly robust at the national level, given the large sample size and good response rates.⁵⁶⁴ In addition, our survey is nationally representative,⁵⁶⁵ so diversion measures are a reliable

⁵⁶³ Parties' response to the Provisional Findings, paragraph 539.

⁵⁶⁴ Further, in his report, Professor Sturgis notes that i) the survey was carried out to a high professional standard and according to industry best practice, ii) there was no evidence to suggest the profile of orders during the week was in any notable way different from the profile of orders in other weeks, iii) he does not consider the risk of framing bias of notable significance, and iv) national level estimates, even for most subgroups, will be very precisely estimated, given the large sample size and equal probability design.

⁵⁶⁵ It is representative of areas that Sainsbury's and Asda sell online delivered groceries within the UK.

reflection of the degree of closeness of competition between the Parties at a national level. We are therefore confident in placing significant weight on the evidence from the CMA online survey.

- 11.29 In relation to competition between online delivered groceries retailers, when considering diversion ratios, the CMA online survey results suggest that Asda's closest online competitors are Tesco online ([50–60%]), Sainsbury's online ([10–20%]) and Morrisons online ([10–20%]).⁵⁶⁶ A far smaller proportion of Asda spend would switch to Iceland online ([0–5%]), Ocado ([0–5%]), Waitrose online ([0–5%]) and Amazon ([0–5%]).⁵⁶⁷
- 11.30 For Sainsbury's, the top four responses were Tesco online ([40–50%]), Waitrose online ([10–20%]), Ocado ([10–20%]) and Asda online ([10–20%]). A smaller proportion of Sainsbury's spend would switch to Morrisons online ([5–10%]), Iceland online ([0–5%]) and Amazon ([0–5%]).⁵⁶⁸
- 11.31 The CMA online survey therefore suggests that, at the national level, Tesco is the closest competitor to each of the Parties from among the other online delivered groceries retailers. However, it also indicates that the Parties compete closely with each other. For Asda, the next-closest online competitors (after Tesco) are Sainsbury's and Morrisons, with all other online competitors offering only a limited constraint. For Sainsbury's it is Waitrose, Ocado and Asda, and to a lesser extent Morrisons. Overall, [90–100%] of online diversion from Asda was to one of Tesco, Sainsbury's, or Morrisons, whereas the equivalent figure for Sainsbury's was only [60–70%]. The Parties therefore face rather different constraints from third parties, with Waitrose and Ocado being much more important constraints on Sainsbury's than on Asda. Between the Parties, Sainsbury's appears to be a materially stronger constraint on Asda than vice versa.

Our assessment of the Parties' data

- 11.32 In Chapter 10 we described our views on the Parties' evidence in relation to market definition. The Parties submitted that the same evidence, namely the Kantar switching data, the Lapsed customer surveys, the Nielsen data and the Parties' switching analyses, is relevant for an assessment of closeness of competition between online delivered grocery retailers. With the exception of the Kantar data, we consider that the concerns we have with these pieces of evidence in relation to market definition are equally applicable when

⁵⁶⁶ Based on the proportion of spend that would go to another online provider if the Asda website were no longer available.

⁵⁶⁷ CMA analysis of the CMA online survey.

⁵⁶⁸ CMA analysis of the CMA online survey.

considering closeness of competition, which we discuss in the following paragraphs.

11.33 In general, we consider that the most relevant evidence for closeness of competition would show how the sales (in terms of value) of an online delivered groceries retailer would be affected by a change in its offer, such as a price increase, or the closure of a rival website. With regards to the Parties' evidence:⁵⁶⁹

- (a) We are not able to assess what is driving any particular customer movement. Some switching (or lapsing) that is captured by this evidence will be driven by the customers' circumstances changing, not by changes in the offering.
- (b) Some of this evidence is representative of customers, but not of value. This evidence therefore does not fully capture closeness of competition because customers who spend more are more valuable to the Parties, and therefore it is the lost spend, rather than lost customers, that is more important to our assessment.

11.34 We consider that we can place more weight on the Kantar Worldpanel switching data, given that: i) it is a large, robust survey; ii) the figures refer to sales value rather than customer numbers; and iii) we consider the likelihood of switching being driven by changes in circumstances is lower when comparing switching within a channel (ie online), than across channels (ie from online to in-store).^{570,571}

11.35 We note that, overall, the evidence submitted by the Parties and the CMA online survey broadly corroborate each other regarding the closeness of competition between the Parties. All of the evidence suggests that Tesco online is the biggest constraint on both Parties' online operations, and both Parties face another online constraint that is similar to or marginally stronger than the constraint from each other's online offering (Morrisons for Asda, and Ocado for Sainsbury's).⁵⁷²

⁵⁶⁹ While we note two broad issues below, there are a range of other issues that are specific to each piece of evidence or analysis and are discussed in detail in Chapter 10, but not discussed here.

⁵⁷⁰ Kantar data is discussed in more detail in Appendix D.

⁵⁷¹ For instance, customers might switch between channels because they may no longer be available at home for deliveries or they may have sold their car and can no longer easily get to a supermarket. However, changes in circumstances may also affect switching within a channel, for example because a customer moves house and only certain providers deliver to the new address.

⁵⁷² The Kantar Worldpanel switching data suggests the constraint from Ocado is slightly stronger than the Parties' other evidence suggests, with [20–30%] of Sainsbury's switching losses going to Ocado compared with [10–20%] going to Asda; and [10–20%] of Asda's switching losses going to Ocado compared with [10–20%] going to Sainsbury's. See Appendix D.

11.36 Contrary to the Parties' views, we do not consider that the Parties need to be each other's closest competitor to provide a significant competitive constraint on each other.

National shares of supply

11.37 Table 11.2 below shows our estimates of the shares of supply at the national level for online delivered groceries, based on revenue, for 2017 and 2018. Post-Merger, based on 2018 figures, the Parties would have a combined share of around [30–40%], with an increment of around [10–20%].⁵⁷³

11.38 As the table below shows, post-Merger the Parties would be the second-largest online delivered groceries retailer, after Tesco (with [30–40%]). The next-largest retailer would be Ocado, with [10–20%]. All other players each have a [5–10%] share or less.

Table 11.2: Shares of supply in online delivered groceries

Party	2017		2018	
	Online Sales (£m)	Share of supply (%)	Online Sales (£m)	Share of supply (%)
Asda	[£]	[10–20]	[£]	[10–20]
Sainsbury's	[£]	[10–20]	[£]	[10–20]
Post-merger share		[30–40]		[30–40]
AmazonFresh	[£]	[0–5]	[£]	[0–5]
Iceland	[£]	[0–5]	[£]	[0–5]
Morrisons	[£]	[5–10]	[£]	[5–10]
Ocado	[£]	[10–20]	[£]	[10–20]
Tesco	[£]	[30–40]	[£]	[30–40]
Waitrose	[£]	[0–5]	[£]	[0–5]
Total	[£]	100	[£]	100

Source: CMA analysis.

Note: Shares of supply are based on sales revenue in the 2018 calendar year for 2018, and either 2017 calendar year or 2017/18 financial year for 2017.⁵⁷⁴

11.39 There are four key points we consider relevant to our assessment:

- (a) Tesco has a far higher share of supply than any other online delivered groceries retailer;
- (b) Asda, Sainsbury's and Ocado are the next largest, all of comparable size;
- (c) There are only four online delivered grocery retailers of significant size;
- (d) In comparison to in-store, Morrisons is much smaller in online, and the discounters are not present.

⁵⁷³ A description of how shares of supply were calculated can be found in Appendix I.

⁵⁷⁴ See Appendix I on the collection of revenue data and calculation of shares of supply.

Extent of geographic overlap and upward pricing pressure estimated using GUPPI analysis

- 11.40 The Parties' Supply Points overlap to a very significant degree. Of the Parties' combined 530 Supply Points, all of Sainsbury's Supply Points overlap with an Asda Supply Point, while only one Asda Supply Point does not overlap with any Sainsbury's Supply Points.
- 11.41 Further, the findings of our Supply Point assessment (set out below in paragraph 11.108) are that the Merger will result in an SLC in over 100 Asda Supply Points. This represents approximately 50% of Asda's Supply Points. Our Supply Point assessment finds no SLCs in Sainsbury's Supply Points. We note further that there are many more Asda Supply Points which have GUPPIs which, although not exceeding the GUPPI threshold used in our decision rule for the Supply Point assessment, are nevertheless material. If the Merger may be expected to result in competition concerns in local areas representing a significant proportion of the Parties' online offer (which, for Asda, this assessment indicates it would), the Merger may create an incentive to worsen the national aspects of the Parties' offerings across all Supply Points.
- 11.42 In Chapter 8 we discussed in detail why GUPPIs are appropriate for our assessment and the factors that are relevant in interpreting whether a given level of GUPPI indicates that an SLC may be expected to arise. In Chapter 8 we discussed GUPPIs in the context of in-store groceries, and we consider that many of the points described in that Chapter are also relevant to the discussion of GUPPIs for online delivered groceries.
- 11.43 In summary, in the context of online delivered groceries:
- (a) The GUPPI aims to measure the Parties' incentives to degrade any of their online-specific PQRS following the Merger.
 - (b) The national GUPPI for each Party is calculated by taking the national diversion ratio from the CMA online survey (which is nationally representative of the Parties' orders) and combining this with the online national margin. The GUPPI for each Party also takes into account the fact that some of the customers who divert to the other Merging party will

divert to their in-store offer (while others will divert to their online offering).⁵⁷⁵

- 11.44 We are using national variable online margins of [X]% for Sainsbury's and [X]% for Asda.⁵⁷⁶
- 11.45 The Parties told us that they generally [X]. At Provisional Findings, in the absence of additional information, we calculated national online variable margins using the Parties' online management accounts, applying the same individual cost line variability estimated for in-store groceries. In their response, the Parties made additional submissions on [X], arguing that [X]. Where we found this evidence sufficient, we adjusted our estimates of the online variable margins accordingly.⁵⁷⁷
- 11.46 We consider that, having made these adjustments, the variable online grocery margins stated above represent our best estimates. However, it is possible that these figures remain overstated, particularly for Sainsbury's, because, as discussed in paragraph 22 of Appendix F, the Parties' online delivered groceries accounts [X]. We note that, if the online margins were reduced because of this, the margins on in-store groceries would increase.
- 11.47 However, there is an additional factor that is not captured in the margins reported here, and that may mean that these margins are understated: the variable margins the Parties provided are accounting margins only, and do not take into account the economic value of future growth in the online business, or the positive impact that having an online offering has on in-store sales. We are not able to assess how this factor balances out against the possibility of overstating margins due to [X], so for the purposes of our GUPPI analysis we have not made any further adjustments to the margins provided by the Parties.
- 11.48 Finally, these margin estimates are based on volume changes which are sufficiently large to result in certain operational cost changes (eg adjusting the number of staff, and logistics costs). However, smaller price changes could still be profitable, and would be associated with higher variable margin estimates, closer to the Parties' gross margins. Accordingly, we have conducted a sensitivity which shows the GUPPI estimates using the Parties'

⁵⁷⁵ The GUPPI is then the sum of the diversion to the Merging party online, multiplied by the online margin, and the diversion to the Merging party in-store, multiplied by the in-store margin. This is different to how we calculate our in-store GUPPI, where we base it exclusively on diversion to the Parties' in-store offering.

⁵⁷⁶ We used national margins given that robust estimates for individual Supply Point margins were not available.

⁵⁷⁷ Details on our calculation of online variable margins are in Appendix F.

gross margins, which would represent the maximum plausible estimate of the variable margin. See footnote 581.

- 11.49 As discussed in Chapter 10, paragraph 10.18, given the concern that some customers may have misinterpreted the price increase diversion question in the CMA online survey, and having considered submissions by the Parties and the report by Professor Sturgis, GUPPIs have been calculated using only the forced diversion survey question.⁵⁷⁸ The diversion ratios also include (ie allow for) own-brand diversion to in-store. We discuss the treatment of own-brand diversion in Appendix E, paragraphs 106 to 117. In deciding to include own-brand diversion for online delivered groceries we have taken into account how respondents may have interpreted the forced diversion questions and that there could be limited incentive for the Parties to degrade PQRS at their stores, given the competitive constraints and relevant competitive parameters are likely to be different between the online business and in-store business. However, we also note that we have found an SLC at all of the Parties' supermarkets (see Chapter 8), meaning that the store a respondent had in mind when answering the CMA online survey may face deterioration of PQRS. We consider this may mean that our approach underestimates the level of diversion between the Parties because respondents may not have taken this into account.
- 11.50 The national diversion ratio from Asda online to Sainsbury's online is [10–20%] (and Asda online to Sainsbury's in store is [0–5%]), while the national diversion ratio from Sainsbury's online to Asda online is [5–10%] (and Sainsbury's online to Asda in-store is [0–5%]). The greater diversion from Asda to Sainsbury's than Sainsbury's to Asda is likely due to the asymmetric nature of online constraints, with Sainsbury's facing a greater competitive constraint from Ocado and Waitrose than Asda. We further note that this contrasts with the situation in in-store groceries, where Asda faces strong competition from players that are not present, or are weaker, in online groceries (for instance Aldi, Lidl and Morrisons).⁵⁷⁹

⁵⁷⁸ Whether both the price and forced diversion questions or only the forced diversion question is used has very little impact on the diversion ratio. For instance, Asda's diversion to Sainsbury's online is [10–20%] using price and forced and [10–20%] using forced only, while Sainsbury's diversion to Asda online is [5–10%] using price and forced and [5–10%] using forced only.

⁵⁷⁹ For instance, evidence in Chapter 8 suggests that, for in-store groceries, Asda is closer to Aldi and Lidl than Sainsbury's is, and Sainsbury's is closer to Waitrose and M&S than Asda is (we also note that Ocado currently sells Waitrose products and will sell M&S products as of 2020). For further detail see paragraph 8.35, (where internal documents suggest Sainsbury's focuses on Waitrose and M&S more than Asda does), paragraph 8.63 (where Kantar switching data shows Asda has higher switching losses to Aldi and Lidl than Sainsbury's does, and the reverse in true regarding Waitrose), and paragraph 8.96 (where the Parties submit that Asda is much closer to Aldi and Lidl in terms of consumer profile than to Sainsbury's – which, in turn, has the most in common with Waitrose).

- 11.51 Using these variable margins and diversion ratios⁵⁸⁰ we have estimated national GUPPIs. The results show that the Asda GUPPI is [0–5%] and the Sainsbury's GUPPI is [0–5%].⁵⁸¹
- 11.52 The difference in the GUPPI between Asda and Sainsbury's can be partly explained by the greater diversion from Asda to Sainsbury's than Sainsbury's to Asda,⁵⁸² [X].⁵⁸³
- 11.53 As the national assessment is not based on a decision rule we have not set any threshold above which an SLC may be expected to arise.⁵⁸⁴ However, in assessing the level of the GUPPI and the impact on rivalry, we have given consideration to:
- (a) The level of efficiencies that may be expected to arise from the Merger;
 - (b) The requirement that any lessening of competition must be substantial, and any uncertainty regarding the accuracy and robustness of data and evidence used in the GUPPI calculation.
- 11.54 In relation to efficiencies, we consider that the reasoning set out in Chapter 8, paragraphs 8.276 to 8.279, applies equally to the interpretation of the GUPPI for online delivered groceries. In particular, we have found that it is appropriate to assume that the Merger will give rise to around £500 million of rivalry-enhancing efficiencies, all of which can be expected to accrue to the Parties' groceries and GM businesses⁵⁸⁵ (including online delivered groceries).
- 11.55 For the purposes of the GUPPI assessment, £500 million efficiencies would translate into a downward pressure of around 1.25% in a GUPPI analysis.⁵⁸⁶ Having satisfied ourselves that efficiencies of this level may be expected to arise from the Merger, we consequently do not consider that a GUPPI of around 1.25% or below would be supportive of an SLC finding.⁵⁸⁷ We note

⁵⁸⁰ And a price ratio of Asda to Sainsbury's of [X].

⁵⁸¹ As discussed in paragraph 11.48, we have also conducted a sensitivity using gross margins, resulting in the Asda GUPPI increasing by [X]%, and Sainsbury's GUPPI increasing by [X]%. This sensitivity also will increase the Supply Point GUPPIs by a similar percentage (the actual amount will vary from Supply Point to Supply Point).

⁵⁸² Approximately [X] of the difference in GUPPIs is a result of greater diversion from Asda to Sainsbury's than vice versa.

⁵⁸³ [X].

⁵⁸⁴ In response to the Provisional Findings, the Parties submitted that the CMA had set its national online GUPPI threshold at an inappropriately low level of 0% ([Parties' response to the Provisional Findings](#), paragraph 544), however as the national assessment is not based on a decision rule, we have not set any threshold.

⁵⁸⁵ Excluding Argos.

⁵⁸⁶ Downward pricing pressure is equal to the level of efficiencies divided by the Parties' total combined revenue. If efficiencies are equal to £500 million, and the combined groceries and general merchandise revenues of the Parties (excluding Argos) is approximately £[X], this equates to 1.25%.

⁵⁸⁷ As we have taken into account efficiencies directly when interpreting the level of the GUPPI as part of our national assessment, we have not separately considered efficiencies in the countervailing factors section of this chapter.

that the Sainsbury's national GUPPI (using the most recent version of the margin figures, following Sainsbury's submissions in response to the Provisional Findings) is below this level but that Asda is above and therefore is not supportive of an SLC finding in relation to Sainsbury's online delivered groceries offering in the national assessment.

- 11.56 Similarly, in relation to substantiality, we consider that broadly the same reasoning set out in Chapter 8, paragraphs 8.280 to 8.289, applies to the interpretation of the GUPPI for online delivered groceries. In particular, we consider that there are no reasons to expect that small (but positive) levels of pricing pressure would not be likely to translate into price increases (or other deterioration in PQRS) that would be consistent with an SLC. In this regard we note groceries are a non-discretionary expenditure that accounts for a significant share of household spend; that pass-through is unlikely to be low; that no operational adjustment would be required to change the elements of PQRS in question; and that the GUPPI considers neither feedback effects between merging parties nor second order effects from third parties. Further, as regards uncertainty and bias, we consider that national diversion for online delivered groceries is robustly estimated (given the scale and representativeness of our survey). As such, we consider that any allowance for uncertainty would be smaller when interpreting the national average GUPPI figures than when interpreting Supply Point GUPPI figures, given the larger sample size and ability to use a direct estimate of diversion. For the avoidance of doubt, this means that the decision-rule threshold (and the precise number of SLCs) for the local assessments do not inform our national assessment.

The future of online delivered groceries

- 11.57 We are also conscious that, while online delivered groceries only account for 6% of groceries, this is steadily growing and innovation may play a larger role than in other areas of groceries.⁵⁸⁸ As discussed in Chapter 10, both the Parties and third parties have invested in their digital platforms, while continually testing and developing their websites.^{589,590}
- 11.58 As with other online services, the technology and service offering is likely to develop, and therefore any SLC may lead to a reduced incentive to innovate and continue to improve the online offering in the future. We have considered

⁵⁸⁸ The online channel is forecast to be the fastest growing grocery channel, expecting to increase in value to £17.3 billion by 2023, equivalent to a compound annual growth rate of 9% (see Chapter 4). However, as noted in footnote 59 above there is some indication that this growth may be slower than it has been historically.

⁵⁸⁹ In addition, there may be innovation in delivery fulfilment, for example Ocado's automated CFCs.

⁵⁹⁰ Furthermore, a number of internal documents show Sainsbury's comparing its digital experience and different aspects of its websites to [redacted], and an Asda document notes that Asda [redacted].

the Parties' submission that innovation in grocery retail is driven by innovation in other industries, and that the website serves purposes other than for the sale of online delivered groceries. However, we consider that the Parties and their competitors are still responsible for bringing any innovation to grocery retailing, and that the main purpose of the Parties' website is to sell online delivered groceries, notwithstanding any ancillary purposes.

Conclusion on national assessment

11.59 The evidence set out above indicates that, nationally, the Merger would result in a reduction in the number of competitors in online delivered groceries from eight to seven. However, of these eight retailers, only four (Tesco, Sainsbury's, Ocado and Asda) have national shares of supply materially in excess of 5%. Morrisons, which has most of its online delivered groceries delivered through a contract with Ocado, has a national share of supply of around [5–10%]. This weak position relative to its position in in-store groceries may partly be explained by the fact that Morrisons entered online delivered groceries far later than Sainsbury's, Asda or Tesco,⁵⁹¹ 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 appear to provide a weak competitive constraint on the Parties: as well as their low national shares, [redacted].⁵⁹² We cover the possibility of expansion by these smaller competitors in the section on entry and expansion. In addition, in contrast to in-store groceries, neither Aldi nor Lidl offer online delivered groceries.⁵⁹³

11.60 Further, while Ocado is a relatively strong player overall, with a national share of supply similar to Asda, it is limited to certain parts of the country (with [70-80%] coverage of UK postcodes). Only three online delivered groceries retailers (Tesco, Sainsbury's, Asda) have a near-national presence and a significant number of online delivered groceries customers would have a restricted choice of provider following the Merger: sometimes only the Parties and Tesco.⁵⁹⁴ We note that the Parties overlap in all but one Supply Point.⁵⁹⁵

⁵⁹¹ Morrisons entered online delivered groceries in 2014.

⁵⁹² Asda's internal documents suggest that Asda reviews [redacted], with much less focus on other suppliers. Sainsbury's internal documents typically show a focus on [redacted].

⁵⁹³ Aldi sell alcohol online, but do not offer other online delivered groceries.

⁵⁹⁴ Approximately [redacted] households have the Parties and Tesco as their only online delivered grocery options (based on an average of 15 households per postcode unit). This represents [0–5%] of UK postcodes. [5–10%] of UK postcodes face a reduction of 4 to 3 online competitors.

⁵⁹⁵ All of Sainsbury's Supply Points overlap with an Asda Supply Point, while only one Asda Supply Point does not overlap with any Sainsbury's Supply Points.

- 11.61 We note that online delivered groceries are constrained to some extent by in-store groceries offerings. However, as set out in Chapter 8, the Parties are both significant national players in in-store groceries.
- 11.62 We also note the asymmetries in the constraints faced by the two 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 competitor 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.
- 11.63 Consistent with this, for Asda customers, who are more likely to divert to Sainsbury's than vice versa, the national GUPPI (based on a large, robust survey) shows that there would be material upwards pricing pressure post-Merger, even after the identified rivalry-enhancing efficiencies are accounted for. Particularly in the light of updated financial data provided by Sainsbury's following our Provisional Findings, which reduced the relevant margins and therefore the GUPPI figures, we do not come to the same conclusion as regards Sainsbury's customers.
- 11.64 Lastly, as discussed in paragraph 11.58, we have also considered that the Merger may lead to a reduced incentive to innovate and continue to improve the online offering in the future.
- 11.65 In light of this evidence, we have found that the combination of two of the four largest online delivered groceries retailers (each with a share of supply of around [10–20%]) is more likely than not to give rise to an incentive to degrade PQRS (in particular delivery pass prices and the quality of the website and apps) across Asda's online delivered groceries offerings, resulting in an SLC in each local area where Asda is present. Asda faces varying degrees of competitive pressures from a range of other groceries retailers, including in-store retailers, but these constraints would not be sufficient to offset the substantial loss of competition between the Parties in online delivered groceries post-Merger. We do not reach the same finding for Sainsburys.
- 11.66 We also considered whether there were countervailing factors which could offset the Asda SLCs. We set out our assessment of entry and expansion and efficiencies in paragraphs 11.110 to 11.134, following the Supply Point local assessment.

Supply Point local assessment

- 11.67 Having found through our national assessment SLCs in every local area in which Asda is present, this section separately considers whether there are SLCs in any individual local markets arising from an incentive on the part of the Parties to deteriorate locally-set parameters of competition in some local areas but not others.
- 11.68 At the Supply Point level the Parties can or do flex some aspects of their offering so that they differ between one Supply Point and another ([X]).⁵⁹⁶ Furthermore, post-Merger, the Parties could change their approach and flex more competitive parameters at the Supply Point level, the most obvious of which would be Asda delivery prices.⁵⁹⁷
- 11.69 Since these competitive parameters are set at the Supply Point level, or could post-Merger be set at the Supply Point level, it is appropriate to assess whether the Merger could lead to an SLC in certain local areas, through the deterioration of these Supply Point competitive parameters.
- 11.70 There are also further parameters, such as the range of products at store pick stores, that can vary locally by Supply Point, but are uniform across online and in-store at that particular store. While we have not assessed this, it is possible that, where we have found a local SLC in in-store supermarkets, there could be an equivalent degradation of the online offering in that area, if it were a store-pick store.

Decision-rule approach

- 11.71 As the Parties currently operate 530 Supply Points across the UK, and the competitive pressures in each will vary, we recognised that it would not be practicable to perform an assessment of each local area in turn, using the same range of qualitative and quantitative evidence used for our national assessment, within the time frame of a merger investigation. As such, it was necessary to devise a decision rule to establish whether the Merger is, on the balance of probabilities, likely to give rise to an SLC in any local markets.
- 11.72 GUPPI is an appropriate measure to use for our competitive assessment, because it aims to directly measure the upward pricing pressure that would result from the loss of competition between the Parties. GUPPI therefore

⁵⁹⁶ The range in store-picking stores for online delivered groceries is likely to be driven by competition between bricks-and-mortar stores. Therefore, for the reasons set out in paragraph 11.9, this assessment is carried out as part of our in-store assessment.

⁵⁹⁷ See paragraphs 10.66 to 10.68 in Chapter 10.

more closely reflects how customers make their choices (and how rivals compete) than a fascia counting exercise, which simply counts all the brands in a local area, and treats them as equally attractive to a customer. As such, to the extent it is possible to calculate GUPPIs at a Supply Point level, we consider this evidence to be most relevant to our assessment.⁵⁹⁸

Calculation of Supply Point GUPPIs

- 11.73 We calculated a GUPPI for each Supply Point in which the Parties overlap by combining online margins with diversion ratios. As explained in Chapter 8, when calculating GUPPIs for our local assessment of the Parties' supermarket overlaps, we used direct survey diversion if the store was surveyed in the CMA store exit survey. Similarly, for online delivered groceries, diversion ratios have been calculated using the CMA online survey. Where the sample size was large enough we used the direct survey estimate of diversion for a given Supply Point (henceforth referred to as 'direct survey diversion').^{599,600}
- 11.74 For our local assessment of the Parties' in-store supermarket overlaps (as set out in Chapter 8), where we had not directly surveyed a store, we used a WSS methodology to calculate diversion. The WSS methodology was based on distance, store size and brand strength. With regards to online delivered groceries, distance and store size are not relevant as customers make decisions based on the brands (and associated features) of retailers who deliver to their address. Therefore, for online delivered groceries, as explained further below, where the survey sample size was below 100 we estimated a diversion ratio using information on the competitor set present at that Supply Point.
- 11.75 Following the CMA established best practice in survey design, we usually place more weight on survey diversion ratios when the underlying sample sizes are larger. Using the information provided in the CMA online survey regarding each customer's location and preferred option in response to our diversion questions, we have calculated diversion ratios to each of the other online delivered groceries retailers in each of the Parties' Supply Points. However, there were a number of Supply Points (in particular for Asda) where the resulting sample size was less than 100 (notwithstanding the large sample size overall). Therefore, in view of our best practice, we decided to

⁵⁹⁸ The use of GUPPIs in this investigation is discussed in more detail in Chapter 8.

⁵⁹⁹ As for our calculation of national diversion we have used respondents' answers to forced diversion. See Appendix I and Appendix B for more details.

⁶⁰⁰ Unlike the CMA store exit survey, the CMA online survey was designed to be nationally representative rather than to cover specific Supply Points.

calculate GUPPIs based on direct survey diversion only for those Supply Points where the sample size is at least 100.⁶⁰¹⁶⁰²

11.76 Where our sample size is less than 100 for a Supply Point we have estimated a diversion ratio for each Supply Point (henceforth referred to as ‘estimated diversion’). The methodology used to create these estimates is described in Appendix I, but the basic premise is that diversion from Sainsbury’s to Asda, for instance, in each Supply Point, is the revenue weighted average diversion from Sainsbury’s to Asda amongst different competitor sets present across the Supply Point’s delivery postcodes.⁶⁰³

Parties’ views

11.77 The Parties submitted that the CMA online survey does not generate robust diversion estimates for individual Supply Points, and that the methodology of grouping areas into bands is not supported by the data.⁶⁰⁴

11.78 In particular, the Parties stated that they continue to have significant concerns relating to the robustness of the CMA online survey when using it for evidence in the Supply Point analysis. In particular, we consider the Parties concerns with the CMA online survey were similar to that raised in relation of the assessment of market definition:⁶⁰⁵

- the survey was unrepresentative;
- the price rise diversion question was biased;
- the survey contained high levels of ‘don’t knows’;
- the survey contained framing bias; and
- the results are different from those suggested by the Parties’ evidence, including Kantar switching data, as well as third party sources.

⁶⁰¹ [CMA78](#).

⁶⁰² In the case of Sainsbury’s direct diversion was therefore used for 14 (out of 244) Supply Points, and for Asda only 2 out of 285 Supply Points used direct diversion.

⁶⁰³ To do this, we group postcode units according to the set of competitors that offer online delivered groceries to customers located there, referring to each group as a ‘Band’ . For example, Band 6 consists of Asda, Sainsbury’s, Tesco and Ocado, Band 13 consists of Asda, Sainsbury’s, Tesco, Ocado and Waitrose. We use our survey results to estimate a diversion ratio between the Parties for each Band. For each Supply Point, we then calculate the average of these Band diversion ratios, where each Band diversion ratio is weighted according to the importance (by revenue) of a given Band within that Supply Point.

⁶⁰⁴ [Parties’ response to the Provisional Findings](#), paragraphs 592 to 602.

⁶⁰⁵ These are discussed in more detail in Chapter 10 and Appendix B.

- 11.79 Our assessment of the Parties' views on the CMA online survey are discussed in detail in Chapter 10 and Appendix B.
- 11.80 Both the Parties' submissions and the report by Professor Sturgis note that for the vast majority of Supply Points the sample size is small,⁶⁰⁶ and thus Professor Sturgis notes the 95% confidence interval around any direct estimate is wide. The Parties also submitted that the CMA then extrapolates results from 42 surveyed areas to 530 Supply Points.⁶⁰⁷
- 11.81 The Parties submitted [redacted].⁶⁰⁸
- 11.82 The Sturgis Report notes that, 'because the level of competition and potential for diversion is highly sensitive to local conditions, differential coverage within bands could result in the band level estimates providing poor predictions of the direct Supply Point level estimates.'
- 11.83 The Parties show the level of local variation by taking diversion ratios for postcode areas within Bands, suggesting that there is significant variation across postcode areas within bands.⁶⁰⁹
- 11.84 The Parties also submitted that the Supply Point diversion estimates are unrelated to the number of competitors present in an area. In particular, the Parties first submit that the overwhelming majority of SLCs are found in areas where there is a wide set of competitors covering the area.⁶¹⁰ Secondly, the Parties submit that [redacted].⁶¹¹

Our assessment

- 11.85 We agree with the Parties that a limitation of the Supply Point assessment is that it does not capture all the possible local factors that affect diversion at any given Supply Point. However, we disagree with several of their submissions on this issue.
- 11.86 The Parties' statement that the CMA extrapolates results from 42 surveyed areas is incorrect. As explained in paragraphs 30 to 36 of Appendix I, estimates are based on diversion amongst groups of competitors which

⁶⁰⁶ Parties' response to the Provisional Findings, paragraph 590.

⁶⁰⁷ Parties' response to the Provisional Findings, paragraph 588.

⁶⁰⁸ Parties' response to the Provisional Findings, paragraph 599.

⁶⁰⁹ Parties' response to the Provisional Findings, Figure 16 and Figure 17.

⁶¹⁰ Parties' response to the Provisional Findings, paragraphs 617-618.

⁶¹¹ Parties' response to the Provisional Findings, paragraph 618.

generally have larger sample sizes and cover multiple Supply Points.⁶¹²⁶¹³ In addition, we consider that the Parties' comparison of the level of local variation and the Band level variation is flawed. This is because the local areas have such small sample sizes⁶¹⁴ that any variation could be due to sampling error as opposed to genuine differences.

- 11.87 With regards to the Parties' submission that the Supply Point diversion estimates are unrelated to the number of competitors present in an area, we consider this is partly correct. In particular, there are some instances where the addition of a competitor increases diversion between the Parties. However, there are also many instances where diversion between the Parties is higher when there are fewer competitors. More importantly, the Parties' submission highlights both the disadvantage of using a simple fascia count in a decision rule, and the necessity and advantages in taking into account of the *identity* of competitors and the constraint they impose, when assessing the closeness of competition between the Parties.
- 11.88 For instance, the Band with all eight competitors has a relatively high diversion ratio from Asda to Sainsbury's. We do not consider this to be problematic, for the following reasons:
- (a) Most of the Asda Supply Points that rely heavily on this Band are in London and the South East.
 - (b) Sainsbury's is relatively strong in this area (as confirmed by having a relatively high share of supply in this region), and Asda customers are likely to switch to Sainsbury's.
 - (c) Asda customers do not have the option of going to Aldi or Lidl for online groceries, and Tesco and Morrisons are (relatively) less popular in London (again confirmed by relatively lower market share).
 - (d) This is also an area of high population density, and therefore likely greater demand, leading to a wider number of active competitors.
 - (e) Therefore, we see higher diversion from Asda to Sainsbury's, despite there being eight competitors in total, because Sainsbury's is a relatively close competitor to Asda here.

⁶¹² As described in Appendix I, for the few Bands that do have a sample size of less than 100, we set the diversion to zero.

⁶¹³ While there are a handful of Bands that are only present in a single Supply Point, the vast majority of Bands are present in many Supply Points, with one Band present in [X] Asda Supply Points and [X] Sainsbury's Supply Points.

⁶¹⁴ For instance, less than 10% of postcodes areas within Bands have a sample size of 100 or more.

(f) We consider that in general comparisons between SLC findings that result from a given GUPPI threshold and fascia counting are of limited value, since fascia counts ignore important market features, such as the varying strength of constraint from different competitors. See paragraph 8.131 where we discuss the limitations of fascia counting.

11.89 Lastly, with reference to the level of local variation, unlike in-store, a customer's choice is not likely to be dependent on the location or size of a Supply Point as long as the customer is able to get a delivery. Therefore, the brand of the grocery retailer (where brand represents many factors associated with their offering such as price and quality of the product) appears to be the most significant differentiator between online delivered grocery retailers. See paragraph 11.74.

Comparing estimated and direct diversion

11.90 We also compared the estimated diversion ratios with the direct survey diversion ratios across Supply Points. While Appendix I covers this in more detail, the key findings are:

- (a) as the estimated diversion ratio is constructed by averaging diversion amongst different competitor sets, it reduces variance and therefore the distribution of diversion ratios is nearer the national average diversion ratio than are the direct survey diversion ratios;
- (b) there is a stronger correlation when the direct survey diversion has a larger sample size;⁶¹⁵ and
- (c) the correlation between our estimated diversion ratios and the direct survey diversion is weaker when the direct survey estimate has a lower sample size.

11.91 The weak correlation is likely to be due to the small sample sizes for the direct survey diversion ratios and hence large sampling error,⁶¹⁶ and in part because the estimated diversion ratios cannot fully capture all the possible factors that affect diversion at any given Supply Point.

11.92 We consider that the estimated diversion ratios are the best available evidence in the absence of sufficiently robust direct survey diversion ratios. However, we took the limitations of our diversion estimates into account

⁶¹⁵ See Figure 1 and Figure 2 in Appendix I, where we compare the estimated and direct diversion for Supply Points (i) where the Supply Point sample size was 80 or greater and (ii) where the Supply Point sample size was less than 80.

⁶¹⁶ Asda has smaller sample sizes per Supply Point.

when considering the appropriate threshold to apply for our decision rule approach.

GUPPI threshold

- 11.93 As described above in paragraphs 11.40 to 11.56, for the purposes of our national assessment of online delivered groceries, we have used a national GUPPI as one indicator, in combination with a range of qualitative and quantitative evidence, to conclude whether, in the round, the Merger gives rise to an SLC.
- 11.94 For the purposes of the local assessment, in a similar way as for in-store groceries, we are using the GUPPI as the basis for our decision rule. We have set out the factors that are relevant to interpreting the level of the GUPPI above in paragraph 11.53.⁶¹⁷ These are (i) efficiencies and (ii) substantiality and uncertainty. We consider these factors in turn. Having taken account of these factors, the GUPPI threshold we have used for our Supply Point assessment is 2.75%.
- 11.95 As regards efficiencies, as noted above, we have found that it is appropriate to assume that the Merger will give rise to around £500 million of rivalry-enhancing efficiencies, which would translate into a downward pressure of around 1.25% in a GUPPI analysis in online delivered groceries as it did for in-store groceries.^{618, 619} We consequently do not consider that a GUPPI of around 1.25% or below would be supportive of an SLC finding in a local area.⁶²⁰
- 11.96 For the reasons set out in paragraph 11.56 above, we consider that the same factors which contribute to our assessment of the substantiality of the lessening of competition for in-store groceries would apply to online delivered groceries and this applies equally to our local assessment.

⁶¹⁷ In response to the Provisional Findings the Parties submitted that the CMA's choice of GUPPI threshold was too low with respect to our online Supply Point assessment ([Parties' response to the Provisional Findings](#), paragraph 544), just as it was for our in-store assessment. We respond to the Parties' detailed arguments on the appropriate level for a GUPPI threshold in Chapter 8.

⁶¹⁸ Downward pricing pressure is equal to the level of efficiencies divided by the Parties' total combined revenue. If efficiencies are equal to £500 million, and the combined groceries and general merchandise revenues of the Parties (excluding Argos) is approximately £[§<], this equates to 1.25%.

⁶¹⁹ In Chapter 16 we set out our analysis of the likely efficiencies generated by the Merger. The Parties told us there was a merger-specific efficiency relating to online as Sainsbury's would have access to the Asda HSC located in [§<]. In this area there was substantial demand for [§<]. We have not, however, received evidence from the Parties on the size of these potential synergies and therefore have not been able to take them into account in our assessment.

⁶²⁰ As we have taken into account efficiencies directly when setting the threshold for the GUPPI-based decision rule for our local assessment, we have not separately considered efficiencies in the countervailing factors section of this chapter.

- 11.97 As regards uncertainty, we have undertaken a significant amount of analysis to calculate the Supply Point GUPPIs, but nevertheless there is inevitably some uncertainty around any estimates. As per our in-store assessment in Chapter 8, we have considered whether it would be appropriate, when setting our GUPPI threshold, to take account of any remaining uncertainty and/or bias around the accuracy of our GUPPI figures or our efficiencies allowance.
- 11.98 We may be aware that certain assumptions will tend to result in our analyses underestimating or overestimating the true level of pricing pressure, albeit with some uncertainty as to the magnitude of the effect. In such instances we may find it appropriate to lower or raise the GUPPI threshold.
- 11.99 We recognise in particular that the diversion methodology for Supply Points with fewer than 100 survey responses tends to draw those local Supply Point GUPPI estimates towards the national average GUPPI. As a result, *on average*, GUPPIs below the national average are likely to be slightly overestimated and GUPPIs above the national average slightly underestimated.⁶²¹ However, for any given Supply Point it is not possible to determine whether the methodology has led to the estimated GUPPI being over - or under-estimated. We have therefore not considered it appropriate to adjust the GUPPI figures themselves to reflect this issue.
- 11.100 With reference to a 2.75% GUPPI threshold, this issue may lead us to underestimate the extent of competition concerns for certain Sainsbury's Supply Points, as the national average GUPPI for Sainsbury's is [0–5%]. For Asda it may lead us to overestimate the extent of competition concerns at certain Supply Points, as the national average GUPPI is [0–5%]. We have taken this into account when setting the GUPPI threshold. The difference between the threshold of 2.75% and the average GUPPI of [0–5%] is small, so any over-estimation is unlikely to lead to the GUPPI crossing the threshold, and we consider that the threshold includes a sufficient margin (1.5 percentage points above the efficiencies allowance) to account for substantiality and the resulting uncertainty in the estimates and avoid incorrectly finding an SLC at any given Supply Point.
- 11.101 In addition, the approach of applying a diversion ratio of zero to any Bands with less than 100 responses, as described in paragraph 31 of Appendix I, introduces a bias that reduces the diversion between the Parties and tends to underestimate the GUPPIs, given that diversions are nearly always above zero.

⁶²¹ This is explained in Appendix I.

- 11.102 Finally, we also consider that the use of variable margins rather than gross margins in our GUPPI calculations, our approach to own brand diversion (discussed in paragraph 11.49) and expansion methodology (discussed in paragraph 11.135) will tend to lead to GUPPIs being slightly underestimated.
- 11.103 Overall, after careful analysis and taking into account the difficulty of quantifying the potential impact of these, and other previously detailed, assumptions, the estimates of pricing pressure represent, in our judgement, a good estimate of the relevant variables.
- 11.104 There will also inevitably be some uncertainty around elements of our evidence where we have no reason to consider that this would bias the analysis in any particular direction. In such instances, we may find it appropriate to raise the threshold in order to be confident that each SLC identified has been proved to be more likely than not in the context of the decision rule approach and the specific context of this case (albeit this would increase the risk that we would incorrectly decide that there was no SLC in some areas).
- 11.105 We have undertaken a significant amount of analysis to calculate the Supply Point GUPPIs, as described fully in the paragraphs above and in Appendix B and I. Furthermore, our assessment of the expected rivalry-enhancing efficiencies arising from the Merger has also been the product of extensive information gathering and scrutiny.
- 11.106 Nevertheless, there is inevitably some uncertainty around any estimates, particularly at the Supply Point level⁶²². In order to reduce the risk of 'false positives' (i.e. the incorrect finding of an SLC in a local area), we consider it would be appropriate to account for this in the GUPPI threshold.
- 11.107 In summary, we decided to allow an additional margin of 1.5% above the efficiencies allowance of 1.25% for us to be satisfied, on the balance of probabilities, that in each Supply Point failing the decision rule, the Merger gives rise to an SLC in the circumstances of this particular case. This takes into account the need for any lessening of competition to be substantial, and allows for uncertainty. It leaves a sufficient margin such that our GUPPI figure for a Supply Point would need to misestimate the 'true' GUPPI figure by a significant amount for us to incorrectly find an SLC at that Supply Point. In our judgement this is unlikely to be the case. Taking all relevant factors in the

⁶²² Uncertainty is to an extent more significant at the Supply Point level given that our methodology does not capture all the possible local factors that affect diversion at any given Supply Point. This is not the same at the national level where such sources of variation are averaged out.

round, we therefore decided to set the threshold for the GUPPI decision rule for our Supply Point at 2.75%.

Conclusion on Supply Point local assessment

11.108 Based on the assessment carried out above, we find that the Merger may be expected to result in an SLC in the markets for online delivered groceries around 149 Asda Supply Points. We have not found any SLCs in the markets for online delivered groceries around Sainsbury's Supply Points. This result is in part related to the difference in the national online margins (given that robust estimates for individual Supply Point margins are not available), but is also related to differences in diversion ratios, which suggest that Sainsbury's currently acts as a competitive constraint on Asda in more local areas than the other way round (which we would expect, given the difference in the national diversion ratios). The difference between Asda and Sainsbury's Supply Points is consistent with our finding that the Merger creates an incentive to degrade nationally-uniform parameters of competition (that are specific to online delivered groceries) at Asda Supply Points but not at Sainsbury's Supply Points.

11.109 We also considered whether there are countervailing factors which could offset the potential substantial lessening of competition in these local areas. In this regard we consider entry and expansion and efficiencies below.

Countervailing factors

Entry and expansion

11.110 We have considered whether new entry or expansion by competitors would mitigate the initial effect of the Merger on competition, such that no SLC would arise. In assessing whether entry or expansion might prevent an SLC, we consider whether it would be timely, likely and sufficient. Our detailed review of entry and expansion, including our assessment of the evidence submitted by the Parties and third parties, is contained in Appendix H.

11.111 The Parties submitted that the approach taken by the CMA, which they submitted focuses only on the current market share data, is highly likely to underestimate the dynamic and increasing impact of entry and expansion by competitors.⁶²³

⁶²³ [Parties' response to the Provisional Findings](#), paragraph 625.

11.112 The Parties submitted that the CMA significantly underestimates entry and expansion because in its Provisional Findings it failed to:⁶²⁴

- (a) Identify entry by M&S;
- (b) identify Ocado's expansion plans;
- (c) recognise the extent of Amazon's expansion plans;
- (d) recognise Waitrose's ongoing expansion;
- (e) recognise the scale and scope of Morrisons' expansion plans; and
- (f) take account of Iceland's expansion plans.

11.113 Finally, the Parties submitted that the CMA's assessment should consider the full impact of entry beyond short term impacts, and presented data showing that Morrisons has a higher market share in areas which it entered in 2014 (or before) than where it entered in 2016.⁶²⁵

11.114 We first assessed the investment required to enter online delivered groceries or expand coverage. The evidence suggests that investing in CFCs is expensive and, for Asda and Sainsbury's, [redacted]. This, and the extended timelines required, suggest that there are considerable barriers to entry for firms who seek to enter online delivered groceries by building CFCs. Store-based picking models appear to be more profitable, but this option is only available to those firms which have existing stores in the areas they want to enter and the ability to convert those stores for use in online delivered groceries.

11.115 We then tested whether any grocery retailers had specific expansion plans in online delivered grocery services. As part of this we used our information gathering powers under section 109 of the Act and issued multiple notices requiring third parties to produce documents and information relating to any entry and expansion plans in online delivered groceries within the next two years. These were sent to Aldi, Amazon, Booths, Co-op, Iceland, Lidl, Morrisons, M&S, Tesco and Waitrose.

11.116 The evidence on specific entry and expansion plans shows varying appetites for expansion in online delivered groceries. We have assessed the Parties' views on expansion by third parties, including their arguments that some grocery retailers could use third parties to deliver groceries. We place more

⁶²⁴ [Parties' response to the Provisional Findings](#), paragraph 557 to 586.

⁶²⁵ [Parties' response to the Provisional Findings](#), paragraph 623 to 625.

weight on the views and documentary evidence we have received directly from third parties regarding their own entry and expansion plans.

11.117 Iceland and Morrisons gave us a list of postcodes for areas they had firm expectations of expanding into within the next two years. We considered that this geographic expansion would be both timely and likely.

11.118 We reviewed Amazon's response and information provided by the Parties regarding Amazon. [REDACTED] This is set out in more detail in paragraph 49 of Appendix H. [REDACTED].⁶²⁶

11.119 We reviewed the evidence regarding Co-op's plans, including information provided by the Parties and by Co-op itself. Co-op told us that it had launched a trial online offer on 22 March. This was the first example of Co-op products delivered from a Co-op website and a Co-op customer interface. The trial involved a range of [REDACTED] SKUs and delivery limited to a maximum [REDACTED] radius from the store. We noted the [REDACTED] range of SKUs being offered, the relatively small size of the stores used for store-picking, and Co-op's description of its strategy. Based on this evidence we found that Co-op's offering would not be likely to fall within our relevant market definition for online delivered groceries and therefore it should not be considered as entry into the relevant market.⁶²⁷

11.120 We reviewed the evidence regarding the new Ocado/M&S joint venture, including information provided by the Parties, and by Ocado and M&S themselves. We do not consider this to be new entry by M&S into online groceries. M&S is purchasing a 50% share in the existing retail business of Ocado, rather than establishing a new retail proposition or otherwise adding substantial online delivered groceries capacity. [REDACTED]. Consequently, we do not think that the transaction will lead to a substantial change in the competitiveness of Ocado within the next two years. The information we have received does not lead us to find that any geographic expansion by the JV will be timely and likely.⁶²⁸

11.121 Having reviewed the evidence set out in Appendix H, we found that there was no other entry into online delivered groceries which would be timely or likely.

11.122 We have also reviewed evidence on forecast sales expansion by each competitor to capture future growth, which suggested that competitors do not

⁶²⁶ See Appendix H.

⁶²⁷ See Appendix H.

⁶²⁸ See Appendix H.

expect their position in the market to change substantially in the coming years.⁶²⁹

11.123 With respect to the Parties' submission showing that Morrisons had a higher market share in areas which it had entered in 2014 as compared to areas it entered in 2016, we note that i) we would expect that Morrisons would have first chosen to enter areas where it expected to be strong, and therefore it could not be assumed that they would reach the same strength in areas they entered at a later date and ii) we generally consider expansion over the next two years, and therefore the strength of Morrisons beyond this is of lesser importance for our assessment.

11.124 Our conclusion is that the planned expansion by Iceland and Morrisons will be timely and likely, and the scale of this expansion will be small. [X].

11.125 Our conclusion is that the planned new offering from [X] will be timely and likely, but it will not be sufficient to countervail the SLCs arising from our national assessment. [X].⁶³⁰ [X], and therefore we think that it is unlikely that this expansion will impose a substantial constraint on the Parties in a timely manner.

11.126 We have also considered the threat of entry. If the Parties believe that they will face more competition in the near future this could act as a constraint on them raising prices, because an increase in price could trigger entry or wider expansion from a competitor. We note that some of the Parties' internal documents (and media/analyst reports) speculate that the discounters may start offering online delivered groceries. However, as it takes time to build up online capabilities, we consider that the Parties would only be constrained if there was strong evidence that these potential rivals were very close to entering or expanding significantly.⁶³¹

11.127 Given our conclusion that only the expansion by [X], Iceland and Morrisons will be timely and likely, we consider that overall at the national level entry and expansion by rivals would not be timely, likely and sufficient to countervail the SLCs we have found.

11.128 However, to capture our view that expansion by [X], Morrisons and Iceland is timely and likely in certain Supply Points we have included their expansions plans in our competitive assessment.

⁶²⁹ See Appendix H.

⁶³⁰ [X].

⁶³¹ Given the substantial physical infrastructure required to support an online delivered grocery business, disruptive innovation from outside the current competitors may be difficult.

11.129 The Parties submitted that the approach taken by the CMA at Provisional Findings for including expansion at the Supply Point level was flawed, because given the significant variation of diversion estimates within bands, and the lack of relationship between number of brands in the band and diversion it could result in a higher diversion ratio between the Parties, rather than lower diversion ratio.⁶³²

11.130 As discussed in paragraphs 11.87 to 11.89 we disagree with the Parties submission, however we acknowledge that the approach taken previously could lead to higher Supply Point GUPPIs in some areas. To address this, we have adapted our approach to incorporating expansion into our local assessment.

11.131 Our updated approach for including [X], Morrisons and Iceland expansion areas as a countervailing factor is as follows:

- (a) First, we calculated the average national diversion ratios to these three competitors from each of the Parties in areas where both the competitor and the Party currently supply online groceries.
- (b) Second, we obtained from [X], Iceland and Morrisons information on the additional postcodes where they planned to expand their coverage.
- (c) Third, we reduced our local GUPPI estimates for every Supply Point that served postcodes where one or more of these competitors was planning to expand into. This reduction assumed that these expanding competitors would receive the same proportion of diversion from the Parties in these new expansion areas as they do on average across the UK.

11.132 These reduced local GUPPI estimates therefore incorporate the countervailing effect of any planned entry in a systematic way within our local analysis. Furthermore, expansion into the area served by one of the Parties' Supply Points can only decrease the GUPPI calculated for that Supply Point.

11.133 This methodology may overstate the impact of expansion in these areas. While the methodology assumes that competitors will receive diversion from the Parties equal to the average diversion received across the UK, this may not be the case for two reasons:

- (a) Competitors are likely to first enter in areas where they believe they are most likely to be successful. In subsequent expansion areas these

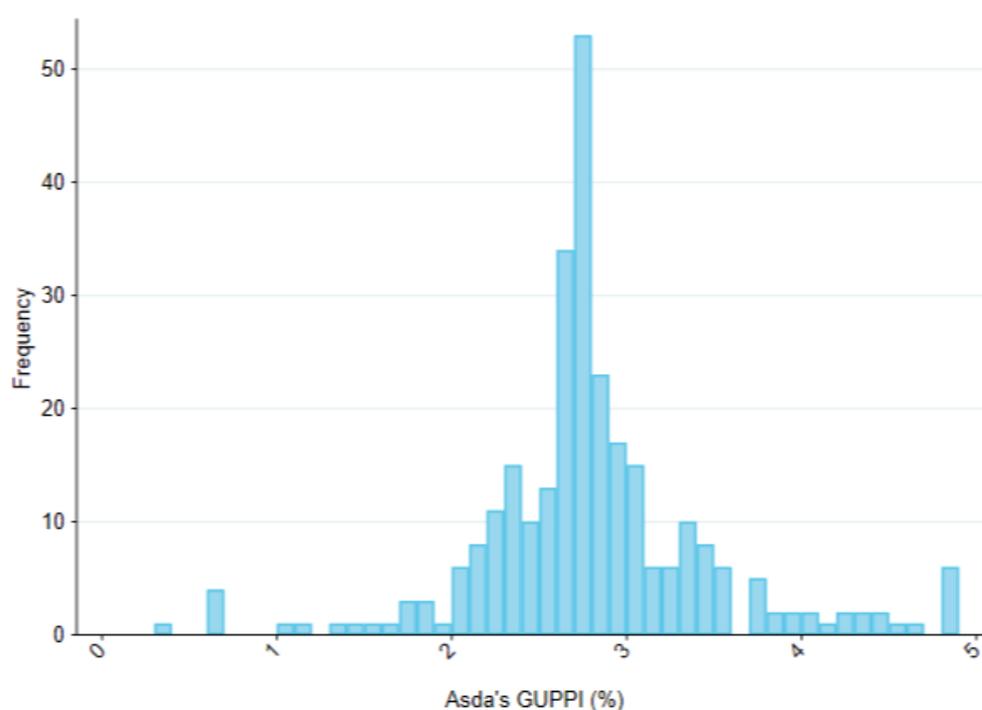
⁶³² [Parties' response to the Provisional Findings](#), paragraph 618 to 619.

competitors may not be able to achieve the same diversion from the Parties.

- (b) It may take time to build up customer recognition and reputation in a new area, therefore, diversion from the Parties could be lower than the national average shortly after expansion.

11.134 After accounting for the countervailing effect of expansion from [X], Morrisons and Iceland, the number Supply Points resulting in SLCs (based on a GUPPI threshold of 2.75%) falls by 6 to 143. The distribution of GUPPIs from all of the overlapping Asda Supply Points in the UK. can be seen in Figure 11.1 below.

Figure 11.1: Distribution of the GUPPIs for Asda's Supply Points that overlap with Sainsbury's Supply Points



Source: CMA analysis.

12. Online delivered groceries: coordinated effects

12.1 This Chapter considers the potential for coordinated effects in online delivered groceries. As set out in Chapter 9, concerns regarding coordinated effects arise when a merger makes tacit coordination more likely to emerge or makes pre-existing coordination more stable or effective. In concentrated markets where firms recognise their mutual interdependence, repeated interaction between firms can lead them to refrain from initiating price cuts (as this is likely to provoke a matching price cut from competitors) or to

initiate price rises (as competitors may recognise that following the price rise is the most profitable approach) without the need for any active collusion between them.

- 12.2 The Guidelines set out that all three of the following conditions must be satisfied for coordination to be possible:⁶³³
- (a) Firms need to be able to reach and monitor the terms of coordination.
 - (b) Coordination needs to be internally sustainable among the coordinating group, ie firms find it in their individual interests to adhere to the coordinated outcome.
 - (c) Coordination needs to be externally sustainable, in that the coordination is not undermined by competition from outside the coordinating group.
- 12.3 We assessed whether the Merger might be expected to give rise to an SLC in online delivered groceries markets through coordinated effects, using the framework set out in the Guidelines. As part of our assessment, we examined the extent to which the three conditions set out in the Guidelines are met currently, and the extent to which they would be met following the Merger. We have conducted our analysis with a form of hypothetical coordination in mind which takes account of the characteristics of online delivered groceries and considers all the available evidence in the round.

Parties' views

- 12.4 The Parties submitted that there would not be an SLC resulting from coordinated effects in online delivered groceries. The Parties consider that the conditions for coordination are not currently present in online delivered groceries and that the Merger will not materially change this in relation to any of the three conditions necessary for coordination to take place.
- 12.5 The Parties submitted that the form of coordination considered most likely by the CMA (as set out in paragraph 12.9) could not arise, for the following reasons:
- (a) the Parties and Tesco would not have the ability or incentive to fundamentally amend the way they each set delivery charges in order to coordinate where Ocado is not present;

⁶³³ [CC2 Revised](#), paragraph 5.5.9.

- (b) there are numerous factors that curtail the ability of the Parties and Tesco to reach and monitor the terms of coordination on delivery charges;
- (c) members of the hypothetical coordinating group would have the ability to profitably deviate from this form of coordination; and
- (d) there is considerable scope for competitors to disrupt coordination.⁶³⁴

Third parties' views

- 12.6 As set out in Chapter 9, several third parties were concerned about the level of concentration in the groceries sector that would result from the Merger and the potential for coordinated effects.
- 12.7 Morrisons considered that the impact of the Merger in online delivered groceries would be even larger than for in-store groceries, as post-Merger approximately 75% of sales would be controlled by Tesco and the Merged entity. Morrisons said that the online delivered groceries channel is a competitive market with high barriers to entry, and that a number of market players (including Morrisons) do not provide national coverage, which means that there are many areas in which customers would only have a choice between two retailers post-Merger. Morrisons said that the creation of this duopoly could mean that Tesco and the Merged entity would potentially increase delivery prices and increase profits, given the lack of competition in some parts of the UK.⁶³⁵
- 12.8 We did not receive any further submissions from third parties on coordinated effects in online delivered groceries.

Our assessment

Form of coordination

- 12.9 It is appropriate to conduct our assessment of the potential for coordinated effects with a specific hypothetical form of coordination in mind. Based on our assessment of the characteristics of online delivered groceries and the evidence set out below in paragraphs 12.11 to 12.94, 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:

⁶³⁴ [Parties' response to the Provisional Findings](#), paragraph 631.

⁶³⁵ [Summary of the hearing with Morrisons](#), paragraphs 41 and 42.

- (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 and in most local areas and which have the broadest geographic coverage. As discussed in paragraphs 12.39 and 12.40, we considered it unlikely that the incentives of Ocado (which is one of the top four largest online delivered groceries retailers) or any other smaller online delivered groceries retailers, including Morrisons, would be sufficiently aligned with Asda, Sainsbury's and Tesco for a common understanding to be reached with them. We therefore assessed the ability for Ocado and the other smaller online delivered groceries retailers, including Morrisons, to disrupt any coordination between Asda, Sainsbury's and Tesco. For the reasons set out below, we did not consider that this would undermine the external sustainability of such coordination.
- (b) The focal point of coordination would be delivery pricing, including delivery charges and other related elements, such as slot length and minimum basket size.⁶³⁶ Coordination could involve increasing delivery charges, slot lengths, and/or minimum basket sizes. Delivery pricing is an aspect of competition specific to online delivered groceries, unlike the price of groceries,⁶³⁷ and over which there is a high level of transparency. We did not consider it likely for the terms of coordination to relate to these charges indirectly through an understanding to limit capacity growth because of a lack of transparency over capacity (see paragraph 12.50).
- (c) Given the differing levels of 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 hypothetical coordinating group are weakest. This would most likely comprise areas where Ocado is not active. We considered a straightforward approach would be for coordination to emerge across Postcode Areas where Ocado is entirely absent. The geographic scope of coordination is further discussed in paragraphs 12.59 to 12.65.
- (d) We considered that this form of tacit coordination would be most likely to emerge through amendment to the pricing policies of the hypothetical coordinating group over time and their repeated interactions.⁶³⁸ For

⁶³⁶ Where we refer to delivery pricing in the rest of this section, it should be understood to include delivery charges, slot length and minimum basket size.

⁶³⁷ Grocery prices are the same across both online and in-store for all online delivered groceries retailers, except for Amazon and Ocado which do not offer in-store groceries.

⁶³⁸ [CC2 Revised](#), paragraph 5.5.10.

instance, one member of the hypothetical coordinating group would increase its delivery prices and see how the other members responded. The final terms of coordination could then vary depending on those responses. For example, if the other members of the hypothetical coordinating group raised delivery prices across a wider set of areas, the geographic scope of coordination may be expanded.

- 12.10 While we considered this to be the most likely form of coordination, this does not mean that other forms of coordination, for example over a wider area or among a wider hypothetical coordinating group, would be implausible. However, we have not assessed other forms of coordination individually and therefore cannot reach specific conclusions in respect of them.

Pre-existing coordination

- 12.11 We first assessed whether there was any evidence of pre-existing coordination in online delivered groceries. While pre-existing coordination is not required for a merger to lead to coordinated effects, in general, a merger in a market already showing coordinated outcomes would be likely to make coordination more sustainable or more effective, unless the structure and scale of the merged firm is so different from those of its predecessors that the incentive to coordinate has been removed.⁶³⁹

Parties' views

- 12.12 The Parties submitted that there was no evidence of coordination in online delivered groceries and therefore the only possible conclusion was that such coordination was not present.
- 12.13 The Parties submitted that there was no evidence of coordination in areas where the CMA's theory would predict it should already exist and that this was primarily due to the constraint from in-store groceries. There was no evidence that delivery prices were higher in Northern Ireland, where there were fewer online retailers than elsewhere in the UK. Asda charged the same delivery price across the entire UK, and Sainsbury's used the same approach to delivery prices for customers in Northern Ireland as it did for those in other parts of the UK. Until August 2018, [✂].

⁶³⁹ [CC2 Revised](#), paragraph 5.5.8.

Our assessment

- 12.14 To assess whether there was any evidence of pre-existing coordination in online delivered groceries, we examined:
- (a) the current approaches to delivery pricing;
 - (b) internal documents;
 - (c) past observed outcomes, in particular the relative levels of delivery prices; and
 - (d) the profitability of online delivered groceries retailing.

Current approaches to delivery pricing

- 12.15 As explained in Chapter 10, online delivered groceries retailers currently set their delivery pricing in different ways including setting specific prices per slot, offering delivery passes, and providing free deliveries over minimum spend levels. Some retailers do not vary delivery pricing according to the geographic location [redacted] (Asda, Iceland, Amazon) whereas others do (Sainsbury's, Ocado, Morrisons and Tesco).
- 12.16 Whilst Asda sets the same delivery prices across the UK, Tesco and Sainsbury's vary their charges by geographic location with Tesco having [redacted] sets of prices and Sainsbury's having [redacted] different sets of prices. We noted that these differing approaches made pre-existing coordination in relation to delivery pricing unlikely. We did not find evidence that the local variations in pricing that do currently exist (for Tesco and for Sainsbury's) are related to the presence or absence of certain competitors. As noted above, the Parties told us that until August 2018 [redacted]. However, Sainsbury's accepted that this suggests that in those areas there is less demand for online delivered groceries. We considered that a comparison of prices between areas was of limited value unless it accounted for the impact of different demand and supply conditions.

Internal documents

- 12.17 We reviewed the Parties' internal documents and some of these suggested that there is an understanding of competitors' mutual interdependence in online delivered groceries. We also reviewed internal documents of Tesco, some of which appear also to show an understanding of the desirability of influencing competitors' responses to Tesco increasing its delivery prices.

- 12.18 The Parties' internal documents show that they react to changes in competitors' delivery pricing, particularly [REDACTED]. For example, in 2016, Sainsbury's reported that it had changed its delivery pricing to bring it into line with [REDACTED]. Similarly, Asda in a 2016 delivery pricing review noted that in 2014 it had increased the number of £1 slots to match [REDACTED] and that in 2015 it rebalanced weekend slot pricing in line with [REDACTED].
- 12.19 We have seen evidence that in 2015/16 Tesco engaged [a consultant] 'to help [Tesco] develop a three to five year strategy for [their] Grocery Online business and to define the plan needed to deliver that strategy'. This was referred to in Tesco's internal documents as the 'Grocery Online Future Model'. The final form of [a consultant's] work was discussed at Tesco's UK board in January 2016 and a £[REDACTED] price rise in relation to delivery prices was recommended. [REDACTED]. [A consultant] found that 'the economic implications of the agreed strategy are highly dependent on competitor and customer reactions. [REDACTED].
- 12.20 This provides evidence that in the view of Tesco's advisors there is a common interest across the industry in increasing delivery prices to reflect the value of the service provided and that the success of this plan would be influenced by competitors' responses. We noted that the plan does not appear to have been implemented exactly as envisaged. The timing of the sharp increase in Tesco delivery prices seen in Figure 12.1 does not appear to line up with the timing envisaged in the documents, although Tesco has increased its average delivery prices over time. We asked Tesco about the progress on this project and it confirmed that [REDACTED].

Past observed outcomes

- 12.21 We reviewed evidence on average delivery prices between 2014 and 2018, as set out in Figure 12.1. This shows that there are material differences in the price levels and the average prices do not appear to move in parallel (which we might expect to see if competitors were already coordinating). While these national average slot prices do not enable an understanding of any underlying changes in local slot prices (such that we cannot be sure of the position in different geographic areas), we did not consider this evidence to be consistent with pre-existing coordination in relation to delivery prices.

Figure 12.1: [REDACTED]

[REDACTED]

Source: [REDACTED].

- 12.22 We see from Figure 12.1 that Tesco has increased its delivery prices since late 2015. The Parties told us that 'when Sainsbury's increased its delivery

prices, in part in response to a Tesco price change from 2016, it resulted in [redacted] of “at least [redacted] orders per week” negating any [redacted].⁶⁴⁰ It appears that Asda did not respond or only made a limited response towards the end of 2017 around the time Morrisons did. Tesco confirmed that it took a long time for the sector to respond to its changes in delivery charge pricing ‘I do not think anybody in the market moved for quite a long time, but I think, with the exception of Ocado, you will have seen everybody start to reintroduce some mechanism in terms of trying to charge for delivery’. We considered that the response to Tesco's increase in delivery prices could not be interpreted as evidence of pre-existing coordination however, because, Asda did not increase price until much later and Sainsbury's then appeared to partly reverse its response. We also noted that Tesco maintained its pricing increase and made further small increases (suggesting that Tesco's price increases were not predicated solely on anticipating that other retailers would also increase prices).

Profitability of online delivered groceries

- 12.23 Very high margins might be consistent with coordination, if firms are making additional profits as a result of their coordination, whereas very low margins could be inconsistent with (effective) coordination. However, in this case we considered that an assessment of the levels of margins would be of limited value due to the difficulty in assessing the 'competitive' level of margins against which to compare.
- 12.24 Online delivered groceries appear to be less profitable than in-store groceries. Our analysis of margins, based on figures provided by the Parties, found that [redacted] (see Appendix F for more detail). In addition, Tesco told us that its ‘online business is less profitable than its stores business’ as set out in a recent results presentation. The Tesco internal documents described above suggest this is an industry-wide issue; they contained the following statement, ‘Our similar competitors have comparable or worse economics. [redacted].’

Conclusion on pre-existing coordination

- 12.25 We did not find sufficient evidence to support a finding of pre-existing coordination in online delivered groceries. There is some evidence of online delivered groceries retailers recognising their mutual interdependence and, in particular, Tesco being advised that the economic implications of a strategy to raise delivery prices were highly dependent on competitor responses. We

⁶⁴⁰ Parties' response to the Provisional Findings, paragraph 638.

consider that this evidence is relevant to our assessment of the conduciveness of the relevant markets to coordination and the likelihood of coordination emerging post-Merger.

Conduciveness to coordination

12.26 We have considered the extent to which characteristics of online delivered groceries may be conducive to coordination and the hypothetical form of coordination set out in paragraph 12.9. This section considers the pre-Merger situation, with the change from the Merger considered in the following section. The evidence from the previous section on whether there is pre-existing coordination is also relevant to this analysis.

Condition 1: Ability to reach and monitor the terms of coordination

12.27 For coordination to emerge, the coordinating retailers need to be able to reach a common view on the scope of coordination. This need not involve a precise outcome, but needs to be sufficiently clear to enable their behaviour to be aligned. To sustain coordination, they will also need to be able to observe each other's behaviour sufficiently to ensure that deviation from the coordinated outcome can be detected. If deviation goes undetected then there will be no incentive to sustain a non-competitive outcome.

Parties' views

12.28 The Parties submitted that a hypothetical coordinating group in online delivered groceries would be prevented from reaching and monitoring the terms of coordination by the lack of transparency and high degree of complexity in online delivered groceries. The Parties highlighted complexity in delivery prices, for example Tesco charging higher prices for narrower slots, Ocado's dynamic delivery pricing, the numerous forms of delivery passes available and the diversity of business models. The Parties stated that Sainsbury's had little visibility or understanding of Ocado and Morrisons' approaches to delivery pricing and that the varying approaches were not applied uniformly throughout the UK. According to the Parties, the complexity of online delivered groceries is compounded by the interaction between online and in-store and pure online retailers are likely to have different incentives compared to those with online and in-store operations.

12.29 With regard to the form of coordination that we consider most likely (as set out in paragraph 12.9), the Parties submitted that the Parties and Tesco could not reach and monitor the required terms of coordination for the following reasons:

- (a) The Parties and Tesco lack the ability to coordinate in the geographic areas identified: Sainsbury's has [§] clusters of prices designed to maximise delivery efficiency. Amending each of the sets that include an area where Ocado is not present would have a negative impact on the functioning of these clusters (including outside the areas where Ocado is not present). Adding another cluster would create a significant cost as is clear from the fact that Sainsbury's does not currently flex pricing at a local level. [§].⁶⁴¹
- (b) The Parties and Tesco would have no incentive to coordinate in the areas identified: The areas where Ocado is not present account for a small proportion of the Parties' online business: one-fifth of delivery areas; no more than [20–30%] of total delivery charges for Asda and [10–20%] for Sainsbury's; less than [0–5%] of both Asda's and Sainsbury's total online revenues; and [0–5%] of the average basket for Asda and [0–5%] for Sainsbury's. Furthermore, despite their limited size, delivery charges are very visible and an important factor for consumers that have a significant reputational impact.⁶⁴²
- (c) There is insufficient transparency between firms over how many delivery slots are available at any given time, over the use of vouchers and also as to how competitors' delivery pricing varies by area. There is no way of ascertaining the extent to which any of Sainsbury's, Tesco or Asda are engaging in targeted vouchering activity in a particular local area or on different elements of the cost. Even if it was possible to monitor whether such vouchers exist it would be impossible to monitor the quantity provided.⁶⁴³

Our assessment

12.30 As set out below, we considered several factors which could affect the ability of retailers to reach and monitor terms of coordination pre-Merger: stability of shares of supply and demand; symmetry of structure and business models; the number of firms; transparency over delivery pricing; complexity of delivery pricing; and complexity over the geographic scope of coordination.

⁶⁴¹ [Parties' response to the Provisional Findings](#), paragraphs 633 to 636.

⁶⁴² The Parties provided evidence that delivery price increases led to online customer lapsing, and would have a 'significant knock-on reputational effect'. [Parties' response to the Provisional Findings](#), paragraphs 637 to 646.

⁶⁴³ [Parties' response to the Provisional Findings](#), paragraphs 648 to 654.

Stability

- 12.31 Where market conditions are relatively stable it is generally easier to coordinate behaviour. Continually changing market conditions could disrupt any common understanding and make it harder for firms to maintain coordination over time.
- 12.32 Shares of supply among online delivered groceries retailers are relatively stable and, according to Figure 12.2. below, demand for online delivered groceries has been steadily growing at approximately [10–20%] per year.

Figure 12.2: Shares of supply for online delivered groceries

[✂]

Source: Sainsbury's.

- 12.33 The Parties submitted that a market characterised by increasing demand would prevent alignment on a coordinated outcome in relation to online delivered groceries. We consider, however, that increasing demand is not necessarily a barrier to reaching a common understanding especially if, as in this case, growth appears to be steady and predictable as each coordinating firm would be able to assess their 'fair share' of steady growth such that they would still be able to detect deviations.⁶⁴⁴
- 12.34 As can be seen in Figure 12.2, there has been some entry and expansion in online delivered groceries, however this has not dramatically affected the shares of sales of the major online delivered groceries retailers. According to the data above, over the last seven years, Asda's share has changed from [10–20%] to [10–20%] and Sainsbury's share has remained around [10–20%]. Whilst Morrisons entered in 2014, it had only gained around a [0–5%] share by 2017⁶⁴⁵ according to these figures, and the shares of other players such as Ocado and Waitrose have been relatively stable. Tesco has experienced the biggest change with its share reducing from [50–60%] to [40–50%] over this time period but by a small amount each year. Therefore, despite the growth, there have not been sharp fluctuations in share and entrants, such as Morrisons and Iceland, have not made major share gains. We discuss other potential entry and expansion in paragraph 12.93 although we do not consider that it would contradict the analysis above.

⁶⁴⁴ Expected growth could also make deviations from coordination less likely as the benefit is a short-term gain and the cost is future lower prices when demand will be higher (see paragraph 12.67).

⁶⁴⁵ Based on IGD data and so may not match other share figures presented elsewhere.

- 12.35 We considered the degree of innovation in online delivered groceries. In particular, there have been innovations in the CFC model which is currently used primarily in areas of high population density, especially by Ocado.⁶⁴⁶ While we considered that innovation may play a larger role than in other areas of groceries, we did not consider any of the innovations we are aware of to be disruptive to coordination.
- 12.36 The evidence suggests that whilst there has been some entry and expansion, the market shares have been relatively stable, and this stability would help a hypothetical coordinating group to reach an understanding.

Symmetry

- 12.37 The more similar the business models of online delivered groceries retailers, the more likely they are to be able to arrive at a common perception of what the terms of coordination should be. However, it may be possible for differences between members of a potential coordinating group to be reflected in the terms of the coordination, for example with lower cost retailers setting a lower price, but maintaining relative price levels.
- 12.38 Asda, Sainsbury's and Tesco each has a similar online model, which primarily relies on delivering groceries through the 'store-pick' method. They also all offer in-store groceries. As the Parties highlighted, players with both in-store and online offerings are likely to have different priorities compared with those with only online offerings. Asda, Sainsbury's and Tesco, along with the other main online delivered groceries retailers, each offer a similar wide range of groceries. They are also the only three online delivered groceries retailers with near national coverage.
- 12.39 In comparison, Ocado's incentives appear different and we did not consider it would be part of the hypothetical coordinating group. Ocado is likely to have less incentive to coordinate over online delivered groceries as a result of not having any physical stores through which to recapture any customers that divert away from online as a result of higher delivery pricing.⁶⁴⁷ Ocado is also a smaller grocery retailer than Tesco, Asda and Sainsbury's in absolute terms; as a result, any sales increase is likely to have a greater impact on

⁶⁴⁶ In the areas where Ocado is not present, Asda, Sainsbury's and Tesco all use the store-pick model for their online delivered groceries.

⁶⁴⁷ While M&S, which is purchasing a 50% share of Ocado's retail business, has physical stores, we did not consider this would give Ocado the incentive to coordinate (see M&S's website (27 February 2019), [Bringing the best together: transforming UK online grocery shopping M&S and Ocado announce new joint venture](#)) (see Appendix H).

Ocado's input prices.⁶⁴⁸ Ocado's geographic coverage is also more limited than the members of the hypothetical coordinating group.⁶⁴⁹

- 12.40 We did not consider Morrisons or other smaller online delivered groceries retailers would be part of the hypothetical coordinating group. Morrisons also has a different business model to Tesco, Asda and Sainsbury's as it has entered into agreements with Amazon and Ocado in relation to fulfilment services and technology and uses capacity in Ocado's fulfilment centres. Furthermore, Morrisons only entered the online delivered groceries sector in December 2013 and has a much smaller share and lower level of geographic coverage. Morrisons, as well as other smaller online delivered groceries retailers, would also have less incentive to coordinate if it believed the larger members of the hypothetical coordinating group would coordinate without them (see paragraph 12.77 below). Morrisons' online geographic coverage is also more limited than the members of the hypothetical coordinating group.⁶⁵⁰

Number of firms

- 12.41 The lower the number of firms which are coordinating, the easier it will be to reach a tacit understanding.⁶⁵¹ As a starting point, it will generally be easier for a firm to know what its rivals are doing when there are fewer of them and it will therefore be easier to interpret market interactions and reach the terms of coordination between a smaller group of retailers.⁶⁵²
- 12.42 Coordination would be more likely where the hypothetical coordinating group is smaller as it would involve aligning fewer sets of behaviour based on a smaller number of relationships between the members. This could increase the likelihood of any common understanding emerging given the greater likelihood that incentives would be aligned and the smaller number of interactions that may be required to effectively coordinate behaviour. The number of relationships and interactions required are important because, given we are assessing the potential for tacit coordination, participants would need to anticipate and react to the others' responses in the markets to coordinate without any direct discussion between the members of the hypothetical coordinating group.

⁶⁴⁸ See paragraphs 15.37 to 15.38 for more details of our analysis into scale and input prices.

⁶⁴⁹ Following the announcement of the Ocado/M&S JV (see M&S's website (27 February 2019), [Bringing the best together: transforming UK online grocery shopping M&S and Ocado announce new joint venture](#)), we asked Ocado whether this was likely to result in geographic expansion of its activities in online delivered groceries and it confirmed that it had no plans to expand geographic coverage within the next two years.

⁶⁵⁰ See Table 11.1 above.

⁶⁵¹ [CC2 Revised](#), paragraph 5.5.11.

⁶⁵² [CC2 Revised](#), paragraph 5.5.13.

12.43 Based on the market characteristics outlined above, we consider that at present the most likely hypothetical coordinating group in the markets for online delivered groceries would consist of three of the four largest UK online delivered groceries retailers: Tesco, Asda and Sainsbury's. This means there would currently be three sets of incentives that would need to be aligned within any common understanding forming the basis of coordination. In addition, in practical terms, each member of the hypothetical coordinating group would need to anticipate the responses of two other members and then those two other members would need to respond.

Transparency of delivery pricing

12.44 Being able to observe the actions of competitors helps online delivered groceries retailers develop mutual awareness that may then help them reach a common understanding. Further, the more transparent the markets are, the easier it will be to monitor coordination.

12.45 We have found that online delivered groceries retailers monitor their competitors' delivery pricing. Asda told us that it reviewed the delivery prices of [redacted]. Sainsbury's told us that it monitored delivery prices for [redacted]. This monitoring can be seen in Figure 12.3 showing [redacted] and Figure 12.4 showing [redacted].

Figure 12.3: Sainsbury's monitoring of competitor delivery offers

[redacted]

Source: Sainsbury's.

Figure 12.4: Asda monitoring of competitor slot pricing

[redacted]

Source: Asda.

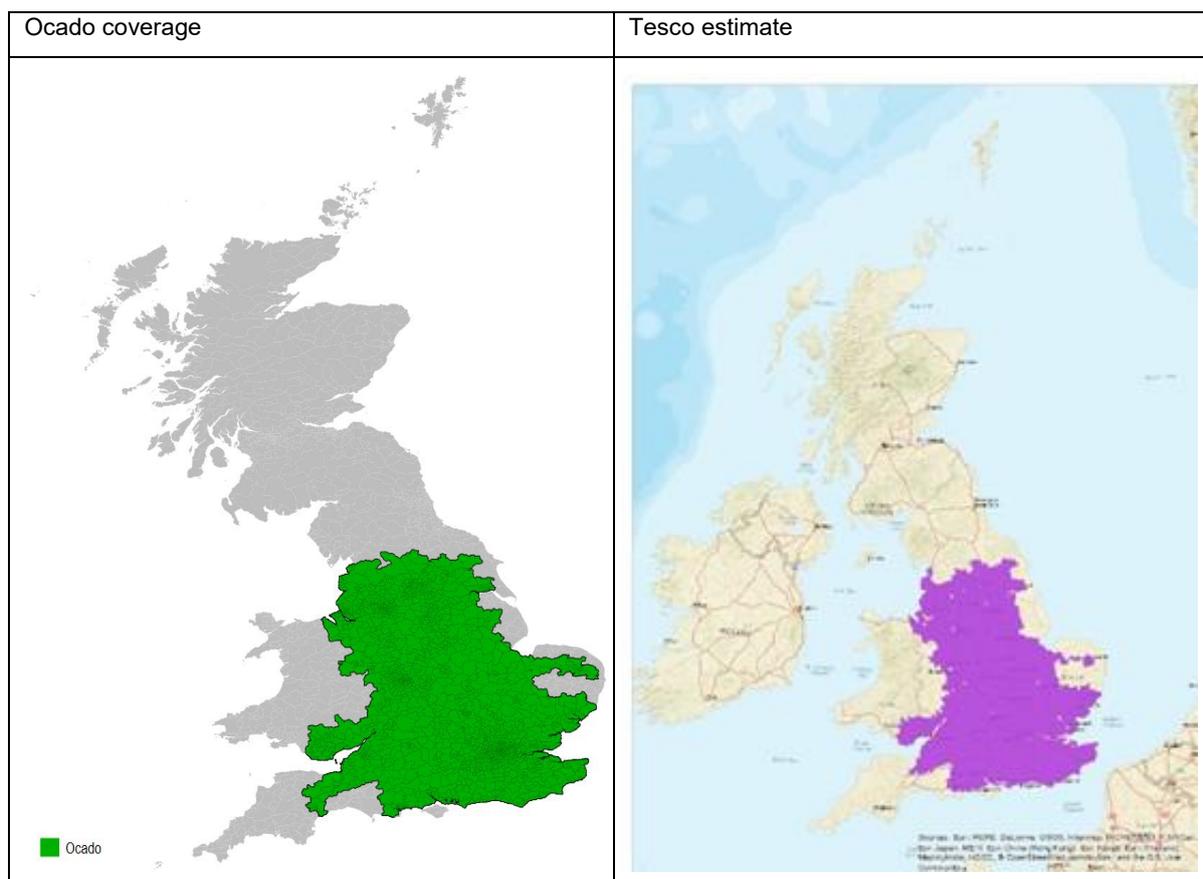
12.46 While the delivery prices available to consumers on online delivered groceries retailers' websites are transparent, vouchering may make the effective charges paid by customers less transparent. We found that vouchering is not very commonly used at present although it is used more by Sainsbury's than Asda – according to the Parties [redacted]% of Sainsbury's and [redacted]% of Asda's online transactions had a voucher associated with them, although we note that the level of vouchering could change. We note that we did not have evidence of the extent of vouchering used by Tesco. We considered whether voucher use is monitorable to some extent. Tesco told us that it [redacted]. While we considered that a more systematic version of this approach would need to be adopted by each of the members of the

hypothetical coordinating group in order to monitor voucher use for the purposes of coordination, this does not appear to be a significant cost.

12.47 We also considered that coordination could be monitored indirectly through impacts on each online delivered grocery retailer's own sales. If one of the members of the hypothetical coordinating group stopped coordinating and improved its offer to customers (for instance through greater use of vouchers), that would affect the sales of the other members of the coordinating group. Tesco told us that [X]. While it would involve some cost and may have limitations, such as requiring interpretation as to why sales have changed, we considered that such indirect monitoring would likely be sufficient to monitor the terms of coordination.

12.48 There is transparency over the geographical coverage of each online delivered groceries retailer as this is obtainable from each retailer's website by inputting a postcode. Tesco's understanding of where Ocado operates compared to data submitted by Ocado can be seen in Figure 12.5. As such, we consider that the hypothetical coordinating group would already be aware of the competitors which they face in different areas.

Figure 12.5: Ocado coverage of GB ((i) Ocado coverage and (ii) Tesco estimate)



Source: Ocado and Tesco.

- 12.49 In order for there to be to coordination in a limited number of areas, there would also need to be transparency over delivery pricing in those local areas. We understand that delivery pricing in all areas is transparent, but that online delivered grocery retailers currently perform only limited monitoring of regional pricing. The Parties told us that they are not even aware of how many sets of delivery pricing are operated by Tesco⁶⁵³ and that Asda is not aware of the sets operated by Sainsbury's.⁶⁵⁴ However, Tesco told us that it is able to see whether competitors charge different prices according to geographic location as it also looks at regional pricing. We consider that while coordination in a limited number of areas may require additional monitoring in those areas, there is a sufficient degree of transparency around pricing in different areas and such monitoring would not be costly.
- 12.50 We considered whether the terms of coordination would relate to delivery pricing indirectly through an understanding to limit capacity growth. However, we understand that it is possible to add capacity to existing delivery networks simply through increasing the number of vans and drivers.⁶⁵⁵ Furthermore, as the Parties highlight, they do not have visibility over how many delivery slots are available at any given time.⁶⁵⁶ We therefore considered that it would be difficult for online delivered groceries retailers to monitor any common understanding to limit capacity and did not assess the likelihood of this form of coordination further. As set out in paragraph 12.72(a), we did not consider a lack of transparency over capacity would be likely to undermine coordination on delivery pricing.
- 12.51 We considered that the transparency of delivery pricing would assist in reaching a common understanding. Whilst vouchering reduces transparency, we considered that there are ways to overcome this obstacle in order to monitor any coordination on delivery pricing, either directly or indirectly, through the impact on the sales of the members of the hypothetical coordinating group.

Complexity of delivery pricing

- 12.52 Reaching and monitoring terms of coordination will be harder where there is a greater degree of complexity in the markets concerned. The degree of complexity will depend on the number and type of products sold and the number of aspects of competition over which firms compete (eg price and

⁶⁵³ Although we note that Asda is aware that Tesco has non-national pricing.

⁶⁵⁴ [Parties' response to the Provisional Findings](#), paragraph 653.

⁶⁵⁵ Tesco only has recent experience of adding additional capacity within its existing network, which is primarily achieved through adding more vans and drivers.

⁶⁵⁶ [Parties' response to the Provisional Findings](#), paragraph 653.

non-price factors). Where there are fewer products and the aspects of competition over which the firms compete are simpler, it may be easier for the firms to identify a focal point around which to coordinate.

- 12.53 We found that there is some complexity around delivery pricing, including: different prices by time of the day, day of the week and by area; minimum basket sizes; delivery pass options (including variations in the length); free delivery over a minimum spend; and slot lengths. Online delivered groceries retailers adopt different approaches to these factors which may make understanding and responding to each other's behaviour more challenging. For example, the Parties stated that Ocado's dynamic pricing model is complex and they have limited understanding of Ocado's pricing as a result.
- 12.54 However, we note that the approaches of the Parties and Tesco to delivery pricing appear relatively comparable, with each charging for deliveries based on location and time of slot with a minimum basket size. This is one of the reasons why we consider that at present a hypothetical coordinating group of Tesco and the Parties would be most likely.
- 12.55 We considered the degree of complexity of delivery offers among Asda, Sainsbury's and Tesco. In its monitoring of competitors' delivery offers, Sainsbury's compared the following elements of online deliveries: coverage; start and end time of deliveries; the availability of a delivery subscription; minimum basket size; and the availability of same day delivery (as can be seen in Figure 12.3). Each of Asda, Sainsbury's and Tesco have similar near-national coverage and all offer delivery passes. Delivery start and end times vary slightly, with Sainsbury's starting deliveries later and varying the time at the weekend. Sainsbury's and Tesco offer same day delivery whereas Asda does not. All have minimum basket sizes or a surcharge for smaller baskets. All also vary their prices by time of day and day of week. We considered that this showed that there would be some complexity in reaching a common understanding over delivery pricing due to differences between the offerings of Asda, Sainsbury's and Tesco and variations within their pricing, eg by time of day. We also noted, however, that it appears possible to monitor these factors which could reduce the impact of this complexity on the ability to reach and monitor a common understanding.
- 12.56 There is some evidence that online delivered groceries retailers already have some ability to manage this complexity in a way that would help in reaching and monitoring a common understanding, for example through calculating average slot prices (as can be seen in Figure 12.1 above). Further, the hypothetical coordinating group could simplify some elements of this complexity to facilitate coordination by more closely aligning the different elements of their deliveries, for example, by having the same minimum

basket sizes. This simplification would need to be reached by all three of the hypothetical coordinating group given the different approaches adopted by each of them currently. Furthermore, we did not consider that it would be realistic or commercially desirable to remove the complexity of varying prices by time of day and day of week. The Parties told us that the point of varying the delivery price is to smooth demand across the day and week in order to balance utilisation of the stores' delivery network (ie by pushing volumes towards timeslots with traditionally lower demand).⁶⁵⁷ We considered that this incentive would remain post-Merger and so would limit the simplification that could be achieved.

- 12.57 We consider that delivery passes would not be part of the most likely terms of coordination. We note that each of Tesco, Asda and Sainsbury's currently sets its delivery pass offering uniformly across the UK, whilst delivery prices (for Tesco and Sainsbury's) and minimum basket size (for Asda) vary by geographic area. We considered it unlikely that online delivered groceries retailers would introduce subnational delivery pass prices due to the visibility of the price of delivery passes. This means that coordination over delivery passes would need to be national and, for the reasons set out below in paragraphs 12.60 and 12.61, we do not think that coordination would be likely to take place at the national level. We considered that the exclusion of delivery passes from the terms of coordination could add to the complexity of reaching a common understanding. We further consider the impact of delivery passes on internal sustainability in paragraph 12.72(c).
- 12.58 Overall, we consider that at present there is a certain degree of complexity in current delivery pricing which may be a challenge to reaching a common understanding. However, this complexity is limited to variations around a single delivery service and does not apply to the same extent to all elements of delivery pricing (eg slot length).

Complexity of the geographic scope of coordination

- 12.59 There may also be some complexity relating to the geographic scope of coordination. As set out in paragraph 12.9(d), we considered that the terms of coordination, including the scope, would be most likely to emerge through amendment to the pricing policies of the hypothetical coordinating group over time and their repeated interactions with the other coordinating group members. For example, one member of the hypothetical coordinating group could increase its delivery prices across a specific area or region and if, in response, the other members of the hypothetical coordinating group also

⁶⁵⁷ Parties' response to the Provisional Findings, paragraph 634.

raise their delivery prices across a similar area, this would be sufficient to establish the geographic scope of coordination.

- 12.60 As set out in paragraph 12.84, we consider that coordination would be more difficult in certain areas, particularly in and around London. As such, we considered whether pre-Merger the hypothetical coordinating group could reach terms of coordination that excluded these areas. As noted in paragraph 12.85, in the areas where the combined shares of supply of Asda, Sainsbury's and Tesco are lowest, the largest online constraint external to the hypothetical coordinating group is Ocado.
- 12.61 We considered that, at least at first, the hypothetical coordinating group would most likely seek a relatively simple approach to maximise the chance of reaching a common understanding. As such, we considered that the most likely approach would be for one of the coordinating group members to raise its delivery prices, and for the others to follow, in areas where the external constraints are weakest. Many of these areas are relatively clear-cut, for example, Ocado is not present at all in Northern Ireland or Scotland. We considered a straightforward approach would be for coordination to emerge across Postcode Areas where Ocado is entirely absent.⁶⁵⁸ We note that the Parties' combined revenue from online delivered groceries in those areas is over £[redacted].⁶⁵⁹ While coordination would likely be externally sustainable in an area wider than this, we considered that online delivered groceries retailers may be more uncertain of each other's responses in the areas of the country currently served by Ocado. For example, Ocado is a relatively closer competitor to Sainsbury's than to Tesco or Asda,⁶⁶⁰ meaning that the hypothetical coordinating group's incentives may not be as closely aligned in areas where Ocado is present.
- 12.62 We also recognise that at present there are different approaches to varying delivery pricing by area amongst Asda, Sainsbury's and Tesco.
- (a) Asda does not currently vary its delivery prices by geographic area, although Asda told us it has done so, albeit rarely, in the past.⁶⁶¹ Asda varies the minimum basket sizes for online delivered groceries between

⁶⁵⁸ We also excluded Postcode Areas where just one of the hypothetical coordinating group are present. The resulting Postcode Areas are: AB, BT, CA, DD, DG, DH, DL, EH, FK, G, HS, IV, KA, KW, KY, LD, ML, NE, PA, PH, PL, SA, SR, TD, TR and TS.

⁶⁵⁹ In calculating this figure, and all subsequent figures in this chapter that relate to the hypothetical coordination group's geographic coverage or revenue we have excluded Sainsbury's planned new supply point in Kendal. This makes a very small impact because Kendal does not have any revenue, and almost all of its postcode coverage is already covered by Tesco and Asda and therefore included in the hypothetical coordination group.

⁶⁶⁰ Our online survey found that [10–20%] of Sainsbury's customers who diverted to an online delivered groceries retailer diverted to Ocado compared to [0–5%] of Asda's customers.

⁶⁶¹ [redacted].

areas; in some areas the minimum is £25, while in others it is £40.⁶⁶²

Whilst Asda does not currently vary delivery prices, this is not necessarily evidence that it would be costly to do so; the main barrier cited by the Parties is that it would involve moving away from its preferred strategy, which would entail high costs.⁶⁶³

(b) Sainsbury's has [redacted] different pricing clusters across the UK grouped on the basis of factors relating to the mix of customer delivery models and capacity/demand. Sainsbury's has been carrying out delivery pricing trials and based on the evidence we have seen about these trials, we consider it has the ability to change delivery pricing at the Supply Point level.

12.63 Tesco has [redacted] sets of delivery pricing based on the different operating models in those areas, ie via a CFC in London and parts of the south east or through store-pick elsewhere. Tesco has also been carrying out trials on its delivery pricing and told us that [redacted]. Tesco told us that it has the ability [redacted].

12.64 From the evidence above, we consider that in the pre-Merger situation it is possible, at little additional cost, for the Parties and Tesco to vary delivery pricing by geographic area to a sufficient extent to allow for coordination in a limited area. However, the existing approaches do not appear to be targeted to areas according to the competitive dynamics, and therefore to coordinate in areas where Ocado is not present would require a change in approach. We consider the current lack of alignment of pricing by region, particularly Asda's current uniform approach, to be a challenge to coordination.

12.65 We note that the Parties consider that there would be insufficient benefit to justify altering the way in which they each currently set delivery prices. We recognise that, as the Parties set out (see paragraph 12.29(b)), delivery pricing in areas where Ocado is not present makes up only a small part of their revenue. However, the online market is growing and therefore the proportion of revenue affected will increase, also the evidence suggests that altering the current approach to delivery pricing would not involve a significant cost.

Conclusion on ability to reach and monitor coordination

12.66 Based on the factors discussed above, on balance we consider that it is not likely that online delivered groceries retailers would currently be able to reach a common understanding in relation to online delivery pricing. This is primarily due to the fact that each of the members of the most likely

⁶⁶² [Asda website: What is the minimum order amount?](#)

⁶⁶³ [Parties' response to the Provisional Findings](#), paragraph 639.

hypothetical coordinating group currently takes a different approach to setting delivery prices. We recognise that it appears these approaches could be changed at relatively limited cost. However, we still consider that the fact that the approaches of all three retailers would need to change and that an understanding would then need to be formed between three independent operators is likely to be an obstacle to coordination currently. In contrast, given the high levels of transparency in the markets for online delivered groceries, monitoring of any common understanding would be relatively easy. On balance, although there are some aspects which would point towards online delivered groceries retailers being able to reach a common understanding in the markets currently, we do not consider that, at present, it is more likely than not.

Condition 2: Internal sustainability

- 12.67 Coordination will be sustainable only where the additional profit from coordination is sufficiently high, and there is an effective mechanism to respond to deviation (making the profit from deviation sufficiently low to make it unattractive).⁶⁶⁴ If coordination is not sufficiently profitable, or the response of others to deviation is not sufficiently swift and costly to the firm deviating, an online delivered groceries retailer may prefer to deviate. It might do so if the short-term gain from having a more competitive offering than the other coordinating online delivered groceries retailers outweighs the costs to it of future lower prices due to the breakdown of coordination.
- 12.68 The hypothetical coordinating group's common understanding of objectives need not be precisely formulated, and so what constitutes 'deviation' may not be clearly defined. This does not affect the underlying assessment of internal sustainability. Coordinating online delivered groceries retailers still need to consider the short-term benefits of deviating against the cost of punishment, ie the loss of the gains from coordination.

Parties' views

- 12.69 The Parties submitted that they would derive limited additional profit from coordination and would therefore have insufficient incentive to coordinate in areas where Ocado is not present, given the considerable cost of implementing the CMA's hypothesised coordination mechanism.⁶⁶⁵ This is partly a result of the delivery charges in these areas accounting for less than

⁶⁶⁴ [CC2 Revised](#), paragraph 5.5.15.

⁶⁶⁵ [Parties' response to the Provisional Findings](#), paragraph 646.

[0–5%] of both Asda’s total online revenues and Sainsbury’s total online revenues.⁶⁶⁶

12.70 The Parties gave the following ways in which the members of the hypothetical coordinating group could deviate from a coordinated outcome:

- (a) Increase the availability of lower-price slots and/or decrease the availability of higher-price slots in the specific local areas covered by the hypothetical coordination.
- (b) Increase the use of vouchering in the specific local areas covered by the hypothetical coordination.
- (c) Reduce the price of delivery passes.
- (d) Reduce the price of one or more grocery items to gain increased volumes (across all areas and in-store) from the lower total price paid by the customer.⁶⁶⁷

12.71 The Parties submitted that the members of the hypothetical coordinating group do not have the ability to respond quickly and effectively to any deviation. The Parties highlighted that Asda has changed its delivery pricing only four times in the past three years and Tesco also very infrequently increased its delivery prices.⁶⁶⁸

Our assessment

12.72 We consider that the forms of deviation submitted by the Parties (see paragraph 12.70) have important limitations, in particular:

- (a) Increasing the availability of lower-price slots and/or decreasing the availability of higher-price slots: This would require adding and/or reducing capacity at particular times of the day or week, which we considered unlikely to be profitable. Tesco told us that adding capacity essentially means adding vans and drivers (who would need to do full shifts) and so it would be difficult to add capacity only for certain times of day. Incurring the cost of such additional capacity and only using it for the lowest revenue slots makes this unlikely to be a profitable form of deviation. Equally, not using existing capacity while slots are in the

⁶⁶⁶ Parties’ response to the Provisional Findings, paragraphs 641 and 642.

⁶⁶⁷ Parties’ response to the Provisional Findings, paragraph 661.

⁶⁶⁸ Parties’ response to the Provisional Findings, paragraph 662.

greatest demand and have the highest revenue seems unlikely to be profitable.

- (b) Increasing the use of vouchering: As discussed above (see paragraph 12.46), we considered that it would be possible to start monitoring voucher usage by other retailers in a more systematic way to observe any deviation from coordination. Whilst we recognise that it may not be possible to observe the precise quantities of vouchers that may be issued,⁶⁶⁹ it is also possible to monitor their usage indirectly through the impact on sales as noted in paragraph 12.47.
- (c) Reducing the price of delivery passes: We considered that delivery pass prices are easily observable and any change would trigger a similar response from other members of the hypothetical coordinating group. While deviating by reducing delivery pass prices could have the benefit of tying customers in, it has disadvantages too. As delivery pass prices are set nationally, this form of deviation is unlikely to be profitable, because it would require moving away from profit maximising delivery pass prices across the rest of the country.⁶⁷⁰
- (d) Reducing the price of one or more grocery items: As grocery prices are set nationally across both in-store and online, this form of deviation is unlikely to be profitable, because it would require moving away from profit maximising grocery prices for all in-store groceries and the rest of online delivered groceries.⁶⁷¹

12.73 We considered that the most likely response to any deviation would be a reversion (or partial reversion) to more intense competition by the other coordinating online delivered groceries retailers rather than a deliberate punitive strategy.

12.74 How swiftly this breakdown of coordination would follow on from deviation is an important factor in assessing the benefit of deviation. This is because the benefit from deviation (ie having a more competitive offer than the remaining coordinating grocery retailers) only lasts until those grocery retailers who had been coordinating react to the deviation.

⁶⁶⁹ [Parties' response to the Provisional Findings](#), paragraph 651.

⁶⁷⁰ In particular, we consider the fact that the delivery pass price typically appears on the retailer's website without needing to input a postcode and may appear on advertising/vouchering makes it more visible. Also, moving to localised delivery pass pricing would presumably require an additional control to prevent customers located in areas where the price was more expensive from signing up to a delivery pass using an address in a cheaper area but actually getting deliveries to the original address in the more expensive area.

⁶⁷¹ While vouchering would allow local variation in grocery pricing, this is considered above in paragraph 12.72(b).

- 12.75 We considered that this reaction could very quickly follow on from deviation. Whilst we took into account the Parties' submission that Asda has only changed its delivery prices four times over the past three years and Tesco has increased its delivery prices very infrequently, we considered that this did not necessarily reflect an inability to do so. We also noted the evidence that Sainsbury's changes its delivery pricing [REDACTED]. For example, as part of slot pricing [REDACTED]. [REDACTED].
- 12.76 This means that, if online delivered grocery retailers had reached a common understanding to coordinate, provided the external constraints were sufficiently limited, the additional profit from coordination over delivery pricing would be sufficient to make it worthwhile for grocery retailers to maintain a coordinated outcome given the ability to respond rapidly to any deviation.
- 12.77 We considered that the significant shares of supply of each of the hypothetical coordinating group would mean that it would be in the interests of each to respond should any of the others deviate. In contrast if the hypothetical coordinating group included any smaller online delivered groceries retailers, such as Morrisons, and it stopped coordinating, the larger members of the hypothetical coordinating group would probably not have the incentive to respond as the gain from the higher delivery prices would still outweigh the loss of volume from customers switching to Morrisons given its low share of supply.

Conclusion on internal sustainability

- 12.78 Based on the reasoning set out above, we conclude that, the characteristics of the relevant markets are conducive to coordination on online delivery pricing being internally sustainable at present.

Condition 3: External sustainability

- 12.79 Coordination will be sustainable only if the outside competitive constraints on the grocery retailers involved in coordination are relatively limited. It is not necessary for all firms in the markets to be involved in coordination but those firms which coordinate need to be able collectively to exercise a degree of market power.

Parties' views

- 12.80 The Parties submitted that there are two sources of external competition that would undermine any attempt at coordination between the Parties and Tesco: Ocado and, more significantly, in-store groceries.

- (a) Ocado, the Parties submitted, is a strong competitor with a business model that relies heavily on scale, and accordingly, has a strong incentive to increase volumes and capacity and a weak incentive to follow any price increases given the importance of volume. The Parties said that Ocado, along with Amazon, must be considered as mavericks and are well-positioned to disrupt any attempted coordination in the online channel.
- (b) The Parties highlighted that given the essentially identical pricing and range across in-store and online delivered groceries, the only real trade-off that customers make when choosing channel is that of convenience versus delivery charge. Further, as the competitor set for in-store groceries is wider than that for online delivered groceries, the impact of increasing the relative attractiveness of in-store (by degrading the online offering in some way) would be to increase the number of competitors who could disrupt coordination between a set of online competitors. The importance of this constraint can be seen by the fact that delivery prices in Northern Ireland, where there are only three significant online players (the Parties plus Tesco), are no higher than in the rest of the UK. The Parties submitted that, based on the CMA's national share of supply estimates, the Parties could jointly be expected to recapture no more than around 26% of any sales lost to in-store.⁶⁷²

12.81 The Parties submitted that in areas where Ocado is not present it would be incorrect to place no weight on the external constraint provided by online operators outside the hypothetical coordinating group. The Parties highlighted that in some areas where Morrisons is present its share of supply is [X]% and other online providers (including Iceland and Waitrose) are highly rated by customers, as supported by Which? consumer rankings.⁶⁷³ The Parties also submitted that in over two-thirds of the local areas identified by the CMA as conducive to coordination, two or more of these third-party operators are present, and one additional competitor is present in all but two of the remaining areas.⁶⁷⁴

12.82 The Parties told us that there was substantial evidence of new entry and expansion in online delivered groceries. The investment required for online delivered groceries was not sufficiently high to deter entry and expansion. In particular the Parties highlighted the following key points relevant to coordination in areas where Ocado are not present:

⁶⁷² Parties' response to the Provisional Findings, paragraph 669.

⁶⁷³ Parties' response to the Provisional Findings, paragraph 670.

⁶⁷⁴ Parties' response to the Provisional Findings, paragraphs 670–672.

- (a) The M&S/Ocado joint venture is well-positioned to expand beyond Ocado's current coverage.
- (b) Morrisons is rapidly expanding the coverage of its online offering through the roll out of its store-pick model, which according to the Parties' internal analysis has the potential to reach 96% of the UK population.
- (c) Amazon's size, experience and reputation mean it is uniquely positioned to expand its presence in the UK grocery market at an unprecedented pace and recent reports indicate that it is planning to significantly increase its in-store and online presence in the UK grocery market.⁶⁷⁵

Our assessment

Current constraints

- 12.83 We considered the current level of concentration in online delivered groceries at a national level. Asda, Sainsbury's and Tesco have a combined national share of supply for online delivered groceries of around [70–80%]. Ocado has a [10–20%] national share of supply of online delivered groceries. Morrisons is the next largest online delivered groceries retailer although its national share of supply is much lower at around [5–10%]. All other online delivered groceries retailers are smaller, with Amazon, which was particularly highlighted by the Parties, having a less than [0–5%] national share.⁶⁷⁶
- 12.84 We considered local shares of supply because delivery pricing is currently varied between areas and we consider that this local variation could be increased (see paragraph 12.64). We found that in many areas, particularly in Northern Ireland, Scotland, North and West Wales and North and South West England, Asda, Sainsbury's and Tesco had a combined share of supply greater than [90–100%]. In other areas, specifically London, we found the combined share of supply of Asda, Sainsbury's and Tesco was less than 50%. We considered in these latter areas the form of coordination we are considering would be less likely to be externally sustainable, because of the constraint from online delivered groceries retailers outside the hypothetical coordinating group. As a result of this we considered that the hypothetical coordinating group would seek to reach terms of coordination that excluded these areas.
- 12.85 The ability of the hypothetical coordinating group to reach terms of coordination in certain geographic areas is considered in paragraphs 12.62 to

⁶⁷⁵ [Parties' response to the Provisional Findings](#), paragraph 675.

⁶⁷⁶ A description of how shares of supply in this section were calculated can be found in Appendix I.

12.65. We found that where Asda, Sainsbury's and Tesco have lower combined shares of supply, Ocado was one of the largest online delivered groceries retailers outside the coordinating group. Morrisons is the only other online delivered groceries retailer with a share of supply over [10–20%] in any Postcode Area. While, as the Parties note, Morrisons' share is as high as [20–30%] in some areas, these are areas where Ocado is also present. In all areas where the hypothetical coordinating group has a combined share of less than 80%, Ocado was the largest or second largest online delivered groceries retailer outside the hypothetical coordinating group.

- 12.86 As set out in paragraph 12.61, we considered that the hypothetical coordinating group would most likely reach an understanding to coordinate in areas where Ocado does not operate as this is where their mutual interdependence is highest. In those areas, the hypothetical coordinating group has a combined share of supply of [90–100%]. Our online survey found that in areas where Ocado is not present [80–90%] and [80–90%] of diversion from Asda and Sainsbury's respectively to online delivered groceries retailers is to other members of the hypothetical coordinating group. While we did not survey Tesco customers, we noted that Kantar Worldpanel switching data shows that a large majority of Tesco's losses and gains nationally are to Asda and Sainsbury's.⁶⁷⁷
- 12.87 Coordination, compared to competition, would reduce the constraint on increasing delivery prices, because the probability of losing sales to other members of the hypothetical coordinating group would be reduced as a result of them also increasing their delivery prices. This means that the change in incentive on Asda, Sainsbury's and Tesco as a result of coordination depends on the degree to which they currently constrain each other. We considered that at present the members of the hypothetical coordinating group exercise a significant constraint on each other. Overall, our online survey found that in areas where Ocado does not operate, [70–80%] and [70–80%] of diversion from Asda and Sainsbury's respectively is to members of the hypothetical coordinating group either in-store or online.
- 12.88 We considered that the current constraint from outside the hypothetical coordinating group is very limited in areas where Ocado is not present. We noted the Parties' submission that there are other competitors in almost all these areas and by some measures some are highly rated by consumers,⁶⁷⁸ however based on past consumer purchasing behaviour and their stated preferences these constraints appear weak. Across the areas where Ocado

⁶⁷⁷ [REDACTED].

⁶⁷⁸ Parties' response to the Provisional Findings, paragraph 672.

is not present, the combined share of supply of online delivered groceries of Morrisons, Iceland, and Waitrose is just [5–10%], with Iceland as the largest with [0–5%]. Similarly, they are collectively responsible for just [10–20%] and [10–20%] of online diversion from Asda and Sainsbury's respectively.

- 12.89 We also considered the constraint from in-store grocery retailers. In response to the forced diversion question in our online survey, in those areas where Ocado is not present [30–40%] of Asda online spend and [40–50%] of Sainsbury's online spend would have switched to an in-store option.⁶⁷⁹
- 12.90 However, a significant proportion of any diversion from the Parties' online offerings to in-store is likely to be recaptured by Asda, Sainsbury's and Tesco in-store. This recapture limits the constraint on coordination from in-store groceries as some of the downside of sales lost from online will be offset by the benefit of sales recaptured in-store. [A consultant] noted the likely positive impact on Tesco's stores of its recommendation to Tesco of increasing delivery price, as a result of slowed growth in online delivered groceries and spend returning to physical stores (including Tesco stores).
- 12.91 Each member of the hypothetical coordinating group would recapture diversion in-store from its own online offering and from those of the other members. Our online survey found that, in those areas where Ocado is not present [30–40%] and [40–50%] of the proportion of spend that diverted from Asda and Sainsbury's respectively to an in-store option was to each Party's own in-store offering. However, this does not include diversion from the online offerings of other members of the hypothetical coordinating group (ie Tesco). Our online survey found that, in those areas where Ocado is not present [40–50%] and [50–60%] of spend that was diverted from Asda and Sainsbury's respectively to an in-store option was to one of the Parties' in-store offering. The Parties considered that they could be expected to recapture no more than their national share of supply of in-store groceries. We considered that our survey estimates of diversion are likely to give a better estimate of the likely recapture because they: (i) cover only the areas where we consider coordination is most likely to occur and (ii) account for different preferences of customers, in particular online customers being more likely to divert to the in-store offering of the same brand (for example both Asda's and Sainsbury's online customers are disproportionately more likely to divert to that same firm in-store rather than to other in-store options). Furthermore, the Parties' national share of supply for in-store groceries (which is calculated on the basis of the total market for in-store groceries)

⁶⁷⁹ Survey results from CMA online survey. Our assessment of the scale of the constraint from in-store is set out in Chapter 10. We note that the Parties considered that the constraint from in-store represents 40% of diversion ([Parties' response to the Provisional Findings](#), paragraph 673).

would not reflect any diversion from Tesco online to the Parties' in-store offerings. Tesco online has a share of supply of around [50–60%] in areas where Ocado is not present.

12.92 Overall, in view of the currently varying levels of constraint from Ocado, we consider it less likely that coordination would emerge in areas where Ocado is present. However, we do not consider that this would rule out any coordination between Tesco, Asda and Sainsbury's. As there are a large number of areas where Ocado is not currently active, we consider it likely that, if Tesco, Asda and Sainsbury's were able to reach terms of coordination in areas where Ocado is not present, current external constraints would not destabilise any such coordination.

- *Constraint from entry and expansion*

12.93 We examined whether the entry and expansion of online delivered groceries retailers outside the hypothetical coordinating group would undermine coordination. Our detailed review of entry and expansion, including our assessment of the evidence submitted by the Parties and third parties, is contained in Appendix H. In particular, we found:

(a) The information we have received relating to the new Ocado/M&S joint venture⁶⁸⁰ does not lead us to find that geographic expansion by the JV will be timely and likely. As discussed in Appendix H, we do not consider this to be new entry by M&S into online delivered groceries. M&S is purchasing a 50% share in the existing retail business of Ocado, rather than adding substantial online delivered groceries capacity.⁶⁸¹ In addition, in Ocado's response to notices requiring the production of information and documents under section 109 of the Act (Section 109 notices) sent by the CMA on 6 March 2019 and 4 April 2019 it stated that it has no plans to expand its geographic coverage within the next 24 months, despite a commitment to increase capacity equivalent to a further eight CFCs over the next 12 years.

(b) We consider that in some locations entry by Iceland and Morrisons will be timely and likely. However, we noted that recent entry does not appear to have resulted in rapid share gains. For example, Morrisons entered online delivered groceries in December 2013 [redacted].⁶⁸² While we recognise that

⁶⁸⁰ As set out in Appendix H, we do not consider this to be new entry by M&S into online groceries. M&S is purchasing a 50% share in the existing retail business of Ocado, rather than adding substantial online delivered groceries capacity (see M&S's website (27 February 2019), [Bringing the best together: transforming UK online grocery shopping M&S and Ocado announce new joint venture](#)).

⁶⁸¹ See Appendix H, paragraph 69.

⁶⁸² CMA analysis.

Morrisons could expand into those areas where it has stores but has not yet launched online operations and which are part of the coordinated areas (eg other parts of Scotland), it has no firm plans to do so within the next two years. In addition we noted that Morrisons does not have stores in Northern Ireland and so would not be able to expand its store pick model to the whole of the coordination area.

- (c) Amazon told us [REDACTED].
- (d) Tesco told us that they were not planning on expanding their geographic coverage, although they are planning to increase store-pick capacity in existing areas outside of London.
- (e) Waitrose told us they were not planning on expanding their geographic coverage, [REDACTED].
- (f) Lidl told us that it monitored developments within the retail market and had explored options to bring its groceries online. [REDACTED]⁶⁸³ [REDACTED].
- (g) Aldi told us that they had no current plans to move into online delivered groceries.⁶⁸⁴
- (h) Booths told us that they had no definite plans to enter online delivered groceries in the next two years.
- (i) While Co-op told us that it had launched a trial online offer on 22 March, based on the evidence submitted we found that Co-op's offering would not be likely to fall within our relevant market definition for online delivered groceries and therefore it should not be considered as entry into the relevant market.⁶⁸⁵

12.94 Based on a review of the evidence, we found that entry or expansion was not likely to undermine coordination in any area where Ocado is not present.

Conclusion on external sustainability

12.95 We consider that the main constraints on increasing delivery prices for each of the members of the hypothetical coordinating group are each other. The external constraint from those outside the hypothetical coordinating group

⁶⁸³ [REDACTED].

⁶⁸⁴ See Appendix H.

⁶⁸⁵ As discussed in Appendix H, Co-op has launched a trial online offer in London. We have reviewed the evidence provided by the Parties and Co-op, noting the [REDACTED] of SKUs, the relatively small size of the stores used for store-picking, and Co-op's description of its strategy. Based on this evidence we found that Co-op's strategy should not be considered as entry into online delivered groceries. See Appendix H, paragraph 68.

varies according to the area, with Ocado being an important competitor who would potentially act as a constraint on coordination on delivery pricing in some locations. We do not consider the current constraint from any other online delivered groceries retailers to be sufficient to undermine coordination. We also find that entry or expansion is not likely to undermine coordination. As such we conclude that it is most likely that coordination would be externally sustainable in areas where Ocado does not operate at present.

Conclusion on the three conditions pre-merger

12.96 We conclude that at present one of the three conditions necessary for coordination is not met. On balance, we conclude that the hypothetical coordinating group would likely not have the ability to reach and monitor a common understanding in the markets pre-Merger due to the fact that each currently takes a different approach to setting delivery prices, which would need to be aligned, and an understanding would then need to be reached between three independent operators. However, we consider that the form of coordination that would be most plausible would likely be internally and externally sustainable.

Evidence on merger effect

12.97 As noted above, we consider there is no clear evidence of pre-existing coordination and that one of the three conditions for tacit coordination is not met pre-Merger. We therefore consider the impact of the Merger and whether coordination would be more likely to emerge post-Merger (ie whether each of the three conditions for coordination would be met post-Merger).

Parties' views

12.98 The Parties submitted that the conditions for coordination are not currently present in online delivered groceries and that the Merger will not materially change this in relation to any of the three conditions necessary for coordination to take place. In particular, the Parties submitted that:

- (a) The changes brought about by the Proposed Merger would not significantly increase the ability to align on terms of coordination, because:

- (i) There is no intention to harmonise the delivery pricing of the two Parties and if Asda were to significantly change its approach, it would face a negative customer reaction.⁶⁸⁶
 - (ii) The mere fact that both Asda and Sainsbury's would be under the same management could not give Tesco sufficient information to allow it to align on delivery pricing.⁶⁸⁷
 - (iii) Greater symmetry between members of the hypothetical coordinating group would not necessarily mean that incentives will be more aligned.⁶⁸⁸
- (b) The Merger would not result in there being less incentive to deviate from coordination, because:
- (i) the Merger will not increase transparency to the degree necessary to allow the hypothetical coordinating group to be more certain of each other's actions; and
 - (ii) even if they were to become more certain this would not decrease deviation incentives.⁶⁸⁹
- (c) In-store options, existing online competitors and the entry/expansion of online competitors each pose a significant external constraint, and these factors are not impacted by the Merger.⁶⁹⁰

Our assessment

12.99 Below we explore the impact of the Merger on the three conditions set out in paragraph 12.2. While we are looking at the impact on all three conditions, given that we find that the second and third conditions are likely to be met pre-Merger, it is not necessary for the Merger to affect those two conditions for the Merger to increase the likelihood of coordination.⁶⁹¹ While considering the impact of the Merger, we have in mind the form of coordination set out in paragraph 12.9, although the hypothetical coordinating group would consist of the Merged entity and Tesco.

⁶⁸⁶ [Parties' response to the Provisional Findings](#), paragraph 658.

⁶⁸⁷ [Parties' response to the Provisional Findings](#), paragraph 659.

⁶⁸⁸ [Parties' response to the Provisional Findings](#), paragraph 656.

⁶⁸⁹ [Parties' response to the Provisional Findings](#), paragraph 664.

⁶⁹⁰ [Parties' response to the Provisional Findings](#), paragraph 667.

⁶⁹¹ [CC2 Revised](#), paragraphs 5.5.9 and 5.5.19. We also agree with the Parties response to the Coordinated Effects working paper (paragraphs 8-13) that all three conditions need to be met following the Merger and if we did not consider any of the conditions to be satisfied pre-Merger we would need to find a Merger effect on each condition.

Impact on the ability to reach and monitor coordination

- 12.100 We considered whether following the Merger the ability to reach and monitor coordination would be satisfied.
- 12.101 We noted that the Merger would be likely to increase the symmetry between the members of the hypothetical coordinating group in areas where Ocado is not present. In contrast to the pre-Merger situation where Tesco is substantially larger than each of Sainsbury's and Asda, post-Merger the two members of the hypothetical coordinating group (ie Tesco and the Merged entity) would each have similar shares of supply online in areas where Ocado is not present. While for in-store, which is the key out-of-market constraint, we do not have figures for shares of supply in areas where Ocado is not present, we noted that nationally the Merged entity's combined share of supply would be similar to Tesco. Similarly, the Merger may remove an asymmetry in the incentives of the hypothetical coordinating group; our local assessment of online unilateral effects suggested that Sainsbury's may be a greater constraint on Asda than Asda is on Sainsbury's. As such the Merger is likely to reduce any barrier to reaching a common understanding that existed as a result of the current asymmetry between the hypothetical coordinating group.
- 12.102 We examined whether the Merger would strengthen the ability to reach and monitor coordination because it reduces the number of members of the hypothetical coordinating group from three to two and as such from three relationships to just one. We consider that this would make it easier for the hypothetical coordinating group to reach a common understanding for the following reasons:
- (a) A reduction in complexity of delivery pricing. Following the Merger, even if they maintain separate brands, the Merged entity could internally align their approach to delivery pricing, reducing the overall degree of complexity within the hypothetical coordinating group. For example, at present Asda is the only member of the hypothetical coordinating group that chooses not to vary delivery prices by location in the UK, although it does vary minimum basket sizes. At present this is a hindrance to coordinating in a subset of areas, such as where Ocado is not present. Following the Merger, the Merged entity could decide to adopt an approach to delivery pricing that is more similar to Sainsbury's (which has carried out more tests of different delivery prices than Asda has and currently has different delivery prices in different parts of the UK). We note that the Parties have submitted that it is not their intention to harmonise their delivery pricing. However, we did not consider there is any obvious barrier to such harmonisation. The reduction to two members of the

hypothetical coordinating group also means that either could align their approach to pricing with the other. Pre-Merger it is not possible for any of the members to unilaterally align its pricing with both the other members.

- (b) A reduction in the number of relationships in the hypothetical coordinating group from three to one would make the process of reaching a common understanding more straightforward.⁶⁹² We considered that this form of coordination could emerge through repeated interactions in the markets, as set out in paragraph 12.9(d). If there are three members of a hypothetical coordinating group and one increases its delivery prices above the competitive level, both other members of the hypothetical coordinating group must respond for coordination to occur. Following the Merger, there is just one other member of the hypothetical coordinating group that needs to respond. The decision whether to respond to an increase in delivery prices is also simplified. At present when considering whether to respond, each of the other two members of the hypothetical coordinating group needs to consider whether the other will also respond. Following the Merger, there is no third member to consider when thinking about whether to respond to the other member of the hypothetical coordinating group. As such, the Merger makes reaching a common understanding more likely.

12.103 We considered whether the fact that the Parties intend to keep their two brands separate after the Merger affected these reasons. We considered that decisions relating to delivery pricing could be aligned and taken collectively even while maintaining two brands. These decisions would be internal to the Merged entity as opposed to needing to be agreed tacitly between two independent firms as would currently be the case. Also, Tesco would know that the two brands were being operated by the same management. This would allow Tesco to anticipate that each of the two brands would take into account their impact on the other and that if one aligned delivery pricing the other would be very likely to do the same. As such, we did not consider the ways in which the Merger affects the ability to reach a common understanding would be affected by keeping the two brands of the Parties separate. We considered that monitoring may be affected by maintaining two brands, as Tesco may still need to monitor prices set by both brands (even if they were aligned), however as we found that monitoring would already be possible in the current market, we did not consider that this would present an obstacle to coordination.

⁶⁹² With three firms there are three interrelationships, ie A-B, B-C and C-A, whereas with two firms there is just one, ie A-B.

12.104 Based on the reasoning set out above, and in particular the reduction in the number of members of the hypothetical coordinating group, we consider that the ability to reach and monitor coordination would increase as a result of the Merger. We considered that following the Merger, it was more likely than not that this condition would be met, a change from the present situation.

Impact on internal sustainability

12.105 We considered whether the Merger would impact the second condition of coordination, internal sustainability.

12.106 We considered that the Merger would not affect how quickly coordinating online delivered groceries retailers could respond to deviation or any of the other factors we considered in paragraphs 12.72 to 12.77. The Merger would reduce the likelihood of deviation given the fact that Asda and Sainsbury's would be under common ownership post-Merger and therefore each of Tesco and the Merged entity would be more certain of the other's actions and there would be less incentive to deviate.

12.107 Based on the reasoning set out above, we conclude that the hypothetical coordination would be more internally sustainable post-Merger.

Impact on external sustainability

12.108 We considered whether the Merger would impact the third condition of coordination, external sustainability.

12.109 As both Parties are within the hypothetical coordinating group, we considered that the Merger would not have an impact on the overall external constraint on coordination. As such, we considered that following the Merger there would still be a limited external constraint in certain areas.

12.110 We also considered whether either Party has less incentive to coordinate as a result of external constraints than the other members of the hypothetical coordinating group (eg because it is constrained to a greater extent by competitors outside of the group) and whether the Merger would be likely to remove that barrier to coordination. We noted that the CMA online survey found Sainsbury's customers were marginally more likely than Asda's to divert to the other members of the hypothetical coordinating group. However, we considered that the difference was not large enough for there to be a significant change following the Merger.

12.111 Based on the reasoning set out above, we conclude that the external stability of coordination would not be significantly affected and that a hypothetical coordination would continue to be externally sustainable post-Merger.

Our overall assessment

12.112 As set out above, we find that the Merger will increase the ability of Tesco, Asda and Sainsbury's to reach and monitor a common understanding in relation to delivery pricing in certain local markets for online delivered groceries to a sufficient extent that this condition would be met post-Merger. We find that such a hypothetical form of coordination would be more internally sustainable and that external sustainability would not be reduced by the Merger.

12.113 Given that the Merger impacts on two of the three conditions for coordination and that all three conditions are likely to be met post-Merger we find that the Merger would make coordination over delivery pricing in online delivered groceries, in areas where Ocado does not operate, more likely than not. We therefore conclude that, considering all the evidence in the round, the Merger would be expected to result in an SLC in the 108 local markets for online delivered groceries which are listed in Appendix N.

13. General merchandise

Parties' activities

13.1 As noted in Chapter 4, 'general merchandise' (GM) refers to the Parties' offering of non-consumable, non-food items. The Parties offer a wide range of GM products and overlap in the following GM categories: toys; electricals; homeware; nursery and baby; entertainment; clothing; stationery; DIY and garden; furniture; and various financial services, including credit cards, personal loans and non-life insurance.

13.2 We have focused our investigation on those GM segments (or sub-segments) in which the available information indicates the Parties have a relatively high share of supply and/or the Merger would lead to a material increment in the share of supply at the national level.⁶⁹³ These segments are clothing (in

⁶⁹³ In the [Issues Statement](#) (paragraph 43) we stated that we did not plan to focus on other segments of GM given that the available evidence indicates that there will remain a sufficient degree of competition. We have not received any additional evidence since the publication of the Issues Statement to depart from that view. As such, these other segments of GM are not addressed further in this final report.

particular, childrenswear and generic schoolwear,⁶⁹⁴ which is a sub-segment of childrenswear), electricals (in particular, personal care electricals (PCEs) and small kitchen appliances (SKAs)) and toys.

13.3 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. The Parties offer only generic schoolwear items (ie without school logo embroidery).

13.4 Sainsbury's Argos⁶⁹⁵ 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).

13.5 The Parties also supply a range of toys.

13.6 The Parties offer these products both in-store and online.

Market definition

Product scope

13.7 The Parties submitted that there is no need to define a precise product market for GM products given that there is a high degree of supply side substitutability, at the retail level, between GM segments.⁶⁹⁶

13.8 In previous cases, the CMA (and its predecessors) have assessed GM across separate segments and in some cases narrower sub-segments.⁶⁹⁷ We consider that this is a good starting point for determining the product market definition in this case. As explained below, the conditions of competition differ across segments, including the set of competitors and the Parties' relative positions.

⁶⁹⁴ Generic schoolwear items are items that are not specific to a single school and can generally be purchased from several retailers. Bespoke schoolwear items are specific to a single school and often include the logo of that specific school. Many schools have exclusive agreements with specific retailers for the provision of bespoke schoolwear. The majority of school uniforms in the UK are comprised of both bespoke and generic items (Department for Education (June 2015), *Cost of school uniform 2015 research report*, page 18).

⁶⁹⁵ Given the different offerings with respect to GM that Sainsbury's and Argos offer, in this chapter there are references to 'Sainsbury's Argos' when we are referring to the company as a whole, and 'Sainsbury's' or 'Argos' when we are considering just one of these entities.

⁶⁹⁶ [Parties' response to the Issues Statement](#), paragraph 292.

⁶⁹⁷ [Sainsbury's/Home Retail Group merger inquiry](#) (2016); [GUS plc/Index \(part of Littlewoods Ltd\) merger inquiry](#) (2005); [Tesco Holdings plc/Dobbies Garden Centres plc merger inquiry](#) (2007).

13.9 In this context, in determining the appropriate product market definition for our competitive assessment, we have considered:

- (a) the GM segments of clothing, electricals and toys (in which the Parties have relatively high shares of supply), and whether within each of these segments it is appropriate to define more granular product markets (namely PCEs or SKAs for electricals, and childrenswear or generic schoolwear⁶⁹⁸ -as a segment of childrenswear- for clothing); and
- (b) for all these segments, the extent to which it is appropriate to differentiate between whether they are sold online or in-store. We have not performed this analysis for each segment (ie clothing, electricals and toys) given that the majority of the evidence received from the Parties and third parties referred to GM overall or there were not substantive differences in third parties' views across the individual segments.

Clothing

Parties' views

13.10 The Parties submitted that the appropriate product market definition is the retail supply of clothing in the UK, without further segmentation, on the basis that:

- (a) the conditions of competition do not vary significantly across narrower segments of clothing, given that similar retailers are active in each segment and they can adjust their offerings within and across segments with relative ease (ie there is a high degree of supply-side substitutability);⁶⁹⁹ and
- (b) with respect to schoolwear specifically, several childrenswear competitors have launched schoolwear ranges in the last decade,⁷⁰⁰ suggesting a high degree of supply-side substitutability between schoolwear and other segments of childrenswear. Many retailers, such as Primark, also sell items (eg white shirts and black trousers) that could be used as part of a school uniform even if the retailer does not have a specific schoolwear offering.

⁶⁹⁸ In this chapter, any references to 'schoolwear' refer to generic schoolwear unless specified otherwise.

⁶⁹⁹ [Parties' response to the Issues Statement](#), paragraph 302.

⁷⁰⁰ These competitors were: Next (2009), Morrisons (2010 and 2013 under their nutmeg range), Aldi (2012), Pep&Co (2015) and Lidl (2016).

Third parties' views

- 13.11 Third party clothing retailers generally agreed that it was easy and quick to start offering or to expand their offering to childrenswear and schoolwear.
- 13.12 Several competitors already offer all clothing segments including schoolwear, such as Tesco, M&S and Next. Some competitors such as Aldi do not offer clothing (including schoolwear) throughout the year but have back to school offerings at particular times of the year. Lidl submitted that they do not offer clothing (including schoolwear) on a listed basis but offer clothing lines at various times during the year on an in/out basis. There are other competitors that focus on or offer only childrenswear, such as Mothercare, Boots and Morrisons.
- 13.13 Boots, M&S, Debenhams, Morrisons and Boohoo.com, stated that it would not be difficult to expand clothing ranges or start offering childrenswear, and that it would take up to 12 months to extend clothing ranges, from the beginning of product design to delivering products in-store, based on supplier lead-times.
- 13.14 With respect to schoolwear, Boots, Matalan, Tesco, Morrisons and Next stated that there are no specific arrangements needed to offer generic schoolwear beyond those required to offer general childrenswear.

Our assessment

- 13.15 We have considered the impact of the Merger on the retail supply of clothing in the UK. We have also considered the impact of the Merger on the retail supply of the following narrower segments of clothing:
- (a) menswear;
 - (b) womenswear;
 - (c) childrenswear; and
 - (d) generic schoolwear (as a sub-segment of childrenswear).
- 13.16 In particular, we consider that it is appropriate to assess the impact of the Merger across these narrower segments as:
- (a) there is limited demand-side substitution between these different segments; and
 - (b) with respect to childrenswear and, in particular, schoolwear, the Parties have a higher share of supply than in other clothing segments. For this

reason, we have decided to focus our competitive assessment on these segments and not other segments such as menswear and womenswear, where the Parties' share of supply is lower.

- 13.17 However, it is not necessary for us to reach a conclusion on the precise product market definition, since, as set out below, no competition concerns arise on any plausible basis.

Electricals

Parties' views

- 13.18 The Parties submitted that it is not appropriate to segment the electricals market into narrower product markets. According to the Parties, retailers supplying products in any sub-segments of electricals will typically supply those products alongside a much wider set of products and they can also easily expand their offering across segments (ie there is a high degree of supply-side substitution).⁷⁰¹

Third parties' views

- 13.19 Boots, Debenhams and B&M stated that they offer, or would consider offering, either SKA or PCE, but were unlikely to expand to other segments of electricals because it did not fit with their current offering. Morrisons and Dixons Carphone submitted that it would not be difficult to expand its PCE or SKA range, but Boots and B&M noted that any expansion would be constrained by limited space.

Our assessment

- 13.20 We have considered the impact of the Merger on the retail supply of electricals. In previous cases concerning the supply of electricals, the CMA has assessed the impact of the merger on the retail supply of electricals across narrower sub-segments.⁷⁰² Based on the lack of evidence from third parties on supply-side substitutability between sub-segments of electricals, different competitor sets across different sub-segments and the fact that the Parties have a higher share of supply in these sub-segments, we have also considered the impact of the Merger on the following narrower sub-segments of electricals:

⁷⁰¹ [Parties' response to the Issues Statement](#), paragraphs 298 and 299.

⁷⁰² [Sainsbury's/Home Retail Group merger inquiry](#) (2016).

(a) PCE; and

(b) SKA.

13.21 However, it is not necessary for us to reach a conclusion on the precise product market definition, since, as set out below, no competition concerns arise on any plausible basis.

Toys

Parties' views

13.22 The Parties submitted that it is not appropriate to segment the toys segment because:

(a) the Parties and major competitors are active across all sub-segments;

(b) retailers of toys are readily able to alter their competitive positioning (product portfolio, marketing, etc.) to focus on any toy sub-segment to respond to competitors; and

(c) as noted by the CMA in VTech/LeapFrog merger inquiry,⁷⁰³ there is no commonly accepted segmentation within toys.⁷⁰⁴

Third parties' views

13.23 On ease/difficulty of expanding range, no third-party retailers who responded to the CMA's investigation stated that it would be difficult to expand their toys range to cover other segments of toys not currently offered.

Our assessment

13.24 In previous cases concerning the supply of toys, the CMA has assessed the impact of the merger on the retail supply of toys, with no further sub-segmentation.⁷⁰⁵ In light of the evidence set out above, we have decided that this approach is also appropriate in this case.

13.25 However, it is not necessary for us to reach a conclusion on the precise product market definition, since, as set out below, no competition concerns arise on any plausible basis.

⁷⁰³ Vtech/LeapFrog merger inquiry (2017).

⁷⁰⁴ Parties' response to the Issues Statement, paragraph 296.

⁷⁰⁵ Sainsbury's/Home Retail Group merger inquiry (2016); Vtech/LeapFrog merger inquiry (2017).

Delineation by supply channel

- 13.26 For each of the categories above (ie clothing, electricals and toys), we considered whether it is appropriate to segment the product market by supply channel (in particular in-store versus online).

Parties' views

- 13.27 The Parties submitted that it is not appropriate to consider separate sales channels (namely, in-store and online) as separate product markets, because:
- (a) many leading retailers, including the Parties, operate both in-store and online channels and supply products at a uniform price across channels, many with free delivery on orders above a total sales amount;
 - (b) high and rapidly growing internet penetration can be clearly observed across all major non-food product segments, including clothing, which the Parties submit is evidence of competitive substitution from in-store channels;
 - (c) 'customer (and retailer) journeys' now combine multiple channels, meaning that the boundary between online and in-store is increasingly blurred; and
 - (d) enhancements to the online models have eroded the competitive distinctiveness of physical stores, such as immediacy, availability, and ability-to-inspect.

Third parties' views

- 13.28 Most third-party retailers in clothing, toys and electricals were of the view that the retail supply of GM online competes with and constrains the retail supply of GM in-store.
- 13.29 Given that the reasoning given by these third parties and the set of competitor retailers differ between each segment, we provide a detailed summary of the third-party views for each of these segments on the constraint from online retailers in the competitive assessment below.

Our assessment

- 13.30 With respect to defining separate product markets for different supply channels, in our view the Parties' submissions do not address whether there exists a sufficiently large group of 'marginal' customers who would be willing

to switch between supply channels in response to a small but significant change in the relative competitive offerings in the in-store and online channel for GM.

- 13.31 Unlike in online delivered groceries, there are a large number of players who offer online delivered GM products. There are also differences in the business models employed: for instance, some GM online retailers use third party established operators (eg Royal Mail, DPD) for their delivery networks, and distribution generally is less costly given that GM products can be delivered without the need for refrigerated vans.
- 13.32 We have received mixed and limited evidence on whether online and in-store GM retailers belong to the same product market. In each of the GM segments we have assessed (ie clothing, electricals and toys), online sales have grown in the last few years; however, the proportion of in-store sales is still higher than the proportion of online sales (see paragraphs 13.72, 13.108 and 13.147). Online penetration varies by segment: in 2017, online clothing sales amounted to only 25.7% of all clothing sales, whereas for electricals the equivalent figure was 48.6% and for toys 36.8% (see paragraphs 13.72, 13.108 and 13.147). Also, in each of these segments, there is a large variation in the proportion of online sales between different retailers with an in-store presence (see paragraphs 13.73, 13.109 and 13.148).
- 13.33 Nevertheless, it is not necessary for us to conclude on whether this distinction is appropriate since, as set out below, no competition concerns arise on any plausible basis. We consider further the constraint between online and in-store sales of GM as part of our competitive assessment below.

Conclusion on product market definition

- 13.34 For the reasons set out above, we have conducted our assessment within the following product markets:
- (a) the retail supply of clothing, including the narrower segment of childrenswear, and the sub-segment of generic schoolwear;
 - (b) the retail supply of electricals, including the narrower segments of PCE and SKA; and
 - (c) the retail supply of toys.
- 13.35 However, in each case, it is not necessary for us to reach a conclusion on the precise product market definition, since no competition concerns arise on any plausible basis.

Geographic scope

Parties' views

13.36 The Parties submitted that although retail competition is fundamentally local in nature, it is not necessary to carry out a separate local analysis for any GM segment because, in their view, there could not plausibly be a competition issue for GM in local areas where no equivalent competition issue exists for groceries. This is because:

- (a) the Parties' grocery competitors also sell similar ranges of GM, including clothing;
- (b) in addition to competition from other grocers, the Parties also face a wide range of competition from generalist retailers (such as department stores and discounters) and specialist retailers in each GM category; and
- (c) online retailers deliver to nearly every address in the UK and are a strong constraint in every local market.

Third parties' views

13.37 We have not received any submissions from third parties with respect to the geographic scope of the market definition.

Our assessment

13.38 We agree that retail competition, including for GM, is local, particularly on the demand side, as noted in the CMA's 'Retail mergers commentary'.⁷⁰⁶ In our view, the arguments submitted by the Parties are insufficient on their own to conclude that there are no concerns with respect to GM in any local areas where there is no concern with respect to groceries. For instance, grocery competitors' Medium stores may provide some constraint on the Parties' groceries offering without providing a material constraint on the Parties' GM offering in a local area.

13.39 We do however note that some in-store GM retailers with online offerings and some online-only GM retailers deliver to nearly every local area in the UK. This may impose a competitive constraint in every local area.

⁷⁰⁶ [CMA62](#), paragraph 1.6.

- 13.40 Given that consumers shop in local retail stores,⁷⁰⁷ our starting assumption is that there will be material local competition on one or more aspects of PQRS. However, in some cases the available evidence may also indicate that PQRS is in fact set on a national basis (and not in a way which responds locally to local competition).
- 13.41 As explained in paragraphs 13.43 to 13.53 below, we have considered the evidence available in this case to determine whether the Parties and third parties adjust the specific parameters of competition relating to GM on a national basis, and not in a way which responds locally to local competition.

Conclusion on geographic scope

- 13.42 Our conclusion on the geographic market definition is that the market is fundamentally local. However, as noted in paragraphs 13.43 to 13.53 below, we have also assessed whether in this case the Parties and third parties adjust one or more aspects of PQRS relating to GM nationally (and not in a way which responds locally to local competition).

Parameter flexing

- 13.43 We have considered whether, as a result of the Merger, the Parties would be able or incentivised to exploit any potential SLC in local areas by altering the parameters of competition (such as price, range, and availability) in some stores and not others (ie at the local level). If not, then it may not be necessary to carry out a local analysis for GM.

Parties' views

- 13.44 In general, the Parties set prices uniformly across their stores. However, store managers are [REDACTED].
- 13.45 Sainsbury's submitted that, in contrast to allocation of food space, [REDACTED]. Generally, [REDACTED].
- 13.46 Asda submitted that local store managers can [REDACTED], however they do not feed into decisions made on line-level product choices. [REDACTED]. Asda submitted that the reason for this is [REDACTED].
- 13.47 The Parties indicated that range is set nationally. In particular, Asda stated [REDACTED].

⁷⁰⁷ CMA62, paragraph 1.6.

13.48 Many other parameters of competition such as opening hours, staffing levels, and store cleanliness are not specific to their GM offering, but are common across all areas of the Parties' in-store businesses and are taken into account in our groceries assessment.

Third parties' views

13.49 To understand if, as a result of the Merger, the Parties would flex competitive parameters locally in clothing, electricals and toys, we sought to understand common industry practices and asked third parties about their approach to local flexing.

13.50 With respect to clothing, we received mixed evidence. Tesco indicated that the extent of local variation is limited (10% of stores), and that it does not reflect local competition. JD, Morrisons and Mothercare said that range is set at a national level, mainly because they want a consistent brand offering to the consumer and Morrisons said that purchase volumes are fixed. However, Debenhams, M&S, Matalan, John Lewis and Primark noted that store size, customer profiles and space allocation play a role in range setting. Debenhams stated that local stores can approach the buying team if they see a local opportunity, for instance a competitor closing nearby. Matalan told us that it considers new store openings and closures and, depending on who the competitor is, it may tailor the range accordingly.

13.51 With respect to electricals, B&M, Boots, Morrisons, Superdrug, Wilko, Tesco and Dixons Carphone said that they set range nationally. For example, Morrisons said that the main reason was fixed purchasing volumes. Only Debenhams and Robert Dyas stated that they do flex range locally. For instance, Debenhams said that local managers can approach the buying and planning team if they see a local opportunity (like a competitor closing nearby).

13.52 With respect to toys, B&M, ELC, Morrisons, Tesco, The Entertainer and Smyths said that they set range at a national level, because it is too complex or costly to adjust at store level, they want to provide a consistent offering to consumers across the country or they have fixed purchasing volumes. However, John Lewis and M&S allow for some local flexibility.⁷⁰⁸ John Lewis said that in some instances, the propensity of location to sell a particular brand/category/product well or poorly will be accommodated in ranging decisions. It noted that generally, applying ranging decisions nationally is efficient and allows to build scale. However, exceptions at local level can

⁷⁰⁸ In the case of M&S, we note that these statements apply to its whole GM business, and not just to the specific category of toys.

improve sales, reduce mark downs and give better service. It indicated that stores can be affected by local competitive landscapes. M&S said that local store conditions such as size, customer demographics as well as competitive landscapes are all considered.

Our assessment

13.53 The Parties and the majority of third parties adjust the specific parameters of competition relating to GM, such as price, range and space allocation (as opposed to other parameters relating to the overall store environment) on a national basis (and not in a way which responds locally to local competition). Only a minority of third parties submitted that they set some of these aspects locally, but they do this with respect to factors such as store size or customer profiles and not in a way which responds locally to competition, with the exception of one third party. Given this, we expect that any SLC would result from the aggregate impact of the changing competitive dynamics in each local area. Because the Parties' stores are spread widely across the UK we consider that the national shares of supply, and evidence on competition at the national level such as internal strategy documents, are indicative of this aggregate impact. Given this, and taking into account the CMA's discretion to prioritise the use of its resources within the confines of the statutory timetable, we have not conducted an area-by-area local analysis to assess the effect of the Merger in GM.

Unilateral effects

13.54 With respect to GM, we have assessed the Merger on the basis of horizontal unilateral effects. We have assessed whether the Merged firm would profitably raise prices (or otherwise degrade its offering) on its own and without needing to coordinate with its rivals.⁷⁰⁹ We conduct this assessment separately for segments of clothing, toys and electricals (and the sub-segments) below.

Clothing

National shares of supply

13.55 The UK market for clothing is fragmented, with the Parties and their top ten competitors accounting for 49% of sales value and 70% of sales volume.⁷¹⁰ GlobalData estimated that clothing specialists accounted for around 71.2%

⁷⁰⁹ [CC2 Revised](#), paragraph 5.4.1.

⁷¹⁰ Kantar data for the 52 weeks up to 11 February 2018.

clothing sales in 2017, with grocers and department stores accounting for around 9.5% each.

- 13.56 The Parties have relatively low national shares of supply in clothing with a combined share of supply of 6.8% by value and 15.5% by volume.⁷¹¹ Considering the narrower sub-segments of womenswear, menswear and childrenswear, the Parties have higher shares of supply in childrenswear: 15.6% by value.⁷¹² This would mean that post-Merger, the Parties would have the largest share of supply in childrenswear (by value) in GB. Table 13.1 and Table 13.2 below displays the shares of supply of the Parties and its closest competitors for the segments of clothing and childrenswear respectively.

Table 13.1: The Parties and closest competitors' shares of GB clothing, footwear and accessories sales, 52 weeks ending 11 February 2018

%			
<i>Retailer</i>	<i>Sales value</i>	<i>Retailer</i>	<i>Sales volume</i>
Sainsbury's (Tu)	2.3	Sainsbury's (Tu)	4.8
Asda	4.5	Asda	10.7
<i>Combined</i>	<i>6.8</i>	<i>Combined</i>	<i>15.5</i>
M&S	9.3	Primark	16.2
Next/Dir	7.2	M&S	10.5
Primark	5.8	Next/Dir	6.1

Source: The Parties (Kantar).

Table 13.2: The Parties and closest competitors' shares of GB childrenswear sales, 52 weeks ending 11 February 2018

%			
<i>Retailer</i>	<i>Value</i>	<i>Retailer</i>	<i>Volume</i>
Asda	11.5	Asda	20.0
Sainsbury's	4.1	Sainsbury	6.5
<i>Combined</i>	<i>15.6</i>	<i>Combined</i>	<i>26.5</i>
Next/ Dir	13.0	Primark	14.7
Primark	7.2	Next/ Dir	10.0
M&S	6.2	Tesco	8.4

Source: The Parties (Kantar).

- 13.57 Within the segment of childrenswear, the Parties appear to compete closely in the sub-segment of generic schoolwear. Post-Merger the Parties would have a combined share of supply in schoolwear of 23.4% by value, making

⁷¹¹ We have included both value and volume shares on basis that Kantar and GlobalData report both measures. However, according to [CC2 Revised](#) (paragraph 5.3.3), when products differ in quality it may be appropriate to use sales revenue as the basis to measure concentration. Given that clothing products differ in quality and that we do not have evidence to demonstrate whether the items have been defined accurately for the calculation of volume shares, we consider that it is appropriate to use value shares instead of volume shares for our competitive assessment. Shares of supply for the top ten UK retailers are displayed in Table 1 of Appendix J.

⁷¹² A separate set of estimates by GlobalData suggests that Asda's shares of supply by value in 2017 was 3.5% and Sainsbury's share of supply by value in 2017 was 2.0%, which are lower than the Kantar estimates. Shares of supply for the top 20 UK retailers are displayed in Table 2 of Appendix J.

the Merged entity the largest generic schoolwear retailer in the UK.⁷¹³

Table 13.3 displays the shares of supply of the Parties and its closest competitors in the retail supply of generic schoolwear.

Table 13.3: The Parties and closest competitors' shares of supply in generic schoolwear in the UK, 12-week period ending last week of August 2017

Retailer	%	
	Volume	Value
Asda	28.3	17.4
Sainsbury's	9.9	6
Combined	38.2	23.4
M&S	16.1	21.1
Tesco	13.5	9.7
School/School shop	2.6	6.9

Source: The Parties. Data comes from Kantar and is 12 w/e for 27 August 2017.

Note: It is unclear if the geographic area covered in the Kantar data is from the whole of the UK or only GB.

Parties' views

13.58 The Parties submitted that:

- (a) they have low national market shares in clothing;
- (b) they are not particularly close competitors in clothing and face a range of competitors. This is demonstrated in their internal documents by the range of competitors benchmarked, and by survey evidence conducted by GlobalData, which indicates that a significant proportion of customers that shopped for clothing at each Party also shopped at M&S, Primark, Next and Tesco (and for Asda, also at Primark, Tesco, M&S, Next and New Look);
- (c) any competition concerns in childrenswear, and in particular, schoolwear are unfounded given the ease of entry and expansion;
- (d) the sale of generic schoolwear is constrained by independent shops that sell bespoke schoolwear; and
- (e) there are no grounds to assess the sale of clothing in-store separately from online, on the basis that the UK clothing market has been characterised in recent years by the large growth of online sales, with third party reports showing that online sales growth is higher than for in-

⁷¹³ Data comes from Kantar and is 12 w/e for 27 August 2017 and 28 August 2016. Shares of supply for the top ten UK retailers are displayed in Table 3 of Appendix J.

store, and that the Parties' internal documents show that they monitor the clothing offerings of online competitors.⁷¹⁴

Internal documents

13.59 Our review of the Parties' internal documents showed that the Parties specifically tracked other supermarket competitors; however, they also considered a number of specialist clothing retailers. The Parties appear to compete closely in childrenswear (although there are several other key competitors in this area) and even more closely in schoolwear. This may be because an important childrenswear competitor, Primark,⁷¹⁵ does not supply schoolwear as a discrete category, although Primark does supply childrenswear items that can be used as part of school uniforms.

Asda internal documents

13.60 Asda's internal documents show that Asda's key competitors for childrenswear are [REDACTED]. They also show [REDACTED]. In schoolwear, Asda reported in 2015 that its key competitors were [REDACTED].

Sainsbury's internal documents

13.61 Sainsbury's internal documents show that it [REDACTED].

13.62 One of Sainsbury's strategy documents [REDACTED].

13.63 In a 2018 Sainsbury's report [REDACTED].

Third parties' views

13.64 According to Aldi, Debenhams, JD, M&S, Matalan, Mothercare, Tesco, Boohoo.com, John Lewis and Shop Direct, the Parties are important competitors and compete closely in the supply of clothing, childrenswear, and schoolwear, having similar propositions. Matalan noted that the Parties are very close competitors, although it noted that other supermarkets and Primark also compete very closely, offering similar value, convenience and range.

13.65 On the breadth and similarity of the Parties' range, we received mixed evidence. M&S indicated that it perceived the Parties' ranges as both being

⁷¹⁴ In response to the Provisional Findings, the Parties also submitted that no concerns can, on the evidence, arise in relation to GM ([Parties' response to the Provisional Findings](#), paragraph 4).

⁷¹⁵ Primark is referred to as the 'price leader' in the UK clothing market.

more focused on value and considered the Parties' range breadth to be relatively similar, whereas Boots submitted that Sainsbury's offers a more premium clothing range in terms of quality, design and price in comparison with Asda. Amazon noted that the Parties focus on their own label products and that there is limited overlap of identical products though they offer many competitive alternatives.

- 13.66 JD, Matalan, Morrisons, Boohoo.com and Shop Direct mentioned that the Parties have strong positions and compete closely in childrenswear, with both Parties being seen as offering a similar proposition, range and value point.
- 13.67 John Lewis and Matalan noted that the Parties and other supermarkets benefit from providing a combined offering of groceries and clothing. John Lewis stated that the supermarkets promote during key selling periods (eg Back to School), and benefit from economies of scale to set low prices.
- 13.68 Debenhams, Mothercare and Shop Direct expressed concerns about the effect of the Merger on the supply of clothing (particularly childrenswear), alluding to a high combined market share, higher prices, lower quality and more buyer power post-Merger. (Buyer power is discussed in Chapter 15).

Survey evidence from market reports

- 13.69 The Parties and one third party submitted evidence from GlobalData's online survey of shoppers in 2017, on the proportion of surveyed shoppers who bought clothes from multiple retailers. We note that patterns of cross-shopping may reflect customers making complementary purchases within clothing, rather than substituting between retailers, and may therefore provide only limited evidence on the closeness of competition between different retailers.
- 13.70 According to the GlobalData survey, of the customers that shopped in Sainsbury's for clothing, 31.5% of those customers also bought clothing from Asda, behind M&S (42.4%) and similar to Primark (32.5%), Next (29.8%) and Tesco (29.5%).⁷¹⁶
- 13.71 While the survey does not contain information about the proportion of Asda customers also shopping at Sainsbury's' (as Sainsbury's is not in the top ten clothing retailers considered in the analysis), it does indicate that a sizable

⁷¹⁶ Information on cross-shopping between the top ten UK clothing retailers in 2017 can be found in Table 8 of Appendix J.

proportion of Asda clothes shoppers also shop at Primark (39.3%) and Tesco (27.6%).

Competitive constraint from online

- 13.72 GlobalData estimated that online sales growth for clothing is higher than for in-store, and that online sales accounted for 25.3% of total clothing spend in 2017.⁷¹⁷
- 13.73 Among retailers with an in-store presence, there is large variation in the proportion of sales conducted online: for instance, Matalan told us that it makes only [0–10%] of its overall clothing sales online, whereas John Lewis told us that this proportion is [higher].⁷¹⁸ According to the Parties' data for schoolwear sales, Asda made [20–30%] of their schoolwear sales online in the first 10 months of 2018,⁷¹⁹ and Sainsbury's Argos c.[20–30%].⁷²⁰

Parties' views

- 13.74 The Parties argue that the UK clothing market has been characterised in recent years by the large growth of online sales. They quote third party reports that indicate that online growth continues to surpass in-store growth. They also refer to high street retailers reassessing their traditional brick-and-mortar stores, shifting attention to their online offering (eg M&S and Zara).

Internal documents

- 13.75 Our review of the Parties' internal documents has identified very few examples of the Parties monitoring the clothing offerings of online-only competitors [X].⁷²¹ The Parties conducted their own review of internal documents provided to the CMA. The Parties' review of Sainsbury's Argos internal documents dated between 1 May 2015 and 30 April 2018, found that [X] were mentioned in [X] internal documents respectively. The Parties review of Asda internal documents produced to the CMA, found that [X]

⁷¹⁷ In our assessment of GM, we have included Click and Collect services as part of our figures on the online market. This is in contrast to our approach in groceries outlined in footnote 108. We have adopted this approach because GM products are more commonly one-off purchases where the ability to inspect products in-store is a more important consideration for in-store purchases. In comparison, grocery purchases involve a higher proportion repeat purchases of identical products. However, we have not found it necessary to reach a precise definition on the scope of an online market in GM because no competition concerns arise on any plausible basis.

⁷¹⁸ Information on the percentage of sales made online by competitors is displayed in Table 11 of Appendix J.

⁷¹⁹ Based on Asda schoolwear sales for the 2018 year up until October.

⁷²⁰ Based on schoolwear sales values (net of returns) for the 2018 year up to the w/e 20 October.

⁷²¹ We note that we did not review every internal document that the Parties submitted to us which was relevant to GM. Instead, we selected a sample of documents from the Parties using a one-in-n approach and supplemented this random sample with additional documents that seemed particularly likely to be relevant to GM based on their filenames.

were mentioned in [redacted] internal documents respectively. We have placed limited weight on this evidence because it is not clear in what context these mentions were made, and we do not know how many internal documents mention competitors with in-store offerings.

13.76 However, one Sainsbury's internal document notes [redacted].

Third party views

13.77 Aldi, Amazon, Debenhams, JD, Morrisons and Boohoo.com were of the view that the retail supply of clothing online competes with and constrains the supply of clothing in-store.

13.78 In addition, Amazon and Matalan noted that customers increasingly switch between online and in-store shopping in their 'customer journey', and that the distinction between in-store and online offerings are increasingly blurred given the growth of click-and-collect and other delivery models. However, Tesco noted that these general patterns of customer behaviour are different for clothing at supermarkets, where the majority of spend comes from customers who shop in-store only.

13.79 Aldi, Boots and Tesco also noted that online clothing sales are growing at a faster rate than in-store sales. Tesco submitted that online is an important part of the clothing market accounting for just under a third of sales, and online sales are growing whilst in-store sales are shrinking.

13.80 Aldi, Debenhams, M&S and Mothercare further noted that consumers are increasingly shopping online, due to the convenience, ease of comparison, and wider range available online, and John Lewis and Debenhams also noted that online clothing customers are more sensitive to prices.

13.81 Only one online-only competitor (Shop Direct) stated that, for own branded clothing, the extent to which a customer will switch between channels may be lower because of the bespoke nature of the product (quality, design, fit). M&S, Morrisons, Mothercare and John Lewis, whilst stating that online clothing offerings constrain in-store offerings, also acknowledge the relative advantages of in-store offering such as ability to inspect items before purchase, and better customer service and advice.

13.82 On delivery pricing and coverage, in general, third parties confirmed that they deliver to nearly everywhere in the UK, except for outlying islands and other more remote parts of the UK. Click and Collect in store is often free or lower cost than delivery to home and some third parties offer free delivery to home for purchases above a certain amount.

Our assessment

- 13.83 We have assessed whether the Merger is likely to result in an SLC for clothing in general, as well as for the segment of childrenswear and the sub-segment of generic schoolwear.
- 13.84 Our analysis indicates that the Parties compete closely in clothing and in the segments and sub-segments that we have considered. The Parties are particularly close competitors in childrenswear and generic schoolwear, where the shares of supply show that the Merged entity would be the UK's largest retailer. However, our review of the available evidence suggests that both Parties face major competitors in each segment and sub-segment of clothing.
- 13.85 In the wider segment of clothing the Merged entity would have a low national share of supply of 6.8% and the Merger would result in a small increment of 2.3% (both figures by value). Post-merger the Parties would be constrained by a large number of competitors with similar offerings. We therefore conclude that the Merger may not be expected to result in an SLC with respect to the clothing segment.
- 13.86 In childrenswear, the Parties have limited national shares of supply, with a combined share of 15.6% and the increment resulting from the Merger would be small given Sainsbury's low share of 4.1% (both figures by value). Although the Parties appear to compete closely in the retail supply of childrenswear, there are a number of other close competitors, such as: Tesco, Next, Primark, M&S, Matalan or Debenhams that impose a competitive constraint on the Merged entity. On this basis, we conclude that the Merger may not be expected to result in an SLC with respect to childrenswear.
- 13.87 Within childrenswear, the Parties appear to compete closely in the sub-segment of generic schoolwear. Within this sub-segment, the Parties have a combined national share of supply of 23.4%, with an increment of 6% (both figures by value). However, there are a large number of competitors offering generic schoolwear at competitive prices and with a wide geographic coverage, such as: Tesco, M&S, Next, Matalan, Debenhams, Shop Direct, Morrisons or 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.⁷²² In this regard, according to the

⁷²² For example, [Wyvern Primary School](#) suggests that parents can purchase uniform items from Primark.

available evidence, we consider that Primark seems to be a strong competitor in childrenswear generally, and particularly at the lower price end (where the Parties operate), and is monitored closely by the Parties.

13.88 On this basis, we conclude that the Merger may not be expected to result in an SLC with respect to the narrower sub-segment of generic schoolwear.

Electricals

National shares of supply

13.89 In the widest segment of electricals, the Parties would have a combined share of supply of less than 12% with an increment of less than 0.7%.⁷²³ We have also considered two narrower sub-segments of electricals where the Parties have relatively higher shares of supply (PCE and SKA). The Parties' combined shares accounted for between 15.1% and 16.5% of sales of PCE in 2018 and 24.4% of sales of SKA in 2017.⁷²⁴ Table 13.4 below displays the shares of supply of the Parties and its closest competitors in the retail supply of electricals.

13.90 For PCE, the Parties had previously submitted an older estimate which suggested that the Parties' combined share of PCE in 2016 was 24.2%. This suggests either that there was a material reduction in PCE share of supply over two years or that the 2016 and 2018 estimates, which are from two different sources, are calculated on different bases. The latter explanation seems more likely given the lack of other evidence pointing to a material reduction in the Parties' market position, but we considered both estimates in our assessment and note that our conclusion would be the same on either basis. Table 13.5 and Table 13.6 below show the shares of supply of the Parties and its closest competitors for the segments of PCE and SKA, respectively.

Table 13.4: The Parties and closest competitors share of supply in electricals in the UK, 2017

<i>Retailer</i>	<i>Share of supply</i>
	%
Sainsbury's	<0.7
Argos	10.6
Asda	<0.7
<i>Combined</i>	<i><12.0</i>
Dixons Carphone	26.4
Amazon	16.6
John Lewis	8.0

Source: The Parties (GlobalData).

⁷²³ Shares of supply for the top ten UK retailers are displayed in Table 4 of Appendix J.

⁷²⁴ Shares of supply for the top ten UK retailers are displayed in Tables 5 and 6 of Appendix J.

Table 13.5: The Parties and closest competitors shares of supply in PCE in the UK, 2018 (published in August)

	%
<i>Retailer</i>	<i>Share of supply</i>
Sainsbury's	2.7
Argos	12.4
Asda	<1.4
<i>Combined</i>	<i><16.5</i>
Boots	21.1
Amazon	17.0
Tesco	9.4

Source: The Parties (GlobalData).

Table 13.6: The Parties and closest competitors share of supply in SKA in the UK, 2017

	%
<i>Retailer</i>	<i>Share of supply</i>
Sainsbury's	3.6
Argos	15.6
Asda	5.2
<i>Combined</i>	<i>24.4</i>
Amazon	10.6
Dixons Carphone	10.4
Tesco	7.2

Source: The Parties (GlobalData).

Parties' views

13.91 The Parties stated that there is no prospect of an SLC arising in electricals, or with respect to the narrower PCE and SKA segments. The Parties submitted that:

- (a) they have relatively low combined shares of supply in electricals, and in the particular segments the CMA is considering, with shares recently declining as shown in estimates and forecast from GlobalData; and
- (b) they are not particularly close competitors in electricals and noted that Asda supplies a significantly more limited range of electrical products than Sainsbury's, and that both Parties benchmark against a wide variety of competitors, including online and in-store players.

13.92 With respect to the competitive constraint from online, the Parties submitted that two large online-only competitors (AO.com and Amazon) are among the range of competitive constraints that they face in electricals.

13.93 The Parties noted that online penetration is high, and that customers are increasingly switching between channels. The Parties submitted that this strong constraint from online will continue post-Merger, and therefore, 'in-store only' shares do not give an accurate view of the market dynamics.

Internal documents

- 13.94 Our review of the Parties' internal documents showed that the Parties monitor a number of competitors in the electricals market.
- 13.95 A 2015 Argos internal document indicates that the market segments of core electricals and PCE in particular [REDACTED].
- 13.96 A 2017 internal document by Sainsbury's Argos reported that key competitors for SKA are [REDACTED]. For PCE, their key competitors listed are [REDACTED]. In the same document, Sainsbury's Argos [REDACTED].
- 13.97 From these documents, [REDACTED]. Another internal document [REDACTED].
- 13.98 Asda has [REDACTED].

Third parties' views

- 13.99 Overall, we received mixed views from third parties about the extent to which the Parties compete closely in SKA and PCE.
- 13.100 Dixons Carphone, Shop Direct, Debenhams and John Lewis did not regard the Parties as close competitors. However, Morrisons and Tesco noted that the 'Big 4' are close competitors to one another in electricals (and GM generally), as they have similar ranges and propositions, based on GM areas that are complementary to the grocery shopping trip.
- 13.101 Sainsbury's Argos was mentioned as a close competitor in SKA and PCE by all third parties who responded to the CMA's investigation. Asda was also mentioned by many third parties but was generally regarded as a more distant and weaker competitor than Argos. However, all third parties also mention a large group of other close competitors, including both multi-channel retailers and online-only retailers.
- 13.102 The main concern expressed by third parties was a possible increase in buyer power post-Merger. (Buyer power is discussed in Chapter 15).

Price points

- 13.103 According to the information provided by the Parties, there are differences in the Parties' average price within the segments of PCE and SKA. These different average prices may indicate that the types of goods the Parties sell differ or that one of the Parties offers the same or similar products at lower prices. Lower average prices may suggest smaller impulse purchases, whereas higher average prices could be indicative of larger planned

purchases. In PCEs the average price points are Asda [£10–20], Sainsbury's [£20–30] and Argos [£30–40]. In SKAs the average price points are Asda [£10–20], Sainsbury's [£20–30] and Argos [£20–30].

Survey evidence from market reports

13.104 The Parties and third parties submitted evidence from GlobalData's survey of shoppers in 2017, on the proportion of surveyed shoppers who bought electricals from multiple retailers.⁷²⁵

13.105 The competitive constraints between the Parties in electricals is asymmetric. According to the GlobalData's survey, of the customers that shopped in Argos for electricals, 6.8% of those customers also bought electricals from Asda. According to this evidence, Argos' customers are more likely to shop from Dixons Carphone (21.5%) and Amazon (13.1%).

13.106 Conversely, according to GlobalData's report, 31.1% of Asda's electrical customers also bought electricals from Argos, and Argos appears to be the most common other shopping location for Asda electrical customers. Asda's customers are also likely to shop at Dixons Carphone (20.0%) and Amazon (14.4%).

13.107 However, as noted in paragraph 13.69, the patterns of 'cross-shopping' could reflect customers making complementary purchases within electricals rather than substituting between retailers and may therefore provide only limited evidence on the closeness of competition between retailers.

Competitive constraint from online

13.108 There is a relatively high online penetration in electricals. According to GlobalData, 48.6% of electrical sales in 2017 were made online. For the sub-segments of electricals where the Parties have a strong position, online penetration is lower relative to electricals as a whole. This is consistent with the view that online is less relevant for lower-value, impulse GM products.

(a) Verdict Retail estimated that the percentage of sales online for PCEs was 32.6% in 2016.

(b) GlobalData estimated that the percentage of sales online for SKAs was 36.3% in 2017.

⁷²⁵ Information on cross-shopping between the top ten UK electrical retailers in 2017 can be found in Table 9 of Appendix J.

13.109 For in-store competitors, the proportion of electrical sales made online varies widely: for instance, Aldi told us that it makes only [0–10%] of its overall electrical sales online, whereas John Lewis told us that this proportion is [higher]. Argos’s proportion of electricals’ sales made online is [60–70%]. This proportion remains above [50–60%] in both PCEs and SKA.⁷²⁶ Sainsbury’s and Asda have a relatively low proportion of electricals’ sales made online, with neither having a proportion of more than [0–10%] in any of the three segments.

Parties’ views

13.110 The Parties cite two online-only competitors, AO.com and Amazon, as being among the range of competitive constraints that they face in electricals.

Internal Documents

13.111 [REDACTED], according to one of Sainsbury’s internal documents. In that document, Sainsbury’s [REDACTED].

Third party views

13.112 All third parties who responded to the CMA’s investigation indicated that online offerings constrain in-store offerings. Morrisons, Dixons Carphone and Shop Direct noted the price comparison role of online as well as the importance of price for electrical products, and indicated that online customers were more price sensitive, and that the branded/commoditised nature of the products made it easier to compare prices. Amazon, Boots and Dixons Carphone stated that consumers increasingly switch between online and in-store shopping. Boots and Superdrug specifically noted that, for electricals, if the price drops online, this can lead to lower sales in-store.

13.113 AO.com told us that their research showed that consumers frequently shop across channels for PCE and SKA whilst Dixons Carphone stated that, although the online and in-store channels constrain each other, the online channel is a more important constraint on the retail channel because customers can use mobile devices to check prices online whilst they are in the shop.

13.114 Boots and Morrisons noted that physical stores retained some advantages for consumers relative to online sales, such as customers wanting to ask staff questions about products and test products. Debenhams noted that certain

⁷²⁶ Information on the percentage of sales made online by competitors is displayed in Table 12 of Appendix J.

SKA brands, such as KitchenAid, have selective distribution agreements in place which require stock to be displayed in stores in order to supply that retailer.

13.115 Amazon and B&M said that it was difficult to identify what constitutes an in-store or online offering in small electricals, with one of them noting in this regard the growth of click-and-collect and different delivery models.

Implications of a hypothetical separate market for online and offline

13.116 The national shares of supply noted in paragraph 13.89 include in-store sales, as well as sales made online. These shares of supply are appropriate for assessing the impact of the Merger on a hypothetical market that includes both online and in-store sales of electricals and the sub-segments of PCE and SKA. Additionally, we have also considered the impact of the Merger if online and in-store were separate markets.

13.117 GlobalData estimated that 48.6% of sales in electricals in 2017 were made online. Given that Asda's proportion of electricals sales made online in 2017 was less than [0–5%], we were able to estimate that Asda's market share in a hypothetical online only market for electricals in 2017 was [0–5%]. Therefore, the increment in market share resulting from the Merger would be negligible. Following the same approach, we estimate that Asda's market share in the hypothetical online only markets for PCE and SKA were [0–5%] and [0–5%] respectively.

13.118 We have also estimated the combined shares of the Parties' in a hypothetical in-store market for electricals, PCE and SKA to be [10–20%], [10–20%] and [20–30%] (by value), respectively. These are lower shares of supply (or almost exactly the same share in the case of SKA) than the Parties would hold in a wider market that included both online and in-store sales.

Our assessment

13.119 Our assessment of the available evidence suggests that the Parties compete in electricals, including the narrower segments of PCE and SKA. However, each are constrained by a range of grocery and non-grocery retailers, such as: Boots, Dixons Carphone, Tesco, Morrisons, Debenhams, AO.com, John Lewis and Amazon.

13.120 Asda's share of supply in all three segments is relatively low, with the highest being 5.2% in SKA. In addition to this, third parties generally did not think that Asda competed as strongly as Sainsbury's Argos in electricals.

13.121 Third parties also suggested that the Parties may not compete closely in PCE and SKA because of their different offerings and Sainsbury's Argos' broader range. This view is supported by the evidence submitted by the Parties on average price points which shows that Sainsbury's and Argos have a higher average product price than Asda in both PCE and SKA.

13.122 In addition, we consider that online may impose some constraint in electricals on the Parties across the UK, although this constraint appears to be slightly weaker in the segments of PCE and SKA. All third parties who responded to the CMA's investigation stated that online retailers constrained sales in physical stores. Notably, Sainsbury's Argos internal documents suggest that Amazon imposes a strong competitive constraint in electricals.

13.123 On the basis of the evidence outlined above, we conclude that the Merger may not be expected to result in an SLC with respect to electricals, or the narrower segments of PCE or SKA.

13.124 Our conclusions do not depend on the extent to which online sales constrain in-store sales. We also conclude that no SLC may be expected to arise in either a market for the online sales of electricals, PCE and SKA, or an equivalent market for in-store, or a market that included both online and in-store sales:

- (a) No SLC would exist in an online market because Asda's online proportion of sales online is very low and would lead to a very small increment in an online market in each of the three segments.
- (b) We would not find an SLC in-store on the basis that Argos' low proportion of in-store sales would lead to relatively low shares of supply in each of the three segments.
- (c) Finally, we would not find an SLC in a market that included both online and in-store given that, as mentioned in paragraphs 13.119 to 13.122 above, the Merged entity will be constrained by a wide range of competitors, the combined shares of supply would be low and they seem to have a different offering from each other.

Toys

National shares of supply

13.125 The Parties have a combined share of supply in toys (by value) of 23.6% with an increment of 5.6%. We also considered shares of supply excluding Toys R Us who recently exited the market: here the Parties' combined share of

supply was 26% with an increment of 6.2%.⁷²⁷ Table 13.7 below displays the shares of supply of the Parties and its closest competitors in the retail supply of toys.

Table 13.7: The Parties and closest competitors shares of supply in toys (by value) in the UK, 2017

<i>Retailers</i>	<i>Share of supply</i>	<i>%</i>
Sainsbury's	3.6	
Argos	14.4	
Asda	5.6	
<i>Combined</i>	23.6	
Toys R Us	10.2	
Amazon	10.1	
Tesco	9.1	

Source: The Parties (NPD).

Parties' views

13.126 The Parties submitted that they face strong competition from a wide range of competitors, many of which are increasing their shares of supply, including Amazon, Smyths, The Entertainer and B&M. According to the Parties, the UK toy industry is highly fragmented with a large number of retailers active both in-store and online, with online penetration being strong and predicted to keep growing.

13.127 The Parties indicate that Sainsbury's and Asda are not close competitors in toys. According to its internal documents, Sainsbury's considers its top competitors to be [redacted].⁷²⁸

13.128 As regards the competitive constraint from online players, the Parties noted that one of the trends characterising the UK toy sector is the continuing growth of online sales, led by the growth of Amazon which is predicted to grow its share of supply from 9.6% to 13.3% over the next five years.

Internal Documents

13.129 Sainsbury's internal documents show that they monitor several competitors in toys. A report from Sainsbury's [redacted].

13.130 An Argos 'Toy Strategy' document from 2015 indicates that [redacted].

⁷²⁷ We considered two further sensitivities: A sensitivity to excluding online only providers and shares of supplies provided a different source (GlobalData). Full shares of supply are displayed in Table 7 of Appendix J.

⁷²⁸ [Parties' response to the Issues Statement](#), paragraphs 307 and 308.

13.131 We identified limited information on Asda's key toy competitors in Asda's internal documents. However, the evidence suggests that [REDACTED].

13.132 Asda also reports [REDACTED].

13.133 Sainsbury's documents [REDACTED].⁷²⁹ [REDACTED].

13.134 In 2017, Sainsbury's Argos reported [REDACTED].

13.135 One Sainsbury's Argos document [REDACTED].

13.136 In 2017, Argos recorded a [REDACTED]. An internal document stated [REDACTED].

Third parties' views

13.137 Overall, some third parties believe that the Parties compete closely in the market for toys, and the main concern regarding the Merger was a possible increase in buyer power of the Merged firm. (Buyer power is discussed in Chapter 15).

13.138 B&M, ELC, Tesco, John Lewis and Smyths noted close competition between the Parties. John Lewis said that along with Tesco, the Parties operate a very similar model/pricing strategy and approach to toys. Tesco corroborated this statement, noting that the 'Big 4' are close competitors to one another.

13.139 All third parties who responded to the CMA's investigation consider Sainsbury's Argos to be a close competitor in toys. Asda was also mentioned by many third parties, though three of them did not mention it as a close competitor. Many other competitors are mentioned, including Amazon which is mentioned as a close competitor by every respondent.

13.140 On merger concerns, some third parties mentioned they were worried about an increase in buyer power, referring to the waterbed effect. Some competitors noted the effect on availability of in-demand toys and the Merged firm being able to arrange more deals for exclusives.

13.141 ELC, Ocado and Smyths also referred to the dominance the combined firm would have in the toy market. Ocado and ELC noted that this dominance would be greater given the demise of Toys R Us.

⁷²⁹ [REDACTED].

Price points

13.142 According to the information provided by the Parties, there are differences in Sainsbury's and Asda's average prices for toys and Argos' average prices. As noted in paragraph 13.103, lower average prices may suggest smaller impulse purchases, whereas higher average prices could be indicative of larger planned purchases. On average, price points for toys are similar for Asda and Sainsbury's at [£0–10] and [£0–10] respectively. Argos has a relatively higher price point of [£10–20].

Survey evidence from market reports

13.143 The Parties and third parties submitted evidence from GlobalData's survey of shoppers in 2017, on the proportion of surveyed shoppers who bought toys from multiple retailers.⁷³⁰

13.144 The competitive constraints between the Parties in toys may be somewhat asymmetric. According to the Global Data survey, of the customers that shopped in Argos for toys, 22.3% of those customers also bought toys from Asda. According to this evidence, Argos' customers are more likely to shop at Amazon (46.7%) and a similar number of customers are likely to shop at Smyths Toys (22.4%) and Tesco (20.4%).

13.145 Conversely, 51.9% of Asda's toys customers also bought toys from Argos, and Argos appears to be the most common other shopping destination for Asda's toys' customers. However, Asda's customers are similarly likely to shop at Amazon (45.4%) and significantly likely to shop at Smyths Toys (22.4%) and Tesco (20.4%).

13.146 However, as noted in paragraph 13.69, patterns of 'cross-shopping' could reflect customers making complementary purchases within toys rather than substituting between retailers and may therefore provide only limited evidence on the closeness of competition between retailers.

Competitive constraint from online

13.147 Online penetration in toys is strong and predicted to continue growing. Global Data estimated that 36.8% of sales in toys and games in 2017 were made online. It also expects that Amazon will overtake Argos as the leading toy

⁷³⁰ Information on cross-shopping between the top ten UK electrical retailers in 2017 can be found in Table 10 of Appendix J.

retailer by 2020. The proportion of consumers who did not shop for toys and games online in 2017 was 37%, decreasing from 40% in 2016.

- 13.148 For in-store competitors, there is large variation in the proportion of sales conducted online between different toy retailers: for instance, Morrisons told us that it makes only [0–10%] of its overall toy sales online, whereas John Lewis told us that this proportion is [higher].⁷³¹

Parties' views

- 13.149 The Parties submitted that one of the trends characterising the UK toy sector is the continuing growth of online sales, led by the growth of Amazon which is predicted to grow its share off supply from 9.6% to 13.3% over the next five years.

Internal documents

- 13.150 In a 2018 Sainsbury's internal document, [redacted].

Third party views

- 13.151 Most third parties indicated that online offerings constrain in-store offerings to some extent. Morrisons and Shop Direct noted the price comparison role of online, the importance of price and availability for toys, that online customers were more price sensitive and that the branded/commoditised nature of the products made it easier to compare prices. Amazon and Boots stated that consumers increasingly switch between online and offline shopping.
- 13.152 Boots and Morrisons noted that physical stores retained some advantages for consumers relative to online sales, such as customers wanting to ask staff questions about products, test products, and a more tangible shopping experience.
- 13.153 The Entertainer noted that it offers the same prices for some products both in-store and online. Amazon said that it was difficult to identify what constitutes an in-store or online offering in toys with the growth of click-and-collect and different delivery models. Shop Direct and Smyths said that the level of switching between channels was high and Tesco indicated that online is more relevant for higher priced, branded or commodity products, such as toys.

⁷³¹ Information on the percentage of sales made online by competitors is displayed in Table 13 of Appendix J.

Implications of a hypothetical separate market for online and offline

- 13.154 The national shares of supply noted in paragraph 13.125 include sales from in-store as well as online sales. These shares of supply are appropriate for assessing the impact of the Merger on a market that includes both online and in-store sales of toys. Additionally, we have also considered the impact of the Merger if online and in-store sales of toys were separate markets.
- 13.155 GlobalData estimated that 38.6% of sales in toys and games in 2017 were made online. Given that Asda's proportion of toy sales made online in 2017 was [10–20%], we were able to estimate that Asda's market share in an online only market for toys in 2017 was [0–5%]. Given this, the increment in market share resulting from the Merger would be small.
- 13.156 We have also estimated the Parties' combined share of supply in an in-store only market for toys to be [20–30%]. This is a lower market share than the Parties would hold in a wider market that included both online and offline sales.

Our assessment

- 13.157 Our assessment of the available evidence suggests that the Parties do compete closely in toys. However, the available evidence also shows that they are constrained by a range of grocery and non-grocery retailers, such as Tesco, Smyths, the Entertainer, and Amazon.
- 13.158 Third-parties suggested that the Parties compete closely in toys, although several third-parties noted that Sainsbury's Argos was a stronger competitor than Asda. This is reflected in the shares of supply: Sainsbury's Argos has a share of supply of 18% (largely Argos with 14.4%) whereas Asda has a smaller share of supply of 5.6%.
- 13.159 Evidence submitted by the Parties on average price points shows that Argos has a significantly higher average product price than Asda and Sainsbury's. This may suggest that Argos's offering is different and may not compete as directly with Asda as the shares of supply may suggest.
- 13.160 Argos made [60–70%] of its sales online compared to Asda and Sainsbury's whose online sales account for [10–20%] and [0–5%] respectively. In conjunction with internal document evidence that suggests Argos [redacted], this may suggest that Argos targets different consumers or types of purchases.
- 13.161 The evidence suggests that online retailers may constrain to some extent in-store retailers in the sale of toys. GlobalData estimated that 36.8% of sales in toys and games in 2017 were made online. Most third parties stated that

online retailers constrained in-store sales. Further to this, Sainsbury's internal documents suggest that Amazon imposes a competitive constraint.

13.162 On the basis of the above we conclude that the Merger may not be expected to result in an SLC with respect to the retail supply of toys.

13.163 Our conclusion does not depend on the extent to which online sales constrain in-store sales of toys. We also conclude that no SLC would arise in either a hypothetical market for the online sales of toys or the equivalent market for in-store sales, or a market that included both online and in-store sales:

(a) We would not find an SLC in an online market because Asda's proportion of sales online is very low and would lead to a very small increment in an online market.

(b) We would not find an SLC in-store on the basis that Sainsbury's Argos' high proportion of online sales would lead to relatively low combined market share.

13.164 Finally, we would not find an SLC in a market that included both online and offline sales given that, as mentioned in paragraphs 13.157 to 13.161 above, the Merged entity will be constrained by a wide range of competitors, Sainsbury's Argos seems to be a stronger competitor (according to shares of supply figures and third parties' evidence) and they have a different focus: Asda is mainly present in-store whereas Sainsbury's Argos have a greater focus online (mainly due to Argos which has made [60–70%] of its sales online).

14. Fuel

14.1 The Parties overlap in the retail supply of fuel (both petrol and diesel, and to a lesser extent auto-LPG) in the UK. Sainsbury's has 314 PFSs and Asda has 321 PFSs; the Parties also have a small number of additional PFSs in the pipeline ([redacted] for Asda and [redacted] for Sainsbury's).⁷³²

14.2 In the Issues statement,⁷³³ we stated that we were not minded to conduct any further investigation into the supply of auto-LPG, on the basis that our initial assessment indicated that there remained sufficient competition in the two local areas in which the Parties overlapped (on any plausible market definition) in the supply of auto-LPG. We have not received any further

⁷³² The CMA's analysis is based in part on the Experian Catalist forecourt site dataset from November 2018.

⁷³³ [Issues Statement](#), paragraph 12.

evidence since the publication of the Issues Statement to depart from that view. The supply of auto-LPG is therefore not addressed further in our report.

Market definition

Product scope

Parties' views

14.3 The Parties submit that:

- (a) consistent with previous decisions by the OFT and the CMA, the relevant product market is the retail supply of road fuels, encompassing both petrol and diesel;
- (b) consistent with previous decisions by the OFT and the CMA, the retail supply of auto-LPG forms a separate product market from the retail supply of road fuels; and
- (c) it is not necessary to consider further segmentation, such as a distinction between motorway and 'off-motorway' PFSs.

Third parties' views

14.4 We did not receive any submissions from third parties on the scope of the relevant product market.

Our assessment

14.5 The CMA (and its predecessors) have conducted a number of investigations in relation to the retail supply of road fuels, most recently in its phase 1 merger investigation MFG/MRH.⁷³⁴

14.6 We have not received any evidence to support departing from the product scope adopted in those previous cases. We therefore adopt as the relevant product market definition the retail supply of road fuels.

⁷³⁴ Anticipated acquisition by Completed acquisition by CD&R Fund IX (MFG) of MRH (GB) Limited (ME/6750/18) (2018).

Geographic scope

Parties' views

14.7 The Parties submitted that there is evidence to suggest that the catchment areas for the Parties' PFSs are significantly wider than the catchments adopted by the OFT and CMA in past decisions. The Parties submitted that a geographic catchment of 25 minutes' drive-time was appropriate, based on the following evidence:

- (a) Sainsbury's [REDACTED].
- (b) Asda [REDACTED].⁷³⁵
- (c) Sainsbury's submitted the results of an analysis of Nectar data ([REDACTED]% of Sainsbury's customers use a Nectar card for their fuel purchase). Using data on home addresses and excluding 'commuter' and 'seasonal' stores,⁷³⁶ Sainsbury's submitted that 80% catchment area drive-times are [REDACTED] minutes for urban stores and [REDACTED] minutes for rural stores.
- (d) The Parties conducted an exit survey of ten pairs of PFSs, and Sainsbury's separately conducted an online survey via its Nectar customer database of 20 Sainsbury's PFSs (the same ten as the Parties' exit survey, plus an additional ten sites) (together referred to as the 'Parties fuel surveys'). The Parties stated that their surveys focused on those PFSs where the Parties' sites are relatively close and/or there are relatively few competitors nearby. The surveys asked respondents how long it took them to travel to that PFS. The average 80th percentile response, across the surveyed PFSs, was around [REDACTED] minutes.
- (e) [REDACTED].

Third parties' views

14.8 We did not receive any submissions from third parties on the scope of the relevant geographic market.

Our assessment

14.9 Our starting point is that competition takes place mainly at the local level, as customers will consider options available to them in a local area when they

⁷³⁵ [REDACTED].

⁷³⁶ In its normal course of business, [REDACTED].

need to buy fuel. This is consistent with the position adopted in previous cases in which, for petrol and diesel, past OFT and CMA decisions have adopted a 10-minute drive-time catchment in urban areas and a 20-minute drive-time in rural areas.⁷³⁷

14.10 We had some concerns regarding the evidence submitted in support of each of the Parties' arguments for a 25-minute drive-time catchment area:

- (a) While Sainsbury's [REDACTED].⁷³⁸ The Parties have explained that Asda's [REDACTED].⁷³⁹
- (b) Nectar customers may not be representative of all Sainsbury's fuel customers. For instance, they may be willing to travel further to a PFS that offers Nectar points⁷⁴⁰ than customers who do not collect Nectar points.
- (c) Using Nectar customers' home addresses is likely to overstate the distance travelled, as many PFS customers may be travelling from another destination rather than directly from their home. While the Parties have tried to correct for this by excluding PFSs which are adjacent to 'commuter' and 'seasonal' grocery stores, this may also apply to customers of other PFSs which are not adjacent to such stores.

14.11 Nevertheless, we consider it is likely that supermarket PFSs will have wider catchment areas than non-supermarket PFSs (which have been the focus of the CMA's past decisions relating to the supply of road fuels) because:

- (a) Supermarket PFSs have lower prices for fuel than non-supermarket PFSs,⁷⁴¹ and some customers will be prepared to travel further to obtain these cheaper fuel prices; and
- (b) Customers may be willing to travel further for a combined groceries and fuel shopping mission than for a fuel mission alone.

14.12 As part of our investigation, we have conducted a number of analyses and gathered a range of evidence on the Parties' pricing practices and consumer preferences.

⁷³⁷ [Anticipated acquisition by MRH \(GB\) Limited of 78 service stations from Esso Petroleum Company Limited \(ME/6603/16\) \(2015\)](#), paragraph 28; [Completed acquisition by Motor Fuel Limited of 228 petrol stations and other assets from Murco Petroleum Limited \(ME/6471-14\) \(2014\)](#), paragraph 35; [Anticipated acquisition by Motor Fuel Limited of 90 petrol stations from Shell Service Station Properties Limited, Shell U.K. Limited and GOGB Limited \(ME/6534/15\) \(2015\)](#), paragraph 25.

⁷³⁸ [REDACTED]. For instance, a Sainsbury's internal document, [REDACTED].

⁷³⁹ [REDACTED].

⁷⁴⁰ In addition to Sainsbury's PFSs, Nectar points can be collected from BP PFSs.

⁷⁴¹ In our fuel price dataset, covering the period 1 April 2016 to 31 July 2018, the median supermarket PFS fuel price was consistently below the median non-supermarket PFS fuel price on each day, for both diesel and unleaded petrol. The average difference was around 4ppl for both diesel and unleaded petrol.

- 14.13 We have conducted a price concentration analysis (PCA), which aims to identify the effect that market concentration has on prices. We use it to inform our assessment of the distance at which the entry (or exit) of a rival PFS has an impact on a centroid PFS's prices. This includes whether supermarket PFSs exert a competitive constraint at greater distances than non-supermarket PFSs.
- 14.14 The analysis is based on data (including pricing data) collected by Experian Catalyst, a third-party provider of petrol forecourt information, covering daily prices at all PFSs in the UK for the period Q2 2016 to Q2 2018. This is supplemented with the Parties' own pricing data for the same period. We describe this data more fully in Appendix K.
- 14.15 We used this data to analyse changes in prices and local concentration (based on a count of the number of competing PFSs in the local area) for each PFS on a quarterly basis. We counted supermarket and non-supermarket PFSs separately, grouping each type of PFS into five drive-time bands (up to 5 minutes, 5-10 minutes, 10-15 minutes, 15-20 minutes and 20-25 minutes). This allowed us to estimate parameters representing the average effect that an additional supermarket and non-supermarket PFS within each of these bands has on fuel prices at a centroid PFS.⁷⁴²
- 14.16 The results of the analysis (set out in full in Appendix K) suggest that:
- (a) the number of supermarket PFSs up to a 20-minute drive-time from a centroid PFS has a statistically significant impact on fuel prices at the centroid.
 - (b) non-supermarket PFSs have a statistically significant effect on prices only when located within a 5-minute drive-time of the centroid.
- 14.17 In interpreting these results, we take account of the fact that the changes in concentration used to estimate the impact of competition on fuel prices are unlikely to be random. As noted by the Parties,⁷⁴³ this affects the PCA in particular in relation to non-supermarket PFSs, as most of the variation in the number of non-supermarket-PFSs in our dataset is due to exits as opposed to entries. Catalyst data shows that exiting PFSs tend to have much lower fuel volumes and shop sales than the typical non-supermarket PFS, and score lower in terms of quality and visibility.⁷⁴⁴ These exiting PFSs, therefore, can

⁷⁴² We accounted not only for the opening of new PFSs or their closures, but also for changes of ownership from a non-supermarket to a supermarket owner (and vice versa). A change of ownership from non-supermarket to supermarket is treated in the analysis as the exit of a non-supermarket PFS and the simultaneous entry of a supermarket PFS.

⁷⁴³ [Parties' response to the Provisional Findings](#), paragraph 744.

⁷⁴⁴ See Appendix K for more details.

be expected to have a lower impact on their competitors' prices than the average non-supermarket PFS. As the analysis is driven by these exits, it may assign a weight to non-supermarket PFSs which is lower than their actual competitive impact. The lack of a statistically significant effect on prices by non-supermarket PFSs beyond 5 minutes' drive from the centroid might be partly the result of this bias.⁷⁴⁵

14.18 The other pieces of analysis are discussed in more detail in paragraphs 14.93 to 14.96 and 14.126 to 14.141 below. We discuss here our findings from these sources of evidence that are relevant to the scope of the geographic market:

(a) *Pricing analysis* (paragraphs 14.126 to 14.141 below and Appendix K (paragraphs 56 to 87)). According to our models of the Parties' pricing rules (which predict the competitor that each of the Parties' PFSs would set prices in response to on each day, based on a simplified version of their overall approach to pricing):

(i) Sainsbury's PFSs [REDACTED].⁷⁴⁶

(ii) Asda's PFSs [REDACTED]. When interpreting these results, we note however that our pricing rule does not take into account [REDACTED].

(b) *CMA fuel survey* (paragraphs 14.93 to 14.96 below). Analysing the responses to the CMA fuel survey, 80% of respondents stated that they travelled [REDACTED] minutes' drive-time or less (Asda) and [REDACTED] minutes' drive-time or less (Sainsbury's) to arrive at the PFS at which they were surveyed. Considering the distance to the PFS that respondents said that they would divert to if they knew that the PFS was closed for refurbishment, 80% of respondents stated that they would divert to a PFS which was [REDACTED] (Asda) and [REDACTED] (Sainsbury's) minutes' drive-time or less from the PFS at which they were surveyed.⁷⁴⁷ There was no material difference in these responses depending on whether the PFS diverted to was a supermarket or non-supermarket PFS.

14.19 We consider that:

⁷⁴⁵ The Parties raised a number of other potential issues with the data underlying the PCA, which we address in more detail in Appendix K.

⁷⁴⁶ [REDACTED].

⁷⁴⁷ Given that the survey took place at the Parties' PFS premises, respondents may have been biased towards indicating diversion to PFSs close to the one where they were surveyed. It is possible that, if interviewed, for example, at home, respondents would have been more likely to indicate diversion to PFSs farther from the Parties' PFS but closer to their home. However, we expect the magnitude of the potential bias to be small.

- (a) greater weight should be given to evidence which is directly informative of the set of relevant competitive constraints facing each PFS. We consider that this includes: (i) the PCA; (ii) the distance between the Parties' PFSs and the competitor PFSs in response to which the Parties set their prices; and (iii) the distance to the PFS that survey respondents said they would divert to; and
- (b) less weight should be given to evidence that relies on or could reflect distances to PFSs from customers' home addresses, such as the Parties' Nectar data analysis and responses to survey questions about travel times, because a significant proportion of fuel customers may not be travelling directly from home and may need to refuel, for example, near their place of work or during a long journey far from home. Moreover, as observed at paragraph 14.10(b) above, Nectar customers may be willing to travel further to a PFS that offers Nectar points than customers who do not collect Nectar points.

14.20 Taking into account all of the evidence, we consider it is appropriate to adopt a different approach to the size of the relevant catchment area, depending on whether the PFS in question is a supermarket or a non-supermarket PFS.

14.21 Given the evidence reviewed above, we adopt as the relevant geographic market local catchment areas which include:

- (a) competitor non-supermarket PFSs up to 10-minutes' drive-time; and
- (b) competitor supermarket PFSs up to 20-minutes' drive-time.

14.22 We recognise that market definition is a useful tool and not an end in itself and while in our competitive assessment we analyse in more detail the competitive constraints from the set of competitors within the relevant geographic market as defined above, we also take account of and make explicit adjustment for any 'out-of-market' constraints, including for PFSs beyond the drive-times specified above.

National assessment

14.23 As set out in paragraphs 14.7 to 14.22, the relevant markets for road fuels are local. Pricing in fuel is also largely set locally. Nevertheless, in our view, there are currently parameters of competition in the Parties' fuel business which are not varied at the local level and are instead set centrally and applied uniformly across the Parties' PFS estate. This includes the overarching elements of the Parties' national pricing strategies, [REDACTED].

- 14.24 We also note that the Parties overlap across a high proportion of their PFS estate. Sainsbury's has 314 PFSs (and we are aware of [X] Sainsbury's pipeline PFSs) and Asda has 320 PFSs (and we are aware of [X] Asda pipeline PFSs). Using a 20-minute drive-time, 249 Sainsbury's PFSs (and [X] of its pipeline PFSs) overlap with an Asda PFS, and 279 Asda PFSs (and all [X] of its pipeline PFSs) overlap with a Sainsbury's PFS.
- 14.25 If the Merger may be expected to result in competition concerns in local areas representing a significant proportion of the Parties' overall PFS estates, the Merger may create an incentive to worsen the Parties' offerings across all their PFSs, including aspects of their offerings that are set centrally. The effect would be a deterioration of the Parties' offering 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' estates would reflect the aggregate competitive constraints that the Parties face in each of the local areas where they operate.⁷⁴⁸
- 14.26 To undertake this national assessment, we have considered a range of evidence which provides a centralised, or aggregate, view of the competition which the Parties face. We first set out the Parties' submissions, before reviewing in turn the following:
- (a) Evidence on national shares of supply;
 - (b) Evidence on which factors most affect customers' choice of PFS (which helps inform our understanding of the parameters on which the Parties compete with other grocery retailers);
 - (c) Evidence on the degree to which the main parameters of competition are set locally and how the incentive to set these parameters locally may change post-Merger;
 - (d) For each Party, the national weighted average GUPPI: an index measure calculated from combining diversion ratios and margin information, to provide an indication of the upward pricing pressure incentive that is expected to result from the Merger.

Parties' views

- 14.27 The Parties state that competition is fundamentally local in fuel retailing, and that the key aspects of their fuel offers are either set locally or through a central framework that is implemented or varied locally, in either case driven

⁷⁴⁸ CMA62, paragraphs 1.13-1.17.

by local competitive conditions. The Parties recognise that pricing policies are designed centrally, but state that they are subject to a significant degree of human judgement, so that the rules themselves do not automatically translate to a certain degree of ‘aggressiveness’.⁷⁴⁹

14.28 The Parties submit that there is no basis for any national theory of harm that would go beyond concerns arising from an aggregation of local competitive interactions.⁷⁵⁰ In the Parties’ view, there are no national concerns that would not be resolved straightforwardly by addressing any local concerns.

14.29 The Parties also point to national shares of supply, stating that the UK fuel retail sector is not concentrated and that the Parties on any measure will have a combined share of no more than 18% by volume,⁷⁵¹ and to the relatively low industry margins which reflect, in their view, the intense competition between fuel retailers.⁷⁵²

Third party views

14.30 We asked third parties to comment on how fuel prices are set, closeness of competition (particularly between supermarkets and non-supermarkets), overall profitability and views on the Merger. The evidence received from third parties, set out in paragraphs 14.32 to 14.45 below, suggests that:

- (a) price and location are the two most important factors for customers’ choice of PFS;
- (b) pricing is set by all operators at a local level and takes into consideration nearby competitors’ prices and promotions;
- (c) supermarkets, and Asda in particular, have the lowest fuel prices, and Asda is perceived to be the first to cut prices;
- (d) supermarkets are cheaper due to economies of scale, buyer power and willingness to forgo profits on fuel sales in order to drive footfall into their grocery stores (we note however that this was not supported by one supermarket competitor’s response);
- (e) oil majors invest more than supermarkets in providing higher quality fuel; and

⁷⁴⁹ [Parties’ response to the Provisional Findings](#), paragraph 827.

⁷⁵⁰ [Parties’ response to the Issues Statement](#), paragraph 360.

⁷⁵¹ [Parties’ response to the Issues Statement](#), paragraph 361.

⁷⁵² [Parties’ response to the Issues Statement](#), paragraph 363.

- (f) the Merger would lead to a high combined market share, especially in certain local areas and this could lead to increased prices, particularly Asda's prices.

14.31 Third-party views are also relevant to and have been taken into account in our local assessment.

Competitive parameters

14.32 Third parties ([REDACTED]) said that the main focus of customers when choosing a PFS is price. [REDACTED] noted that fuel is a homogeneous product and that brand is not as important as price. It further said that transparency of pricing is a particular feature of the market, as pricing is clearly displayed at the road-side, which means that customers can easily compare pricing between sites.

14.33 Apart from price, [REDACTED] said that they believe that important factors are availability and ease of use of the PFS. [REDACTED] said that its customer research shows that after price, convenience of location is the second most important factor for customers. One competitor ([REDACTED]) said that some customers are fully price sensitive while others prefer to use their local sites even if there is a price difference with other service stations.

14.34 BP said that the key factors that contribute to customer choice in selecting which PFS to visit will depend on their customer mission: fuel price is one factor, but the non-fuel retail offering may also be a key part of a customer's decision-making. The relative importance of these factors varies from area to area.

Closeness of competition between supermarket and non-supermarket PFSs

14.35 Some third parties ([REDACTED]) said that supermarket fuel prices are often lower than non-supermarket prices. [REDACTED] said that grocery retailers are invariably both the first to cut prices (usually nationally or to certain price points) and the last to raise them. MFG said that supermarkets often constrain other players from raising prices. [REDACTED] also said that Asda particularly was the price leader, and [REDACTED] noted that the other three larger grocery retailers (ie Tesco, Sainsbury's and Morrisons) usually follow Asda with price cuts.

14.36 MFG said that supermarket fuel providers are a very strong competitive constraint, which is set to increase further as they continue to grow their networks by acquiring new sites or developing new PFSs on their existing grocery store sites. Moto said that competition between supermarket PFSs and non-supermarket PFSs is asymmetric, ie that supermarket PFSs

constrain non-supermarket PFSs, but non-supermarket PFSs do not constrain supermarket PFSs.

- 14.37 Some third parties ([REDACTED]) said that oil majors invest in providing better quality fuel than supermarkets. [REDACTED] further said that they tend to invest in differentiating their fuel offering from supermarkets – including the grades on offer (eg super unleaded and differentiated diesel), additives and/or advertising/promotion of fuel quality claims. [REDACTED] said that there is a general assumption that some supermarket fuels do not carry, for example, the same level of additive for engine cleaning and are therefore not of the same quality as the fuel supplied by the major oil companies. It added that the supermarket fuel providers do not make claims about the quality of their fuels in the same way as the oil companies.

Why supermarkets are cheaper

- 14.38 Some third parties ([REDACTED]) said that supermarket fuel operators are cheaper because they benefit from negotiations with wholesale fuel suppliers due to the large volumes of fuel they can expect to sell. Moto stated that it believes that supermarket fuel operators are able to price more cheaply because they have the resources to source a sophisticated supply and distribution network and have the ability to use fuel as a loss leader to increase store profits, offsetting any reduction in fuel margins.
- 14.39 The Petrol Retailers Association said that supermarket fuel operators have used more profitable in-store grocery sales to cross-subsidise fuel, charging low fuel prices and making a variety of temporary offers (eg discounts on fuel for customers spending £50 in-store).
- 14.40 Tesco said that one reason that Asda is the cheapest fuel retailer may be that most Asda stations are unmanned, and therefore they have a lower cost operating model. More generally, Tesco said that it believes that one reason for higher prices at the oil majors may be that their sales per outlet are typically lower, and therefore the fixed costs of operating a site are spread over lower volumes. Tesco does not believe there is buying advantage between players.

Closeness of competition between the Parties

- 14.41 Some third parties ([REDACTED]) believe that the Parties compete closely. BP said that competition between local sites is strong and, at a brand level, BP would regard Sainsbury's and Asda as close competitors, such that if one of the competitors raised their prices, a significant proportion of customers would switch to the other competitor, or to other supermarket brands.

- 14.42 Harvest Energy said that its perception is that Asda has been the cheapest fuel retailer in the UK for at least the last two years. Its perception is that Sainsbury's has come a somewhat distant second with the price gap between the two being wider than between other competitors but that, overall, this varies from area to area.
- 14.43 [X] said that the Parties are not, in general, any closer competitors to each other than any other suppliers. [X] said this would depend on local market conditions and that it does not generally observe a distinction between Sainsbury's and Asda's prices on the one hand, and other supermarket competitors on the other, albeit that Asda might have a more pronounced discount policy.

Views on the Merger

- 14.44 Some third parties ([X]) said that they do not anticipate negative effects from the Merger. [X] said that it thinks that supermarket sites would continue to have a constraining effect on prices post-Merger.
- 14.45 Other third parties (Morrisons,⁷⁵³ Tesco, [X]) said that they believe that competition might be lost as a result of the Merger. Morrisons said that the importance of both Parties, but Asda in particular, in acting as a price marker in local areas is a key determinant of local competition.⁷⁵⁴ [X] said that it understands that Sainsbury's has [X] and, whilst its buying power will be enhanced, it may have less incentive to pass any benefit on to the consumer. Tesco said that given the pricing dynamics, the Parties may have a reduced incentive to maintain Asda's low prices, particularly in areas where there is not either a Morrisons or a Tesco. [X] said that it believes that there will inevitably be some areas where the combined presence of the Parties in a town will lead to a significant local market share under a merged company.

Our assessment

Shares of supply and scale of local overlaps

- 14.46 The Parties' combined share of supply (18% by volume, and 7.5% by number of sites) may not be expected to give rise to concern in a sector where products are largely undifferentiated.

⁷⁵³ [Morrisons response to the Issues Statement](#), paragraph 1.14.

⁷⁵⁴ [Morrisons response to the Issues Statement](#), paragraph 1.14.

Table 14.1: National fuel retail shares by brand, 2018

<i>Brand</i>	<i>Share of volume %</i>	<i>Share of sites %</i>	<i>Ratio of volume share to site share</i>
Sainsbury's	10.2	3.7	2.76
Asda	7.7	3.8	2.03
<i>Parties combined</i>	<i>17.9</i>	<i>7.5</i>	<i>2.39</i>
Tesco	16.1	6.0	2.68
BP	14.8	14.8	1.00
Shell	13.6	12.4	1.10
Esso	11.9	13.6	0.88
Morrisons	9.8	4.0	2.45
Texaco	5.2	8.8	0.59
Gulf	2.3	5.6	0.41
Jet	2.2	3.9	0.56
Other	5.6	21.1	0.27

Source: The Parties' (Final Merger Notice, Table 30).

14.47 We note, however, that national shares of supply do not take account of the relative closeness of competition of different retailers. In particular, supermarket fuel retailers are likely to compete more closely with each other than with non-supermarket fuel retailers. This is confirmed by our local analysis (see paragraph 14.104). Moreover, shares of supply do not account for the extent of geographic overlap between the Parties' PFSs and those of competing retailers, which is important as the Parties and other retailers do not compete for national customers but rather for local customers. We therefore consider these shares in light of other evidence of the closeness of competition between the Parties.

Parameters of competition and degree to which they apply uniformly across the Parties' estates

14.48 Evidence from third parties (paragraphs 14.32 to 14.34) and from the CMA fuel survey (paragraphs 14.95(c) and (d)) consistently indicates price and location as the two main parameters of competition in the supply of road fuels. Supermarket PFSs, in particular, tend to have lower prices, while non-supermarket PFSs tend to be more conveniently located.

14.49 Although the Parties set prices which are varied locally and take into account local competitive conditions, the central framework that they are implementing to set these local prices has an intrinsic level of aggressiveness (ie tendency to set lower prices to defend share or take share from competitors) and is viewed in a wider context. Both Parties have national 'pricing rules' (discussed in paragraph 14.128 below) which are applied uniformly nationally, although they result in local variations in prices. Asda's overall pricing approach, [X]. These rules imply a centrally determined level of aggressiveness even if local managers are given some flexibility when applying them. Third parties told us that Asda was the price leader and often the first to cut prices among the major supermarket retailers, and this is confirmed by [X].

14.50 The findings of our local assessment (discussed at paragraphs 14.60 to 14.158 below) are that the Merger will result in an SLC in 127 local markets centred on the Parties PFSs. This represents around 20% of the Parties' PFS estates. As set out in paragraph 14.25, if the Merger may be expected to result in competition concerns in local areas representing a significant proportion of the Parties' overall PFS estates (and assuming that the Parties do not find it profitable to simply depart from a uniform national approach), the Merger may create an incentive to worsen the Parties' offerings across all of their PFSs (such as changing their overall approach to price setting to a less aggressive one, having fewer or higher national price caps, etc.).

14.51 We note that Sainsbury's, through its [X]. In our view, [X] suggest that:

- (a) it would be feasible for the merged entity to change its pricing approach and adopt even more localised price setting rules for fuel than under the Parties' current approach; and
- (b) the additional complexity and implementation costs to Sainsbury's of doing so are outweighed by the benefits of increasing profits by [X].

14.52 The merged entity will have a larger PFS estate with greater variation in local demand and competition across local areas than Sainsbury's current PFS estate. Since the benefits of more localised price setting are greater if there is more variability in local demand and in local competition between the areas, we conclude that the merged entity will also likely find it profitable to adopt more localised pricing approaches. All other things equal, this makes it less likely that the Merger would lead to higher prices in every local area of the Parties' PFS estate.

National weighted average GUPPI

14.53 As described in Chapter 8, GUPPI is a metric that describes merging parties' incentives to raise prices and/or degrade the quality of their offering, their product range or their service levels (ie worsen their PQRS) post-merger. It does this by combining information on diversion ratios and margins.⁷⁵⁵ The greater the incentive to raise prices or degrade other elements of the offering (signalled by a higher GUPPI figure), the more likely the merger may be expected to result in an SLC.

14.54 In this part of our assessment, we have used a national weighted average GUPPI as one indicator, in combination with the range of qualitative and

⁷⁵⁵ The GUPPI calculation also takes into account for the ratio between the Parties'. In relation to fuel, prices are very similar at the Parties' PFSs, so that the ratio is approximately one.

quantitative evidence discussed above, to conclude whether, in the round, the Merger gives rise to competition concerns at a national level in relation to the supply of road fuels.

- 14.55 As described in detail in our local assessment (paragraphs 14.81 to 14.124 below), we calculated a GUPPI measure for each local area in which the Parties are present,⁷⁵⁶ combining information on local diversion ratios and local margins. To measure the expected upward pricing pressure in aggregate across all of these local areas, we calculated an average of the local GUPPIs at each of the Parties' PFSs, weighting each PFS according to the volume of fuel sold, to produce a national weighted-average GUPPI for each of the Parties. This produced a national weighted-average GUPPI for Sainsbury's of 0.85% and for Asda of 0.96%.
- 14.56 The GUPPI values reflect the low average variable margins the Parties generate from PFS sales ([]%) for Sainsbury's and []%) for Asda; see Appendix F). The GUPPI also accounts for the recapture of supermarket revenue when customers divert both PFS and supermarket spending.
- 14.57 As discussed in Chapter 16, paragraphs 16.150 to 16.166, we do not have sufficient evidence to support the existence of rivalry-enhancing efficiencies in relation to fuel. Therefore, when interpreting the GUPPI figures produced by our analysis, unlike in our assessment of unilateral effects in in-store groceries, we did not assume any downward pressure in a GUPPI analysis as a result of efficiencies.
- 14.58 Nevertheless, considered in light of the other evidence reviewed above, and taking into account the same factors described in our local assessment (paragraphs 14.149 to 14.151) when interpreting GUPPI levels, we do not consider that the national weighted average GUPPI that we have calculated implied a material incentive on the Parties to degrade competitive parameters at a national level post-Merger.

Conclusion on national assessment

- 14.59 Overall, based on the analysis set out above, we conclude that the Merger may not be expected to lead to an SLC in every local area where one or more of the Parties is present on the basis of this national assessment.

⁷⁵⁶ GUPPI is 0 in all local areas where the Parties do not overlap.

Local assessment

Parties' views

- 14.60 Given that competition in fuel retailing takes place mainly at the local level, as customers will consider options available to them in a local area when they need to buy fuel, the Parties submit that the degree to which they are close or more distant local competitors will depend on the local circumstances, in which the key factors are the number of rivals, convenience of location for customer (including ease of access), price, and convenience on-site of the fuel purchase itself (eg ability to pay in cash or by card at an automated pump) and the non-fuel retail offer.⁷⁵⁷
- 14.61 The Parties submit that non-supermarket fuel rivals will continue to constrain the Parties post-merger and should be given appropriate weight in any competitive assessment at the local level. The Parties highlight that:
- (a) Non-supermarket PFSs are typically better able to compete on convenience of location, which is a primary driver of customer choice. Oil majors like BP and Shell typically have the most convenient sites, which are easier to access and exit from main thoroughfares and visible at some distance. In contrast, supermarket PFSs are generally constrained by the locations of their existing grocery stores, as their fuel sites are almost always located in or around these stores.⁷⁵⁸
 - (b) The proportion of the Parties' fuel customers that combine both fuel and grocery purchases in a single trip is relatively low. Moreover, even if the ability to combine a fuel purchase with a grocery shop was a strong driver of choice for fuel customers, many non-supermarket PFSs are increasingly expanding their non-fuel offerings, particularly food-to-go, convenience grocery and coffee.⁷⁵⁹
- 14.62 The Parties argued that the CMA should apply a systematic approach focused on the key factors of competition at the local level, including location and price. The Parties drew attention to the filters used in previous CMA (and OFT) cases in the fuel retailing sector at phase 1, which the CMA and OFT have used to identify sites/local areas which may raise prima facie concerns.⁷⁶⁰ These are:

⁷⁵⁷ Parties' response to the Issues Statement, paragraphs 344 and 345.

⁷⁵⁸ Parties' response to the Issues Statement, paragraphs 348–350.

⁷⁵⁹ Parties' response to the Issues Statement, paragraphs 346 and 347.

⁷⁶⁰ Parties' response to the Issues Statement, paragraph 353.

- (a) nearest competitor: the merging parties are each other's nearest competitor by drive time;⁷⁶¹
- (b) fascia counts: '4 to 3' or worse on a 10-minute drive-time catchment (urban areas) or 20-minute drive-time catchment (rural areas) – in more recent cases on both a fascia and an ownership basis;⁷⁶²
- (c) price marking:⁷⁶³ either party identifies a site of the other party as its primary price marker or either party identifies a site of the other party as one of three or fewer competing sites;⁷⁶⁴ and
- (d) supermarket fascia count: '2 to 1' in supermarket fascia on a 10-minute drive time catchment (urban areas) or 20-minute drive time catchment (rural areas), ie the merger removes the only remaining supermarket rival in the relevant catchment area.⁷⁶⁵ This filter has only been used in one previous case.

14.63 The Parties submitted that, although these are phase 1 filters (and therefore will be generally be more conservative than required for a phase 2 assessment, given the lower legal threshold that applies at phase 1), for the most part they provide a useful starting point for our investigation in this case, except that they should be adapted to reflect a catchment area of a 25-minute drive-time.⁷⁶⁶

14.64 The Parties also submitted that the CMA's consideration of survey evidence should follow the approach taken in previous cases, such as *Shell/Rontec*,⁷⁶⁷ which suggests that an area is unlikely to raise competition concerns even on a phase 1 'realistic prospect' standard where there is good survey evidence that the diversion ratio between the relevant parties is under 40%. They said this is particularly the case given the evidence of the Parties' [§]. The Parties submitted that this would imply that raising prices would not be profitable unless extremely high diversions between Sainsbury's and Asda

⁷⁶¹ For example: [Motor Fuel/Shell](#) (ME/6534/15), paragraph 53; [Motor Fuel/Murco Petroleum](#) (ME/6471-14) (2015), paragraph 64; [Shell/Rontec](#) (ME/5191/11) (2012), paragraph 64; [Proposed acquisition by Rontec Investments LLP of petrol forecourts, stores and other assets from Total Downstream UK plc, Total UK Limited and their affiliates](#) (ME/5139/11) (2011), paragraph 30.

⁷⁶² For example: [Motor Fuel/Shell](#) (ME/6534/15), paragraph 53; [Motor Fuel/Murco Petroleum](#) (ME/6471-14) (2015), paragraph 64; [Rontec/Total](#) (ME/5139/11) (2011), paragraph 30.

⁷⁶³ Some road fuels retailers identify, for each of their PFSs, a list of local competing PFSs whose prices are closely monitored. These PFSs are called 'price markers'. In some cases, one of these PFSs is chosen as 'primary' price marker.

⁷⁶⁴ For example: [Motor Fuel/Shell](#) (ME/6534/15), paragraph 53; [Motor Fuel/Murco Petroleum](#) (ME/6471-14), paragraph 64; [Shell/Rontec](#) (ME/5191/11), paragraph 80; [Rontec/Total](#) (ME/5139/11), paragraph 37.

⁷⁶⁵ [Anticipated acquisition by Tesco plc of former BP/Safeway petrol forecourts and stores from Wm Morrison Supermarkets plc](#) (ME/1975/05) (2005), paragraph 42.

⁷⁶⁶ [Parties' response to the Issues Statement](#), paragraph 355.

⁷⁶⁷ [Shell/Rontec](#) (ME/5191/11), paragraphs 99 and 107.

were observed.⁷⁶⁸ In this respect, the Parties considered that diversion ratios based on in-person exit surveys are likely to overestimate diversion between the Parties due to a framing bias in favour of supermarket fuel retailers, as the respondents are in a supermarket PFS environment. The Parties noted that their online fuel surveys, which would be less subject to this framing bias, on average tend to find lower diversion ratios between the Parties than exit surveys taken in the same areas.⁷⁶⁹

- 14.65 The Parties further submitted that a reasonable approach to identifying local SLCs would be to use an initial screening mechanism based on the filters discussed above,⁷⁷⁰ followed by an area-by-area analysis that makes use of a broader range of local evidence.⁷⁷¹ The Parties propose that maps, the GUPPI and Pricing Indicator indices (discussed in paragraphs 14.81 to 14.141) could be used in the context of such an area-by-area analysis.⁷⁷²
- 14.66 The Parties stated that [redacted], and [redacted].⁷⁷³ The Parties submitted that any additional overlaps created through new openings that are planned can be addressed on a case-by-case basis at the local level, using the same systematic approach as for overlaps generated by existing sites.⁷⁷⁴
- 14.67 We discuss further specific submissions from the Parties on elements of our analysis where relevant below.

Third party views

- 14.68 The third-party views discussed in paragraphs 14.30 to 14.45 above are relevant to and have been taken into account in our local assessment of unilateral effects.

Our assessment

Approach to competitive assessment

- 14.69 The CMA and OFT have conducted a number of merger investigations in the fuel retailing sector. Each of these cases has been resolved at phase 1. In these cases, the CMA (and OFT) used a number of filters to identify

⁷⁶⁸ [Parties' response to the Issues Statement](#), paragraphs 356 and 357.

⁷⁶⁹ [Parties' response to the Issues Statement](#), paragraph 358.

⁷⁷⁰ This argument was made in response to the Provisional Findings. The Parties had previously argued that it was pragmatic to use an approach such as GUPPI or WSS analysis as an initial screening mechanism.

⁷⁷¹ [Parties' response to the Provisional Findings](#), paragraph 817.

⁷⁷² [Parties' response to the Provisional Findings](#), paragraph 820.

⁷⁷³ [Parties' response to the Issues Statement](#), paragraph 359.

⁷⁷⁴ [Parties' response to the Issues Statement](#), paragraph 359.

sites/local areas which may raise prima facie concerns, and therefore required a more in-depth review. The filters used in previous CMA and OFT cases are described at paragraph 14.62, above.

14.70 We have decided not to use those filters in the current case for the following reasons:⁷⁷⁵

- (a) The filters were designed for and previously applied to the investigation of mergers between non-supermarket fuel retailers. The filters, therefore, reflected the competitive constraints faced by non-supermarket PFSs, rather than supermarket PFSs. Moreover, they took into account the presence and strength of the constraint imposed by supermarket fuel retailers, which, unlike in the Merger under investigation, was not expected to change.
- (b) The filters were applied in phase 1 investigations, where we have less scope to engage in an in-depth analysis, requiring the use of simpler approaches.⁷⁷⁶

14.71 Instead, we sought to devise an approach that would be tailored to this case and would: (i) allow us to systematically take account of the wide variety of evidence available, without the need to conduct a manual assessment of a large number of local areas; and (ii) best reflect the key parameters of competition at the local level, in particular the importance of price and location.

14.72 On this basis, we adopted a decision rule to establish whether the Merger would, on the balance of probabilities, be likely to give rise to an SLC in certain local markets. This decision rule is primarily based on a GUPPI analysis applied to each local area where the Parties' PFSs are present (similar to the approach adopted in our in-store local unilateral effects assessment), which combines

- (a) a WSS analysis of how customers would divert from the Parties' centroid PFS to local competing PFSs, based on evidence of customer diversion from the CMA fuel survey; and
- (b) information on the Parties' variable margins.

⁷⁷⁵ The initial filters set out in paragraph 14.69 were however used as a starting point for identifying a pool of potentially problematic PFSs, for the purposes of selecting 32 PFSs to survey for the CMA fuel survey. See further details in Appendix B.

⁷⁷⁶ In their Response to the Provisional Findings (at paragraphs 727-732), the Parties pointed out that the CMA had rejected the use of these filters on the basis that they generated 166 sites, which was too many to assess individually. However, this number was the result of a coding error; the actual number is around 70. We have addressed this error but we continue to consider that using these filters would be inappropriate in this case.

- 14.73 The GUPPI analysis is complemented by a pricing analysis which uses the internal pricing rules on which the Parties' fuel prices are based, which incorporate the prices and other characteristics of local competing PFSs.
- 14.74 We introduce the GUPPI analysis and pricing analysis in the following subsections. We also explain the relative merits of each and the weight we attach to each in our competitive assessment. Finally, we explain how we have combined these analytical approaches into our decision rule.
- 14.75 The PCA analysis discussed in paragraphs 14.13 to 14.17 could also in principle provide evidence relevant to the local competitive assessment. In particular, the weights generated by a PCA analysis could be converted into an alternative WSS.⁷⁷⁷ However, for the reasons discussed in paragraph 14.17, the results of the analysis are likely to contain a bias against non-supermarket PFSs, which would make any estimated WSS based on the PCA less reliable than the WSS based on the survey evidence. For this reason, we have decided not to use the results of the PCA for the purposes of the local competitive assessment.⁷⁷⁸

Interaction between groceries and fuel

- 14.76 Before discussing the component parts of the GUPPI and pricing analyses, we consider how the Parties' ability to offer customers both groceries and fuel may affect our assessment of the competitive effects of the Merger in the supply of road fuels.

Parties' views

- 14.77 The Parties consider that it is appropriate for the CMA to examine the competitive effects of groceries and fuel separately, because the competitor set and the way that competition works is different in each category. Further, the Parties argue that any competition concerns would be addressed by a separate assessment of each segment, because:
- (a) A minority of customers buy both groceries and fuel in a single transaction. Based on the Parties' analysis of Nectar data, only [20–30%] of Sainsbury's fuel customers bought groceries using their Nectar card in the same visit, and only [10–20%] of Sainsbury's groceries customers at

⁷⁷⁷ This approach was explored in our Provisional Findings.

⁷⁷⁸ The Parties had previously submitted that, in constructing the weights to be used in a GUPPI, it would be appropriate to take account of the evidence beyond the CMA fuel survey and, in particular, of the findings of the PCA. However, in their response to the Provisional Findings (paragraphs 744 and 749), the Parties remarked on the bias affecting the PCA (discussed in paragraph 14.17, above) and the lack of correlation between PCA-based WSS and survey diversion. Finally, the Parties noted that the bias could be exacerbated by the re-classification of Co-op PFSs as non-supermarket PFSs (discussed in Appendix K).

stores with a PFS also bought fuel using their Nectar card. This means that the merged firm will primarily compete for customers who are not buying both groceries and fuel, for whom there is no reason to consider that competitors without a combined offer would be a less effective competitor.

- (b) Even for customers that currently purchase both groceries and fuel in a single visit, there is no evidence to suggest that they would not split their basket if the price of either element were to increase. The Parties' fuel surveys suggest that less than a quarter of those customers who used the main grocery shop as well as buying fuel would divert both purchases to a single alternative rival if the price of fuel were to increase (rather than either keeping their grocery shop with the survey grocery store, or diverting their grocery and fuel purchases to two different rivals).
- (c) The evidence used to assess customers' preferences and diversion patterns would already capture any interdependencies that could suggest that stores with both groceries and fuel are closer competitors than stores with just one or the other. For instance, surveyed customers that sufficiently value a combination offer will say that they will divert to another store that offers both groceries and fuel.⁷⁷⁹

Our assessment

14.78 There are several sources of evidence that support the view that it is appropriate to consider the Parties' fuel and groceries operations together:

- (a) The Parties' internal documents⁷⁸⁰ indicate that they believe that having a PFS on-site or adjacent to a supermarket leads to an increase in groceries sales. For example, one Sainsbury's document [REDACTED]. Similarly, an Asda document [REDACTED].⁷⁸¹

- (b) In addition, Sainsbury's [REDACTED].

14.79 We further note that, in the CMA fuel survey, 33% (Sainsbury's) and 43% (Asda) of respondents had used or were planning to use the supermarket in addition to buying fuel, and 10% (Sainsbury's) and 13% (Asda) of respondents stated that they would divert their supermarket spending as well as their fuel spending if the PFS were not available.

⁷⁷⁹ [Parties' response to the Issues Statement](#), paragraphs 162 to 166.

⁷⁸⁰ We reviewed the internal documents that the Parties submitted as annexes to their Merger Notice and in their response to our requests for information.

⁷⁸¹ [REDACTED].

14.80 In our view, the Parties' post-Merger incentives to worsen any aspect of their competitive offering for fuel 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, and the extent to which these would be recaptured by the other Party. We discuss at paragraphs 14.113 to 14.120 how we have taken into account this interaction between fuel and non-fuel sales in our local assessment.

GUPPI analysis

14.81 The GUPPI analysis combines the following pieces of evidence:

- (a) a WSS derived from survey evidence on customer diversion; and
- (b) the Parties' margins.

14.82 This section discusses how we have computed the WSS, and how we have combined it with information on the Parties' margins in a way that accounts both for the margin earned on the Parties' fuel sales, and the margin earned on the Parties' non-fuel sales that would divert with those fuel sales.

14.83 A WSS analysis based on customer diversions (estimated from survey evidence) enables us to incorporate the following evidence:

- (a) price and location, which are the two most important factors for customers choosing which PFS to attend (see third-party views at paragraphs 14.32 to 14.34 and the findings from the CMA fuel survey at paragraphs 14.95(c)-(d) below);
- (b) supermarket PFSs are cheaper than non-supermarket PFSs, on average and controlling for a range of factors (see third-party views at paragraph 14.35 and our analysis at paragraph 14.11(a));⁷⁸²
- (c) the competitive constraint from one PFS on another diminishes as the distance between them increases, and this effect depends on whether the PFS is operated by a supermarket or not, with a supermarket PFS continuing to exert a material competitive constraint at greater distances relative to a non-supermarket PFS (see paragraph 14.104 and Appendix K); and

⁷⁸² The OFT published a report on the determinants of fuel prices (diesel and petrol), for which they measured local market concentration with fascia counts: OFT (2013), [Econometric analysis on the determinants of price differences across the UK](#).

(d) in areas where a competitor owns several PFSs within close proximity, the competitive constraint that the competitor exerts on the Party's PFS is determined by the number and location of all its nearby PFSs, not just by the PFS that is closest (see paragraphs 14.95(g)-(i) on diversion patterns by destination site from the CMA fuel survey, below).

14.84 The WSS methodology systematically incorporates these findings by applying a specific weight to each PFS in a given local area based on whether it is a supermarket PFS or not and on its distance from a given Party's PFS (which we call the 'centroid' PFS). The weights are derived by estimating the relation between customer diversion, obtained through the CMA fuel survey, and the characteristics of local competitors. The estimated coefficients are then applied to PFSs in non-surveyed areas to assign weights to each of them. The weights obtained from this approach are an estimate of the proportion of customers that would divert to each PFS in the case of a price increase at the centroid PFS. By adding the weights of all PFSs of one of the Parties in a given local area, the analysis captures the competitive constraint exercised by that Party on a given PFS of the other Party, taking account of the competitive effect of other PFSs in that area.

14.85 Before providing a more detailed explanation of our WSS methodology, which draws from the results of the CMA fuel survey, we discuss the evidence from:

- (a) The Parties' fuel surveys, which include an online and an exit survey; and
- (b) The CMA fuel survey.

The Parties' online and exit surveys

14.86 As explained in paragraph 14.7(d), the Parties submitted the results of an exit survey for 20 PFSs (10 Sainsbury's PFSs and 10 Asda PFSs) and an online survey of Nectar customers for 20 PFSs (the 10 Sainsbury's PFSs covered by the exit survey and an additional 10 Sainsbury's PFSs). The Parties stated that their surveys focused on those PFSs where the Parties' sites are relatively close and/or there are relatively few competitors nearby.

14.87 The Parties submit that an online/telephone survey is useful to counter a potential bias from an in-person exit survey, for which respondents may be skewed towards stating that they would consider/divert to competitors that happen to be geographically close, rather than to competitors that might be convenient to the customer over a less immediate time frame (eg regular commute).

- 14.88 We have some concerns with the quality of the Parties' surveys, as discussed below and with further details in Appendix B:
- (a) We were not provided with any evidence that PFSs were chosen at random to survey.
 - (b) The interviewer instructions for the Parties' fuel surveys did not provide sufficient assurance that the interviewers across the surveyed sites recruited respondents in a consistent and random way.
 - (c) The Parties were unable to provide evidence of sufficient quality assurance of the fieldwork.
 - (d) The Sainsbury's PFS online survey is a survey of Nectar customers only. These customers are unlikely to be a representative sample of all users of Sainsbury's PFSs.
 - (e) We do not agree with the Parties' assertion that an online survey would be more accurate than a face-to-face survey. The Parties report that their online survey gave different diversion results than their face-to-face survey, but they do not provide any convincing evidence that it is more accurate.
- 14.89 The Parties' fuel exit survey also took a different approach to the diversion question than the CMA fuel survey. In the Parties' survey, respondents were first asked which fuel brand they would have switched to; this question was first asked unprompted, but respondents answering 'don't know' were prompted with a list. Once the respondent had chosen a fuel brand they were then prompted with a list or map of all of that brand's PFSs (and no others) within a 25-minute drive time and asked which of these they would have been most likely to use.
- 14.90 In our view, the Parties' approach assumes that respondents will be able to recall the brand of their alternative PFS. Once the respondent has selected a brand, they are not presented with PFSs of other brands. We had concerns that there may be a sizable group of respondents who might recall the location of the alternate PFS that they would divert to more readily than the brand of that PFS, particularly as brand is a relatively less important parameter of competition in fuel retailing relative to price and location.⁷⁸³
- 14.91 Therefore, in the CMA fuel survey, we asked an unprompted diversion question and probed for a response, without requiring respondents to pre-

⁷⁸³ See paragraph 14.100.

select a brand of PFS. Starting with unprompted questions is our standard method of measuring diversion. We consider it reduces bias, when compared with the Parties' suggested prompted approach.

- 14.92 For these reasons, we have decided not to place any weight on the Parties' surveys for the purpose of our local competitive assessment, and to rely instead on the results of the CMA fuel survey and pricing analysis, which we consider provide more reliable evidence for the purposes of our assessment.

CMA fuel survey

- 14.93 For the purposes of identifying the sample of PFSs to be surveyed, we first identified the Parties' PFSs failing the filters used in past cases (excluding pipeline PFS; see paragraph 14.62 above), based on the information available at the time, and then took a stratified random sample by:
- (a) ensuring a range of drive-times to the nearest PFS of the other merging Party;
 - (b) including the only two PFSs failing the filters in Northern Ireland (one for each Party); and
 - (c) avoiding picking two PFSs from the same Party within the same postcode area.
- 14.94 The Parties broadly agreed with this approach. After consultation with the Parties, we also checked the sample to ensure a good balance of: Asda PFSs with different payment types (such as staffed PFSs with a full shop, staffed PFSs with only a payment kiosk, and unstaffed PFSs); geographic distribution; PFSs which were standalone and PFSs which were adjacent to a supermarket; and presence of competitors. Our survey sample included 16 Asda PFSs and 16 Sainsbury's PFSs.
- 14.95 The main findings of the survey are as follows:
- (a) The majority of customers travelled less than 10 minutes' drive to their PFS. Asda PFS customers have a slightly longer journey time on average.
 - (b) For approximately two-thirds of Sainsbury's (71%) and Asda (65%) customers the primary purpose of travel was to visit the PFS, the shop or the supermarket.
 - (c) Price was mentioned as a reason for their choice of PFS by 48% of Sainsbury's customers and 71% of Asda customers. It was cited as the

main reason for choice of PFS for 29% of Sainsbury's customers and 49% of Asda customers.

- (d) Location was mentioned as a reason for their choice of PFS by 61% of Sainsbury's customers and 60% of Asda customers. It was cited as the main reason for choice of PFS by 40% of Sainsbury's customers and 32% of Asda customers. Related to location, 16% of Sainsbury's customers and 20% of Asda customers said that 'proximity to the supermarket' was a reason for their choice of PFS, and 8% of Sainsbury's and Asda customers gave this as their one main reason for their choice of PFS.
- (e) A third (33%) of Sainsbury's PFS customers also visit the supermarket, compared to more than two-fifths (43%) of Asda PFS customers. Less than a fifth of customers visited the PFS shop or kiosk.
- (f) Customer mean spend on fuel and distribution of spend was comparable between Sainsbury's and Asda PFSs, with mean spends at both Parties' PFSs at just over £[redacted].
- (g) There was a clear negative correlation between fuel spend-weighted diversion ratio to the other Party and distance to nearest PFS of the other Party.
- (h) Over three-quarters of both Sainsbury's and Asda customers diverting their fuel only would go to a site within a 10-minute drive. Over two-thirds would do the same when diverting their combined fuel and supermarket spend.⁷⁸⁴
- (i) The diversion ratio to the other Party was higher for customers diverting their fuel and supermarket spend together than it is for those diverting their fuel spend alone.

14.96 The fuel spend-weighted diversion ratios to the other merging Party from the CMA fuel survey are reported in Appendix K. Our approach to own-brand diversion is discussed in Chapter 8, paragraphs 8.222 to 8.223. In summary, our approach has been to exclude own-brand diversion when calculating diversion ratios between the Parties.⁷⁸⁵

⁷⁸⁴ We note, however, that in relation to non-supermarket PFSs, the survey results may underestimate diversion beyond a 10-minute drive (see paragraph 14.103).

⁷⁸⁵ We recognise that this approach to own-brand diversion could result in an overestimate of the GUPPI in some circumstances (if, for example, one of the Parties' other PFSs has a lesser incentive to raise its price than the centroid PFS for which the GUPPI is calculated). We take this into account when determining the appropriate GUPPI threshold.

Predicted diversion ratios and WSS

- 14.97 As we did not survey every PFS, we do not have an estimate of the diversion ratio to the other Party for each of the Parties' PFSs.
- 14.98 The evidence from the CMA fuel survey, third-party views, and the Parties' views suggests that the key factors for customers' choice of PFS, and hence diversion, are location and price. The latter is significantly affected by whether the PFS is operated by a supermarket or not.
- 14.99 Based on these insights, we used a fractional response model⁷⁸⁶ to estimate a relationship between diversion from each centroid PFS in the CMA fuel survey to other local PFSs and the following explanatory variables: a) the drive-time distance of the local PFS to the centroid PFS; and b) whether the local PFS was a supermarket or a non-supermarket PFS.
- 14.100 Unlike for the analysis of in-store groceries, we do not distinguish between different supermarket brands nor between different non-supermarket brands. This was because survey evidence (see paragraph 14.95) and third-party evidence (see paragraph 14.32) indicate that brand (except for the distinction between supermarket and non-supermarket PFSs) is much less important than price and location as a determinant of customer choice of PFS.
- 14.101 Using this estimated relationship between diversion and the location and type of PFS, we derived estimates for the diversion to local PFSs around each of the Parties' PFSs that were not surveyed. Using the predicted diversion ratios from our model, we constructed a WSS measure for each competitor within the relevant drive-time catchment around each of the Parties' centroid PFSs.
- 14.102 For the Parties' PFSs where we conducted the CMA fuel survey, WSS were computed using the diversion information directly obtained from survey respondents at each PFS, rather than the estimated diversion derived from the model discussed above. This is consistent with the approach we adopted in relation to the local assessment of in-store groceries and allows us to account for those variations in competitive conditions across the surveyed areas that are not captured by the model.
- 14.103 All WSS were then adjusted to allow for out-of-market constraints. To determine the appropriate level of the adjustment, we considered the results of the CMA fuel survey, which showed that, on average across the surveyed PFSs, [5-10]% of diversion takes place either to supermarket PFSs further

⁷⁸⁶ See Appendix K for details. We use a fractional response model rather than a linear regression, as we did in our Provisional Findings, as the Parties observed that the linear regression explained only 25% of the variation in survey diversion ([Parties' response to the Provisional Findings](#), paragraph 749).

than a 20-minute drive-time or to non-supermarket PFSs further than a 10-minute drive-time. The Parties argued that, particularly in relation to non-supermarket PFSs, the survey results underestimate diversion beyond a 10-minute drive time from the centroid PFS. The issue is discussed more fully in Appendix B. To account for this potential bias, we adopted a 7.5% out-of-market adjustment.⁷⁸⁷

14.104 The results of this analysis indicate that, while generally diversion decreases with distance, supermarket PFSs attract a significantly larger diversion than non-supermarket PFSs located at the same distance from one of the Parties' PFSs. Our approach to the analysis and its results are described more fully in Appendix K.

14.105 One potential drawback of the WSS approach is that the surveyed sites were randomly selected from those PFSs that failed the filters used in previous CMA and OFT retail fuel merger cases (set out in paragraph 14.62, above). As the Parties argued, the methodology used to select the PFSs to be surveyed implies that they are not representative of the Parties' wider PFS estate. This may limit the reliability of any inferences that we draw from the survey about the Parties' wider PFS estate.

14.106 We also recognise that the WSS estimated through our model explain only 46.2% of the variation in diversion observed in the surveyed areas. While we consider this proportion to be sufficiently high to make the WSS informative of local competitive conditions, we take into account the uncertainty around these estimates when deciding on the appropriate GUPPI threshold in paragraph 14.151.

GUPPI calculation

14.107 For the purposes of this part of our assessment, the GUPPI is designed to assess the Parties' post-Merger incentives to deteriorate aspects of their fuel offering. We have therefore calculated a GUPPI based on the WSS and information on the Parties' fuel margins. We refer to this as the 'single-product GUPPI', as it only takes into account the Parties' activities in the supply of road fuels.

14.108 However, as described in paragraphs 14.78 to 14.80 above, the Parties' post-Merger incentives to worsen any aspect of their competitive offering for fuel will be affected not only by the loss of revenue from fuel sales, but also by the extent to which a loss of fuel customers would also lead to a loss of revenue

⁷⁸⁷ This adjustment is also sufficient to correct for any potential bias towards geographically closer PFSs (see footnote 747).

from grocery and GM sales to those customers, and the extent to which these would be recaptured by the other Party. To reflect this, we adjust the GUPPI to also take into account the Parties' margins on non-fuel sales that would also be expected to divert with any diversion of fuel sales. We refer to this as the 'multi-product GUPPI', as it takes into account the Parties' activities in both the supply of road fuels and the supply of in-store groceries and GM.

14.109 Given the important interaction between the Parties' fuel and non-fuel operations, we consider that the multi-product GUPPI is a better measure for the purposes of our assessment. However, as the single-product GUPPI is used to calculate the multi-product GUPPI, we discuss this first, before discussing the multi-product GUPPI.

- *Calculating the single-product GUPPI*

14.110 As in our assessment of in-store groceries, we calculated a single-product GUPPI for each of the Parties' PFSs, combining information on local diversion ratios and local PFS margins.

14.111 For the diversion ratios, as discussed at paragraph 14.102 above (and consistent with the approach taken in our assessment of in-store groceries), for PFSs that were surveyed, we used evidence on diversion ratios taken directly from the CMA fuel survey, rather than the estimated WSS, as we consider that this direct evidence on local competitive interactions is likely to be the most informative for the purposes of our assessment.

14.112 For the margins, we estimated individual variable margins for each of the Parties' PFSs. We have also included the non-fuel revenue and cost associated with the PFS site (eg shops, carwashes, ATMs, etc). Our methodology for estimating the margin is explained in Appendix F. For the recently opened or pipeline PFSs, for which individual cost data were not available, we used each Party's average national margins for the Parties' PFSs.

- *Calculating the multi-product GUPPI*

14.113 To account for the interaction between fuel and non-fuel sales and the impact this would have on the pricing pressure the Parties would face post-merger, we add to the single-product GUPPI a component reflecting the impact of grocery and GM sales. In determining the appropriate adjustment, we took into account the following evidence:

(a) The proportion of fuel customers who also purchase groceries;

- (b) The patterns of diversion for customers who purchase both fuel and groceries, including the proportion of customers who would divert their fuel spending alone and those who would divert both their fuel and groceries spending, either separately or together; and
- (c) The variable margins on groceries and GM at the supermarket adjacent to each PFS.

14.114 On the first of these points, as set out in paragraph 14.95(e), in the CMA fuel survey, 33% (Sainsbury's) and 43% (Asda) of respondents had used or were planning to use the supermarket in addition to buying fuel.⁷⁸⁸ 10% (Sainsbury's) and 13% (Asda) of respondents stated that they would divert their supermarket spending as well as their fuel spending if the PFS were not available. Of these respondents:

- (a) 7% (Sainsbury's) and 9% (Asda) would divert fuel and supermarket spend together, ie to the same location, which would necessarily be a supermarket with adjacent PFS;
- (b) 3% (Sainsbury's) and 4% (Asda) would divert fuel and supermarket spend separately.

14.115 On the second point, the CMA fuel survey collected information about the brand of supermarket where respondents said that they would divert their supermarket spend, in response to forced diversion of their fuel spend. However, the CMA fuel survey did not collect information about the specific store to which the respondent would divert their supermarket spend.⁷⁸⁹ Given the lack of direct evidence on where the respondent to the CMA fuel survey would divert their supermarket spending, for the purpose of the GUPPI we assumed that the customers diverting their supermarket spending separately from the fuel spending followed the same diversion pattern as the customers responding to the CMA store exit survey who told the interviewer they had also bought (or were going to buy) fuel at the adjacent PFS; we computed a WSS following the same approach used for in-store groceries (see paragraphs 8.99 to 8.186), but without applying the adjustments based on the entry/exit analysis.⁷⁹⁰ For customers diverting both supermarket and fuel spending to the same location, we estimated diversion by excluding the

⁷⁸⁸ We also note that the Parties submitted that, according to an analysis of Nectar customers who purchased fuel, [20-30]% of Nectar customers purchasing fuel at a Sainsbury's PFS were found to also have bought groceries from the main grocery store on the same visit ([Parties response to Issues statement](#), paragraph 164).

⁷⁸⁹ This was because it was decided that it was important to ensure that the survey did not take more than five minutes on average, in order to achieve good response rates at PFS.

⁷⁹⁰ The entry/exit analysis does not provide evidence directly related to the sub-population of customers of both fuel and grocery.

grocery stores without a PFS and rescaling the weights of the remaining stores accordingly. The calculation is described more fully in Appendix K.

14.116 On the third point, we have also reflected in our analysis the effect of grocery and GM variable margin at the adjacent supermarket. The variable margin for grocery and GM are set out in Table 8.3 of Chapter 8.

14.117 Taking into account the three factors set out above, to produce the multi-product GUPPI we added to the single-product GUPPI for each of the Parties' PFSs an adjustment obtained as the sum of the following components:

- (a) The proportion of customers who would divert grocery, GM and fuel spend separately, multiplied by the WSS of the other Party and by the corresponding variable margin,⁷⁹¹ and
- (b) The proportion of customers who would divert grocery, GM and fuel spend together, multiplied by WSS of the other Party when assuming that the customer can divert only to supermarkets with a PFS, and by the corresponding variable margin.⁷⁹²

- *Parties' views on multi-product GUPPI calculation and further analysis*

14.118 Respondents to the CMA fuel survey were asked about diversion in the case that the PFS at which they were surveyed was not available (forced diversion). The Parties argued that the proportion of respondents who would divert both their fuel and groceries spend in case of forced diversion is likely to be higher than the corresponding proportion in response to an increase in the price of fuel. In other words, customers of both fuel and groceries are likely to be less sensitive than fuel-only customers to an increase in the price of fuel. If this is the case, the diversion rates in paragraphs 14.114(a) and (b) would overestimate the frequency of diversion of groceries spend and, as a result, our multi-product GUPPI would be too high.

⁷⁹¹ Technically, we should also multiply by the ratio of one Party's average groceries transaction value to the other Party's average fuel transaction value. In practice, these quantities are very similar, so the ratio will be approximately one. For instance, the CMA fuel survey informs us that the average transaction value and the distribution of the Parties' fuel customers spend on fuel is comparable between Sainsbury's and Asda PFSs (with mean spend of £[redacted] at Sainsbury's and £[redacted] at Asda, DJS Fuel Survey Report, Table 4), and it also informs us that the average transaction value for the Parties' fuel and groceries customers on fuel and groceries is very similar, with average spend at supermarket around £[redacted] (DJS Fuel Survey Report, Table 5) and average spend at PFS (fuel and kiosk) around £[redacted] for Asda and £[redacted] for Sainsbury's (calculated as the mean fuel and kiosk spend for fuel and groceries customers, based on the DJS survey dataset).

⁷⁹² The same considerations as in footnote 791 apply here.

- 14.119 Given this potential bias, the Parties further submit that it is important to take account of both the fuel-only (ie single-product) GUPPI and the multi-product GUPPI in our assessment.
- 14.120 The Parties have also submitted that the customers who would divert fuel and supermarket spend separately may have different preferences in relation to grocery alternatives compared to the wider population of fuel and grocery customers. In particular, they have noted that survey respondents who said they would divert both fuel and grocery spend were most likely to name Aldi as the alternative brand to which they would divert their grocery shopping.⁷⁹³
- 14.121 We consider that a single-product GUPPI is likely to underestimate the pricing pressure faced by the Parties. We recognise that the Parties' argument implies that our multi-product GUPPI may overestimate the actual pricing pressure faced by the Parties. However, there are potential biases in the other direction. For example, customers diverting only fuel spend may be more price sensitive and therefore more likely to choose cheaper alternatives, such as other supermarket PFSs including the other Party's PFSs. If that was the case our approach, by underestimating the frequency of fuel-only diversion, may introduce a bias that counteracts the one put forward by the Parties.
- 14.122 We also recognise that customers diverting both fuel and groceries may have different preferences in terms of groceries alternatives than the wider population. However, the limited information about grocery diversion collected through the CMA fuel survey does not allow us to estimate diversion separately for this group.
- 14.123 We therefore acknowledge that there is uncertainty around 'the diversion of grocery spend for fuel and grocery customers and potential biases in the approach we have used to estimate it, although it is not clear whether this would lead to any material under- or overstatement. We take this into account when determining the appropriate GUPPI threshold to use in our decision rule, discussed further in paragraphs 14.142 to 14.156.
- 14.124 The Parties have analysed the average effect of a PFS on grocery sales, based on evidence from their internal documents, the CMA fuel survey and an analysis of the impact of new PFS openings. The Parties have estimated that, on average across their PFS estates, this 'halo effect' corresponds to [redacted]ppl.⁷⁹⁴ In other words, the presence of a PFS generate additional grocery

⁷⁹³ Parties' response to the Provisional Findings, paragraph 758.

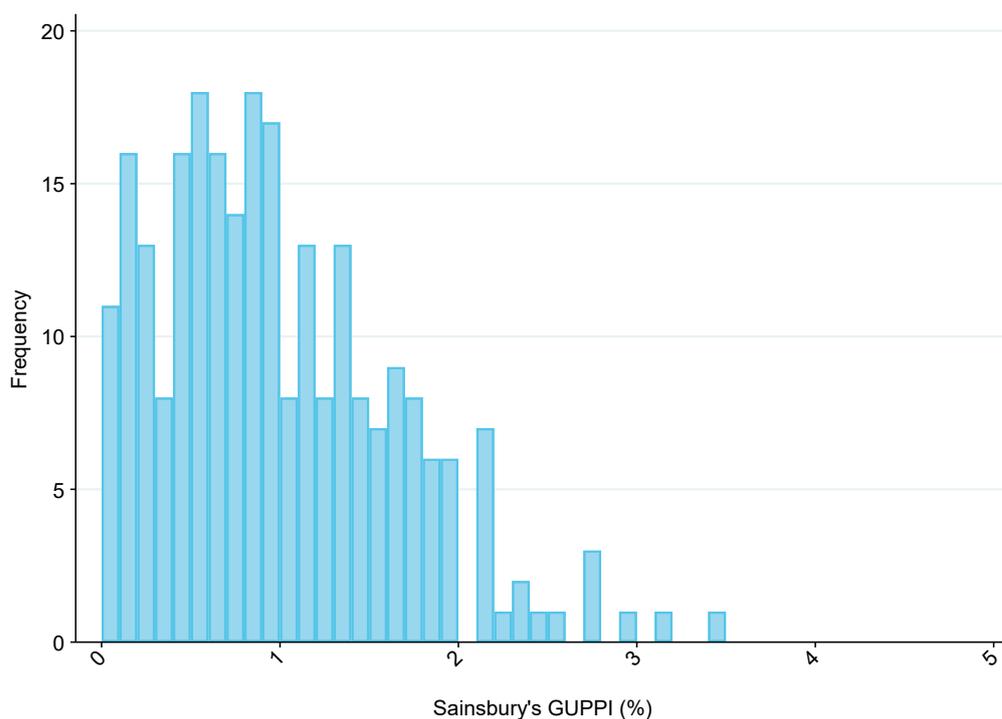
⁷⁹⁴ Parties' response to the Provisional Findings, paragraph 824. See also Parties' response to Question 1 of the CMA's request for information dated 22 March 2019.

sales at the Parties' supermarkets worth approximately [X] pence for each litre of fuel sold. We have computed the 'halo effect' implied by our grocery adjustment discussed above and found it to be broadly consistent with the halo effect estimated by the Parties (see Appendix K for details about our methodology and the results of the comparison).

- *Results of multi-product GUPPIs*

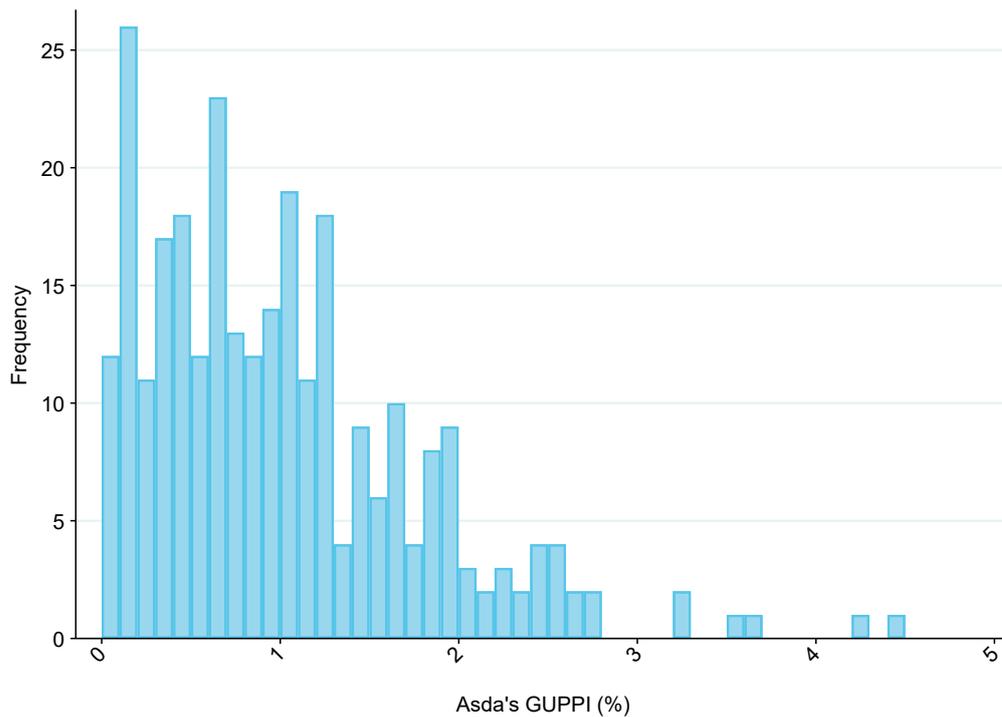
14.125 The distribution of the multi-product GUPPIs across the Parties' PFS estates is set out in Figures 14.2 and 14.3 below.

Figure 14.2: Distributions of multi-product GUPPIs across Sainsbury's PFS estates



Source: CMA analysis.

Figure 14.3: Distributions of multi-product GUPPIs across Asda's PFS estates



Source: CMA analysis.

Pricing analysis

14.126 The pricing analysis is consistent with and supportive of some of the main findings in our evidence base, including that:

- (a) the Parties' PFS prices [redacted]; and
- (b) the Parties' PFS [redacted].

14.127 Prices are very transparent in the retail fuel market. Many fuel retailers, including the Parties, receive daily prices for most PFSs in the UK from Experian Catalyst, and take this into account in their own pricing decisions. Many retailers, particularly those who have a large number of PFSs and including the Parties, use national pricing formulae, rules-of-thumb, or algorithms to inform the prices for each of their PFSs, often taking into account the prices of other competing PFSs in the local area.

14.128 According to the Parties, their overall approach to pricing is as follows:

- (a) [redacted], Sainsbury's [redacted]. Additional details on Sainsbury's pricing algorithm are set out in Appendix K.

(b) Asda's [REDACTED]. Additional details on Asda's pricing approach are set out in Appendix K.

14.129 We programmed pricing rules to simulate Sainsbury's algorithm and Asda's pricing approach:

(a) For Sainsbury's, our pricing rule includes the core logic of the '[REDACTED] rule' and [REDACTED], and accounts for [REDACTED].

(b) For Asda, our pricing rule is [REDACTED].

14.130 These pricing rules generated a set of daily diesel and unleaded petrol⁷⁹⁵ prices for each of the Parties' PFSs, which can be compared with the actual prices set by the Parties.

14.131 The Parties have argued that these rules radically simplify the Parties' pricing approaches, [REDACTED]. While we recognise that our model is a simplification, we think it captures the core logic of Asda's pricing approach. As we use the result of our pricing analysis as an indicator, rather than a precise estimate, of the likely local Merger effects, we think such a simplified rule is acceptable.

14.132 We compared the outputs from our pricing rules and the actual prices that the Parties set. Further details are provided in Appendix K, but overall, the pricing rules appear to capture the Parties' pricing behaviour the majority of the time (c.50-55% to within +/- 0.2ppl and c.75-85% to within +/- 1ppl). We view this as a sufficient degree of accuracy to consider this analysis as being informative of the Parties' actual pricing behaviour.

14.133 The Parties have argued that the level of accuracy is too low to represent a validation of the underlying pricing rules; indeed, it is easy to set up pricing rules totally unrelated with the Parties' actual pricing approaches but that achieve higher levels of 'accuracy', eg always setting the same prices as the day before.⁷⁹⁶ We agree with the Parties that the accuracy level achieved by our pricing rules cannot by itself validate the rules. However, we have designed the pricing rule so that they mimic the Parties' actual pricing approaches. The level of accuracy we achieved makes us confident that the rules broadly reflect those approaches.

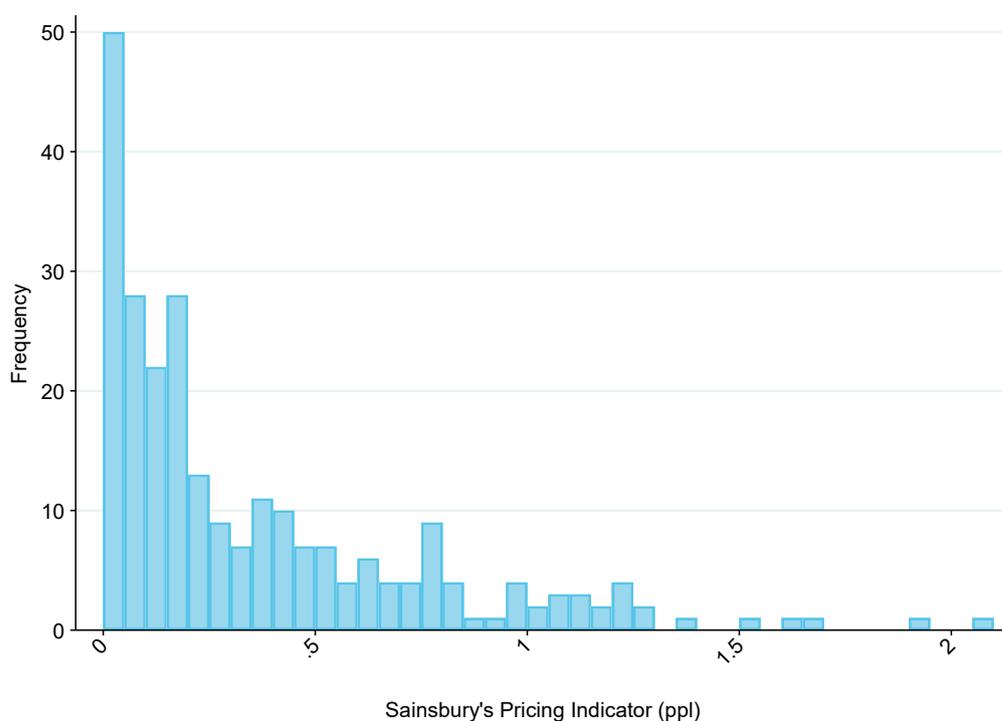
14.134 One feature of both Parties' pricing [REDACTED]. We can think of this competitor PFS as the effective constraint on the Party's centroid PFS on that day.

⁷⁹⁵ We did not include Super Unleaded petrol in our analysis, as it constitutes [REDACTED] of Sainsbury's petrol sales and it is not sold by Asda.

⁷⁹⁶ We note that the Parties' choice of comparator (a rule which predicts that the Parties would set the same price as yesterday's price at each of their PFS) would be incapable of predicting any change in prices whatsoever.

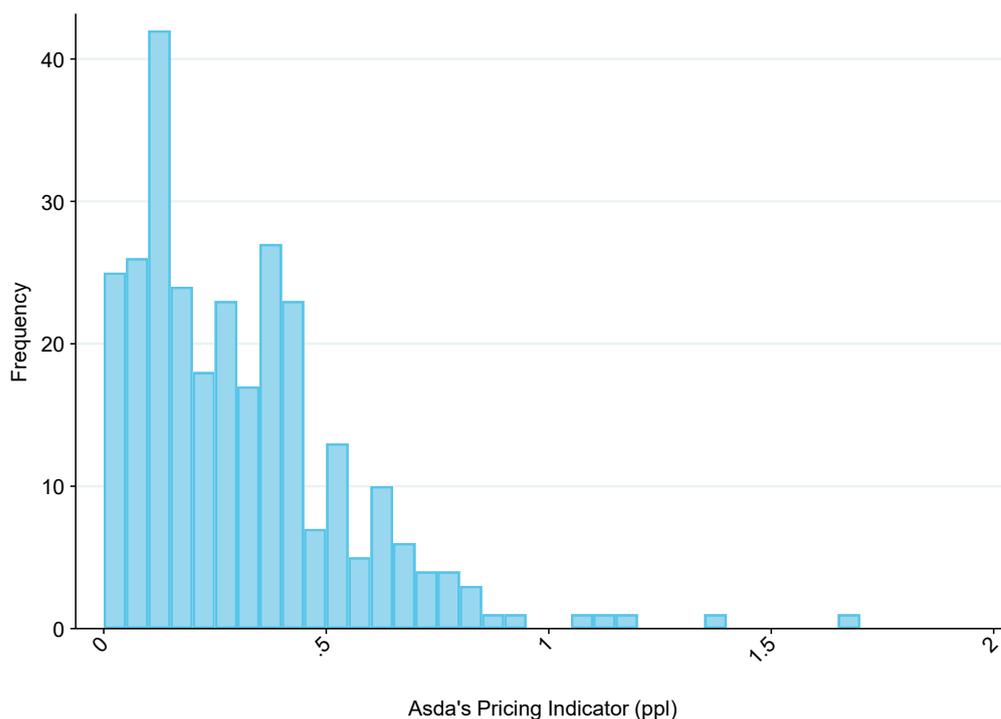
14.135 Where the other Party's PFS was the effective constraint for one of the Parties' centroid PFS, we analysed the difference in the prices generated by the Parties' pricing rules if the rules ignored the other Party's PFS. For each of the Parties' PFSs, we computed a volume-weighted average of the price differences for diesel and unleaded petrol. We call this average difference the 'Pricing Indicator'. While we do not see the Pricing Indicator as a precise estimate of the Parties' post-Merger fuel prices at each PFS, we consider it to be a reliable indicator of the likely Merger effect at each PFS, ie the higher its value, the greater the Merger effect is likely to be. The following figures show the distribution of the values of the Pricing Indicator across the Parties' PFS estates.

Figure 14.4: Distributions of the values of the Pricing Indicator across Sainsbury's PFS estates



Source: CMA analysis.

Figure 14.5: Distributions of the values of the Pricing Indicator across Asda's PFS estates



Source: CMA analysis.

14.136 There are two caveats with this exercise that are worth noting:

- (a) It assumes that all competitor PFSs would set the same prices post-Merger, and would not take into account any changes in the Parties' prices;
- (b) It ignores any incentive for the Parties to jointly increase prices at their PFSs, as a result of recapture of any diversion, and it implicitly assumes that the Parties will retain their current overall pricing approach post-Merger, with the only change being that the Parties will no longer price match against PFSs they own post-Merger.

14.137 The first assumption is common to any analysis that only looks at the 'first-order effects' of a merger, including GUPPI analysis. This assumption tends to reduce the predicted impact and, as such, understate the Merger effect.

14.138 The second assumption is clearly a simplification of the Parties' post-Merger behaviour. The Parties argued that this is not a credible hypothesis and that changes in local competition post-Merger may lead the Parties to modify their pricing approaches. In particular, they have observed that, after the Merger, the current pricing approaches would imply that the Parties would [✂]. This would happen [✂]. The Parties have argued that it is not credible that [✂], given that non-supermarket PFSs have more convenient locations, better

amenities and higher perceived quality of fuel. In order to remain competitive, the Parties' PFSs would have to [REDACTED].⁷⁹⁷

14.139 Finally, the Parties have also argued that, even in the case of Sainsbury's [REDACTED], the current pricing approach [REDACTED], so cannot be used to predict merger effects.⁷⁹⁸

14.140 We acknowledge that the Parties may amend their pricing rules in the future, but we further note that:

- (a) The current pricing rules appear to represent the Parties' best attempt to maximise profits under current competitive conditions and practical constraints.
- (b) Apart from the internalisation of sales that are diverted to the other Party, we are not aware of any major planned entry or exit, changes in ownership, or any other changes in post-Merger competitive conditions that would mean that the current pricing rules would be highly inaccurate post-Merger.
- (c) We recognise that, based on the Parties' argument in paragraph 14.138, the Pricing Indicator could be biased upwards in cases where, post-Merger, [REDACTED]. We note that this bias would affect the Pricing Indicator in local areas where there are limited competitive constraints from supermarket PFSs apart from the other merging Party. These, however, are precisely the cases in which we would be most concerned about the loss of competition between the Parties.
- (d) Even if there were changes to the Parties' pricing approach post-Merger, unless there are material and merger-specific efficiencies for the Parties' fuel business, these changes are more likely than not to result in overall price increases for consumers rather than pro-competitive changes, and so the pricing analysis may overall tend to underestimate the likely Merger effect.

14.141 We agree with the Parties that the results of the pricing analysis cannot be interpreted as accurate predictions of post-Merger prices. A relatively high level of the Pricing Indicator is indicative of weaker local constraints from the Parties' competitors, or areas where the Parties are closely located and setting low prices, and third-party competitors are further away and/or setting

⁷⁹⁷ [Parties' response to the Provisional Findings](#), paragraphs 768(b) and 769.

⁷⁹⁸ The Parties submit that, in order to maximise profits, the pricing rule should take account of the impact of increasing prices at a local Sainsbury's PFS, ie diversion to Asda and the extent lost margins are recaptured. These factors are captured in the GUPPI framework.

higher prices. The Parties expressed a similar view. We consider that the Pricing Indicator is a useful indicator of the magnitude of the likely Merger effect on the Parties' local prices. The indicator is most likely to be biased downwards, for the reasons discussed above. We take the accuracy level of our pricing rules into account when determining the appropriate threshold for concern to be applied to the Pricing Indicator. However, where the Pricing Indicator is sufficiently high, we consider it provides a reliable standalone basis for identifying an SLC, as discussed in paragraph 14.154 below.

Decision rule

Parties' views

14.142 The Parties submitted that we should follow the approach taken in previous cases, such as *Shell/Rontec*, which suggests that an area is unlikely to raise competition concerns, even on a phase 1 'realistic prospect' standard, where there is good survey evidence that the diversion ratio between the relevant parties is under 40%.⁷⁹⁹

14.143 The Parties agreed with the CMA that the sources of evidence incorporated in the analytical approaches outlined above (the survey evidence used in the GUPPI analysis and the Parties' pricing rules incorporated in the pricing analysis) can in principle shed light on local conditions of competition. However, for the purposes of deciding in which local areas the Merger may be expected to give rise to an SLC, the Parties submitted that the CMA should follow a two-step process:

- (a) First, use the filters used in previous CMA (and OFT) cases (see paragraph 14.62) to identify areas where there are plausible concerns of a possible SLC;⁸⁰⁰
- (b) Then, conduct an in-depth area-by-area assessment on these areas, using a broader range of evidence. The Parties submitted that the GUPPI and the pricing analysis could be incorporated as part of the suite of evidence considered in this in-depth review.⁸⁰¹

14.144 Should the CMA decide not to undertake an area-by-area analysis, the Parties submitted that a better determinative approach would be to use the

⁷⁹⁹ [Shell/Rontec](#) (ME/5191/11), paragraphs 99 and 107 and [Parties' response to the Issues Statement](#), paragraph 356.

⁸⁰⁰ [Parties' response to the Provisional Findings](#), paragraph 817. Previously, the Parties had argued for the use of metrics such as GUPPI, adopting thresholds at the 5-10% level.

⁸⁰¹ [Parties' response to the Provisional Findings](#), paragraphs 820 and 821.

previously used filters, diversion ratios, or a combination of the two as the basis for a decision rule.⁸⁰²

Our assessment

- 14.145 For the purposes of our local assessment, and consistent with the approach adopted in our assessment of the supply of in-store groceries, given the number of local areas in which the Parties' PFSs overlap (in excess of 530 PFSs within 20 minutes' drive of each other), it would not be practicable to perform an assessment of each local area in turn. We have discussed at paragraph 14.70 why we do not consider it appropriate to use the filters suggested by the Parties. We therefore consider it necessary to devise a decision rule to establish whether the Merger is, on the balance of probabilities, likely to give rise to an SLC on each local market for the supply of road fuels. We use a decision rule based on the two indicators discussed above (the GUPPI and the Pricing Indicator).
- 14.146 In combining the evidence and results of these analyses, we adopt the following principles:
- (a) We rely on the results of the GUPPI analysis, as the GUPPI is a well-established analytical tool and, in our formulation of a multi-product GUPPI, accounts for the upward pricing pressure each Party would face post-Merger resulting from both fuel and associated grocery diversion to the other Party.
 - (b) For the reason discussed in paragraph 14.102, we compute the GUPPI using the directly observed survey diversion for those PFSs where we have conducted the CMA fuel survey, and the estimated WSS in non-surveyed areas.
 - (c) We complement the GUPPI analysis with the pricing analysis and we interpret high values of the Pricing Indicator as indicative of local areas where the Merger may be expected to lead to higher fuel prices.
- 14.147 Based on these principles, we find an SLC if the GUPPI is above a given threshold. As the GUPPI is based on parameters of competition extrapolated from what we observed in the areas included in the CMA fuel survey, it may not capture some local variation in the conditions of competition in non-surveyed areas. We account for this uncertainty in setting the appropriate GUPPI threshold (see paragraphs 14.149 to 14.153).

⁸⁰² [Parties' response to the Provisional Findings](#), paragraph 818.

14.148 We also consider that a high value of the Pricing Indicator, which is exclusively based on data on each individual local area, provides sufficient evidence for finding an SLC on the balance of probabilities. The appropriate threshold for the Pricing Indicator is discussed in paragraphs 14.154 and 14.155.

- *The GUPPI threshold*

14.149 Given our primary reliance on the GUPPI analysis for the reasons explained above, we have determined the appropriate GUPPI threshold above which an SLC can be expected to arise, on the balance of probabilities. We do not consider it is necessary to adjust this, even for low values of the Pricing Indicator as, in our judgment, the lessening of competition implied when the GUPPI is at that level would feed through to substantial harm. In doing so, we have taken into account the same factors discussed in paragraphs 8.272 to 8.275, in relation to the supply of in-store groceries. In particular, we have taken into account:

- (a) The level of efficiencies that may be expected to arise from a merger;
- (b) The requirement that any lessening of competition must be substantial and any uncertainty regarding the accuracy and robustness of data and evidence used in the GUPPI calculation.

14.150 With respect to efficiencies, for the reasons explained in paragraphs 16.150 to 16.166 we have found that it is appropriate to assume for the purposes of our assessment that the Merger will give rise to no rivalry-enhancing efficiencies in the Parties' fuel operations. It has therefore not been necessary to take into account any downward pricing pressure that would result from efficiencies in interpreting the GUPPI calculations.⁸⁰³

14.151 With respect to the requirement in the legal test that any lessening of competition must be substantial, and in relation to uncertainty, we have had regard to the fact that:

- (a) As with groceries, fuel is for many consumers a non-discretionary expenditure that accounts for a significant share of household spend (3.7% of total household expenditure in the financial year ending 2018).⁸⁰⁴ As a result, even a small percentage increase in the price of fuel would have a substantial adverse impact on UK consumers. We note that PFSs

⁸⁰³ For this reason, we have not separately considered efficiencies in the countervailing factors section of this chapter.

⁸⁰⁴ Office for National Statistics, [Detailed household expenditure as a percentage of total expenditure by disposable income decile group: Table 3.2](#).

advertise their prices in fractions of a penny, which indicates that even small differences in price matter to customers.

- (b) We consider that small (but positive) levels of pricing pressure would represent a substantial lessening of competition and would be likely to translate into price increases. The Parties set prices locally, and change prices frequently, such that there would be no material cost (from an operational point of view) to the Parties in implementing price rises at individual PFSs. The Parties keep a close watch on competitors' prices in the local area and [~~§~~], meaning that changes in the intensity of local competition are likely to feed directly into the Parties' local prices. Given the scale of the Parties' fuel businesses (particularly in volume terms), even a small percentage price increase would lead to a substantial uplift in revenue and profit margin.
- (c) GUPPI accounts for only the individual first-order incentives of each merging party and therefore considers neither feedback effects between merging parties nor second order effects from third parties. We note that as the markets under discussion involve competition in prices, which are strategic complements, second order effects will augment the initial price increases, exacerbating the initial effect. We consider that there is no reason to think that the size of feedback effects relative to the first-order effect identified in the GUPPI would be smaller in this case than in other cases.
- (d) The diversion evidence on which the GUPPI is based derives from a survey of PFSs that are not representative of the Parties' entire PFS estates (see paragraph 14.105). Moreover, the estimated WSS explain only approximately half of the observed variation in diversion, as shown in paragraph 14.106. These factors introduce some uncertainty in the GUPPI estimates. On the other hand, we are confident that known sources of bias in fuel diversions have been compensated through our choice of out-of-market adjustment (see paragraph 14.103).
- (e) There is uncertainty around the estimate of the non-fuel component of the multi-product GUPPI. Part of this uncertainty is common to the GUPPI estimates used for the assessment of the in-store groceries market (see Chapter 8, paragraphs 8.290 to 8.292), although here it only affects part of the multi-product GUPPI. Additional uncertainty is associated with estimating the likelihood of grocery diversion in response to a price increase in fuel, as discussed in paragraphs 14.118 and 14.121, and with the potential differences between the diversion patterns of the customers diverting both fuel and grocery spending and those of the overall

population of fuel and grocery customers (see paragraphs 14.120 and 14.122).

14.152 Taking into account that we consider that even small percentage increases in fuel prices would give rise to significant harm to UK consumers, and in the expectation that even small increases in pricing pressure would translate into price rises, we consider that even relatively small GUPPI figures would support a finding of competition concerns in the individual local markets in this case.

14.153 Taking the factors above in the round, we decided to set the threshold for the GUPPI component of the decision rule for our local assessment at 1.5%. We consider this allows a sufficient margin for us to be satisfied, on the balance of probabilities, that in each area failing the decision rule the Merger may be expected to result in an SLC in the circumstances of this particular case. We note that this is consistent with the threshold applied in our local assessment of the Parties' supermarket overlaps, once accounting for the difference in the expected level of efficiencies.

- *The Pricing Indicator threshold*

14.154 As explained above, we have complemented our GUPPI analysis by looking at the Pricing Indicator, in addition to the GUPPI, to identify possible local areas of concern not captured by the GUPPI. Since we rely primarily on our GUPPI analysis, we have applied a high threshold when using the Pricing Indicator to identify any local areas where an SLC can be expected to arise, on the balance of probabilities, on a standalone basis (ie even for low values of GUPPI). Notwithstanding our general reliance on the GUPPI threshold, in our judgment, the lessening of competition implied when the Pricing Indicator exceeds that high threshold provides a reliable basis on which to identify an SLC. In determining the appropriate threshold, we took into account the same considerations relating to efficiencies, substantiality and uncertainty as for the GUPPI threshold, including:

- (a) As we have found that it is appropriate to assume that the Merger will give rise to no rivalry-enhancing efficiencies in the Parties' fuel operations (see Chapter 16), no allowance for efficiencies needs to be made.
- (b) For the reasons discussed in paragraph 14.151, we consider that even small increases in fuel prices would give rise to significant harm to UK consumers.
- (c) As we explained in paragraph 14.132, the pricing rules used in our analysis to compute the Pricing Indicator do not always generate the

prices actually set by the Parties, and hence the Pricing Indicator is not a precise prediction of the post-Merger prices (and we are not using it as a straightforward price predictor in this way). However, the prices estimated through our pricing analysis fall within +/- 1ppl of the Parties' actual prices 75-85% of the time.

- (d) The Pricing Indicator is computed assuming that competitor PFSs would set the same prices post-Merger; however, should the Parties increase their prices, competitors may respond by doing the same. The calculation also assumes that the Parties will retain their current overall pricing approach post-Merger. To the extent that the Parties may amend their pricing rules, for the reasons discussed in paragraphs 14.140(c) and 14.140(d), these changes are more likely than not to result in overall price increases for consumers rather than pro-competitive changes. Therefore, we consider that the Pricing Indicator would overall tend to underestimate the likely Merger effect.

14.155 Taking these factors in the round, we consider it appropriate to set the threshold for the Pricing Indicator at 1ppl, on the basis that in each area exceeding this threshold the Merger may be expected to give rise to an SLC in the circumstances of this particular case.

- *Application of decision rule*

14.156 Applying the above thresholds:

- (a) For 119 PFSs, the GUPPI is above the 1.5% threshold;
- (b) An additional 8 PFSs are above the Pricing Indicator 1ppl threshold.

14.157 Accordingly, we find that the Merger may be expected to result in SLCs in each of those local areas.

Conclusion on local assessment

14.158 On the basis of the evidence set out above, and applying the decision rule as detailed above, we find that the Merger may be expected to give rise to an SLC, on the balance of probabilities, in the local markets surrounding 68 Asda PFSs and 59 Sainsbury's PFSs. A list of these PFSs is included in Appendix N.

Countervailing factors

Entry and expansion

- 14.159 We have considered whether new entry or expansion by competitors would mitigate the initial effect of the Merger on competition, such that no SLC would arise. In assessing whether entry or expansion might prevent an SLC, we consider whether it would be timely, likely and sufficient.
- 14.160 Consistent with the approach used in our assessment of in-store groceries, we gathered evidence from a number of PFS competitors on their planned new PFS openings within the next two years.⁸⁰⁵ These pipeline PFSs were assigned weights within our WSS, and therefore this future expansion is accounted for directly in the calculation of the local GUPPIs.
- 14.161 We gathered information on pipeline PFS from the supermarket fuel retailers and some of the major non-supermarket PFS operators. As we have not received evidence from all fuel retailers we cannot exclude that additional non-supermarket PFSs could be opened in the next two years. However, given that other supermarket PFSs exert a much stronger constraint on the Parties' PFSs than do non-supermarket PFS,⁸⁰⁶ we consider that the potential omission of the entry of some non-supermarket PFSs from our GUPPI analysis would not affect our SLC findings. We consider that entry and/or expansion would be sufficient to prevent an SLC in a local area only if it involved new entry by a supermarket competitor, and all such planned entry has been factored into our analysis.
- 14.162 Finally, we have not factored in the expected exit of any existing PFSs. We note that the number of non-supermarket PFSs in the UK has been declining in recent years, from 7,018 in the first quarter of 2016 to 6,847 in the second quarter of 2018. Further exit can therefore be expected. The fact that this has not been accounted for in our GUPPI analysis would mean that the GUPPI may be underestimated in certain local areas.
- 14.163 Unlike the GUPPI, the Pricing Indicator does not account for recent or expected entry, as the pricing analysis on which it is based makes use of historical fuel prices. However, entry of a new supermarket PFS is not expected in any of the local areas where we found an SLC based on the level

⁸⁰⁵ Using a cut-off date of December 2020.

⁸⁰⁶ As evidenced for example by the fact that: Supermarket PFSs are cheaper than non-supermarket PFSs, on average and controlling for a range of factors (see paragraph 14.11(a) above); our pricing analysis indicates that supermarket PFSs are the effective constraint on the Parties' fuel prices for [X]% of the time or more (see Appendix K); and unlike supermarket PFSs, non-supermarket PFSs have a significant impact on prices only when located within a 5-minute drive-time from the centroid PFS (see paragraph 14.16 above).

of the Pricing Indicator, nor has any supermarket PFS entered any of those areas in recent months. We therefore consider there would be no countervailing effect from entry or expansion to our SLC findings based on the Pricing Indicator.

15. Buyer power

- 15.1 We considered whether a potential increase in the buyer power of the Merged entity could distort competition in the retail supply of groceries. For the purposes of our competitive assessment, we would only be concerned by an increase in the buyer power of the Merged entity to the extent that it may distort competition in the retail supply of groceries and result in adverse effects on end consumers.⁸⁰⁷ In and of itself, a reduction in the profitability of suppliers does not give rise to an SLC.
- 15.2 Our Issues Statement and our Provisional Findings set out two theories of harm in this respect:
- (a) the exercise of increased buyer power by the Merged entity might result in reduced incentives to invest and innovate on the part of suppliers; and
 - (b) the exercise of increased buyer power by the Merged entity might raise the purchasing costs of rival grocery retailers, which, under certain circumstances, may result in price increases to certain customers.⁸⁰⁸
- 15.3 The remainder of this chapter sets out our assessment of these two theories of harm.

Effect on innovation and investment in the supply chain

- 15.4 The first theory of harm we considered is that the exercise of increased buyer power by the Merged entity might result in reduced incentives to invest and innovate on the part of suppliers. This effect is more likely to materialise in circumstances where three conditions are met:
- (a) investment by suppliers involves significant upfront costs;
 - (b) suppliers and retailers find it difficult to contract for future terms of supply in advance of making the investment; and

⁸⁰⁷ This is the approach prescribed in [CC2 Revised](#), paragraphs 5.4.19–5.4.21, and followed in the Groceries market investigation (30 April 2008), [Final report](#), paragraph 9.3 and Tesco/Booker merger inquiry (20 December 2017), [Final report](#), paragraph 8.10.

⁸⁰⁸ [Issues Statement](#), paragraphs 117 and 121. [Provisional Findings](#), paragraph 15.2.

(c) the merger increases the bargaining power of the merged entity.

- 15.5 If the Merged entity has increased buyer power, it may have the ability and the incentive to force the price of new products down towards the marginal cost of supplying the products. Anticipating this outcome, suppliers may refrain from making the investments in the first place. This theory of harm is sometimes referred to as the ‘hold up problem’.

Third parties’ views

- 15.6 We sent a questionnaire to a sample of 38 large suppliers of the Parties.⁸⁰⁹ We received 34 responses in return, covering 19 suppliers of branded goods, eight suppliers of private label goods, five suppliers of both branded and private label goods and two wholesalers. In response to the questionnaire, 17 suppliers said that they did not expect the Merger to have an impact on their investment and research and development (R&D), while 13 suppliers thought that such an effect was likely or possible. The majority of private label suppliers in our sample thought that the Merger was unlikely to have an impact on their incentives or their capability to invest, whereas half of branded goods suppliers thought that the Merger might have such an impact. In general, the concerns of branded goods suppliers revolved around incentives for New Product Development (NPD) rather than investment in new capacity or production processes. Most of these suppliers explained that they do not normally contract the terms of supply for new products before the products are ready to be launched, and any increase in the concentration and buyer power of grocery retailers might reduce the profitability or increase the risk profile of NPD projects.
- 15.7 We also sent a questionnaire to a sample of 110 of the Parties’ smaller suppliers,⁸¹⁰ and received 33 responses. Twenty-one respondents told us that they did not expect the Merger to have an impact on their investment and R&D, while 11 respondents thought that there might be such an impact (and one respondent said that it would need to increase its R&D as a result of the Merger).⁸¹¹
- 15.8 A few suppliers and grocery retailers explained that in some cases they use exclusivity arrangements to set out the terms of supply of a new product in

⁸⁰⁹ To obtain this sample [redacted].

⁸¹⁰ We built that sample by ranking suppliers by size and picking the ten largest suppliers for each increment of five percentiles in the distribution (so we sample ten suppliers at the fifth percentile, ten at the tenth percentile, etc) until we reached a cost of goods sold (COGS) of £2 million.

⁸¹¹ Of the 11 small suppliers who said the Merger might affect incentives to invest and innovate, four were suppliers of branded products, two were suppliers of own-brand products, and the others supplied both types of products.

advance of a launch in the UK market. Exclusivity contracts typically last for one to twelve months and entail certain obligations on the part of the grocery retailer as well as the supplier. In particular, the grocery retailer is required to guarantee certain volumes and/or distribution levels in exchange for exclusivity. However, such arrangements appear to be negotiated relatively late in the NPD process, and tend to cover a small minority of NPD (typically less than 5% of product launches). The British Brands Group (BBG) also said that increased pressure to supply new products on an exclusive basis could increase costs and reduce revenue potential.⁸¹²

15.9 The BBG said that nine of its members reported that ‘innovation would be significantly more challenging post-Merger should their products not be listed in either of the two near-duopoly retailers’. The BBG emphasised that the climate for innovation in UK grocery was already increasingly challenging, mainly because suppliers are finding it more difficult to find the distribution needed to make a success of NPD.⁸¹³

15.10 The Food and Drink Federation (FDF) provided the results of a survey of its members on the expected impact of the Merger on the supply chain, including incentives to develop new products.⁸¹⁴ The survey indicated that roughly a quarter of NPD projects involve upfront costs greater than 25% of revenues expected in the first year after launch. The survey also showed that roughly one-third of NPD projects benefited from some kind of commitment or support from grocery retailers prior to any upfront investment (although only in 9% of cases did this involve agreement of supply terms), and 35% of respondents said that such commitments were usually necessary for NPD to take place. The survey also indicated that the Parties were the two grocery retailers most likely to offer commitments in support of NPD. Overall, 19% of respondents said that the Merger would make their business less likely to engage in product innovation (59% said that their incentives would be unchanged, 9% said the Merger would make their business more likely to engage in product innovation and 13% did not know).

⁸¹² [BBG initial submission](#), paragraph 67.

⁸¹³ [BBG initial submission](#), paragraph 60.

⁸¹⁴ The FDF stated that ‘[s]uppliers effectively operate in a climate of fear as Sainsbury’s and Asda act as gatekeepers to the market. As a result, suppliers are reluctant to share information that could risk identifying themselves’ ([FDF response to the Issues Statement](#), paragraph 7). [Supplier F] also submitted that those suppliers who are most likely to have been concerned about the impact of the Merger did not respond for fear of retaliation ([Supplier F response to the Provisional Findings](#), paragraph 4.6) This is consistent with the Groceries market investigation (30 April 2008), [Final report](#), paragraph 9.59 and footnote 1 on page 168, which found that suppliers were reluctant to provide the CC with details of specific instances of conduct by grocery retailers, with suppliers noting the potential damage to their business. However, we are satisfied that we have sufficient evidence on which to make findings in relation to these issues for the purposes of this investigation.

- 15.11 The National Farmers' Union of England and Wales (NFU) submitted the results of a consultation with its members about the impact of the Merger on their respective businesses. According to this submission, increased price pressure along a supply chain which is already very competitive is likely to have a detrimental impact on suppliers' ability to invest and innovate. According to this consultation, 74% of NFU members fear that investing in their business will be a challenge in the future and that it would be likely that plans to invest would be reduced by 30% on average as a result of the Merger.⁸¹⁵
- 15.12 Overall, the submissions from suppliers indicated some concerns from suppliers around the impact of the Merger on investment incentives. These concerns were stronger for investment in NPD for branded products.

New product development project investment

- 15.13 To better understand the economics of NPD and how it could be affected by the Merger, we asked suppliers to provide their internal business plans for their most recent NPD projects.⁸¹⁶ We received information on 58 projects from 20 suppliers (14 large suppliers and six small suppliers). We focused our attention on the size of the investment relative to expected revenues (which is an indicator of the extent to which a project might be liable to a 'hold up' problem in the sense specified in paragraph 15.4), and the share of revenues which is expected to come from the Parties over the first three years (which is an indicator of the extent to which the business case of a project is contingent on the terms obtained from the Parties).
- 15.14 The Parties represented on average 37% of revenues expected over the first three years for these projects.⁸¹⁷ There is a broad dispersion around the share of revenues from the Parties, and for 17% of the projects the Parties represent more than half of expected revenues.⁸¹⁸
- 15.15 Some suppliers reported zero investment figures for certain projects. This was either because the project involved the introduction in the UK market of a

⁸¹⁵ [NFU supplementary response to the Provisional Findings](#), page 10.

⁸¹⁶ We asked suppliers to provide their internal business plans for the last three NPD projects that they launched in the UK. As part of this request, we asked suppliers to identify the initial investment incurred to develop the product, the expected revenue from the product over the first three years, and a split of the expected revenue by country and customer. We addressed that request to the large suppliers of branded goods who replied to our phase 1 questionnaire, and to the small suppliers who had said during the phase 1 investigation that the Merger might impact their investment and innovation activity.

⁸¹⁷ This figure only includes projects for which explicit information was provided by the suppliers. In some cases, the suppliers did not provide any information on the share of revenues expected from the Parties, even though they expected to supply at least one of the Parties. These projects are not included in the average figure provided. The sample average might exceed the population average if the suppliers who responded to our questionnaire are particularly exposed to UK grocery retailers.

⁸¹⁸ This figure excludes own brand products.

product that had been developed elsewhere, or because the project related to the extension of an existing product line (eg a new flavour or a new packaging) which involved relatively small development costs that were not recorded. Even excluding these cases, the majority of projects in our sample involved only fairly small development costs, generally representing less than 10% of the revenues expected for the first three years (which is broadly consistent with the results from the FDF survey). In most cases, these projects also related to the extension of existing product lines. In general, the NPD activity of small suppliers involved less upfront cost (relative to expected revenues over the first three years) than that of large suppliers.

- 15.16 There were only two projects that involved significant upfront cost and for which the Parties accounted for a significant share of short-term revenues (approximately one-third). One of these projects was in the confectionary category, and the other was in the drinks category. Both projects involved significant R&D and customer research in the development phase, and were undertaken by large multinational companies.
- 15.17 We asked the two suppliers concerned to comment on the financials of these two projects.
- 15.18 [X] told us that ‘the revenue for the [X] product is relatively small as these are single [X] ranged in the [X] segment. [X] represents c.1% volume share of the [X] market so we expect smaller initial returns. It is however a segment which we would like to grow in the future which is why the investment is relatively high’.
- 15.19 [X] told us that ‘to date, [X] has only been launched in the UK. There are currently no concrete plans to launch the product in other countries until those countries can evaluate the outcome of the UK launch and consider potential improvements to the recipe. Therefore, while it is possible that the product may be launched in other countries within the three year period ([X]), [X] has not yet forecast sales projections outside of the UK’.
- 15.20 These comments suggest that the suppliers developed these two products with a view to growing a particular category or concept in the medium- to long-term. As such, it is possible that the Parties’ share of expected revenues over the first three years might overstate the extent to which the business case of these projects depended on the terms obtained from the suppliers.
- 15.21 In its response to our Provisional Findings, [Supplier F] provided [X] examples of NPD projects where the Parties accounted for a large proportion

of the sales.⁸¹⁹ It told us that ‘in the [redacted] category a number of products have been developed for, and only launched, in the UK. These include several [redacted] products, such as [redacted] for which the Parties accounted for [redacted] % of sales in [redacted]. There are certain new products where the Parties have accounted for [redacted] % of sales (such as [redacted], as well as [redacted]). [redacted] is another product that has been only launched in the UK, on which it spent c.£[redacted] in the first year ([redacted]) in development costs’.

15.22 We acknowledge the additional examples provided by [Supplier F]. However, based on the information provided, it is not possible for us to assess the extent to which the business case of these projects is contingent on the terms obtained by the Parties, and how prevalent such cases are. We also note that some of these products appear to have been developed specifically for certain grocery retailers. In such circumstances it is not clear why the supplier and the grocery retailer would not be able to contract for the development of the product in advance of the investment being made.

Parties’ views

15.23 The Parties submitted that the sample of NPD projects used by the CMA was small and potentially ‘self-selecting’ (in the sense that suppliers more concerned about the Merger might have been more likely to respond), such that caution should be exercised in drawing conclusions from the results. Notwithstanding this issue with representativeness, the Parties submitted that the evidence gathered by the CMA did not indicate any cause for concern. The analysis identifies only a very limited subset of products that might meet the criteria for competitive harms implied by the theory of harm. In general, NPD rarely involves significant upfront investment, and where it does, the Parties do not account for a large share of expected revenues. The Parties also pointed out that one of the NPD projects identified as potentially ‘at risk’ in the CMA’s sample is in the drinks category, where many new products are tested and launched through smaller retailers or the ‘on-trade’ channel, such that suppliers are even less dependent on large retailers than in other categories.

15.24 The Parties also submitted that suppliers do not generally require ex ante support for innovation but that where they do, the Parties can provide such support. For example, Sainsbury’s has a [redacted]-year contract with [redacted], a UK-based branded supplier, which enabled the supplier to introduce a new [redacted] product. Sainsbury’s also co-invested with the supplier to set up a new packing line for the product. This contract was agreed at the same time as

⁸¹⁹ [Supplier F response to the Provisional Findings](#), paragraph 4.9.

the investment was undertaken. Sainsbury's also has a [redacted] team dedicated to discovering new suppliers and products in the UK and globally, [redacted]. The Parties [redacted].

Conclusion on effect on innovation and investment

15.25 The evidence available to us indicates that only a small minority of NPD projects involve significant upfront costs and significant reliance on the terms obtained from the Parties. The few projects in our sample 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. There are also indications, both from FDF's survey and the Parties' representations, that in certain circumstances grocery retailers can and do provide some forms of commitments to support the NPD activity of suppliers. For these reasons, we find 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.

Effect on procurement costs for rival grocery retailers

15.26 The second theory of harm is that the exercise of increased buyer power by the merged entity might raise the purchasing costs of rival retailers, which, under certain circumstances, may result in price increases to certain end customers. This theory of harm is often referred to as the 'waterbed effect' in competition inquiries. It was considered by the CMA in the Tesco/Booker merger inquiry in 2017,⁸²⁰ and by the CC in the Groceries market investigation in 2008.⁸²¹

15.27 The key steps of this theory of harm can be summarised as follows. In the first instance, the lower wholesale prices obtained by the merged entity allow it to reduce retail prices, and thereby attract customers from other, smaller retailers. As smaller retailers lose market share, their bargaining positions and their purchasing costs deteriorate. These smaller retailers then face two competing incentives: on the one hand, they would like to pass on some of the increase in their purchasing costs; on the other hand, they need to maintain lower prices to resist increased competition from the large retailer. If the former effect dominates the latter, then smaller retailers respond by

⁸²⁰ Tesco/Booker merger inquiry (20 December 2017), [Final report](#), paragraph 8.11.

⁸²¹ Groceries market investigation (30 April 2008), [Final report](#), paragraph 5.19.

increasing their prices, which harms these retailers' customers (even if the customers of the Parties benefit from lower prices).

15.28 This theory of harm is therefore premised on the Parties obtaining significant reductions in procurement costs. We consider this issue in Chapter 16 and conclude that the Parties are likely to generate around £500 million of rivalry-enhancing efficiencies from the Merger as result of improved buying terms with suppliers. Notwithstanding the specific quantum of synergies we have estimated, this section considers whether, assuming the Parties were likely to achieve lower procurement costs, waterbed effects could materialise in the UK grocery industry.

Third parties' views

15.29 In response to our Provisional Findings, the NFU submitted that any reduction in price announced by the Parties is unlikely to be passed onto consumers and that increasing buyer power resulting from the Merger could result in unreasonable demands on suppliers, transferring excessive risks and unexpected costs onto primary producers.⁸²² However, in their submissions, the NFU did not indicate whether this increased buyer power would have an impact in the terms of supply to rival retailers.

15.30 We asked large suppliers whether they would expect to change their prices or any other commercial terms to other customers because of the Merger. Most of the comments we received in response to these questions were offered tentatively, and qualified by a level of uncertainty surrounding the future market structure. The responses we received were split as follows:

- (a) Twenty suppliers said that they would not change the terms of supply to rival grocery retailers. In general, this was because they conducted negotiations with different customers independently, or because their markets were very competitive.
- (b) Ten suppliers said that they might increase the prices charged to rival grocery retailers. In general, this was because these suppliers had fixed profit targets and therefore would look to recoup the lost margin elsewhere.
- (c) Two suppliers said that they might need to decrease the prices charged to rival grocery retailers. In general, this was because these grocery retailers

⁸²² [NFU supplementary response to the Provisional Findings](#), pages 10 and 12.

might seek to obtain better terms to remain competitive as a result of the Merger.

- 15.31 We also asked suppliers to comment on whether they had increased prices to their customers as a result of previous mergers (eg Tesco/Booker, Booker/Musgrave, Asda/Netto).⁸²³ Almost all the suppliers who replied to this question (22 out of 24) said that this had not been the case, although some of them pointed out that this Merger was different in nature and scale.
- 15.32 To further explore suppliers' pricing incentives, we asked the ten suppliers who said they would seek to increase prices to rival grocery retailers to comment on the likelihood of success of this strategy, and the factors that might affect the outcome of these negotiations. The responses were split, and most of these suppliers emphasised that the outcome of these negotiations was very difficult to predict. [One supplier] stated that the likelihood that other customers would accept price increases was low as there were already many inflationary pressures in the industry. In contrast, five suppliers were confident or fairly confident in their ability to increase prices, although there were some qualifications. For example, [one supplier] said that it might need to provide some counterpart of value to the grocery retailer, and three suppliers said that while they might enforce price increases, this might result in volume losses from grocery retailers as a result of falling demand.
- 15.33 We asked smaller suppliers whether, in the event that they had to lower prices to the Merged entity as a result of the Merger, they would expect to change prices to other customers. Responses were split as follows: 17 respondents said they would not change prices to other customers; four respondents said they might increase prices to other customers; and 12 respondents said they might need to decrease prices to other customers. Respondents who said they might need to decrease prices generally said that they would expect such requests to come from smaller grocery retailers as they faced lower retail prices from the Merged entity.
- 15.34 In FDF's survey, 53% of respondents said they would increase prices to other customers if they obtained lower prices from the Merged entity. However, only 8% of respondents said that they had increased prices to other customers when they obtained lower prices from the combined Tesco/Booker. The FDF pointed out that it was still 'early days' since this Merger, and few suppliers in the sample previously had separate terms of

⁸²³ Tesco/Booker merger inquiry (20 December 2017), [Final report](#); Booker Group/Musgrave Retail Partners merger inquiry (2 September 2015), [Phase 1 decision](#); Asda/Netto merger inquiry (23 September 2010), [Phase 1 decision](#).

supply to Tesco and Booker. The FDF submitted that the terms negotiated between suppliers and grocery retailers reflect a broad range of factors beyond their size, and a substantial deterioration in the price obtained from the Merged entity may just be the type of 'shock' that causes suppliers to re-evaluate the prices charged to other customers.

- 15.35 In summary, suppliers had mixed views with respect to the effect of the Merger on purchasing costs for rival grocery retailers. Roughly one third of large suppliers said they would seek to increase their prices to rival grocery retailers, though only some of them were confident in their ability to carry this out. In contrast, only 12% of small suppliers said they would seek to increase their prices to rival grocery retailers, whereas 36% of small suppliers said that they would reduce their prices to these retailers.
- 15.36 This plurality of views likely reflects the complex balance of incentives facing suppliers after the Merger: on the one hand, suppliers might have a greater relative bargaining power with respect to rival grocery retailers if their purchasing volumes are reduced, which might create an incentive for these suppliers to seek price increases; on the other hand, the demand from rival grocery retailers might become more price-elastic if they face stronger competition from the Merged entity, which might mitigate any incentives for suppliers to increase prices to these grocery retailers.

Quantitative analysis of the prices charged by suppliers to grocery retailers

- 15.37 To obtain more evidence on the relationship between purchasing shares and prices, we asked large suppliers of branded goods to provide data on the prices they are currently charging to different grocery retailers for a sample of SKUs.^{824,825} Our analysis of this data is summarized in Appendix L. In summary, this analysis indicates that the relationship between the procurement share of a grocery retailer for a particular SKU and the price paid for that SKU by that grocery retailer is non-linear, in the sense that it is stronger for smaller procurement shares than for larger procurement shares.⁸²⁶ For example, starting from a 5% procurement share, a grocery retailer increasing its share by one percentage point (so, from 5 to 6%) would see its average relative price decrease by a factor of 0.009 (ie its procurement costs would decrease by roughly 1%), while starting from a 15% procurement share a grocery retailer increasing its share by one percentage

⁸²⁴ A SKU identifies a distinct product based on attributes such as brand, quantity and packaging.

⁸²⁵ Our analysis focuses on the 'net price' charged for a SKU, which is the price per unit after all discounts, promotions and payments have been accounted for.

⁸²⁶ As explained in Appendix L, our analysis of procurement shares refers to shares for the sampled retailers only.

point would see its average relative price decrease by a factor of 0.005 (ie its procurement costs would decrease by roughly 0.5%). In fact, our analysis indicates that the effect of a small increase in procurement share is not statistically significant when starting from a share of 20 or 25%.

15.38 Overall, this analysis shows that there is a statistically significant relationship between procurement volumes and costs for branded products over some ranges of procurement shares, and that this relationship is non-linear. These findings are consistent with those reached by the CC in the Groceries market investigation in 2008.⁸²⁷ This analysis also shows that for relatively small changes in procurement share, which would be the likely result of price reductions by the Merged entity, the impact on procurement costs is modest.⁸²⁸

Pricing incentives for rival grocery retailers

15.39 Waterbed effects materialise only if rival grocery retailers respond to an increase in their procurement costs by increasing their retail prices. However, a reduction in the prices charged by the Merged entity associated with an increase in the procurement costs of rival grocery retailers is likely to create two different incentives for rival grocery retailers, working in opposite directions: on the one hand, rival grocery retailers would like to pass through a share of any increase in their procurement costs to their customers; on the other hand, they might face stronger price competition from the Merged entity.

15.40 The net effect of these two forces is very difficult to predict, and there can be no general presumption that they will result in a price increase. Instead this is likely to depend on the particular economic context faced by rival grocery retailers: if costs vary significantly with procurement volumes and customers are not too price-sensitive, rival grocery retailers are more likely to increase their prices in response to stronger competition by the Merged entity; in contrast, if costs do not respond much to changes in procurement volumes, and if customers are fairly price sensitive, rival grocery retailers are more likely to reduce their prices in response to stronger competition by the Merged entity.

15.41 It should also be emphasised that the balance of these incentives is not necessarily the same for all grocery retailers. The evidence summarised in the previous section indicates that the relationship between procurement costs and volumes varies along the volume curve: it is stronger for small

⁸²⁷ [Groceries market investigation](#) (2008).

⁸²⁸ See paragraphs 16.89 to 16.101.

grocery retailers than it is for medium to large grocery retailers. Similarly, the price-sensitivity of customers is likely to vary: in general, the customers of a particular grocery retailer will be more sensitive to the price charged by a rival grocery retailer if that rival grocery retailer has a similar positioning in the market (in terms of product offering or store locations).

15.42 Finally, it should be noted that even if waterbed effects materialise and result in higher prices for some customers, the overall impact on customer welfare is ambiguous. The price changes harm some customers (namely, the customers of any grocery retailer which decides to increase its prices in response to the Merger) while benefiting other customers (namely, the customers of the Merged entity and of any grocery retailer which decides to lower its prices in response to the Merger). Given that the evidence above suggests that the relationship between procurement costs and volumes is relatively flat for a large part of the volume range, under most plausible assumptions the overall impact on customer welfare is unlikely to be negative.

Parties' views

15.43 The Parties submitted that their combined procurement share is below 30% in all product categories, and that this implies that the Parties will have no 'anti-competitive buyer power' post-Merger.⁸²⁹ In principle, waterbed effects may arise whenever the merging parties achieve significant reductions in their procurement costs, irrespective of whether this is due to increase scale or other factors. As such, we did not consider it possible or necessary to identify a particular procurement share beyond which anti-competitive effects might be expected.

15.44 The Parties also pointed out that, considering all the suppliers who have engaged with the CMA, over three quarters said that they would not increase prices to rival grocery retailers, and that those suppliers who said that they might increase prices to rival grocery retailers qualified their predictions in various ways. The Parties submitted that a more likely outcome of the Merger is that other grocery retailers would fight to obtain similar benefits to avoid being placed at a disadvantage to the Parties.

Conclusion on effect on procurement costs for rival grocery retailers

15.45 In summary, we found that:

⁸²⁹ [Parties' response to the Issues Statement](#), paragraphs 33–36 and 251–255.

- (a) the majority of the suppliers who engaged with us do not expect to change their prices to rival grocery retailers following the Merger;
- (b) for most grocery 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 grocery retailers, which might lead some rival grocery retailers to reduce, rather than increase prices.

15.46 Overall, it seems unlikely that many grocery retailers would raise their prices in response to the Merger; and even if it were to occur for some individual grocery retailers, the overall net effect on UK customers is unlikely to be negative. On that basis, we find that the Merger is unlikely to lead to customer harm through a waterbed effect.

16. Efficiencies

Introduction

- 16.1 The Parties stated that the Merger offers the opportunity to generate cost savings for both Sainsbury's and Asda on a 'transformational scale'.
- 16.2 The possibility of efficiencies exists in many transactions; however, it is relatively unusual for them to be explicitly examined (particularly in a quantitative fashion) in the competitive assessment of a merger. In this case we have sought to quantify the effect of any such efficiencies, in part due to:
- (a) The potentially material impact these figures could have on our competitive assessment;
 - (b) The high degree of confidence which the Parties have submitted that the CMA can place on these figures, given the level of work undertaken; and
 - (c) The fact that quantified incorporation of rivalry-enhancing efficiencies directly into a competitive effects analysis sits particularly well with the GUPPI models which we have employed in this case.
- 16.3 We note that the terms 'synergy' and 'efficiency' can have specific technical meanings in some contexts. Consistent with the Parties' submissions, we have used both of these terms to represent financial benefits to the Parties which may arise from the Merger, noting that these can take the form of revenue benefits (ie increasing sales by using the combined business to improve their overall proposition, for example by cross-selling additional products to existing customers) or cost benefits (ie reducing their costs as a

result of combining their businesses for example by rationalising their supply chain).

Economic rationale and legal framework

- 16.4 It is possible that efficiencies brought about by a merger may wholly or partially counteract the otherwise adverse effects on competition and any potential harm to consumers.
- 16.5 The CMA's merger assessment guidelines state that 'Efficiencies arising from the merger may enhance rivalry, with the result that the merger does not give rise to an SLC. For example, a merger of two of the smaller firms in a market resulting in efficiency gains might allow the merged entity to compete more effectively with the larger firms'.⁸³⁰
- 16.6 Our guidance states that 'it is not uncommon for merger firms to make efficiency claims. To form a view that the claimed efficiencies will enhance rivalry so that the merger does not result in an SLC [...] the [CMA] must expect, that the following criteria will be met:
- (a) the efficiencies must be timely, likely and sufficient to prevent an SLC from arising (having regard to the effect on rivalry that would otherwise result from the merger); and
 - (b) the efficiencies must be merger specific, ie a direct consequence of the merger, judged relative to what would happen without it'.⁸³¹
- 16.7 In addition, our guidance also explains that savings resulting from supply-side efficiencies, such as cost reductions, are not necessarily rivalry-enhancing if they would not incentivise the company to improve their competitive offer. For example, the merged entity may have the incentive to retain the savings, rather than investing in their customer offer (eg by lowering prices). It explains that 'The Authorities are more likely to take cost savings into account where efficiencies reduce marginal (or short-run variable) costs as these tend to stimulate competition and are more likely to be passed on to customers in the form of lower prices. The Authorities will not in general give as much weight to savings in fixed costs because they may often represent private gains to firms and are less important in short-run price formation, although reductions in fixed costs may play an important role in longer-term price formation'.⁸³²

⁸³⁰ [CC2 Revised](#), paragraph 5.7.2.

⁸³¹ [CC2 Revised](#), paragraph 5.7.4.

⁸³² [CC2 Revised](#), paragraph 5.7.9.

- 16.8 Accordingly, we consider it necessary to assess the source of any synergies, and the implied incentives on the Parties as a necessary part of determining the extent of rivalry-enhancing efficiencies.
- 16.9 When assessing the scale of any potential efficiencies, the guidance also states that ‘Efficiency claims can be difficult for the Authorities to verify because most of the information concerning efficiencies is held by the merger firms. The Authorities therefore encourage the merger firms to provide evidence to support any efficiency claims whether as part of the SLC analysis or the consideration of relevant customer benefits’.⁸³³ However, this does not detract from the fact that the determination of the scale of efficiencies, where they are claimed to arise, lies within the responsibility of the CMA as it forms part of the duty to decide whether a merger may be expected to result in an SLC.
- 16.10 In summary, in order for any potential synergies to be found to be rivalry-enhancing efficiencies, the evidence must lead the CMA to expect that the following cumulative criteria would be met:
- (a) Timely;
 - (b) Sufficient;
 - (c) Likely;
 - (d) Merger-specific; and
 - (e) Incentivise the Parties to improve their customer offer in the relevant market(s).

Parties’ views

- 16.11 The Parties submitted that the Merger would be pro-competitive and would result in substantial benefits to consumers across UK grocery markets as a result of the synergies generated. The Parties stated that the scale of savings had been independently calculated (by consulting firm) [afterwards ‘the consultant’] to be at least £[~~3~~] on an annually recurring basis,⁸³⁴ which would allow for a significant reduction of the Parties’ combined cost base post-Merger. The Parties considered that a large proportion of these savings would be passed on to consumers in the form of price reductions, or

⁸³³ [CC2 Revised](#), paragraph 5.7.5.

⁸³⁴ We note that this consisted of £[~~3~~] of opex and £[~~3~~], and so is elsewhere quoted as £1.6 billion if only considering opex.

investments in greater quality, range, service and convenience to deliver a more compelling customer proposition overall.

16.12 The Parties' submissions discussed a number of different sources of potential synergies, with some including quantified estimates. These are summarised below, including [the consultant's] estimated ongoing annual recurring synergies, where available:

(a) Quantified purchasing synergies

- (i) **Purchasing synergies from 'harmonisation' (c.£[REDACTED]):** Pre-merger, each Party is uncertain as to whether it is receiving the best buying terms from its suppliers. The Merger would allow the Parties to compare actual buying terms currently being achieved, and so would demonstrate where suppliers are able to profitably supply at a lower price on some or all of their products. The Parties would then seek to renegotiate with their suppliers to achieve terms on the total combined volumes which are equivalent to the best that one Party currently receives. This would include savings on groceries, GM, and fuel. In addition, in their most recent analysis, conducted during our investigation, the Parties include additional savings associated with using IPL⁸³⁵ for certain products.⁸³⁶
- (ii) **Additional purchasing synergies (c.£[REDACTED]):** Savings from enhanced scale of the combined entity following the Merger, resulting in increased efficiencies that scale allows for the Parties' suppliers (eg from dealing with a single customer rather than two). These are particularly important in own-brand ranges, where harmonisation of specifications may result in more efficient manufacturing.

(b) Other quantified synergies

- (i) **Property (c.£[REDACTED]):** Extending the Argos proposition to Asda customers through relocating existing Argos stores into Asda stores, or opening new Argos stores in Asda stores. In addition, [REDACTED].
- (ii) **Goods not for resale (c.£[REDACTED]):** Benefits from consolidating spend on items such as marketing, professional services, and security through supplier harmonisation and operational improvements.
- (iii) **Other operational synergies (c.£[REDACTED]):** [REDACTED].

⁸³⁵ IPL, or International Procurement and Logistics, is Asda's importing arm.

⁸³⁶ This included additional savings associated with [REDACTED].

(c) **Unquantified**

- (i) **Synergies in clothing (N/A):** Beyond the cost savings discussed above, the Merger would provide the opportunity to [REDACTED].
- (ii) **Synergies in financial services (N/A):** The Merger would create the opportunity for [REDACTED].

16.13 The Parties emphasised that these calculations were generated by an independent consultancy, but that the Parties themselves have confidence in these estimates as being a conservative estimate of the overall synergies available. In particular, they noted that the calculations had relied on a conservative methodology, and that there would be additional potential benefits in [REDACTED].

16.14 In addition to the specific points raised above, at various times during the investigation, the Parties have mentioned the possibility of additional synergies from other sources ([REDACTED]), but we have not received evidence on these synergies and therefore have only assessed the Parties' efficiency claims detailed above.

Purchasing synergies

16.15 In order to calculate their estimated £1.2 billion of purchasing synergies (the 'Purchasing Synergies Analysis'),⁸³⁷ [the consultant] gathered data from each Party (ensuring that competitively-sensitive information was not exchanged between the Parties themselves, a technique sometimes known as a 'cleanroom'), and used the following methods (more details on these are included in Appendix M):

- (a) **SKU Approach (own-label food products):** [the consultant] estimated the purchasing synergies from harmonisation of own-brand food products through a direct SKU-by-SKU comparison on a sample of own-brand products, coupled with an extrapolation to the un-sampled own-brand sales. In addition, it included a benefit from certain SKUs which were assessed as able to be transferred to Asda's IPL procurement arm ([REDACTED]).
- (b) **Supplier Approach (branded groceries):** Due to the existence of different contractual terms (eg over-riders across multiple products),⁸³⁸ a

⁸³⁷ Consisting of the c.£[REDACTED] purchasing synergies from 'harmonisation' and c.£[REDACTED] of additional purchasing synergies.

⁸³⁸ Over-riders are contractual clauses which are not associated with individual products but apply to a broader range or portfolio. For example, some suppliers may provide a lump sum rebate if the customer spends above a certain amount with them across all of its different products.

direct SKU-by-SKU comparison across branded products would be difficult. Therefore, [the consultant] originally estimated the purchasing synergies on branded grocery products of [<100] suppliers using a comparison of supplier margins for each Party (ie the gross margins generated by the Parties based on the sale of goods from these suppliers), adjusting for differences in retail prices. During our investigation, this analysis was extended to an additional [500–600] matched branded grocery suppliers (ie [600–700] in total) covering almost all branded grocery spend, as a result of additional data becoming available. The Parties also considered the mix of products being sold from [30–40] of these suppliers. There were a very small number of branded suppliers which had data issues, and so for these [the consultant] extrapolated the estimated savings based on the matched suppliers discussed above.

- (c) **Supplier Approach (most GM, excluding clothing, bedding, and gardening & DIY):** In the Parties' original submissions, this spend was generally assessed using the Category Approach (described below). Following Provisional Findings, the Parties updated the analysis to using a Supplier Approach for these subcategories due to the availability of data and in response to concerns raised by the CMA. As with branded groceries, the analysis compared the Parties' gross margin generated on the sale of goods from [100–200] GM suppliers, adjusting for difference in retail prices. The Parties did not explain what (if any) mix analysis was conducted on these suppliers. The estimated purchasing synergies on the GM sales of the remaining suppliers was reached by extrapolating the savings from these [100–200] matched suppliers to the remaining GM spend.⁸³⁹
- (d) **Category Approach (Clothing, bedding, and gardening & DIY):** Similarly to the rest of GM, the existence of different contractual terms makes a direct SKU-by-SKU comparison difficult. Therefore, [the consultant] used the same methodology as the Supplier Approach, but applied to whole sub-categories (ie based on the gross margin generated by sales in sub-categories as a whole). No analysis of the mix of products was conducted in this approach.
- (e) **Fuel Approach (fuel):** [the consultant] estimated the savings [X] and [X]. The estimate for fuel was conducted during the CMA investigation,

⁸³⁹ We note that [the third party] applied the same sensitivities to the GM Supplier Approach as to the branded grocery Supplier Approach, however, it does not state whether any mix analysis was conducted on these GM suppliers.

rather than to support the Parties' assessment of benefits when the Merger was agreed and announced.

- (f) **Beyond Best Terms ('BBT') (all):** In addition to working out the effect of harmonising to the best terms achieved by one of the Parties on existing purchases, [the consultant] estimated the additional savings available from Merger as a result of either having higher volumes with a single supplier or lower supplier transaction costs through dealing with only one organisation. This was applied on top of each of the above approaches. For Grocery and GM this was based on a percentage reduction depending on the nature of the product and scale of volume changes. For fuel, this was based on [REDACTED].

16.16 The relative scale of estimated synergies calculated in each of these approaches is shown in Table 16.1 below:

Table 16.1: Updated estimated purchasing synergies, by approach (£ million)

<i>Approach</i>	<i>Harmonisation (including IPL)</i>	<i>BBT</i>	<i>Total</i>
SKU Approach	[REDACTED]	[REDACTED]	[REDACTED]
Supplier Approach (grocery)	[REDACTED]	[REDACTED]	[REDACTED]
Supplier Approach (GM)	[REDACTED]	[REDACTED]	[REDACTED]
Category Approach	[REDACTED]	[REDACTED]	[REDACTED]
Total grocery & GM	[REDACTED]	[REDACTED]	[£1.2bn]
Fuel	[REDACTED]	[REDACTED]	[REDACTED]
Total, including fuel	[REDACTED]	[REDACTED]	[REDACTED]

Note: We have reflected BBT associated with Bedding and Gardening & DIY in the Category Approach (rather than the Supplier Approach), given that this was the approach used to estimate the relevant harmonisation benefits. Numbers may not sum due to rounding

Source: [The consultant] analysis (updated in the [Parties' response to the Provisional Findings](#)), and Parties' submissions.

16.17 The Parties stated that the purchasing efficiencies were expected to be achieved on an annual recurring basis within [REDACTED] of the Proposed Merger, having been projected to [REDACTED]. They also noted that these timelines were used within their internal valuation modelling.⁸⁴⁰

Other synergies

16.18 As discussed above, the Parties included a description of other potential synergies arising as a result of the Merger. Additional details of these are included in Appendix M. We have discussed these in less detail since these efficiencies were either (i) unquantified, or (ii) unlikely to offset a pricing pressure increase in the relevant markets (as calculated in the GUPPI and explained in paragraphs 16.200 to 16.202 below).

⁸⁴⁰ [REDACTED].

Ability to deliver, and associated risks

- 16.19 The Parties noted the caution expressed by the OFT previously that ‘it would be disingenuous to ignore the fact that assessment of post-merger outcomes, both welfare enhancing [eg efficiencies leading to lower prices] and welfare-reducing [loss of rivalry leading to eg higher prices] is generally an inherently predictive exercise, and is based on probabilities, not certainties’ and acknowledged a ‘healthy CMA scepticism towards efficiency claims, given the risk of self-serving (or simply unduly optimistic) claims made by Parties’. However, they submitted that the analysis conducted to support their submissions in this case was valid, robust, and met any reasonable application of the relevant evidentiary standard.
- 16.20 The Parties stated that each individual assumption ‘needs to be considered in context of the conservatism of the synergies analysis as a whole.’ They stated that they ‘made their decisions in favour of the Proposed Merger not based on a line item of [the consultant’s] analysis of a particular SKU match but on the robustness of the overall synergies total (including the aggregate harmonisation total).’ In particular, they noted that ‘it is important to remember that there was considerable conservatism built into the overall assessment and that [the consultant] did not attempt to exhaustively cover every potential synergy pool’.
- 16.21 The Parties particularly highlighted aspects of their quantified approach to procurement synergies which they considered included conservative assumptions. For example, the application of caps on savings, the ‘close match’ criteria required for SKU matching, no savings being assumed on non-matching SKUs, the high proportion of overlapping suppliers and SKUs, and the relatively small proportion of savings associated with BBT compared to other indications of the benefits of increased scale.
- 16.22 Therefore, the Parties believed that, although they may not achieve the exact benefits from each supplier that have been calculated, [the consultant’s] calculation is an accurate reflection of the benefits that will be achieved in aggregate across the supplier base.⁸⁴¹
- 16.23 The Parties highlighted that previous UK and European retail mergers (including in the grocery sector) often featured procurement and harmonisation synergies, and it is standard practice that these can be delivered on an ongoing and recurring basis.

⁸⁴¹ [Parties’ response to the Provisional Findings](#), paragraph 260.

- 16.24 The Parties also stated that they have experience of estimating and over-delivering synergies as they have done so in the past, in particular in Sainsbury's/Argos and Asda/Netto where both have successfully delivered (or are on track to deliver) the total value of their predicted synergies. The Parties particularly highlighted that, in the case of Asda/Netto, they delivered higher synergies than were targeted pre-merger.
- 16.25 With regard to the uncertainty of supplier negotiations, the Parties noted that while these could inevitably be complex and involve a range of parameters, in many instances the arrangements that the Parties have with suppliers have no volume limits, so that volumes through one supplier can be transferred to the other supplier, subject to the supplier having sufficient capacity.
- 16.26 The Parties stated they are confident in realising the £1.6 billion of synergies quantified by [the consultant], and that this is reflected in the public commitments they have made to annual price investments (discussed in more detail in paragraph 16.204 below).⁸⁴²

Review of potential synergies

- 16.27 The Parties hired [afterwards 'the third party'] to conduct a review of their entire synergies plan. The Parties noted that the level of estimated synergies was reviewed by [the third party] 'in order to meet Sainsbury's obligations in announcing that, post price investment, there would be £500 million net EBITDA synergies available for shareholders'. The Parties emphasised that 'it was not necessary for [the third party] to verify the entire £1.6 billion of synergies and, given the time and budget required for [the third party] to verify the synergies, there was no need to go substantially beyond the £500 million relevant to shareholders, presenting a conservative view of [the consultant's] analysis for the purposes of announcement to shareholders'.
- 16.28 [The third party's] report noted that their scope was to consider and comment on the preparation of the synergy plan, and they would carry out the review using the methodologies and standards which they would apply if the proposed announcement of synergies was covered by Rule 28 of the Takeover Code. As such, its work focused on understandability and reliability from an investor's perspective, and the output would constitute a 'Quantified Financial Benefits Statement'. Furthermore, [the third party's] assessment was based on evaluating whether the Parties' management had

⁸⁴² [Parties' response to the Provisional Findings](#), paragraph 342.

demonstrated appropriate rigour and objectivity in estimating the expected benefits of each synergy initiative.

- 16.29 [The third party] applied a weighting to the estimated synergy figures based on the extent to which it considered that the Parties' management had demonstrated appropriate rigour and objectivity in estimating them. In doing this, it rated each initiative and applied a risk weighting to reflect its stage of development, the access to data and personnel possible, and the level of verifiable evidence.
- 16.30 [The third party's] weightings reduced the estimated totals in the Parties' synergies plan originally submitted to the CMA by the end of [X] from £[X] to £[X], and the estimated savings associated with purchasing synergies from £[X] to £[X].⁸⁴³
- 16.31 In response to our Provisional Findings, the Parties commissioned [the consultant] and [the third party] to conduct further work on their synergies plan and the corresponding estimated and sensitised figures. In particular, the Parties engaged [the consultant] to 'Work with [the third party] to increase the net value of buying synergies by a target of £[X] through identification of potential methodologies and provision of additional information'.
- 16.32 As a result of this work, [the third party] produced a new report on the Parties' updated synergies plan, and applied weightings which now reduced the total estimated savings by the end of [X] in [the consultant's] analysis from £[1.6 billion] to £[1.0 billion], and the estimated savings associated with purchasing synergies from £[1.2 billion] to £729 million.⁸⁴⁴
- 16.33 The update therefore resulted in an increase in the sensitised estimates of £[X] in total, of which £[X] arose from increased grocery and GM purchasing synergies, and £[X] from fuel.
- 16.34 The Parties stated that the [third party's] sensitised figure represents a highly conservative view of [the consultant's] synergies case (and de-risks [the consultant's] analysis to reflect uncertainty considered by the CMA), and that it was highly informative for the CMA's review as 'the lowest plausible bound for the appropriate synergies credit'.⁸⁴⁵

⁸⁴³ At the time, [the consultant] had not produced any estimates associated with savings in fuel, so these were not included in [the third party's] assessment.

⁸⁴⁴ Excludes fuel.

⁸⁴⁵ [Parties' response to the Provisional Findings](#), paragraph 215.

Parties' advisors' views

- 16.35 We held hearings with [the consultant] and [the third party] in order to discuss their estimates, and the evidence supporting them, in more detail.
- 16.36 During these hearings, we particularly sought to understand:
- (a) Their scope and role in the process;
 - (b) Their approach to the synergies assessment; and
 - (c) Their views on how we should interpret the evidence in our assessment.

[The consultant's] views

- 16.37 [The consultant] stated that its approach to estimating the potential synergies from the transaction was supported by its extensive experience of conducting synergy estimation exercises, that it had conducted this harmonisation-type analyses many times before, and it was a 'standard starting point', although it was only really becoming possible to analyse synergies at this level of detail in the relevant time available in recent years.
- 16.38 [The consultant] told us that it was 'cautious by nature', and although it had not conducted any quantitative assessment of the probability of delivering the estimated benefits, it had a '75% probability threshold' when it was 'thinking about assessing the nature of these type of benefits'. It stated that this was reflected in the conservative assumptions that it made during the analysis.
- 16.39 [The consultant] stated that there was no clear reason why firms should be paying different amounts for the same (or close to the same) product, and that this was the most obvious starting point for an assessment of purchasing synergies. It considered that the likely reason for any pricing differences was as a result of inefficient procurement by the grocers. Therefore, although there would be some uncertainty due to the negotiation process, the initial rebasing of prices as a result of removing the information asymmetry is what would generate a significant short-term benefit in a merger. However, the Merger would also result in the Parties doubling in scale, removes a customer from the procurement market, and combines 'the best buying teams from both organisations', all of which put the Parties in a much stronger bargaining position. This structural change 'should enable those pricing reset benefits to endure'.
- 16.40 [The consultant] explained that 'as time passes, [...] industry evolution will continue and the information asymmetry will increase again but that structural change in the nature of the relationship is what supports the enduring

delivery of the benefits that come from that initial pricing reset'. In particular, [the consultant] stated that 'last year's terms and volumes would be the starting point for the [renegotiation with suppliers]', and that combined with the increase in buyer power, its experience was that it was possible to retain the harmonisation benefits (although it did not have any ex-post studies which demonstrated this, as clients rarely commission them).

- 16.41 [The consultant] stated that if there was a difference of opinion between the Parties and a supplier about the scale of the pricing difference, then it would come down to a negotiation, but that the additional information from the Merger would mean that the supplier would not be able to obfuscate in the same way as in a business-as-usual annual negotiation.
- 16.42 Regarding the potential for suppliers to resist harmonisation, [the consultant] stated that there was a risk around this, and that it was a major consideration for the [third party] review (discussed in more detail below). [The consultant] had not factored into its assessment any mechanism for how harmonisation would take place 'tactically' (eg avoiding renegotiation by transferring volume between the Parties' contracts).
- 16.43 [The consultant] stated that it considered other approaches to estimate the buying synergies from the Merger, including benchmarking, but that they were non-specific and crude.⁸⁴⁶
- 16.44 In conclusion, [the consultant] stated that it considered the purchasing synergies figures it calculated (ie £1.2 billion) to be a good estimate of the outcome of supplier negotiations post-Merger, but noted that [the third party] had adopted a lower figure, presumably as a result of applying a higher confidence level.

[The third party's] views

- 16.45 [The third party] stated that in 2013 the UK's Takeover Code changed to introduce the Quantified Financial Benefits Statement regime, and that this had significantly increased the robustness of synergy reviews in the context of public transactions. Since that point, [the third party] had been involved in around 75% of all Quantified Financial Benefits Statement transactions in the UK (including [redacted] and [redacted]). [The third party] said that this was high-risk work

⁸⁴⁶ We note that in the Letter to the Panel re efficiencies hearings, the Parties stated that '[redacted]', however this was not referred to by [the consultant] upon questioning, was not included in any of the documents or analysis underlying the synergies plan provided to us, and no other evidence was provided to support this assertion. Therefore, we are unable to place any weight on it.

(engendering unlimited liability) which required it to take a very rigorous and robust approach.

- 16.46 [The third party] explained that in conducting its independent review of the [consultant's] work, it used its standard assessment methodology which consisted of:
- (a) Reviewing the process followed to develop the plan overall (eg who was involved, the length of time, access to data, management attention, etc); and
 - (b) Assessing individual initiatives against four key criteria which constitute the necessary requirements to produce a robust synergies estimate (specifically (i) the source data, (ii) the documentation & rationale for the savings being achieved, (iii) the assumptions & support for the calculations, and (iv) the management team's track record / level of planning).
- 16.47 When considering [the consultant's] use of harmonisation to assess the expected synergies from the Merger, [the third party] stated that this methodology was not novel, and that it was an approach taken by others. In addition, it noted that 'The assumption on which the synergy plan is based is that the procurement savings are recurring' and stated that this was in line with its experience from various other transactions in the retail sector. However, [the third party] tended not to be involved in post-deal implementation other than in some specific examples (including with the [X]) where it had seen the outcomes.
- 16.48 [The third party] did not seek to directly test the above assumptions (ie the use of harmonisation, and the recurring nature of any savings) on the basis that it was comfortable that these were industry assumptions, and that the approach then 'became, effectively, understanding the mechanics of how they had done that and the dataset that they had used'. [The third party] later expanded on this point stating that 'the basis of our work assumption is that the savings are maintained and that the fundamental coming together of the buying teams and the buying strength of the individual buyers is what maintains the strength going forward on a recurring basis'.
- 16.49 [The third party] also noted that it had seen examples of times where smaller purchasers were receiving better prices than larger purchasers from a given supplier (for example, there may be 10 out of 30 suppliers where the smaller company is buying better), and that this demonstrated the importance of information exchange. It stated that there were various reasons that a smaller purchaser might achieve a better price, such as the existing relationship with

the supplier, but the most common reason was due to the smaller purchaser having a tighter range and achieving higher relative volumes (eg volumes per SKU).

- 16.50 Regarding the potential risks associated with delivery of estimated savings, [the third party] stated that there was always uncertainty around buying synergies, and that this was reflected in its sensitised figures.
- 16.51 [The third party] stated that it did not consider that having two brands would have a material impact on the potential for savings due to the possibility of future product rationalisation.
- 16.52 [The third party] stated that it did not consider whether it would be possible to avoid supplier renegotiation by transferring volume between the Parties' contracts, and did not validate its approach with suppliers as this was a next step which was effectively impossible prior to completion of the Merger.
- 16.53 [The third party] noted that its work included a number of standard disclaimers in particular regarding its potential use by the CMA in the context of assessing potential efficiencies, but that this reflected the fact that the work was prepared for the board and financial advisors, and therefore applied those corresponding standards. The CMA's purposes are clearly fundamentally different to this use. However, [the third party] did state that the sensitised number was its view of the (minimum) quantum of synergies that should be delivered were the Merger to take effect as anticipated.

Third parties' views

- 16.54 We have also received submissions from third parties regarding the potential for, and size of, expected synergies from the Merger, in particular around purchasing synergies. These are described below, although we note that, as with the Parties, there is the potential for submissions to be coloured by the specific interests of the third party. This consideration is discussed in more detail in our assessment.

Suppliers

- 16.55 We asked suppliers about the effect of the Proposed Merger on their ongoing negotiations with the Parties, and in particular whether they would expect to reduce their prices to the combined entity. However, we note that this exercise was largely qualitative in nature, and should not be considered to be a representative sample of all suppliers.

- 16.56 In response to our supplier questionnaires, branded suppliers generally emphasised the complexity of negotiations, and the numerous factors which would be taken into account as a part of these, including: unit prices, discounts for efficiency of logistics or manufacturing, payment terms, levels of investment/promotional support, growth over-riders, gate fees, supporting strategic priorities, ranging, merchandising, new product development, exclusivity, etc.
- 16.57 Many of these suppliers noted that as a result of all these factors, it was hard to predict the outcome of these negotiations ahead of time, but that it was unlikely to be simply about cost price.
- 16.58 In addition to this, numerous suppliers noted that any concessions would be predicated on the supplier receiving reciprocal benefits, such as support, listings, or in store activity ([redacted]), a large branded supplier, stated that it would 'not plan on agreeing to additional investments to either Asda or Sainsbury's without securing value from the merged Parties, such as [redacted]', or as a result of genuine savings in the supply chain.
- 16.59 Larger branded suppliers generally expressed scepticism about the extent of efficiency savings available as a result of the Merger, noting that the Parties' operations were already at scale given their number 2 and 3 positions in UK groceries. They considered that the increment from the Merger would do little to change this unless their operations were integrated (eg [redacted] stated that 'there is no volume benefit for two existing customers becoming one (1+1=2)' which would justify a scale discount but that it would consider, if requested by the merged entity, agreeing to a lower cost per unit 'at the point the two Supply Chains merge' if 'this would provide efficiencies in our Supply Chain (delivering to one point rather than two)').
- 16.60 A number of own label suppliers noted that differences in current specifications between the Parties meant that it would be difficult to align costs without aligning specifications as well. However, if specifications were aligned, this could result in some degree of improved operational efficiencies which could lower costs.
- 16.61 Five large branded suppliers provided us with their own estimates of harmonisation, which can be directly compared with the outputs of the Parties' own analysis. We note that these estimates were simply the direct comparison of current price differences, rather than any form of expectation associated with changes in costs from the Merger. The suppliers' calculations were very different to the Parties', with the suppliers' estimates ranging from 0.1-0.5 of the Parties' estimate, up to 2.5-5.0 times. Although we do not place weight on these specific figures, we note that the aggregate difference of the

suppliers' estimates was [redacted] (ie the suppliers' aggregated estimates of harmonisation are [redacted] of the Parties').⁸⁴⁷

16.62 The Parties submitted that these differences could reflect the self-interests of the suppliers, differences in the time period or exact methodology used, and would only reflect the individual supplier's position rather than the aggregate view. While all of these points may have some validity, we note that:

- (a) Most of these estimates were prepared for internal use within the supplier organisations, including presentation to senior management, and would therefore represent the suppliers' best estimates for the current difference in prices.⁸⁴⁸
- (b) Even if the supplier wished to attempt to 'disprove' the Parties' analysis, the suppliers would not know what figure the Parties had calculated. In addition, the estimates produced did not appear to have any particular bias, with results which were well above and well below the numbers produced by the Parties.
- (c) These figures were generally prepared in response to the announcement of the Merger, and so should reflect similar (albeit not identical) timings to the Parties' analysis. In addition, if the harmonisation figures were very sensitive to specific timings then this could raise concerns in itself, including the risk that the estimate derived from the Purchasing Synergies Analysis may not be reliable due to the time that has elapsed since it was calculated.
- (d) While [the consultant] had to deal with time constraints and data availability concerns as well as having to construct a systematic approach to deal with thousands of different suppliers, the suppliers themselves would have more time and data to calculate an estimate of their own harmonised price, and could include internal members of the business who understand the specific relationship, contract, existing promotional strategies, and commercial context (due to lack of confidentiality issues).

⁸⁴⁷ We note that since the Purchasing Synergies Analysis did not use SKU-level data for branded groceries, we are not able to directly compare between the submissions from the Parties and suppliers to identify specific differences.

⁸⁴⁸ The Parties appear to argue that the CMA should have assessed each individual methodology adopted by these suppliers; [Parties' response to the Provisional Findings](#), paragraph 267. However, given that these were produced to support internal decision-making at the suppliers, the Parties did not provide SKU-level information which we could use to test for differences in input-data, and the fact that we are not placing weight on the quantitative differences, we do not consider an in-depth comparison of methodologies to be necessary.

(e) The Parties' public statements regarding their approach to harmonisation were clear,⁸⁴⁹ and would allow the suppliers to calculate their own estimates of the effect. The Parties dispute this stating that they had not disclosed the Purchasing Synergies Assessment methodology and that suppliers had misunderstood the approach.⁸⁵⁰ However, they do not explain why the suppliers would be unable to accurately calculate their own estimates of harmonisation, or why the [consultant's] methodology would be the only way (or even the best way) to address issues such as promotional spend in the absence of a cleanroom environment.

16.63 We also note that a number of these suppliers highlighted that differences in promotional approach could result in the Parties miscalculating these figures.⁸⁵¹ For example:

- (a) [X] stated that '[when considering] the net price of [X], for example, between Sainsbury's and Asda, and say, [X], we are going to have the Sainsbury's net price for [X]', (a) there is no net price, it does not exist, and (b) they could only deliver that outcome if they were to promote it the same in Asda as in Sainsbury's'.
- (b) [X] stated that: 'the merged entity could (and most likely would) seek to combine both (i) the NET [X] costs of Sainsbury's and (ii) the variable investment of Asda'. This would result in treating the promotional spend from each Party differently.
- (c) [X] stated that: 'the negotiations are likely to be complex in nature, reflecting the different nature of our invoice prices and promotion funding'.

16.64 The final price paid by a retailer is dependent on factors such as promotional activity and retailer support, which may not be fully captured on invoices. Furthermore, the recorded net price would be reduced if higher volumes are sold on promotion due to the support being provided by the supplier. [X] provided additional details on this, stating 'you will see that [Asda] sold a lot more of [X] than Sainsbury's. The reason they were able to sell more of that is because we have promoted it a bit heavier with them [X]. Therefore, they have sold a lot more at the promotional price and, therefore, that net price at the end of the year, mathematically, looks lower. There is no net price for

⁸⁴⁹ For example, 'The basis for our merger is to harmonise buying terms across both businesses. Currently, Sainsbury's and Asda pay large suppliers different prices for identical products. By converging on the same lower price, we will secure considerable savings', [Proposed Sainsbury's and Asda merger](#).

⁸⁵⁰ [Parties' response to the Provisional Findings](#), paragraph 268.

⁸⁵¹ The Parties disagree with these views, stating that they reflect a lack of understanding on behalf of the suppliers about the specific methodology employed, and that the Supplier Approach was designed to account for these issues; [Parties' response to the Provisional Findings](#), paragraphs 271-273.

[redacted]. There is no net price for [redacted]. It is an outcome of whether or not the retailer is ready to promote a product and push volumes’.

- 16.65 Own label suppliers more commonly noted that pure harmonisation of costs of existing products was unlikely since the products often had fundamentally different specifications, and the underlying costs were usually associated with these specifications. Therefore, any savings would need to be reflective of reduced costs to the supplier themselves (eg through specification alignment). This was particularly true where the Parties had transparency agreements (such as open-book accounting or similar mechanisms) in place.

Expected impact on smaller suppliers

- 16.66 Of the 33 smaller suppliers who responded to our phase 1 questionnaire, nearly 85% expected the Proposed Merger to have an impact on their supply terms with the Parties. Of the 30 which provided additional details on this, over 80% expected that the Proposed Merger would result in these suppliers receiving lower prices for their products from the combined entity.
- 16.67 Of the 23 smaller suppliers who currently serve both Parties and expressed a view, they expected the effect of harmonisation would be a reduction in price of between 0% and 33%. A weighted average of these responses⁸⁵² would indicate an overall expected reduction of around [0–5%], with around [redacted] of the respondents considering this to represent the full harmonisation of any price gap. We note that the Parties considered these submissions to be supportive of their position with regards to harmonisation and submitted that smaller suppliers may be able to give a more robust view of the scope for harmonisation given that they sell a smaller range of products, although they did not provide any new evidence on this point.⁸⁵³ We considered the Parties’ submissions but we maintain our view that the views of smaller suppliers are generally indicative estimates of the expected outcome, rather than being supported by detailed analysis, as well as being a relatively small (and potentially unrepresentative) sample.
- 16.68 A number of suppliers referenced the outcome of negotiations following previous mergers, but said that these varied.
- 16.69 The above observations are also consistent with evidence provided by the British Brands Group who sent a questionnaire to 36 of their members and

⁸⁵² Based on the stated combined sales with the Parties and using midpoints of any ranges provided.

⁸⁵³ [Parties’ response to the Provisional Findings](#), paragraph 264.

received responses from a range of suppliers (with a bias towards small companies) and found:⁸⁵⁴

- (a) Due to differences in their models for working with suppliers, the amount of funding received by each Party in terms of pricing discounts, and funding for trade marketing and promotional activities, will differ markedly, presenting major financial challenges were the merged entity to seek to harmonise buying terms without considering all aspects of supplier funding (eg promotions etc);
- (b) Suppliers anticipate harmonisation of prices between the two businesses, with the focus single-mindedly on the unit price of products with no regard to the differing promotional and funding models operated by the two businesses (although in the medium- long-term, it is not clear such differences would be maintained). The financial implications on suppliers are anticipated to be significant; and
- (c) In terms of trade price differences between the two retailers, reports vary from [X] % at the upper end to [X] % or no differences at all at the lower end.

16.70 Similarly, the Food and Drinks Federation (FDF) expressed concerns that the Parties would be able to extract lower prices from suppliers, and that this was through the exercise of increased buyer power and would be for the benefit of shareholders. In particular:

- (a) The FDF considered that the Parties could be expected to have significantly greater buyer power as a result of their increased size post-Merger, and so could be expected to pay lower prices to suppliers as a result. However, the FDF considers that assessing this via a 'harmonisation' analysis is 'highly questionable', in particular since:
 - (i) many suppliers do not serve both Parties and so no harmonisation could occur;
 - (ii) where suppliers serve both Parties, but with different products, the underlying differences in these products would make cost comparisons meaningless;
 - (iii) it is questionable whether the concept of 'price harmonisation' could take account of promotional activity; and

⁸⁵⁴ [Submission from the British Brands Group at launch of phase 2 inquiry](#), paragraphs 20(i), 28 and 34.

- (iv) even if some degree of harmonisation was achieved it would be a short-term effect, since it would be a one-off event that would then have no meaning in any subsequent price negotiations with suppliers.
- (b) The FDF did not consider that there was much opportunity for suppliers to reduce their costs in order to produce efficiencies in the supply chain. In particular, there are very limited opportunities to increase the overall volumes being purchased.
- (c) The FDF considered that the impression given by the Parties that only a small number of large suppliers would receive lower prices following the merger was incorrect, and that this would affect all suppliers. It also noted that 90% of respondents to its survey expected the proposed merger to have a negative or very negative impact on their prices and/or terms of supply.

Other third parties

16.71 Tesco told us that there are significant doubts that any synergies of the scale identified would be achievable in practice, and that the CMA should not offset estimated synergies against potential upward pricing pressures in its analysis. It particularly noted that:

- (a) synergies are inherently uncertain and difficult to realise – there is a long history of unsuccessful mergers in UK grocery retail;
- (b) operating cost savings – which, unlike procurement synergies, are the only synergies that the merging parties have full control over – will be small, do not demonstrate scale economies, and substantially higher cost savings can be achieved without a merger; while there is no ‘Plan B’ for the merging parties to achieve significant merger benefits from operating cost savings, if their estimated procurement benefits fail to materialise;
- (c) a line-level comparison of cost prices is not a reliable indicator of the procurement synergies that will ultimately be achieved;
- (d) there is no evidence of scale advantages in procurement. Instead, volume, growth and efficiencies are key to unlocking procurement synergies with suppliers – the proposed merger does not suggest any of these will result (other than in respect of unbranded suppliers, who, as explained in the hearing Tesco had with the CMA, are not likely to be the source of any meaningful synergies); and

- (e) there are potential dis-synergies that may offset any benefits (eg integration costs, effect of distractions and delaying other plans, standardisation costs, etc).

16.72 Tesco provided additional details of its experience of attempting to harmonise prices following its acquisition of Booker. Tesco told us that:

- (a) There is a key distinction between branded and own-branded goods. In relation to branded goods, suppliers are able to charge a premium because they have developed brands that customers want and are prepared to pay a premium for. In Tesco's experience, branded suppliers would not 'give margin' to customers unless this is compensated either by growth or efficiency. In relation to own-brand, suppliers are already working on such tight margins (around as low as 1%) that they do not have the headroom to offer any cost reductions funded out of margin. Instead, cost reductions in own label rely on realisation of volume, growth or efficiency benefits;
- (b) Negotiations with branded suppliers to reduce cost are primarily about volume, growth, and efficiency, and that unless the Parties' merger were able to offer at least one of these to compensate for the margin reduction for the supplier, then the suppliers would be very unlikely to reduce their prices;
- (c) Comparing genuinely like-for-like prices on products is difficult, but in Tesco's experience, it is highly unlikely that there would be any real differences in price which would not reflect differences in costs, in particular as this represented a reputational risk for suppliers (eg as buyers move between retailers, or between suppliers and retailer). Tesco would expect that most suppliers would, on a net basis, currently be offering similar terms to customers of similar size, including Asda and Sainsburys;
- (d) Based on Tesco's experience from the Tesco/Booker merger, it was impossible to estimate with any accuracy the level of potential buying synergies at an individual supplier-level based purely on an analysis by accountants of supplier terms. For example, an ex-post analysis of the level of net benefits found that the net realised synergies [redacted] ranged widely between around [redacted]% of the original estimates produced by its advisors ([redacted]); and
- (e) Given the limited proposed changes to the Parties' operations post-Merger, there does not appear to be the opportunity for many efficiencies of the kind needed to form the basis of a successful negotiation with

suppliers to offer lower cost prices. Tesco gave the example of being able to take whole-truck deliveries for high-volume lines or combine deliveries for the two entities. However, Tesco considered that it was not clear from the Parties' public statements that they would be able to offer this kind of efficiency when maintaining separate brands, head offices and store networks.

16.73 Morrisons stated that price harmonisation will be difficult to achieve if the Parties are simply seeking to merge volumes, in particular since:⁸⁵⁵

- (a) Suppliers will only tend to invest in offering lower prices in exchange for growth in volumes, which unlocks additional production efficiencies. Simply merging Sainsbury's and Asda's volumes with a particular supplier that was previously supplying both does not deliver any additional volume to that supplier over the pre-Merger situation.
- (b) The Parties would need to harmonise their respective supply chains, products, range, and potentially promotional activity, all of which could reduce choice for customers; and
- (c) To the extent that any synergies are volume related, then such savings are only likely to occur if Asda and Sainsbury's are purchasing (and stocking) the same product ranges.

Other available sources of evidence

16.74 In this section, we discuss other available sources of evidence for the existence of, and scale of, synergies in grocery and GM. We note that we do not have any similar additional evidence available for synergies arising in fuel.

Historical transactions

16.75 Although the level of synergies for a particular transaction will depend on the specifics of the businesses involved, it is common to consider benchmarks from completed transactions between similar companies in the past. We note that the Parties' advisors did this when reviewing the synergy plan, and numerous equity analysts did the same.⁸⁵⁶

⁸⁵⁵ [Morrisons response to Issues statement](#), paragraphs 6.1 to 6.5.

⁸⁵⁶ Including Jeffries, Redburn, Bank of America Merrill Lynch, Bernstein, Exane BNP Paribas, Societe Generale, Macquarie, UBS, and Goldman Sachs.

16.76 We note that when undertaking this exercise, there are aspects of this which raise particular difficulties:

- (a) Often, companies publicly discuss the level of net synergies rather than the gross synergies which are expected to result from the merger, since it is the value of net synergies which would be expected to accrue to shareholders who are often the audience for such announcements;
- (b) Companies will usually discuss the expected synergies prior to a transaction but may not announce the actual level of delivery against the original expectations. Therefore, this comparison is with other companies' expectations which may differ from actual performance (either higher or lower); and
- (c) No two transactions are exactly alike, and there can be important differences in terms of the scale of the transaction or the nature of the market(s) involved.

16.77 As noted above, previous announcements of synergies do not always make clear whether they are referring to net or gross estimates. This makes it difficult to compare these announcements with the Parties' gross synergies estimates, and so we consider that they would represent less useful comparators. Similarly, there can be differences in the nature of the transactions themselves (eg as a result of being in other sectors, or different geographies). For completeness, we note that [the third party] considered the level of expected synergies announced in seven 'comparable transactions'⁸⁵⁷ as averaging [0–5%] of the target cost base and [<1%] of the combined parties' cost base, while the Parties' gross estimates would represent [5–10%] and [0–5%] respectively. The [third party's] sensitised estimates are also substantially higher than the averages, and in fact, higher than all of the comparators included. These are shown in Figures 16.1 and 16.2 below:

Figure 16.1: Total synergies as percentage of target cost base

[✂]

Source: The Parties.

Note: [✂].

Figure 16.2: Total synergies as percentage of combined cost base

[✂]

Source: The Parties.

Note: [✂].

⁸⁵⁷ Tesco/Booker; Empire/Safeway; Sainsbury's/Argos; Ahold/Delhaize; Morrisons/Safeway; Couche Tard/The Pantry; Kroger/Harris Teeter.

16.78 Although we had noted the difficulties with comparing internal figures with announcements and therefore did not use this to produce a quantitative estimate in our Provisional Findings,⁸⁵⁸ the Parties stated that the CMA had compared the Parties' gross (and confidential) unsensitised synergies with announced and sensitised synergies and was incorrect to do so.⁸⁵⁹ Since the publication of the Provisional Findings, the Parties have now publicly announced their gross synergies estimate of £1.6 billion.⁸⁶⁰ This would appear to indicate that the comparisons in Figure 16.1 and 16.2 above are now more valid, and in particular, the expected relative savings as a proportion of the combined cost base of the merging Parties could reflect increases in buying power. Nevertheless, due to the remaining issue around potentially comparing net and gross figures, we could only place limited weight on any quantitative comparison of the above figures in producing a robust estimate of the synergies likely to arise from the Merger.

16.79 The only one of these commonly referenced historical transactions in the groceries sector which explicitly noted the expected value of gross synergies is Ahold/Delhaize⁸⁶¹ which estimated €750 million of gross synergies (the majority arising from buying synergies, with the rest from general, administrative and other savings).⁸⁶² This was equivalent to:⁸⁶³

- (a) 1.2% of the combined entities' revenues;
- (b) 1.5% of the combined entities' cost base.
- (c) 3.4% of the target revenue; and
- (d) 3.75% of the target cost base.

16.80 Applying these figures from Ahold / Delhaize to Sainsbury's / Asda would give an implied range of potential gross synergies of around £[REDACTED],⁸⁶⁴ of which around £[REDACTED] would be variable cost savings (based on €125-150

⁸⁵⁸ See paragraphs 16.53 and 16.129 of the Provisional Findings.

⁸⁵⁹ [Parties' response to the Provisional Findings](#), paragraphs 241 and 243-244.

⁸⁶⁰ "Sainsbury's and Asda have given the detail of their estimated £1.6 billion cost savings to the CMA."

<https://www.about.sainsburys.co.uk/news/latest-news/2019/19-03-19-post-merger-commitments>

⁸⁶¹ In 2015, Ahold (a grocery retailer headquartered in the Netherlands) announced its intention to acquire Delhaize (a grocery retailer headquartered in Belgium) in a deal worth around \$28 billion. The combined Group had 6,500 stores worldwide using a number of different brands, and generated sales of over €54 billion in particular in the US (c.60% of sales), Benelux (c.30% of sales), and Central/South-East Europe (c.10% of sales). https://www.aholddelhaize.com/media/1152/ahold_delhaize_presentation_final_3.pdf, slide 14.

⁸⁶² Eg https://www.aholddelhaize.com/media/6369/180228_ahold-delhaize_q4fy17_summary-report.pdf, page 8; https://www.aholddelhaize.com/media/1152/ahold_delhaize_presentation_final_3.pdf, slide 20.

⁸⁶³ Comparisons with revenues taken from a UBS analyst report, comparisons with cost base taken from [the third party] report.

⁸⁶⁴ Widest parts of the range based on applying [REDACTED]; and applying [REDACTED].

million of the €750 million total Ahold/Delhaize synergies being fixed cost savings (from 'General & Administration and Other'), equivalent to around 20%).⁸⁶⁵

16.81 We note that this estimate is now directly comparable with the estimates from the Purchasing Synergies Analysis, since the Ahold / Delhaize figure is a publicly announced gross estimate, and (as discussed in paragraph 16.78 above) the Parties' own figures are now publicly announced gross estimates.⁸⁶⁶ However, other differences between the two cases more generally still remain.

16.82 In addition to the public data discussed above, [the third party] provided anonymised estimates of the level of buying synergies available based on its experience of similar retail 'clean room' analyses.⁸⁶⁷ This indicated the following:

(a) The Parties' estimations of savings on matched spend was [X]%, which was more than twice the average ([X]%) and substantially higher than the maximum included in the comparator set ([X]%). However, we note that the Parties' approach only included matched spend on own-label products (ie those using the SKU Approach), while the comparators included savings from matched spend on both branded and own-label products. We have therefore adjusted the Parties' estimated savings to address this difference.⁸⁶⁸ Even including this adjustment results in an estimated saving on matched SKUs of [X]%, well above the highest comparator.

Figure 16.3: Percentage saving on matched spend

[X]

Source: Parties.

(b) The Parties' estimates of buying savings as a percentage of combined baseline spend of [X]% (even excluding the BBT contribution) were more

⁸⁶⁵ https://www.aholddelhaize.com/media/1152/ahold_delhaize_presentation_final_3.pdf, slide 20. This assumes that all of the additional synergies identified during implementation (which increased the gross estimate from €500 million to €750 million) were purchasing synergies. If some of these additional synergies were from other sources, it is likely that the variable cost savings would be lower, and hence our estimated comparison would be lower too.

⁸⁶⁶ Parties' response to the Provisional Findings, paragraph 252.

⁸⁶⁷ These 'clean room' analyses involved using data from previous transactions. Therefore, the identities of the comparators were anonymised by [the third party], and we have not assessed the extent to which each of these would represent appropriate comparators.

⁸⁶⁸ The Parties' Supplier Approach estimated a [X]% saving across all branded spend. Since [X]% of branded spend is on common SKUs between the Parties, this would indicate an average saving of [X]% on matched branded SKUs. Combining with the [X]% average saving on own label products results in a weighted average matched saving of [X]%.

than twice the average ([REDACTED]%) and substantially higher than the maximum included in the comparator set ([REDACTED]%).

Figure 16.4: Percentage saving on combined baseline spend

[REDACTED]

Source: Parties.

- 16.83 Applying the average comparison set out in paragraph 16.82(a) above would indicate expected gross buying synergies for the Parties of around £[REDACTED] (depending on whether GM is included).⁸⁶⁹
- 16.84 Applying the average comparison set out in paragraph 16.82(b) above would indicate expected gross buying synergies for the Parties of around £[REDACTED] (depending on whether GM is included).⁸⁷⁰ However, we note that this is likely to be an overestimate of the potential savings, since around [REDACTED]% of the Parties' estimated procurement savings arise from BBT, but this was excluded from their comparator in Figure 16.4.⁸⁷¹
- 16.85 As noted above, the comparators used here were projections, rather than representing the actual level of synergies delivered. This was primarily because companies do not always publicly state the delivery against synergy targets due to the complexity of ringfencing merger-specific savings from general savings, confidentiality, or reputational risks of under-delivery. The actual synergies delivered can be either higher or lower than the original estimate.
- 16.86 The Parties argued that there is evidence that announced synergies are underestimated and over-delivered, providing examples of previous transactions which support this. In particular, the Parties stated that announced synergies are typically conservative, given the statutory shareholder disclosure requirements and the reputational impact of under-delivery, and so a like-for-like comparison would require the respective companies' internal synergies plans.
- 16.87 We recognise that some previous mergers have over-delivered against their announced synergies, but there are also many examples where synergies have been overestimated and under-delivered.⁸⁷² In the absence of any

⁸⁶⁹ Scaling down the total estimated procurement savings in grocery (£[REDACTED]) and GM (£[REDACTED]) by a factor of [REDACTED].

⁸⁷⁰ Scaling down the total estimated procurement savings in grocery (£[REDACTED]) and GM (£[REDACTED]) by a factor of [REDACTED].

⁸⁷¹ If the Sainsbury's/Asda percentage saving in Figure 16.4 was increased by [REDACTED]%, applying the same methodology as in footnote 870 would indicate expected gross buying synergies of £[REDACTED] (depending on whether GM is included).

⁸⁷² For example: 'While acquiring-company management almost universally tout expected "synergies" and efficiency gains, our research shows that, on average, such synergies either do not exist or are only realized over

evidence of systematic over-delivery (in part due to the problems discussed in paragraph 16.76 above), we consider that the announced figures represent the best estimate of likely synergies to arise from the mergers.

- 16.88 Furthermore, a number of the comparators discussed above use [the third party's] clean room data rather than relying on publicly announced figures. These comparators would not appear to be affected by the issues raised by the Parties.

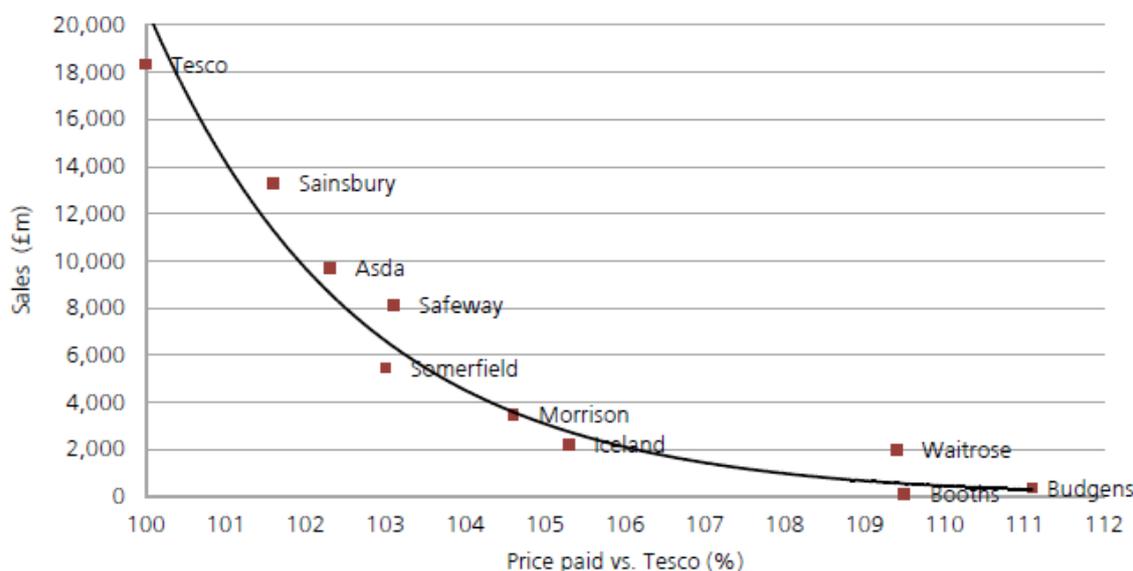
Analysis of the impact of scale on grocery purchase prices

- 16.89 There have been a number of pieces of analysis conducted by the CMA and its predecessor organisation the Competition Commission (CC) which investigated how grocery procurement costs are affected by changes in the volume of grocery products being purchased (ie scale).
- 16.90 By their nature, these analyses investigated the effect of increasing volumes on purchasing prices. They would not specifically reflect the effect of harmonisation but instead reflect all of the benefits of increased scale (eg buyer power, manufacturing and logistical efficiencies, reduced administrative costs etc), and do not account for aspects such as relationships with the retailer or any inefficiencies as a result of the post-Merger maintenance of separate brands (eg maintaining distinct ranges etc) as the Parties are intending.
- 16.91 In the Competition Commission's (CC's) 2000 supermarket market investigation, it published the results of an analysis on the relative purchasing prices being achieved by different UK grocery retailers.⁸⁷³ A graphical chart of this produced in a recent analyst report is shown below.

an extended time horizon (i.e., well over three years)', [S&P Global](#) (2016); 'The open secret about M&A is that most deals fail to generate the synergies companies expect when they announce a merger. In a Bain & Company survey of 352 global executives, overestimating synergies was the second most common reason for disappointing deal outcomes', [Bain & Company](#) (2014); 'They are also consistent with the behavioral view that managers' overestimation of future returns are an important factor in explaining value-destroying merger activities' [National Bureau of Economic Research](#) (2012); 'Yet study after study puts the failure rate of mergers and acquisitions somewhere between 70% and 90%', [Clayton M. Christensen, Richard Alton, Curtis Rising, and Andrew Waldeck in Harvard Business Review](#) (2011); 'Most buyers routinely overvalue the synergies to be had from acquisitions', [McKinsey](#) (2004).

⁸⁷³ [Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom](#), Table 11.10.

Figure 16.5: UK grocers: Turnover (£ million) vs. purchasing price relative to Tesco (2000)



Source: Analyst reports provided by the Parties.

- 16.92 This broadly showed that doubling in sales was associated with a 2% reduction in prices paid by UK supermarkets.
- 16.93 We note that the CC's views at the time were that 'All the larger main parties [supermarkets] should be able to take advantage of most of the cost savings associated with buying in large volumes, so significant differences in margins and prices are more likely to reflect the strength of the buyer than lower costs'.⁸⁷⁴
- 16.94 In 2008, the CC conducted a market investigation into the supply of groceries, including supermarkets and other participants such as grocery wholesalers. As part of this, the CC conducted an econometric analysis of the prices which retailers and wholesalers paid their suppliers. It found that there was a statistically significant relationship between increased volumes and lower prices being paid to suppliers, although volumes were not the only consideration, particularly noting the customer-product relationship was also important.⁸⁷⁵
- 16.95 The CC did not publish specific figures around the purchasing price of each company but, consistent with the 2000 findings, it found that the largest grocery retailers (at this point Asda, Morrisons, Sainsbury's and Tesco), paid substantially less than smaller companies (on average, between 4 and 6 per cent less than the mean). Within this group, Tesco paid, on average, a significantly lower price than the others. However, this average masked

⁸⁷⁴ Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom, paragraph 11.104.

⁸⁷⁵ CC Grocery Market Investigation (2008), Appendix 5.3, paragraphs 9 and 12.

variation in the individual prices paid by retailers, with Tesco not always paying less than the others. When considering larger changes in volume, the effect of growing from a very small customer (purchasing 10 per cent of the mean volume) to a very large customer (purchasing three times the mean volume) (ie a 30-fold increase in volumes) could lead to a reduction in prices of around 9 to 12 per cent.⁸⁷⁶

- 16.96 For the purposes of this merger assessment, we did not rerun the analysis by the CC above which was completed in the context of a market inquiry. However, as a check to see whether conditions appear to have significantly changed in the intervening period, we conducted a sample-based analysis of the prices of branded goods which large suppliers are currently charging to different retailers.
- 16.97 The analysis of this supplier pricing data, which is summarised in Appendix L, supports the previous findings that there is a statistically significant relationship between procurement shares and procurement prices in the UK groceries market. However, this relationship is non-linear, and it tends to be quite weak for procurement shares higher than 15%. The nonparametric regression conducted for the purpose of this analysis indicates that the mean difference in relative prices equivalent to the change in procurement share from combining the Parties would be equal to around 2.2%.⁸⁷⁷
- 16.98 The Parties stated that a more accurate reflection of the change in their procurement shares (a change from [X] % to [X] %) would result in a significantly larger COGS saving (equivalent to [X] %) than the 2% which the CMA referenced in its Provisional Findings.⁸⁷⁸ In addition, [X].⁸⁷⁹
- 16.99 As explained in Appendix L, this analysis is based on data which the CMA gathered from six large supermarkets, and so does not represent the entire procurement market(s). Therefore, we consider that using this regression to calculate expected price reductions using shares based on the entire market would not be correct. In fact, the results would not reflect the actual differences in prices being achieved by the six suppliers included in the dataset. Instead, we have relied on the actual observable differences in procurement shares in the data which demonstrate an expected difference in

⁸⁷⁶ [CC Grocery Market Investigation \(2008\)](#), paragraph 5.22.

⁸⁷⁷ This figure is based on the procurement shares observed in the data, and so increasing from Asda's existing share of [X] % to a combined share of [X] %.

⁸⁷⁸ [Parties' response to the Provisional Findings](#), paragraph 234.

⁸⁷⁹ [Parties' response to the Provisional Findings](#), paragraphs 236-238.

net purchasing costs as a result of differences in scale.⁸⁸⁰ We further note that [X].

16.100 The Parties also raised some further points with this analysis, including the use of a single year of data, the formulation of a relative price index, and the likelihood of unobserved factors correlating with size.⁸⁸¹ These points are discussed in Appendix L, which explains that although we recognise certain limitations (eg only having a single year of data), we consider that this analysis remains informative, particularly in the context of checking if there appear to have been material changes since the CC's findings.

16.101 We have found that this more recent analysis of the effects of increased scale is broadly consistent with the original CC findings. In particular we note that the CC analysis has some advantages (eg [X]), while our more recent analysis is generally more limited in scope as it was conducted during a merger investigation, but may better reflect any changes in the intervening period. Given the context and similarity of results, although we would be inclined to place more weight on the original CC analysis, we consider it reasonable to include both estimates in a broader range as shown below.

16.102 Applying a 2% - 2.2% reduction in COGS for the Parties would be equivalent to around £[X] to £[X] of savings.⁸⁸²

Evidence from previous competition investigations

16.103 As discussed in paragraph 16.2 above, the potential for rivalry-enhancing efficiencies exists in all potential mergers, however it is relatively rare for their effects to be explicitly calculated and incorporated in the analysis in a quantitative manner.

16.104 The Parties highlighted two cases which they consider demonstrate that the CMA (and OFT) recognised the benefits of harmonisation previously:

⁸⁸⁰ In order to sense-check this view, we tested the econometric effect of inflating the procurement market prior to running the regression, which is analogous to allowing for the inclusion of additional market participants for which we do not have data. In order to do so, we assume that the additional market participants are a homogenous group, which we consider to be a strong assumption. By inflating the market by [X]%, the implied procurement share of the Parties is reduced such that their combination would result in an increase from [X]% to [X]% (consistent with the Parties' submission). Rerunning the regression on these updated market shares, and based on an increase in share consistent with the Parties' submission, results in an expected difference in relative prices of 2.2%, which is consistent with our previous analysis.

⁸⁸¹ [Parties' response to the Provisional Findings](#), paragraphs 226 and 228.

⁸⁸² Based on applying a 2% savings to combined grocery COGS of £[X] to a 2.2% saving on the combined grocery and GM COGS (excluding Argos) of £[X]. We exclude Argos from this estimate to be consistent with our overall approach around assessing the incentives of the Parties to alter their supermarket proposition, and the level of revenue included when converting between an efficiencies estimate and a GUPPI threshold contribution.

(a) Asda / Netto; and

(b) Tesco / Booker.

16.105 In particular, the Parties stated that, despite the CMA noting the complexity associated with any supplier negotiations following the Tesco/Booker merger, the final report stated that ‘the merged entity would likely benefit from better terms from some suppliers with regard to some products in grocery wholesaling through a degree of harmonisation of supply terms’, and that the report did not reference any concerns about doubts that these benefits would be maintained in the longer-term.

Our assessment

16.106 As explained in paragraphs 16.4 to 16.10 above, in order for any potential synergies to be found to be rivalry-enhancing efficiencies, the evidence must lead the CMA to expect that the following cumulative criteria would be met:

(a) Timely;

(b) Sufficient;

(c) Likely;

(d) Merger-specific; and

(e) Incentivise the Parties to improve their customer offering in the relevant market(s).

16.107 We consider the cumulative effect of these criteria on any overall figure for rivalry-enhancing efficiencies below.

Timeliness

16.108 We consider that the purchasing synergies, while not being delivered immediately, would be deliverable within a reasonably short time period. The Parties have frequent discussions with their suppliers, and major annual reviews are used to develop Joint Business Plans or similar agreements. The main exception to this would be where tenders have been used (eg [X]), but even in these cases it would be unusual for the duration of these to exceed [X].

16.109 For the non-purchasing synergies, there may be longer lead times to certain aspects of the plan ([X]), but it appears that these would still be implementable within a foreseeable time period.

16.110 We understand that the timelines predicted by the Parties are broadly consistent with those predicted and currently being delivered in other similar transactions, most notably:

- (a) Ahold/Delhaize, where the majority of synergies were predicted to come from purchasing activities, and it appears that they are on track to deliver these within three years.⁸⁸³
- (b) Tesco/Booker, where although the scale of estimated synergies was lower and it is relatively soon after the deal was completed, Tesco has announced that it is on track to deliver its original estimates of £200 million in three years.⁸⁸⁴
- (c) Sainsbury's/Argos, where the nature of the synergies are less directly comparable to the Merger (eg more reliant on property cost synergies than buying), but nevertheless demonstrates that Sainsbury's has been able to deliver these synergies ahead of the announced schedule.⁸⁸⁵

16.111 We therefore consider that any efficiencies that are likely to result from the Merger should be considered to be timely.

Sufficiency

16.112 The Parties submitted that incorporation of rivalry-enhancing efficiencies directly into a competitive effects analysis sits particularly well with the GUPPI model, and 'it is appropriate and straightforward to include these synergies directly in the GUPPI/WSS analysis'. They subsequently explained that this would entail recalibrating the Parties' relevant local diversion results downward or increasing the GUPPI threshold applicable to all local areas.⁸⁸⁶

16.113 We consider that including any rivalry-enhancing efficiencies the CMA finds into the GUPPI threshold would allow for a direct quantitative measure of the extent to which these efficiencies would offset any incentives to increase prices as a result of loss of competition from the Merger. Therefore, the extent to which rivalry-enhancing efficiencies would be sufficient is discussed in more detail in other relevant sections of this report.

⁸⁸³ For example, see 'Synergy savings' section in [Ahold Delhaize's 2018 interim results](#).

⁸⁸⁴ For example, 'As planned, we anticipate that synergies associated with our merger with Booker will generate a benefit of at least £60 million this year, growing to a cumulative c.£140 million in 2019/20 and c.£200 million by 2020/21', [Tesco Interim Results 2018/19](#), page 3.

⁸⁸⁵ [Sainsbury's Interim Results 2018/19](#)

⁸⁸⁶ where the Parties include specific figures for these changes based on their proposed estimates of efficiencies and variable margins.

Likelihood

16.114 In this section, we consider the extent to which we consider that the Merger is likely to generate rivalry-enhancing efficiencies, based on the submissions and evidence provided by the Parties, as well as the body of evidence available to us regarding the likely level of synergies resulting from the Merger.

16.115 The large majority of synergies included in [the consultant's] analysis are purchasing synergies. Therefore, combined with the fact that purchasing synergies represent variable cost savings which are likely to have a direct impact on the Parties' pricing incentives (as discussed more in paragraph 16.202 below), we focus this section on these purchasing synergies.

Purchasing Synergies Analysis

16.116 The Parties have used the Purchasing Synergies Analysis to estimate the likely scale of purchasing synergies as being £1.2 billion. Initially, this was described as a simple harmonisation of buying terms. In their later submissions, they explained that they would expect to deliver this through a combination of:

(a) [REDACTED];

(b) [REDACTED]; and

(c) [REDACTED].

16.117 In their latest submission on this topic, the Parties argued that 'harmonisation is facilitated by information transfer but is underpinned and sustained by the Parties' negotiation tactics and increased buyer power (eg suppliers have one less significant outside option) and this buyer power persists over time preventing suppliers from clawing back the benefits of harmonisation, leading to the estimated benefits recurring on a sustained basis'.⁸⁸⁷

The effects of harmonisation, and interactions with buying scale

16.118 The Parties stated that 'harmonisation and enhanced buyer power cannot be considered separately'. In particular, they stated that we should not draw a false distinction between harmonisation and (pro-competitive) buyer power as they are not independent of each other.⁸⁸⁸

⁸⁸⁷ Parties' response to the Provisional Findings, paragraphs 205 and 286–289.

⁸⁸⁸ Parties' response to the Provisional Findings, paragraph 204.

16.119 In some of their submissions, the Parties conflate their evidence and arguments around harmonisation, effects of increased scale, purchasing synergies, and other synergies. This is particularly apparent in more recent submissions where they are increasingly placing emphasis on the use of heightened buyer power to sustain any harmonisation benefits. For example, when arguing that ‘Purchasing synergies through harmonisation of terms have been consistently identified and credited as an important synergy in UK and European retail mergers, including in the grocery sector’, the Parties include a slide which refers to buying synergies in historical European retail transaction, but makes no reference at all to harmonisation. When submitting similar evidence to support their views about the ‘implementation and/or achievement of recurring purchasing synergies’, the Parties include a schedule of examples which do not reference harmonisation as a source (or in fact, purchasing). The Parties also refer to the existence of ‘ex-post analysis of the delivered benefits’ of harmonisation,⁸⁸⁹ but have not provided any systematic evidence to support this, only a series of more general examples which do not speak to harmonisation specifically. Indeed, the Parties’ advisors stated that although this view of harmonisation is consistent with their experience, ex-post analysis is generally not available.

16.120 We consider that, in any post-Merger negotiations with suppliers, the Parties would seek to use all available resources to maximise their own benefits (one aspect of which is achieving a low procurement price). These approaches would include, for example, using the additional short-term information exchange from the Merger to argue for potential price reductions, discussing the potential to share any efficiencies associated with increased scale, as well as relying on improvements in buyer power from the structural change (eg through loss of an outside option, and a greater threat of delisting products). All of these factors are likely to affect the Parties’ ability to extract a lower price from suppliers during the immediate set of negotiations.

16.121 However, this is not to say that each of these factors is necessarily equivalent. For example, if there were very large differences in current prices, which were larger than the supplier was willing to concede in full, then the Parties would be in a position whereby the ‘harmonised’ price would not be achieved, and they instead are negotiating about the price relying on the relative buyer power of the supplier and the merged entity. In these circumstances, the current price difference would not be informative of the outcome. Similarly, there are times when the Parties would be expected to achieve more than the current difference in price, simply as a result of their increased scale and the threat associated with delisting from a larger entity.

⁸⁸⁹ Parties’ response to the Provisional Findings, paragraph 289.

For example, if there were no current differences in input price, this does not mean that it would be impossible for the Parties to achieve an improved input price as a result of the Merger.

16.122 Furthermore, the effect of a one-time information transfer would be to reduce the level of information asymmetry between the Parties and their suppliers at that moment in time. Although it may be difficult for a supplier to change an individual price soon after it is set, as time progresses, and circumstances change (eg ongoing volatility in the suppliers' costs, investment strategies change, new products are released, and ranges continue to evolve), we would expect that any benefits of the additional information would be reduced as there are no structural changes to allow this improved information to continue.

16.123 Given the eventual loss of any information benefits, the Parties would then be reliant on their improved buyer power to sustain any improvements in terms, and one would therefore expect the medium-term input prices to reflect the relative bargaining powers of the negotiating parties involved. In a rapidly changing and highly competitive market (such as UK grocery, as characterised by the Parties), we would expect this process to be relatively fast.

16.124 There are some circumstances in which an analysis of existing prices may be informative as to the difference in total buyer power arising from a merger. For example, if a very large company was buying a much smaller company, it would expect to bring its current higher level of buyer power to bear across the relevant parts of their combined cost-base. In those circumstances, a comparison between the two companies' current prices may be reflective of the current difference in buyer power, and hence act as a reasonable estimate for the expected benefits of the merger.⁸⁹⁰ However, this case is fundamentally different to the above example, since we have two large companies which both already have significant scale in the products they sell.

16.125 The Parties described these concerns as being 'unsubstantiated and are largely predicated on the submissions of third parties'. However, we consider that they are clear and well-founded concerns which arise directly as a result of the approach adopted in the Purchasing Synergies Analysis, as explained above. In addition, although they disagree with these conclusions, the Parties

⁸⁹⁰ We note that there may be circumstances in which the smaller company is buying more cheaply than the larger company. However, the Parties' advisors explained that this is likely to be from relative volumes in these specific products (ie SKU velocities). Alternatively, it may reflect other considerations, such as the strength of relationships as discussed in paragraph 16.94. As the CC discussed in its report, these variations in individual products are consistent with an overall benefit from increased buyer power.

and their advisors appear to recognise many aspects of the above, in particular the reliance on increased buying scale. For example:

- (a) The Parties, [the consultant] and [the third party] all recognised that, despite the information revelation arising from the Merger, there would always be some level of uncertainty as to the outcome of supplier negotiations,⁸⁹¹ and therefore would not be as simple as simply relying on the additional information to achieve harmonisation of existing prices.
- (b) As mentioned in paragraph 16.22 above, the Parties have now stated that, despite being based on detailed information on suppliers' current prices, the Purchasing Synergies Analysis may not reflect the specific benefits that would be achieved from each supplier. This appears inconsistent with the premise of harmonisation resulting from information revelation at individual suppliers, in particular as it implies that while the Parties' accept that some suppliers would not agree to full harmonisation, others would somehow 'overharmonise' in order to produce the correct aggregate figure.
- (c) The Parties stated that a larger, more significant customer is better able to deliver harmonisation of terms compared to a smaller retailer.⁸⁹² This appears to recognise that it is the relative buying power of the parties involved which will actually determine the outcome of negotiations.
- (d) [The consultant] stated that, over time, the information asymmetry between suppliers and the Parties would increase again, and that the Parties would then be reliant on the structural change (ie the increase in scale) to support the enduring benefits.⁸⁹³

16.126 With regard to the final point which the Parties raise in paragraph 16.116 above, that, [X], we consider that this is incorrect. The merger-effect of removing information asymmetry would not appear to alter the existing economics of the Parties' suppliers. If suppliers were able to profitably reduce their prices to retailers in order to benefit from higher volumes, they would have the incentive to be doing this already. Therefore, in the absence of any clear savings in the supply chain, any attempts to reduce prices between Sainsbury's and Asda post-Merger (eg as a result of harmonisation) would be expected to reduce supplier profitability, and so act against their incentives.

⁸⁹¹ [Parties' response to the Provisional Findings](#), paragraph 218.

⁸⁹² [Parties' response to the Provisional Findings](#), paragraph 287.

⁸⁹³ 'we accept your point that industry evolution will continue and the information asymmetry will increase again but that structural change in the nature of the relationship is what supports the enduring delivery of the benefits that come from that initial pricing reset'.

16.127 We consider that, while short-term negotiations may be influenced by the exchange of information on existing buying terms, the ability to deliver and sustain any efficiencies into the medium-term would be primarily determined by the Parties' combined buyer power/negotiating strength, and that this is not dependent on, or strongly influenced by, information revelation at the point of the Merger.

[The third party] review

16.128 [The third party's] reports submitted to the CMA were heavily caveated, noting (amongst other things):

- (a) The sensitised estimate was referred to as being 'illustrative';
- (b) That we were not entitled to rely on these reports;
- (c) That these reports may not have been appropriate for our needs and are not designed to form the basis of any decision by us;
- (d) That we might have assessed the matters in the reports differently;
- (e) That although it might be relevant for providing information on the underlying initiatives, at least the first report would have been of limited use in being informative for the CMA's purposes of assessing the likelihood of estimated synergies being delivered;
- (f) That these reports did not express any opinion as to the achievability of the synergy benefits identified in the Synergy Plan or the Financial Benefits Statement;
- (g) That the assumptions and estimates underlying the Synergy Plan were inherently uncertain and though considered reasonable by Management as of the date of their preparation, were subject to a wide variety of business, economic and competitive risks and uncertainties that could cause actual results to differ materially from those contained in the prospective financial information; and
- (h) That the information in the reports were not fact and should not be relied upon as being necessarily indicative of future results.

16.129 When questioned directly by the CMA, [the third party] explained that these disclaimers were generally standard text and reflected the fact that this work was not specifically commissioned for the purpose which we may be using it for here. However, it considered that its sensitised figures reflected its

'minimum view' of the quantum of synergies that should be delivered were the Merger to take effect as anticipated.

16.130 As discussed above, the [third party's] review produced some sensitised figures for the potential variable cost savings arising from the Merger, based on the results of the Purchasing Synergies Analysis. Accordingly, any concerns on the principles adopted by [the consultant] (eg the reliance on harmonisation) would also apply to these derived estimates. Furthermore, since the [third party's] methodology consisted of applying broad reductions to the initiatives, it is unclear whether this would sufficiently address any other methodological points raised discussed in more detail below.

16.131 We note that when [the third party] applied the Quantified Financial Benefits Statement standard to all of the Parties' synergies estimates, it would have required that 'Any profit forecast or quantified financial benefits statement must be properly compiled and must be prepared with due care and consideration' and that it must be 'reliable'.⁸⁹⁴ Although the Parties and [the third party] have emphasised the different specific aim of its review of the synergies plan, we note that [the third party's] sensitisation of the Purchasing Synergies Analysis reduced the figure by about 40% (£729 million compared with £[1.2 billion]), reflecting that [⊗] of these synergies were characterised as 'Management not fully able to demonstrate due care and attention' or 'Management unable to demonstrate due care and attention'.⁸⁹⁵ [The third party] told us that these phrases represent a specific and specialist meaning, and that in this context 'due care and attention' should be interpreted as 'suitable for public disclosure by the client without risk adjustment and reporting by us without qualification'.

16.132 The Parties have confirmed that [the third party's] initial view had a very specific purpose which was to assess whether there was at least £500 million net synergies available for shareholders to support a public statement to those shareholders about the anticipated synergies. The Parties claimed that this represented a view at a particular period of time and as further data was made available, [the third party's] sensitised total has increased.⁸⁹⁶ The Parties stated that the CMA ought to accept [the third party's] views as satisfying the standard of proof given the strict requirements of the relevant sections of the Takeover Code, which are designed to provide shareholders with as much certainty as possible.⁸⁹⁷ The Parties' particularly emphasised

⁸⁹⁴ Extract from Rule 28.3 of the [Takeover Code](#).

⁸⁹⁵ Of the £[1.2 billion] of procurement synergies, [⊗].

⁸⁹⁶ [Parties' response to the Provisional Findings](#), paragraph 214.

⁸⁹⁷ [Parties' response to the Provisional Findings](#), paragraph 218.

that 'to completely disregard the independent assessment of [the third party] (with extensive experience in this area), is an unreasonable assessment of the evidence on an analysis and is inconsistent with the burden of proof in assessing efficiencies claims in Phase II mergers'.⁸⁹⁸

16.133 We do not accept the Parties' submissions on this point. Firstly, the CMA has not completely disregarded the assessment by [the third party]: we have conducted an in-depth review of each of [the third party's] reports, have carefully considered all of the related submissions by the Parties and have discussed the issues directly with [the third party]. Secondly, the CMA's duty is to decide whether the Merger may be expected to result in an SLC in any market in the UK. As part of this assessment, where evidence is available, we consider whether rivalry-enhancing efficiencies may arise and whether they would be sufficient to prevent any SLC from arising. We consider that this requires us to adopt a different approach to that which is provided for under the relevant provisions of the Takeover Code, the primary purpose of which are to safeguard shareholders. [The third party] appeared to recognise this point as well.⁸⁹⁹ Finally, we reject the Parties' assertion that we are applying a standard of proof which is higher than the balance of probabilities. We have had appropriate regard to the evidence from [the third party], but do not consider that it would be reasonable to substitute their assessment for our own judgment, particularly given our concerns with the approach they have taken (as discussed below).

Authority of the Parties' external advisors' views

16.134 The Parties stated that it would be unreasonable and inconsistent with the CMA's standard of proof for the CMA to substitute its own judgement in place of the fact-specific empirical evidence of two retail industry specialists (ie [the consultant] and [the third party]).⁹⁰⁰

16.135 We strongly disagree with this statement. Throughout our assessment we have received evidence from a range of sources, and formed judgements on the relative weight to place on each, taking into account considerations such as the robustness of any underlying data, the validity of any necessary assumptions, and the incentives of the parties submitting the evidence. While we accept that [the consultant] and [the third party] are experienced and informed specialists, we would not consider it appropriate to accept their

⁸⁹⁸ [Parties' response to the Provisional Findings](#), paragraph 219.

⁸⁹⁹ 'Your purposes are clearly different. They may be quite similar but they are fundamentally different to the reason we were asked to carry out the work in the first place'.

⁹⁰⁰ [Parties' response to the Provisional Findings](#), paragraph 220.

views as established fact without further investigation (in particular given the nature of any potential synergies assessment as a predictive exercise conducted in contemplation of the Merger) or to simply defer to their judgement in these matters.⁹⁰¹ In fact, we consider that it would be fundamentally inconsistent with our duties to substitute other parties' judgement in place of our own without question, particularly when those other parties in question are acting for the Parties themselves and the purpose of their assessment was not to assess the competitive effects of the Merger. It is in the nature of a merger inquiry for the assessment of efficiencies to be intrinsically linked to the question of whether an SLC may be expected to arise (which is the statutory question that the CMA must answer), in particular due to the need for a consideration of whether efficiencies are sufficient to prevent any SLC from arising. The CMA is clearly best-placed to conduct this assessment.

16.136 Given the information asymmetry that exists in relation to efficiency analysis, much of our evidence comes from the Parties and their external advisors and we have conducted a thorough assessment of this evidence. However, it is appropriate and reasonable for us also to take into account other relevant evidence and then to form our own view of the efficiencies that may be expected to arise from the Merger.

Figures calculated in the Purchasing Synergies Analysis

16.137 As explained in paragraphs 16.12 above, the Purchasing Synergies Analysis relies on a harmonisation approach to support the large majority of the £1.2 billion figure,⁹⁰² which tried to compare an estimate of existing unit costs between Sainsbury's and Asda. Therefore, even if this was a perfect reflection of current unit cost differences, we consider that it provides no indication of the post-Merger outcome arising from increased scale, which would be the key determinant in setting prices in the medium term (as discussed in paragraph 16.127 above).

16.138 In spite of this issue, we have conducted a full assessment of the evidence submitted by the Parties. During this assessment we identified some concerns around the specific methodology and resulting figures produced by the Purchasing Synergies Analysis.

⁹⁰¹ Both [the consultant] and [the third party] recognised that this assessment required the exercise of judgement, in particular when considering its use in different purposes.

⁹⁰² We note that the additional contribution from BBT which the Parties have included does not, and is not designed to, reflect the full extent of post-Merger changes in buyer power.

16.139 The figures estimated in the Purchasing Synergies Analysis appear to be predicated on current procurement practices at the Parties being inefficient. [The consultant] specifically highlighted this as a reason for the Parties apparently receiving different prices, and noted that this might arise as a result of individual negotiators at suppliers typically being in tenure longer (and hence being more experienced) than supermarket buyers. However, it is unclear why these effects would result in each Party achieving different input prices across each product in their portfolio, rather than simply resulting in both Parties systematically paying slightly more for their purchases in a given category depending on the specific skills of the particular buyer (eg if the chicken buyer was more effective at one Party, then we would expect that Party to receive better terms on all of its chicken products).⁹⁰³ We also note the Parties' statement that they '[redacted]',⁹⁰⁴ which would indicate that there was very limited or no scope for information asymmetry between the supplier and the grocer, and yet the Purchasing Synergies Analysis has estimated over £[redacted] of benefits from harmonisation and IPL improvements associated with own label products.

16.140 In general, it is unclear why such market inefficiencies would continue to exist, and that they would be driven by information asymmetry between supplier and grocery. [The consultant] acknowledged this 'conundrum' and was unable to explain why this might occur, simply reiterating that these apparent price differences were directly observable.

16.141 The Parties stated that the level of information revelation required to replicate [the consultant's] work was simply not possible in the ordinary course of business, and could only arise through cartel-like behaviour, in order to provide the timeliness and level of detail required. However, we note that the Purchasing Synergies Assessment includes over £[redacted] of savings based on the difference in the gross margins (ie a single aggregate figure) at one supplier. Given this work is based on prices from mid-2017, but the Parties still consider it a robust estimate of the synergies, it is also unclear why they consider that the value in pricing information would decay particularly quickly.

16.142 Furthermore, if there were large potential savings available through more efficient purchasing by the supermarkets, then the Parties would have correspondingly large incentives to invest more in their buying teams in order to access some of these savings. However, the Parties' combined spend on staff within its buying function is currently only around £[redacted], compared with the Parties' estimated benefits from improved efficiency of at least £[redacted].

⁹⁰³ [redacted].

⁹⁰⁴ Parties' response to the Provisional Findings, paragraph 296.

Therefore, if the relatively short tenure of grocery buyers was resulting in the Parties procuring inefficiently (as stated by [the consultant] above), they would have very strong incentives to increase their remuneration in order to retain these buying staff for longer, and achieve improved buying terms with suppliers.

16.143 The evidence included above would support the view that the Parties are actually already procuring efficiently, and so we would not expect there to be material differences in the terms they are receiving from the majority of suppliers. However, the Purchasing Synergies Assessment appears to indicate that differences in current prices exist, and that significant savings could be generated from reducing these. We therefore consider an alternative explanation for these apparent differences in price, namely that the Purchasing Synergies Assessment does not sufficiently control for other potential factors. These are discussed in more detail in Appendix M, and include:

- (a) Residual differences in the underlying products (SKU Approach);
- (b) Differences in the cost to serve the Parties;
- (c) Differences in non-price terms with suppliers; and
- (d) Mix effects (Supplier Approaches and Category Approach).

16.144 In addition to these methodological concerns with the Purchasing Synergies Analysis, there are numerous smaller steps in the analysis which would introduce additional uncertainty as to the estimate calculated.

16.145 As explained above and in Appendix M, we therefore consider that the Purchasing Synergies Analysis does not adequately account for alternative explanations for the apparent differences in current prices when assessing the potential effect of harmonisation.

Ability to avoid renegotiation

16.146 Our analysis of the Purchasing Synergies Assessment generally assumes that the Parties will be required to renegotiate with their suppliers in order to achieve any improvement in their input prices. This is consistent with statements from [the consultant] and [the third party] (although they both noted that they did not consider this in detail).⁹⁰⁵

⁹⁰⁵ 'We accept that that price harmonisation, the pricing reset, requires a negotiation'; 'The assumption is that the prices are effectively – there is an annual cycle for negotiation'.

16.147 However, the Parties have stated that where their arrangements with suppliers have no volume limits, volumes through one supplier could theoretically be transferred to the other supplier, subject to that supplier having sufficient capacity, which would equate to [REDACTED]. The Parties particularly noted that at least one supplier had raised this point themselves.⁹⁰⁶ However, we note several potential challenges with this approach:

(a) [REDACTED].^{907,908}

(b) [REDACTED].⁹⁰⁹

(c) [REDACTED].^{910,911,912}

(d) [REDACTED].⁹¹³

(e) [REDACTED].

16.148 Furthermore, even if the Parties were able to avoid renegotiation initially, at least with some suppliers, this would likely be short-lived. As discussed in paragraph 16.108 above (and consistent with the Parties' views that any purchasing synergies would be delivered in a timely manner), the Parties have frequent discussions with their suppliers, and major annual reviews are used to develop Joint Business Plans or similar agreements. If the supplier was unhappy with the existing agreement (eg due to the Parties combining their volumes through a single contract), these frequent discussions would provide an easy mechanism for the supplier to initiate a renegotiation.

16.149 Therefore, we consider that our assessment of relative buyer power representing the primary driver of likely purchasing savings in the medium-term post-Merger (as discussed in paragraph 16.127 above) remains valid even if the Parties are able to initially avoid renegotiation with some suppliers by transferring a subset of their volumes through existing contracts.

Fuel purchasing synergies

16.150 For completeness, we note that although the above assessment primarily discusses purchasing synergies for groceries and GM, the key points raised

⁹⁰⁶ [Parties' response to the Provisional Findings](#), paragraphs 293–294.

⁹⁰⁷ [REDACTED].

⁹⁰⁸ [REDACTED].

⁹⁰⁹ [REDACTED].

⁹¹⁰ [REDACTED].

⁹¹¹ [REDACTED].

⁹¹² [REDACTED].

⁹¹³ [REDACTED].

would also apply to the Fuel Approach, which was conducted subsequent to the announcement of the Merger.

16.151 However, there are specific reasons that we do not consider that the Parties' submissions on [the consultant's] calculated synergies in fuel represent a robust estimate of the likely rivalry-enhancing efficiencies arising from the Merger.

16.152 The Parties currently adopt significantly different approaches to fuel purchasing and delivery, with Sainsbury's effectively outsourcing this [redacted],⁹¹⁴ while Asda [redacted].

16.153 The Parties argued that post-Merger, [redacted].⁹¹⁵

16.154 We consider that these arguments, and the Purchasing Synergies Analysis for fuel do not accurately reflect two key points:

- (a) The nature of savings [redacted]; and
- (b) The additional value associated with adopting an outsourced approach.

16.155 The Parties argued that [redacted]. They also provided an example in which two equally sized firms have adopted these different models and are paying the same total costs for their fuel:⁹¹⁶

- (a) Inhouse: Firm A procures fuel at a cost of 98ppl, or £9.8m per annum for the 10 million litres it requires. However, it also spends £220,000 in overhead, on its fuel procurement function, bringing the total cost to £10.02 million.
- (b) Outsourced: Firm B uses a third-party contractor which manages to procure fuel at a cost of 98ppl, or £9.8 million per annum for the 10 million litres required. However, Firm B also pays the contractor a management fee of £200,000. Because Firm B outsources this function, it has lower overhead costs at £20,000, bringing the total cost to £10.02 million as well.

16.156 If the Parties' statements and example were a fair reflection of the circumstances, and the Parties could achieve equivalent total costs (and other benefits) from either model, then they would be indifferent as to which of these models they used, and willing to switch between them. In those circumstances, it is clear that switching between outsourcing and inhouse

⁹¹⁴ Parties' response to the Provisional Findings, paragraph 802.

⁹¹⁵ Parties' response to the Provisional Findings, paragraphs 802 to 806.

⁹¹⁶ Parties' response to the Provisional Findings, paragraph 804.

provision would not result in any efficiencies (rivalry-enhancing or otherwise) regardless of the exact contractual mechanism adopted by the outsourcing firm (eg whether the management fee is specified as a fixed amount, or as a ppl figure).

16.157 In addition, it is clear from this example that the primary fuel suppliers to the two firms are receiving the same unit cost, so there are no purchasing benefits from the combination whereby the outsourcer would achieve lower prices with the primary suppliers by using the inhouse team (from removal of information asymmetry or otherwise).⁹¹⁷ In effect, the outsourcer achieves the same underlying cost for its fuel, and has simply chosen to outsource its overhead costs to an intermediary.

16.158 Therefore, the merger-effect of combining these two firms would not result in improved purchasing terms as a result of reducing information asymmetry, but simply be the removal of some proportion of duplicated overhead (eg by not requiring two full fuel procurement teams). This is consistent with [✂].

16.159 However, to the extent that [✂].

16.160 In addition, we consider that the Parties' arguments, their example above, and underlying analysis do not adequately reflect the importance of non-price factors. The Fuel Approach does not include any considerations of non-price factors, and so appears to assume that these either do not exist or would be unaffected by the Merger.

16.161 The Parties explicitly acknowledge that there are considerations other than price per litre when selecting a procurement model,⁹¹⁸ and provided examples of these. However, the Parties argue that these non-price factors [✂].⁹¹⁹

16.162 Based on the Parties' responses and the explanation of their approach, the most significant potential benefit from outsourcing fuel procurement would appear to be related to the Parties' relative exposure to risk. The potential to include risk transfer is widely acknowledged in outsourcing contracts.⁹²⁰ In these circumstances, there appears to be substantial scope for this transfer of risk. For example, if there was a future disruption in fuel supply, the

⁹¹⁷ This assumes that there are no scale benefits from purchasing fuel. The Parties' analysis of fuel efficiencies is primarily based on harmonisation, and we have seen no evidence for the existence or size of any scale benefits in fuel purchasing.

⁹¹⁸ [Parties' response to the Provisional Findings](#), paragraph 802.

⁹¹⁹ [Parties' response to the Provisional Findings](#), paragraph 802.

⁹²⁰ For example, [The Outsourcing Playbook, Central Government Guidance on Outsourcing Decisions and Contracting](#) (February 2019) includes a section specifically examining the recommended approach to risk allocation in outsourcing contracts.

outsourced provider might be expected to bear the cost of addressing it (eg if a terminal was unable to supply fuel, the outsourcer would be expected to source fuel from other terminals and cover the cost of any incremental spend / associated delivery costs). Bringing the procurement function inhouse would result in the Parties now bearing the risk which was previously transferred.

16.163 The existence of non-price factors which would be lost after the Merger (or would need additional payments to be retained) is also consistent with [X], as can be seen by considering an adjusted version of the Parties' example:

- (a) Inhouse: Firm A still procures fuel at a cost of 98ppl, or £9.8m per annum for the 10 million litres it requires, and continues to spend £220,000 in overhead, bringing the total cost to £10.02 million.
- (b) Outsourced: Firm B still uses a third-party contractor which manages to procure fuel at a cost of 98ppl, or £9.8 million per annum for the 10 million litres required. However, Firm B also pays the contractor a management fee of £300,000 (£200,000 to reflect the cost of outsourced overhead, and £100,000 to reflect additional risk being transfer). Because Firm B outsources its procurement function, it still has lower overhead costs at £20,000, bringing the total cost to £10.12 million.

16.164 The Fuel Approach [X]. However, there is no reason to believe that these differences purely reflect the value associated with outsourcing of overheads, and do not also include additional expenditure associated with other benefits, such as risk transfer which would be lost post-Merger. Given that the Parties have adopted these different procurement models, it appears reasonable to infer that they have done so for good economic reasons which reflect their specific needs.

16.165 We are not in a position to be able to specifically identify any additional value [X] on non-price factors which would be lost by insourcing and hence quantitatively adjust the Parties' analysis. However, to the extent that any of these non-price factors exist, they can only result in the Fuel Approach ([X]) being an overestimate of the potential benefits from the Merger. Therefore, any value from non-price factors associated with outsourcing which would be lost by bringing inhouse, would result in the figures in the Fuel Approach being an overestimate of the true potential savings available.

16.166 Therefore, for the reasons described above, we consider that any savings which might arise from fuel procurement in the Merger would not represent variable cost savings. Furthermore, the figures produced by the Fuel Approach would likely represent an overestimate of any potential savings. Accordingly, we consider that these figures are unlikely to be a robust

reflection of the likely level of variable cost savings through lower procurement costs in fuel that the CMA would expect to result from the Merger.

Evidence from third parties on the Purchasing Synergies Analysis

16.167 The concerns we have identified with the Purchasing Synergies Analysis are further supported by the evidence received from third parties which shows that:

- (a) Many of the benefits from acquisitions are absent or reduced in this Merger. For example, the decision not to integrate brands reduces the availability of savings, and there are no new routes to growth which would provide suppliers with additional value to offset any unit cost reductions.
- (b) The approach of a line-by-line comparison of accounting figures can be a very poor indicator of the likely outcome of actual supplier negotiations (as submitted by Tesco for Tesco/Booker). In particular, there are a large number of both price and non-price parameters included in supplier negotiations, and the Purchasing Synergies Analysis does not sufficiently control for all of these (as discussed in Appendix M).
- (c) While we do not place any significant weight on the individual figures from suppliers, the fact that their estimates of the effect of harmonisation on their own costs are often very different to that calculated in the Purchasing Synergies Analysis (with the different results being both higher and lower than the Parties' estimates) supports the methodological concerns we have identified.

Conclusions on the Purchasing Synergies Analysis

16.168 The Parties stated that the dismissal of the benefits of harmonisation was based on no evidence, and the view that harmonisation would result in enduring benefits reflected the judgement of two retail industry specialists, established practice in analysing retail mergers, and the combined expertise of the Sainsbury's and Asda businesses.⁹²¹

16.169 We have explained in paragraphs 16.118 to 16.167 above why we consider that medium-term prices would be primarily determined by the Parties' combined buyer power/negotiation strength, and not a one-off information exchange. The Purchasing Synergies Analysis relies on an extrapolation of current best terms between the Parties as their estimation of 'harmonisation'

⁹²¹ [Parties' response to the Provisional Findings](#), summary on page 11 and paragraph 290.

but does not seek to quantify the increased buying power from the combination of the Parties. Accordingly, we consider that this analysis would not be a robust estimate for the likely level of recurring procurement savings we should be taking account of in our assessment of this Merger.

16.170 The Parties further stated that dismissing its quantified synergies case, or affording it minimal weight, would be an unreasonable assessment of the evidence and inconsistent with the CMA's standard of proof.⁹²²

16.171 We have fully assessed the evidence and arguments presented by the Parties (including that produced by their external advisors). We agree that the Merger is likely to give rise to opportunities to reduce procurement costs. We also consider that the scale of these potential savings could be significant in absolute terms given the scale of purchasing across both Parties. However, based on our in-depth assessment above, we consider that the figures calculated in the Purchasing Synergies Analysis, and the [third party] sensitivities which are based on these, are unlikely to be a robust reflection of the likely level of recurring procurement savings we could expect to result from the Merger. Therefore, we have concluded that we are unable to attach any significant weight to the Purchasing Synergies Analysis submitted by the Parties as evidence of the rivalry-enhancing efficiencies which we could expect to arise from the Merger.

Other available evidence

16.172 As described in paragraph 16.9 above, the Merger Assessment Guidelines note 'Efficiency claims can be difficult for the [CMA] to verify because most of the information concerning efficiencies is held by the merger firms. The [CMA] therefore encourage[s] the merger firms to provide evidence to support any efficiency claims whether as part of the SLC analysis or the consideration of relevant customer benefits.'⁹²³ Although we are unable to attach any significant weight to the figure calculated in the Purchasing Synergies Analysis provided by the Parties, in this case we consider that there is evidence available which supports an expectation that some degree of procurement savings would be available from the Merger in grocery and GM and which allows the CMA to determine the amount of those savings which it is appropriate for us to include in this case. In particular:

- (a) Suppliers consistently expected to have to reduce their prices to the Parties post-Merger. However, the source and scale of these reductions

⁹²² [Parties' response to the Provisional Findings](#), paragraph 209.

⁹²³ [Merger Assessment Guidelines](#), CC2/OFT1254, paragraph 5.7.5.

varied substantially by individual supplier, and we do not have a representative estimate we could rely on. We also note that suppliers may have had the incentive to emphasise these effects to support their stated concerns about increased Buyer Power which could result in an SLC.⁹²⁴

- (b) The CMA/CC have estimated the benefits of increased scale in groceries both in previous market investigations, and in this case specifically. These consistently show purchasing benefits associated with scale, albeit (1) the significance of these benefit diminishes with size, and (2) scale does not explain all the differences in procurement costs, with the CC's reports specifically observing there are other relevant factors as well (eg relationships with suppliers).
- (c) Previous grocery/retail mergers expected to generate, and have generated, purchasing synergies. However, the scale of estimates included varies between mergers, and announcements usually conflate, or do not clearly distinguish between, any effects of harmonisation compared with increasing buyer power and other considerations (eg additional growth potential, supply chain efficiencies in purchasing, etc).
- (d) Competitors stated that the Merger would generate very limited savings and provided arguments and evidence that harmonisation might be difficult. However, we note that these arguments are consistent with some degree of savings (as has been delivered in Tesco/Booker), and that the competitors may have the incentive to argue for minimal efficiencies arising from the Merger particularly if they were concerned that such efficiencies would improve the Parties' competitive offering.

16.173 We note that where these pieces of evidence include an estimated scale of savings, they are almost always substantially lower than the Parties' submitted estimates.

16.174 The Parties argued that the CMA's approach in Tesco/Booker and Asda/Netto recognised the principles of harmonisation. However, we do not consider that this strongly supports the use of harmonisation in this case. Both of the previous transactions involved a large company acquiring a substantially smaller company. In those cases (as discussed in paragraph 16.124 above), harmonisation would principally involve bringing the large company's buying power to bear across the combined entity, and so a comparison of pre-merger prices between the two would reflect existing

⁹²⁴ For example, 'we question Sainsbury's and Asda's logic on what they have said around supplier price reductions and synergies. [...]. There is no way we think that this will not have an impact on suppliers of all types without increasing buyer power', [Transcript of hearing with Consumer Council Northern Ireland, Food and Drinks Federation, National Farmers Union, National Farmers Union Scotland and Which?](#) (page 14).

differences in buyer power and represent the likely outcome by bringing the smaller company's terms in line with the larger (assuming no/limited benefits of increased scale from the combination). These circumstances are very different to the facts in this case where two similarly sized and very large retailers are merging.

16.175 In addition, we note that, the section of the Tesco/Booker report which is quoted by the Parties is heavily caveated ('the merged entity would likely benefit from better terms from some suppliers with regard to some products in grocery wholesaling through a degree of harmonisation of supply terms') and the same paragraph also goes on to specifically state that 'we have not found it necessary to conclude on the magnitude of any procurement efficiencies'.⁹²⁵

16.176 The Parties also argue that they have a proven track record in accurately forecasting and over-delivering on pre-transaction announced synergy estimates, notably in Asda/Netto and Sainsbury's/Argos, and that the CMA had disregarded this 'concrete evidence of their proven track record'.⁹²⁶

16.177 We have highlighted the significant differences between the mergers referred to by the Parties, and this Merger, most notably the fundamental difference in scale. In Asda/Netto, the acquisition increased the revenue of Asda by around 4%,⁹²⁷ with expected buying synergies being equal to [REDACTED] [<£50] million per year compared with £1.2 billion in this case. In Sainsbury's/Argos, the acquisition increased the revenue of Sainsbury's by around 15%.⁹²⁸ In this transaction, the revenues of each Party would nearly double. Furthermore, Sainsbury's/Argos was a very different transaction with the large majority of synergies accruing from property and central functions/goods not for resale ([REDACTED]%), which account for less than [REDACTED]% of the estimated synergies in this case and, in any case, do not represent variable cost savings.

Conclusion on likelihood

16.178 In paragraphs 16.114 to 16.177 above, we have explained the evidence and our views regarding the likelihood of the Merger producing rivalry-enhancing efficiencies.

⁹²⁵ Tesco/Booker merger inquiry (20 December 2017), [Final report](#), paragraph 26.

⁹²⁶ [Parties' response to the Provisional Findings](#), paragraph 280–283.

⁹²⁷ Netto had revenues of £745 million in 2009 (based on the [Asda/Netto merger inquiry](#) (2010) paragraph 7), while Asda generated revenues of around £19.8 billion in the same period (as filed in Companies House).

⁹²⁸ Home Retail Group generated revenues of around £4 billion, while Sainsbury's turnover was around £23 billion at the time; [Sainsbury's/Home Retail Group merger inquiry](#) (2016), paragraphs 8 and 10.

16.179 When we are assessing the level of potential synergies in a merger, there is a significant element of judgement. Predicting synergies is necessarily uncertain, as it is forward-looking in nature. In addition, there is a substantial asymmetry of information between the Parties and the CMA, and as acknowledged by the Parties, the calculation of likely efficiencies arising from a Merger is prone to ‘the risk of self-serving (or simply unduly optimistic) claims made by Parties’. Therefore, as noted in our guidance, this is an area where we are usually heavily reliant on the Parties to produce robust and compelling evidence to support their claims of potential efficiencies.

16.180 Where the Parties’ evidence on rivalry-enhancing efficiencies are insufficiently robust for our purposes, the CMA would normally reject the submissions, effectively adopting a default value of zero. However, we consider that exceptionally in this case there is a body of evidence available to us which provides evidence on the degree of recurring procurement savings in grocery and GM which are likely to arise as a result of the Merger.

16.181 In these circumstances, we have weighed the other evidence available to the CMA which indicates the likely quantum of savings in these areas in the round, in particular the estimated benefits associated with increased scale, and comparators with other historical transactions.

(a) As discussed in paragraphs 16.89 to 16.102 above, the CMA and CC analyses investigated the total benefits of increasing purchasing volumes in groceries and found there to be a statistically significant relationship. Combining the Parties’ volumes of groceries would result in an expected reduction in costs (albeit a lower level of savings than was estimated by the Parties).

(b) A range of historical transactions, including publicly announced gross purchasing savings in Ahold/Delhaize, and comparisons using equivalent data in previous transactions, all provide a broadly similar estimate when applied to the Parties, and support the estimated benefits from increased scale.

16.182 We would also note that the scale analyses and comparisons with historical transactions would reflect the total variable cost benefits from increasing scale, including increases in buyer power, and improving efficiencies in the supply chain.

16.183 The Parties said that there were reasons why the purchasing synergies available in this Merger would be higher than for comparable transactions, in particular:⁹²⁹

- (a) Buying synergies account for a larger component of overall synergies in this merger than others;
- (b) The change in size of the firms in this transaction is significantly greater than some of the comparators (eg Sainsbury's/Argos);
- (c) Compared to other comparators (eg Tesco/Booker and Ahold/Delhaize), there will be much greater SKU overlap; and
- (d) Some of the comparators involve significant operational split between Europe and the US (eg Ahold/Delhaize).

16.184 With regard to the Parties' first point, we consider that the relatively large proportion of buying synergies compared to other transactions is primarily a result of the over-estimate produced by the Purchasing Synergies Analysis. Accordingly, we do not consider this a good reason in itself to consider that purchasing synergies would be higher than other transactions. Similarly, it is unclear why a larger transaction would necessarily result in a greater percentage saving of variable procurement costs. Indeed, the CC and CMA buying scale analyses appear to indicate that the benefits of increased scale become more modest at higher shares.

16.185 However, we agree with the Parties that considerations which affect the SKU velocity⁹³⁰ (eg as a result of higher SKU overlap, or greater levels of integration) could affect the expected level of procurement savings, and we therefore consider the effect of this below.

16.186 We consider that the post-Merger medium-term input prices, which would reflect the outcome of the negotiations with suppliers, are likely to be primarily determined by the increased buying scale of the Parties. There are likely to be other considerations which result in differences with individual suppliers or on individual products (eg the capability of specific buyers, the historical relationship, and the strategic aims of the businesses), but the total aggregated expected impact would reflect this structural change. This relationship was explored empirically, and in detail, during the CC market investigation and corroborated as still being relevant by our analysis in the

⁹²⁹ Parties' response to the Provisional Findings, paragraphs 203 and 253–255.

⁹³⁰ SKU velocity is equivalent to volumes per SKU.

context of investigating the buyer power theory of harm. Applying these savings to this case indicates an estimated benefit of £[redacted] to £[redacted].⁹³¹

16.187 However, there is the possibility that this analysis would overestimate the level of savings from the Merger. In particular, it is based on a comparison of companies which are integrated in terms of both their consumer-facing and operational perspectives (eg lowering logistics costs by using a single network). In contrast to this, the Parties are intending to maintain separate retail brands post-Merger, which would have the effect of reducing their effective purchasing scale (eg where the Parties maintain distinct propositions through having differentiated ranges and/or products and hence a lower SKU velocity).⁹³² In addition, the buying scale analysis is based on existing operations, and so does not reflect any delivery risk, or the potential for loss of counterfactual benefits,⁹³³ both of which are likely material given the sheer size of this Merger.⁹³⁴ Therefore, it is likely that the buying scale estimates are an overestimate of the likely benefits from the Merger.

16.188 The Parties noted that some of the comparators we have discussed (most notably Ahold/Delhaize) also maintained separate brands. We consider that this is consistent with our assessment that the estimated synergies based on the Ahold/Delhaize transaction would indicate a lower level of gross synergies than expected from the buying scale analysis.⁹³⁵

16.189 While we are not able to accurately quantify the effects of delivery risk, in particular the loss of benefits which exist in the counterfactual, there is some evidence that these could also be large. For example whilst the Parties submit that '[redacted]', Sainsbury's is currently targeting at least £500 million of cost savings in the next three years.⁹³⁶ This delivery risk (including the risk of loss of counterfactual savings) would effectively represent a risk borne by consumers, since if the Parties delivered a lower level of rivalry-enhancing efficiencies from the Merger, there would be an increased upward pressure on prices. We will therefore need to consider this effect as part of the judgement in the round.

⁹³¹ Paragraph 16.102 above.

⁹³² In the [Parties' response to the Provisional Findings](#), paragraph 333, the Parties state that "There should be no change to SKU velocity and no need to increase SKUs from the current range". This appears to misunderstand this point. We do not consider that SKU velocity (ie volumes per SKU) would be lower than today, but that it would be lower than an integrated business of equivalent size post-Merger.

⁹³³ See paragraph 16.195 below.

⁹³⁴ In particular, this Merger is substantially larger than the Parties' previous transactions as discussed in paragraph 16.177 above.

⁹³⁵ Based on mid-points of ranges.

⁹³⁶ [Sainsburys 2018 annual report](#), page 5.

16.190 We will therefore consider the overall scale of likely rivalry-enhancing efficiencies in paragraphs 16.219 to 16.225 below.

16.191 We note that we do not have a similar body of evidence to demonstrate the existence of, or quantum of, potential synergies in fuel and so we consider that we are unable to conclude that any rivalry-enhancing efficiencies would be likely to arise from the Merger in fuel.

Merger-specificity

16.192 Our working counterfactual is the prevailing conditions of competition, so we need to consider broad alternative approaches which the Parties may have used to access some or all of the efficiencies discussed above. From this, we can infer the level of efficiencies which are specific to this Merger.

Loss of efficiencies in the counterfactual

16.193 The Parties are continuing to optimise and improve their existing operations, including by looking to make cost savings where possible. For example, Sainsbury's is currently targeting at least £500 million of cost savings in the next three years.⁹³⁷

16.194 The Parties stated that the initiatives included in this target are business-as-usual improvements, the majority of which [X], and that benefits from harmonisation would be additional to these existing initiatives. In addition, the Parties noted that their intention to retain separate brands post-Merger would further limit potential interruptions to existing initiatives, and that they had a demonstrable track record of integrating acquisitions without disrupting existing cost-saving initiatives (eg in Sainsbury's/HRG and Asda/Netto).⁹³⁸

16.195 Even when well-managed, mergers are often disruptive to businesses and in particular where transactions are large (as in this case), there is a substantial risk that existing operations are affected. One potential impact of this is that the Parties (and their senior management in particular) may have less time to focus on their business-as-usual activities. This could be exacerbated by additional complexity associated with operating multiple distinct propositions (such as separate brands). This could result in a loss of savings which exist in the counterfactual, and so these should be removed from any benefits generated by the Merger.

⁹³⁷ [Sainsburys 2018 annual report](#), page 5.

⁹³⁸ [Parties' response to the Provisional Findings](#), paragraph 337-339.

16.196 Although the Parties appear to have been able to deliver some past mergers without clear evidence of loss of counterfactual efficiencies (although these losses are hard to prove),⁹³⁹ we note that, as discussed in paragraph 16.177 above, this Merger is substantially larger and hence more prone to these types of concerns due to the more extensive disruption to current commercial processes that would be involved.

Alternative approaches to achieving efficiencies

16.197 We consider that there may be other approaches whereby the Parties could replicate at least some of the synergies which are discussed above. In particular:

- (a) A buying alliance could reduce procurement costs.
- (b) A purchasing group could reduce the cost of purchasing, including allowing for any harmonisation of existing terms.
- (c) Other initiatives could provide the benefits of non-purchasing through contractual alternatives, such as introducing GM concessions in Asda, providing financial services from other third parties, etc.

16.198 Although we recognise that any of these approaches is more limited than a merger, and so would be expected to deliver lower financial benefits, we are aware of UK grocers using each of the above approaches (eg Tesco / Carrefour buying alliance, the Co-operatives using the Co-operative Federal Trading Service as a buying group, and various grocers including concessions within their larger stores). It is therefore possible that the Parties could use similar approaches to achieve some synergies which they are currently targeting through the Merger.

16.199 However, [redacted], and they both emphasised the difficulties and limitations of these approaches, particularly if they were to be undertaken with a competitor. We consider these points to be reasonable, and therefore consider that the vast majority of any synergies (and procurement synergies in particular) beyond those already being achieved would be merger-specific.

Incentivise the Parties to improve their customer offering in the relevant market(s)

16.200 As discussed in paragraph 16.7 above, in order to incorporate any synergies into the GUPPI analysis (as proposed by the Parties), these savings would

⁹³⁹ Parties' response to the Provisional Findings, paragraph 339.

need to incentivise the Parties to improve their proposition(s) in the relevant market(s).

16.201 The Parties assert that due to the level of competition present, they would invest [redacted] in improving their customer-facing proposition. They state that their track record (including following Sainsbury's acquisition of the Argos business) supports this.

16.202 Consistent with the economic principles in the GUPPI and our guidance, we consider that variable cost savings can be directly incorporated into the GUPPI as a downward pricing pressure, which would act to offset some or all of the incentives to increase prices as a result of loss of competition from the Merger. However, this principle would not apply to fixed cost savings, revenue synergies, or capital expenditure. The Parties appear to recognise these principles as well.⁹⁴⁰ Therefore, it is appropriate to only include variable cost savings as rivalry-enhancing efficiencies in the GUPPI threshold, and to assume that these would accrue evenly between the Parties (since the benefits of increased scale would affect similarly-sized companies equally).

Public statements

16.203 We note that the Parties have made a number of public statements which could impose conflicting incentives on their decisions on whether and where to invest any savings, and hence influence their future behaviour. In particular around the time the Merger was announced, the Parties stated that they would:

- (a) '[g]enerate net EBITDA synergies, post investments in price, across the enlarged group of at least £500 million';⁹⁴¹ ('the Shareholder Statement') and
- (b) 'expect to lower prices by c.10 per cent on many of the products customers buy regularly'.⁹⁴²

16.204 Following the publication of the Provisional Findings, the Parties made a number of additional public statements, which they describe as 'Public

⁹⁴⁰ [redacted].

⁹⁴¹ See: <https://www.about.sainsburys.co.uk/news/latest-news/2018/combination-of-j-sainsbury-plc-and-asda-group-limited>; <http://www.j-sainsbury.co.uk/~media/Files/S/Sainsburys/documents/reports-and-presentations/2018/preliminary-results-booklet-2017-18.pdf> slide 28, and

<https://www.londonstockexchange.com/exchange/news/market-news/market-news-detail/SBRY/13622801.html>

⁹⁴² See: <https://www.about.sainsburys.co.uk/news/latest-news/2018/combination-of-j-sainsbury-plc-and-asda-group-limited>

Commitments', and which effectively superseded the latter of the two statements above. In particular, they stated that they would:⁹⁴³

- (a) Deliver £1 billion of lower prices annually by the third year post-completion. Invest £300 million in the first year of the combination and a further £700 million over the following two years as the cost savings flow through. This would reduce prices by around 10% on everyday items;
- (b) Sainsbury's will cap its fuel gross profit margin to no more than 3.5 pence per litre for five years; Asda will guarantee its existing fuel pricing strategy; and
- (c) Sainsburys will move to pay small suppliers (turnover with the business of <£250k) within 14 days; Asda will continue to pay its small suppliers within 14 days, in line with existing commitments.

16.205 The Parties publicly stated that their pricing commitment would be independently reviewed by a third party and that they would publish their performance annually.⁹⁴⁴ They provided additional details that they would intend to appoint a large accounting firm to build on their existing SKU-by-SKU methodology of tracking price investment to create a formal reporting standard. The reporting would be for a minimum of three years, would be recorded as a public statement of intent, and that any failure to meet this commitment would be highly damaging to Parties' reputation, and to consumers' trust in them.⁹⁴⁵

16.206 During the response hearing, the Parties clarified that these Public Commitments were not intended to be remedies to any competition concerns identified, and that they were not intended to constitute a legally binding agreement which the CMA would subsequently monitor, although the Parties would be open to discussing the potential for including some form of legal foundation.

16.207 The Parties stated that although they are confident of their synergies estimate, if the final synergies delivered from the Merger ended up being lower, then their public commitment on price investment would take precedence over the public statement to shareholders (subject to reconfirmation of this position in the Class 1 circular; Sainsbury's expects that its shareholders will recognise the need for the Public Commitments given the rationale of the transaction).

⁹⁴³ <https://www.about.sainsburys.co.uk/news/latest-news/2019/19-03-19-post-merger-commitments>.

⁹⁴⁴ <https://www.about.sainsburys.co.uk/news/latest-news/2019/19-03-19-post-merger-commitments>.

⁹⁴⁵ Parties' response to the Provisional Findings, footnote 3.

Effect of public statements

16.208 We consider that the Parties' public statements do not alter the buying power of the Parties or provide other additional mechanisms to produce a greater level of cost savings. Even if they demonstrated the convictions of the Parties, the risk remains that these estimates were 'unduly optimistic'. We therefore consider that the public statements do not provide us with any additional certainty that a particular quantum of efficiencies would arise from the Merger. However, these statements could have an effect on what the Parties would choose to do with any savings which are generated (eg whether they choose to reinvest them in the business or pay them out to shareholders).

16.209 The Shareholder Statement represents a commitment to shareholders, which the Parties described as 'a 'hard' and publicly-announced number' and which they considered to be 'a 'fixed' promise that should not vary regardless of what proportion this ultimately was of the gross synergies total'. The Parties also noted that although the Merger was not subject to the Takeover Code and so did not require a Quantified Financial Benefits Statement, it was considered prudent to apply the same protocols '[~~§~~]'.

16.210 As a Class 1 transaction, the Merger is dependent on receiving the support of Sainsbury's shareholders. The Parties' statement regarding the expected level of synergies which would be expected to accrue to shareholders would be included in the Class 1 circular which would be sent to all shareholders prior to any vote. This represents formal guidance to shareholders and the financial markets regarding the expected outcome of the Merger. Class 1 circulars are used by shareholders when considering whether to support the transaction, as well as financial analysts and others to produce forecasts of profitability and associated financial metrics associated with the Merger which affect the current and future share price. Management would be held to account against this statement and the associated directly-observable consequential (eg increased earnings per share, returns on invested capital),⁹⁴⁶ with implications for the Parties' share price and associated derivatives (such as the incentive schemes for senior employees). The Parties themselves highlight that shareholders and investors are 'well-informed' and have 'hundreds of millions of pounds at stake'.

⁹⁴⁶ These are the metrics which Sainsbury's included in its announcement of the Merger (<https://www.about.sainsburys.co.uk/news/latest-news/2018/combination-of-j-sainsbury-plc-and-asda-group-limited>) although different shareholders would be likely to also use additional financial measures to assess the outcome of the Merger.

16.211 In addition to the above, we note that any incentives arising from the Shareholder Statement are likely to be aligned with the Parties' ultimate economic incentive to maximise profit for shareholders.

16.212 The nature and implications of the Public Commitments, and in particular the commitment around price investment, are less clear.⁹⁴⁷

16.213 The Parties' incentives to invest in price (ie reducing prices with the expectation of increasing profits through higher sales) may be aligned with their broader economic incentive to maximise profits, as is generally the case for variable cost savings (as discussed above). When considering any potential additional effects of the Public Commitments, we have assessed these in the same way as we would assess behavioural remedies as this can assist in coming to a view on their potential effect, although we note the Parties' position that these Public Commitments are not presented as remedies to solve the SLCs. This comparison reveals a large number of risks which are common to other behavioural interventions, in particular:

- (a) **Specification risk:** In order to have the intended effect, the commitment would need to be accurately specified to provide an effective basis for monitoring and compliance, as discussed below. The Parties' Public Commitments in this regard are brief and high level, such that defining compliant behaviour appears problematic. For example, it is unclear whether the commitment applies to all products or only a subset (as was indicated in the Parties' previous public statement around 'many of the products customers buy regularly') and whether any controls exist around non-price factors (eg product weights and quality measures). The practical implications of this are likely to be significant, as it would likely involve the future prices (and potentially other characteristics) of many thousands of different products.
- (b) **Circumvention risk:** Even if the Public Commitments were clearly specified, there is a substantial risk that the Parties would be able to circumvent their effects. For example, the Parties could change their range more frequently than in the counterfactual since the introduction / removal of SKUs would effectively "reset" the baseline price against which investment would need to be measured, and so could avoid or reduce the extent of any actual price reductions.

⁹⁴⁷ The Parties highlighted that the Class 1 circular would also include statements that Sainsbury's management believes there are gross synergies of £1.6 billion, and that at least £1 billion of those synergies will be used to deliver £1 billion of lower prices annually by the third year post-completion, consistent with the Parties' public announcement of 19 March 2019.

- (c) **Distortion risk:** If the Parties sought to remain compliant with their Public Commitments, they may choose to make sub-optimal decisions resulting in negative distortions in the market(s). For example, when considering a trade-off between product quality and price, they may choose to degrade the quality of products in order to reduce prices and hence increase the apparent level of investment.
- (d) **Ability to monitor:** Although the Parties have proposed to appoint an independent company to monitor compliance with their Public Commitments, numerous issues remain. Most significantly, the Parties have not explained how they would be able to set counterfactual prices against which price investment would be measured, since there could be numerous external reasons for changes in prices (eg input price changes / shocks, foreign exchange fluctuations, BAU efficiency improvements, product changes, etc) which would presumably need to be distinguished from price reductions in fulfilment of the commitment.
- (e) **Ability to enforce:** The Parties' current proposals have no specific enforcement mechanism, instead relying on the potential response of consumers to any breach (ie damage to the Parties' reputation and consumers' trust in them).⁹⁴⁸ While we have no doubt that the Parties are highly concerned about maintaining a good reputation with their customers, there are many intermediary steps that would need to take place before this type of reaction would be likely to result in any economic harm to the Parties (eg the need for public/customer awareness of a breach, time delays between reporting, clarity of reporting, and the expectation that sufficient customers would change their behaviour in order to 'punish' the Parties for breaching these commitments). Furthermore, there is no legal mechanism to enforce against future breaches of the Public Commitments. In effect, if the Parties decided that ignoring the Public Commitments was worth the (potentially short-term) public response, there would be no action available to require future compliance.
- (f) **Time limitations:** The Public Commitments (and the pricing commitment in particular) are time-limited, while the structural changes in the market resulting from the Merger are permanent. Therefore, there is no guarantee (or even likelihood) that the Parties would continue any price investment following the expiration of the commitment.

⁹⁴⁸ [Parties' response to the Provisional Findings](#), footnote 3.

- 16.214 If the Parties were to make their Public Commitments legally binding, concerns around enforcement would be partially addressed, but the other concerns would remain. In addition, this would result in the CMA (or another organisation) effectively regulating grocery pricing (or a large subset of grocery pricing), which we do not consider to be a desirable outcome from this merger enquiry.
- 16.215 Similar issues to these would arise with the Public Commitments around fuel, for example it would likely be difficult to monitor Asda's continued adherence to 'its existing fuel pricing strategy' given the current use of judgement applied when it set its PFS prices.
- 16.216 Given the significant issues identified above, we have not sought to translate these Public Commitments into a formal mechanism for ensuring pass-through of cost savings. Instead, we have considered any effects they may have in their current form.
- 16.217 More broadly, we note that if a non-binding public commitment were to be accepted as sufficient to guarantee benefits accruing to customers, then this would risk undermining the UK merger-control regime. Regardless of the level of competition concerns which would arise from a merger, the merging companies could simply make a public commitment to reduce their prices by an equivalent amount, and argue that these represented sufficiently large rivalry-enhancing efficiencies (or Relevant Customer Benefits) to outweigh the associated harm. There would be no guarantee that all (or any) of these benefits would arise and/or be passed on to customers, and no recourse if they did not. It would therefore be reckless to consider a non-binding promise to reduce prices in the future as sufficient to outweigh significant competition concerns, in the absence of compelling evidence which would support the likelihood of this actually occurring.
- 16.218 We therefore consider that the overall effect of the public statements may be to have placed some incentives on the Parties to ensure a minimum return to shareholders in the short/medium-term (eg the next three years), although it is unclear exactly what the impact of this would be. It is difficult to assess the actual impact of the Public Commitments, and for the reasons set out above we place very limited weight on them in this context.

Conclusion on efficiencies

- 16.219 We have considered the potential for rivalry-enhancing efficiencies from the Merger, and the extent to which these efficiencies would act as a countervailing factor to prevent SLCs from arising. Consistent with the Parties' proposals, we have sought to incorporate these efficiencies in a

quantitative fashion in the GUPPI analysis, in order to test the extent to which these efficiencies would be sufficient to outweigh any competition concerns which would arise from the Merger in their absence.

- 16.220 In order to include any benefits from rivalry-enhancing efficiencies in a quantitative fashion, we require some form of quantitative measure of their scale. In this case having conducted a full assessment of the evidence submitted by the Parties, we have serious concerns with the methodology used and the efficiency figures calculated in the Purchasing Synergies Analysis and are unable to place any significant weight on them. We nevertheless consider that, taking all the available evidence in this case in the round, there would likely be some degree of rivalry-enhancing efficiencies.
- 16.221 Given the information asymmetry which exists in relation to potential synergies, it is often difficult or impossible for the CMA to independently produce reliable estimates for the potential synergies in a merger. However, we consider that, exceptionally in this case, there is a body of other evidence available to us which is informative of the degree of procurement savings in grocery and GM and which in the round provides a good basis for our estimate of the efficiencies likely to arise as a result of the Merger.
- 16.222 In these circumstances, the best evidence we have available to estimate the likely scale of procurement synergies (and hence the variable cost savings) arising from the Merger are the figures derived from the assessment of increased buying scale, supported by the comparisons with historical transactions.
- (a) Applying the estimated savings from increased scale to this case indicates a potential saving of £[~~£~~] to £[~~£~~].⁹⁴⁹
 - (b) The estimate implied by a comparison with the announced gross synergy estimates in Ahold/Delhaize (ie £[~~£~~]), indicates that the most likely outcome is towards the bottom of the range indicated by increased buying scale, consistent with the loss of effective scale from maintaining separate propositions and operations.⁹⁵⁰
 - (c) Despite being potential over-estimates and noting our concerns about the comparability of some transactions, sense-checks based on the average savings from other comparable transactions are also consistent with these

⁹⁴⁹ Paragraph 16.102 above.

⁹⁵⁰ Paragraph 16.80 above.

estimates (£[X]) based on a comparison of percentage saving on matched spend,⁹⁵¹ and £[X] based on a comparison of baseline spend).⁹⁵²

16.223 Based on the evidence available, and the specific circumstances in this case, we conclude that the appropriate figure to consider as rivalry-enhancing efficiencies in this case is £500 million.⁹⁵³ We note that, although we did not place weight on the Parties' estimates, this would represent around 70% of the sensitised purchasing synergies produced by [the third party] (£729 million).⁹⁵⁴

16.224 We will therefore include the downward pricing pressure effects of £500 million of rivalry-enhancing efficiencies in any GUPPI thresholds used to inform the quantitative incentives analysis for instore and online groceries.⁹⁵⁵

16.225 We note that we do not have sufficient evidence to support the existence of rivalry-enhancing efficiencies in fuel. Therefore, we make no contribution to the fuel GUPPI threshold in this regard.

17. Conclusions

17.1 For the reasons set out in the preceding chapters, the Inquiry Group appointed to consider this reference has made the following findings on the statutory questions it has to decide pursuant to [section 36\(1\)](#) of the Act:

- (a) arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and
- (b) the creation of that situation may be expected to result in an SLC in the UK in the following respects:
 - (i) The retail supply of groceries in both Sainsbury's and Asda supermarkets on a national basis, ie in every local area in which one or both of the Parties are present.

⁹⁵¹ Paragraph 16.83 above.

⁹⁵² Paragraph 16.84 above.

⁹⁵³ We note that, as discussed in footnote 882, this excludes any purchasing efficiencies which might arise in Argos, which we also exclude from the incentives analysis more generally (eg the revenue used to convert this figure to a downward pricing pressure).

⁹⁵⁴ The third party figure includes purchasing benefits associated with Argos which we have excluded from our incentives analysis. Accordingly, the actual difference between these figures is smaller than a simple comparison would indicate.

⁹⁵⁵ We note that this figure includes rivalry-enhancing efficiencies expected to be generated by instore grocery, online grocery, and GM (excluding Argos). We would intend to apply the same contribution to GUPPI thresholds across these different products, which is equivalent to allocating based on revenue (since the downward pricing pressure is equal to efficiencies / revenue).

- (ii) The retail supply of groceries in supermarkets on a local basis in 537 of the local areas in which both Parties are present.
- (iii) The retail supply of groceries in Asda convenience stores on a national basis, ie in every local area in which an Asda convenience store is present.
- (iv) The retail supply of groceries in convenience stores on a local basis in 18 of the local areas in which both Parties are present.
- (v) The retail supply of online delivered groceries for Sainsbury's and Asda on a national basis, ie in every delivery area served by one or both of the Parties, as a result of the effects identified on a national basis in in-store groceries.
- (vi) The retail supply of online delivered groceries for Asda customers on a national basis, ie in every delivery area served by Asda, as a result of a national reduction in competition between the Parties' online offerings.
- (vii) The retail supply of online delivered groceries for Asda customers on a local basis in 143 delivery areas served by both Parties.
- (viii) The retail supply of online delivered groceries on a local basis through coordinated effects in 108 delivery areas served by both Parties.
- (ix) The retail supply of fuel on a local basis in 127 of the local areas in which both Parties operate PFSs.

17.2 We have set out lists of all the local markets in which we are finding an SLC on a local basis in Appendix N.

18. Remedies

Introduction

18.1 Having concluded that the Merger may be expected to result in an SLC we are required to decide what, if any, action should be taken to remedy, mitigate or prevent that SLC or any adverse effect resulting from the SLC.⁹⁵⁶

⁹⁵⁶ The Act, [section 36](#).

18.2 This chapter considers possible remedies to the SLCs that we have identified and their resulting adverse effects.

Criteria for selection of remedies

18.3 In deciding on a remedy, the Act requires that the CMA shall in particular 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.⁹⁵⁷

18.4 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.

18.5 The CMA will seek to ensure that no remedy is disproportionate in relation to the SLCs and their adverse effects.⁹⁵⁸

Nature of the SLCs

SLC findings

18.6 We have found that the Merger may, on the balance of probabilities, be expected to result in an SLC in the UK in the respects set out in paragraph 17.1 above.

Parties' submissions regarding remedies

18.7 We received representations from the Parties on the Notice of Possible Remedies (the Remedies Notice),⁹⁵⁹ the Provisional Findings⁹⁶⁰ and the working paper on possible remedies (the Remedies Working Paper).⁹⁶¹ The Parties' view was that the number of SLCs identified by us was the result of a 'flawed analysis'.⁹⁶² Their view of the scale of SLCs and on the approach to remedies that would be necessary to address those SLCs is significantly different from our view.

⁹⁵⁷ The Act, sections [35\(4\)](#) and [36\(3\)](#).

⁹⁵⁸ [Merger remedies \(CC8\)](#), paragraph 1.7. This was adopted by the CMA board. The CMA adopted new merger Remedies Guidance on 13 December 2018 ([Merger remedies \(CMA87\)](#)), which applies to merger investigations commenced after that date. However, for investigations that commenced prior to 13 December 2018, the previous Remedies Guidance remains applicable. In this case the CMA is therefore applying [CC8](#).

⁹⁵⁹ [Remedies Notice](#) (20 February 2019).

⁹⁶⁰ [Provisional Findings](#) (20 February 2019).

⁹⁶¹ [Parties' response to the Remedies Notice](#); [Parties' response to the Provisional Findings](#).

⁹⁶² [Parties' response to the Remedies Notice](#), paragraph 1.3.

- 18.8 The Parties disagreed with the approach that we took in the Remedies Working Paper, which was based on those SLCs identified in our Provisional Findings, and which also considered the remedy options proposed by the Parties and other third parties. The Parties commented that the fact that our Remedies Working Paper focused only on the SLCs identified in the Provisional Findings ‘precluded any meaningful engagement’. They considered that ‘our conclusions regarding the effectiveness of their proposed remedy package did not therefore address the question of whether it would be an effective remedy to the SLCs that may ultimately be identified’.
- 18.9 The Parties also considered that the approach to divestiture remedies set out in the Remedies Notice was ‘entirely disproportionate’ and ‘the scope of the conditions imposed was unworkable and effectively equivalent to prohibition’.⁹⁶³

Remedy options

- 18.10 In this chapter we assess the extent to which potential remedies would be effective in addressing the SLCs we have found.
- 18.11 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. The scale and scope of the SLCs that we have identified in this Final Report are similar to those set out in the Provisional Findings⁹⁶⁴ and the Remedies Working Paper, and fundamentally different to those alternative SLCs that the Parties submitted and for which they proposed a remedy.
- 18.12 In the Remedies Working Paper we set out two potential structural remedies:
- (a) prohibition of the Merger; or
 - (b) divestiture to a suitable party (or parties) of assets and operations sufficient to address effectively each of the SLCs identified.
- 18.13 Our initial view, as set out in the Remedies Notice, was that a behavioural remedy would not be an effective remedy to the SLCs or any resulting adverse effects that we found. We said that the number of SLCs, the existence of SLCs in in-store groceries, online delivered groceries and fuel,

⁹⁶³ [Parties’ response to the Remedies Notice](#), paragraph 2.6.

⁹⁶⁴ [Provisional Findings](#) (20 February 2019).

and the complexity of the Parties' operations may make a behavioural remedy or remedies that addressed all these aspects impractical.⁹⁶⁵

18.14 In the rest of this chapter, we set out four potential remedy options. We first assess the effectiveness of these options, with a particular focus on the effectiveness of the two potential structural remedies. We then move on to considering Relevant Customer Benefits (RCBs) and proportionality before deciding on the appropriate remedy in this case.

Effectiveness of remedy options

18.15 The following sub-section assesses the effectiveness of four remedy options:

- (a) prohibition of the Merger;
- (b) the divestiture remedy proposed by the Parties in their response to the Remedies Notice;⁹⁶⁶
- (c) an alternative divestiture remedy; and
- (d) behavioural remedies.

Prohibition

Description

18.16 Prohibition of the Merger would prevent any combination of the Parties' businesses, with Asda and Sainsbury's continuing to operate under separate ownership as independent competitors. This could be effected by accepting undertakings under section 82 of the Act⁹⁶⁷ or making an Order under section 84 of the Act,⁹⁶⁸ prohibiting the current transaction and preventing the Parties from attempting to merge for a further period (our normal practice would be to prevent a future merger within the next ten years, absent a change of circumstances).⁹⁶⁹

⁹⁶⁵ Remedies Notice, paragraph 48.

⁹⁶⁶ Parties' response to the Remedies Notice.

⁹⁶⁷ The Act, section 82.

⁹⁶⁸ The Act, section 84.

⁹⁶⁹ See *Groupe Eurotunnel S.A./SeaFrance S.A. Merger Inquiry Order 2014*, paragraph 12.13 'Prohibition Period'; *Royal Bournemouth and Christchurch Hospitals NHS Foundation Trust/Poole Hospital NHS Foundation Trust merger inquiry undertakings*, paragraph 1.1; *Intercontinental Exchange, Inc./Trayport Merger Inquiry Order 2017 No. 2*, paragraph 9.1; and *Akzo Nobel N.V./Metlac Holding S.R.L merger inquiry undertakings*, paragraph 10 'Prohibited Period'. This practice is consistent with the CMA's approach to prohibiting the reacquisition of divested assets for a period, generally sunset at ten years, described in paragraph 3.8 of *CC8* (and reflected in paragraph 5.10 in *CMA87*).

Views of interested parties

Parties' views

- 18.17 The Parties accept that prohibition would comprehensively and effectively address the SLCs identified and any adverse effects.⁹⁷⁰
- 18.18 However, the Parties submitted that prohibition would be 'disproportionately costly and intrusive'.⁹⁷¹ This view on proportionality partly reflects their differing interpretation of the necessary scale and nature of, and approach to, an appropriate divestiture remedy. The Parties' view, informed by the significantly lower number of SLCs that they consider to be correct, is that the loss of RCBs resulting from prohibition should lead the CMA to implement a remedy other than prohibition.⁹⁷²

Third parties

- 18.19 [Supplier F] commented that in its view, prohibition would be the most effective remedy.⁹⁷³ It also highlighted the risk of a failed divestiture remedy, citing a recent US precedent – Albertsons/Safeway.⁹⁷⁴
- 18.20 GMB Union commented that the Merger was 'incredibly damaging' and the only rational response from the CMA was 'to stop it from going ahead'.⁹⁷⁵

Conclusion on the effectiveness of prohibition

- 18.21 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 arising in any relevant market. Given this, prohibition would represent an effective and comprehensive solution to all of the SLCs identified by the CMA and consequently prevent any resulting adverse effects.

⁹⁷⁰ [Parties' response to the Remedies Notice](#), paragraph 2.2.

⁹⁷¹ [Parties' response to the Remedies Notice](#), paragraph 2.2.1.

⁹⁷² [Parties' response to the Remedies Notice](#), paragraph 2.2.1.

⁹⁷³ [Supplier F response to the Provisional Findings and the Remedies Notice](#), paragraph 1.7.

⁹⁷⁴ [Supplier F response to the Provisional Findings and the Remedies Notice](#), paragraphs 6.2–6.4 and 7.3.

⁹⁷⁵ [GMB Union response to the Provisional Findings and the Remedies Notice](#), paragraph 10.

Remedy package proposed by the Parties

Description

Overview of proposed remedy package

- 18.22 As mentioned in paragraph 18.8 above, the Parties outlined an alternative set of SLCs, substantially lower in number and extent than those that we find, that they considered would arise from the Merger. These comprised 182 SLCs for in-store groceries, 19 SLCs for convenience stores, and 38 SLCs for PFSs.⁹⁷⁶ This alternative set of SLCs also included 11 SLCs in online markets,⁹⁷⁷ although at the Response Hearing (and in the response to the Remedies Working Paper) the Parties said that further calculations had reduced this to zero. The Parties derived their alternative SLCs by applying higher GUPPI thresholds of 5% for in-store and online delivered groceries and a diversion ratio of 40% for PFS.⁹⁷⁸
- 18.23 To remedy this alternative set of SLCs, the Parties proposed a divestiture remedy comprising 125–150 stores, potentially a number of convenience stores sufficient to remedy the 19 SLCs they identified in those markets, and a number of PFSs to remedy the 38 SLCs they identified in those markets.⁹⁷⁹
- 18.24 The Parties' approach to remedies (ie redefining the problem for which remedies are required, rather than addressing the CMA's Provisional Findings as published⁹⁸⁰) limits the extent to which we were able to extrapolate their views on various points of principle on which we sought views. For example, the extent to which remedies of SLCs arising from our local assessment can remedy the SLCs arising from our national assessment (ie those SLCs that relate to nationally-uniform parameters, and which have been identified in every local area in which one or both the Parties are present), the scale of divestiture that would be needed to achieve an effective solution, and the potential need for a brand divestiture. Throughout this chapter, therefore, when we refer to the Parties' remedies proposals, these significant caveats regarding their potential effectiveness apply.
- 18.25 In addition to their proposed remedies package, the Parties made, and publicly announced, a number of 'Public Commitments', namely to invest £1 billion annually in lower prices across the Parties' combined businesses

⁹⁷⁶ Parties' response to the Remedies Notice, page 3.

⁹⁷⁷ Parties' response to the Remedies Notice, page 3.

⁹⁷⁸ Parties' response to the Remedies Notice, page 3.

⁹⁷⁹ Parties' response to the Remedies Notice, paragraphs 1.8 and 4.4.

⁹⁸⁰ Provisional Findings (20 February 2019).

by the third year following completion of the Merger (relative to an undefined future price level), with £300 million invested in the first year post completion, prior to the synergies being realised; to implement a margin cap on Sainsbury's fuel prices, to maintain the existing Asda fuel pricing strategy and for Sainsbury's to move to pay smaller suppliers promptly (ie within 14 days) (Asda to continue to pay its small suppliers within 14 days, in line with existing commitments).⁹⁸¹ The Parties confirmed that the purpose of these commitments is not to address the SLCs and therefore we do not consider them further in this context.

18.26 In the context of their proposed remedies package to address their alternative proposed SLC findings, the Parties submitted that:

(a) 'Divestments designed to address SLCs at a local level will remove all competition concerns ultimately identified (whether at the local or national level)'.⁹⁸²

(b) No additional supporting assets would be required to be included in the divestiture package. Among other reasons, this was because potential purchasers that already operate in the retail sector would have the necessary supporting infrastructure and systems to operate additional stores. The Parties also offered to put in place transitional service arrangements to allow a new entrant time to put in place the necessary infrastructure and systems.⁹⁸³

(c) It would be disproportionate for the Parties to be required to sell additional assets to enable a purchaser to exploit economies of scale or density in purchasing or distribution.⁹⁸⁴

18.27 The Parties also submitted that they should be allowed to select the stores to be included in the divestiture package.⁹⁸⁵ They cited a number of reasons for this:

(a) Previous cases and guidance that the CMA can allow mix-and-match 'in appropriate cases'.

⁹⁸¹ [Parties' response to the Remedies Notice](#), paragraph 4.6 and [Sainsbury's and Asda commit to £1 billion of grocery savings and fuel cap](#) (19 March 2019).

⁹⁸² [Parties' response to the Remedies Notice](#), paragraph 3.1.

⁹⁸³ [Parties' response to the Remedies Notice](#), paragraph 5.8.

⁹⁸⁴ [Parties' response to the Remedies Notice](#), paragraph 5.10.

⁹⁸⁵ [Parties' response to the Remedies Notice](#), paragraphs 5.13–5.21.

- (b) That they should be allowed to choose how best to remedy an SLC in a given area and that it would be disproportionate, restrictive and add cost and complexity were the CMA to select which store should be divested.
- (c) Asda's view (expressed in its Response Hearing) was that purchasers would act as a safeguard as they would not be interested in stores that were underperforming. Sainsbury's also argued that prospective purchasers who were existing operators would prefer mix-and-match as it would enable them to select the assets that best fitted with their existing portfolios.
- (d) That, in the Parties' view there are not major composition risks – 'irrespective of its present branding and operator, a grocery store is fundamentally a grocery store'.
- (e) Allowing mix-and-match would increase flexibility if the purchaser were to be an operator with existing assets that potentially competed in the same local area as one of the Parties' stores, or if a store divestiture would solve more than one SLC if purchased by a particular purchaser, whereas more than one would be required if that purchaser were to choose not to purchase.

Proposed divestiture of stores to remedy in-store supermarket and convenience store SLCs

18.28 Within in-store groceries, the Parties' alternative findings identified SLCs in 182 local markets for supermarkets and 19 local markets for convenience stores.⁹⁸⁶ In our Final Report we identify 1,239 SLCs in local markets for supermarkets arising from our national assessment, and 537 SLCs on the basis of our local assessment. We identify 59 SLCs in local markets for convenience stores arising from our national assessment, and 18 SLCs on the basis of our local assessment.

18.29 The Parties said that a remedy would not be required for convenience stores as the divestiture of supermarket stores would remedy SLCs in each local area and therefore nationally. Moreover, without a national SLC in supermarkets there could be no concern in regard to pricing of items at convenience stores as Asda follows a single price file.⁹⁸⁷ However, they said

⁹⁸⁶ Parties' response to the Remedies Notice, page 3.

⁹⁸⁷ Parties' response to the Remedies Notice, paragraph 5.4.

that they would be prepared to divest assets to remedy remaining convenience SLCs based on a 'more reasonable' GUPPI threshold.⁹⁸⁸

- 18.30 The Parties proposed 'to divest one or more stores, such that each revised in-store SLC no longer raises an expectation of an SLC to the balance of probabilities standard', each store being sold to a suitably qualified purchaser or purchasers.⁹⁸⁹ As noted above, they proposed that they would be able to choose which stores were included, provided the GUPPI level in the local area was brought below the decision-rule threshold.
- 18.31 In response to the Remedies Notice, the Parties did not specifically address whether a single purchaser was required for the whole divestiture package, [X]. In its Response Hearing, Sainsbury's confirmed that it did not believe that a single purchaser should be required. The Parties presented a number of scenarios, [X]. In their view there was also no reason for purchasers to offer similarly integrated multi-channel operations to those of the Parties as the Parties have numerous single channel competitors.⁹⁹⁰
- 18.32 The Parties said that supermarkets and PFSs can operate on a standalone basis, and they therefore do not consider that divestiture of a store to remedy a local in-store grocery SLC would also require divestiture of its accompanying PFS, or vice versa.⁹⁹¹ In the Response Hearing, Sainsbury's said that [X].

Proposed divestiture of assets to remedy online grocery SLCs

- 18.33 Within online groceries, the Parties' alternative findings identified SLCs in 11 local markets.⁹⁹² At the Response Hearing, this number was further reduced to zero. In our Final Report we identify 531 SLCs in local markets as a result of the effects identified on a national basis in in-store groceries. We also identify 286 SLCs in local markets for the supply of online delivered groceries in which Asda is present. Furthermore, we identify 143 SLCs in local markets arising from our local assessment of unilateral effects and 108 SLCs in local markets arising from our local assessment of coordinated effects.
- 18.34 In their response the Parties did not propose a remedy to the 11 SLCs that they identified. Rather, they stated that they fundamentally disagreed with our

⁹⁸⁸ [Parties' response to the Remedies Notice](#), paragraph 5.6.

⁹⁸⁹ [Parties' response to the Remedies Notice](#), paragraphs 5.1 and 5.7.1.

⁹⁹⁰ [Parties' response to the Remedies Notice](#), paragraphs 2.7 and 2.8.

⁹⁹¹ [Parties' response to the Remedies Notice](#), paragraphs 7.9–7.14.

⁹⁹² [Parties' response to the Remedies Notice](#), paragraph 1.7.

Provisional Findings with respect to the supply of online groceries and remained of the view that online delivered and in-store groceries compete in the same market and should not require separate remedies.⁹⁹³ The Parties considered our assessment of online grocery retailing to be fundamentally flawed and rejected the possible need for a brand/website divestiture.

- 18.35 The Parties further submitted that, should we conclude that there is a separate online market, we should use our discretion under section 36(2) of the Act⁹⁹⁴ to decide not to require remedies. They cited the CMA's Remedies Guidance⁹⁹⁵ giving the CMA the discretion not to impose a remedy in exceptional circumstances where the costs of a remedy are disproportionate to the scale of the SLC and its adverse effects. In this case, the Parties believed that a remedy would be disproportionate, as requiring the divestiture of physical stores to remedy online SLCs would deprive a considerably larger number of in-store consumers at those stores of RCBs.⁹⁹⁶
- 18.36 In its Response Hearing, Sainsbury's commented that any local online SLC would be remedied by selling the supply point, thus enabling a competitor to supply online. They rejected the view that customers were unlikely to move from a branded website as not being relevant to bringing in new competition, in their view this was sufficiently addressed by having more competitors able to supply online in that area.

Proposals to address fuel (PFS) SLCs

- 18.37 The Parties' alternative findings identified SLCs in 38 local markets.⁹⁹⁷ In our Final Report we identify 127 SLCs in local markets in fuel.
- 18.38 The Parties do not agree that a PFS should automatically be divested alongside a store where a store divestment is required, citing the CMA's Remedies Guidance⁹⁹⁸ which indicates that the CMA seeks to identify the smallest viable standalone business in establishing an appropriate divestiture package. They believe that it would be viable to operate a PFS separately from a store.⁹⁹⁹

⁹⁹³ [Parties' response to the Remedies Notice](#), paragraphs 1.4 and 6.1.

⁹⁹⁴ The Act, [section 36\(2\)](#).

⁹⁹⁵ [CC8](#), paragraph 1.12.

⁹⁹⁶ [Parties' response to the Remedies Notice](#), paragraphs 6.2–6.5.

⁹⁹⁷ [Parties' response to the Remedies Notice](#), page 3 and paragraphs 4.4.2 and 7.2.

⁹⁹⁸ [CC8](#), paragraph 3.7.

⁹⁹⁹ [Parties' response to the Remedies Notice](#), paragraph 7.10.

- 18.39 The Parties do not accept that a PFS and a store on the same site where both give rise to SLCs should necessarily require divestiture to the same purchaser.¹⁰⁰⁰
- 18.40 In the Response Hearing the Parties told us that [REDACTED].
- 18.41 The Parties said that, in order to retain an effective competitive constraint, any PFS divested on a standalone basis to a non-supermarket purchaser would need to be operated on a high volume/low price model. In order to encourage this, the Parties proposed that a subsidy of [REDACTED]ppl of fuel sold would be paid to such a purchaser for the duration of the site lease or for a period of [REDACTED] years after sale of a freehold. This subsidy would replicate the halo effect of fuel sales on grocery sales and would provide an incentive (but not an obligation) for the purchaser to operate a similar pricing strategy to the Parties.¹⁰⁰¹

Proposals in relation to purchaser suitability

- 18.42 In the context of the alternative SLCs they proposed, the Parties considered that the criteria for determining suitable purchasers should follow our Remedies Guidance.¹⁰⁰² They cited previous cases where retailers at varying levels of scale could operate as effective competitors and so should be considered as suitable purchasers. Other retailers, including discounters and suitably qualified new entrants, should be considered as suitable purchasers.¹⁰⁰³
- 18.43 The Parties also said that PFSs could be operated profitably as single sites or in small groups, and that oil majors and independent forecourt operators would be suitable purchasers.¹⁰⁰⁴

Proposals in relation to the divestiture process

- 18.44 The Parties said that store divestitures were commonplace in this industry and that we should not impose any specified divestiture period, but that if a period was imposed it should be no less than six months.¹⁰⁰⁵

¹⁰⁰⁰ Parties' response to the Remedies Notice, paragraph 5.12.

¹⁰⁰¹ Parties' response to the Remedies Notice, paragraphs 7.4–7.6.

¹⁰⁰² See CC8.

¹⁰⁰³ Parties' response to the Remedies Notice, paragraph 8.1–8.8.

¹⁰⁰⁴ Parties' response to the Remedies Notice, paragraph 8.4.

¹⁰⁰⁵ Parties' response to the Remedies Notice, paragraph 9.1.

- 18.45 The Parties agreed with the proposition in the Remedies Notice¹⁰⁰⁶ that up-front buyers should be required before the Merger could complete. However, they said that completion should be conditional on purchasers becoming contractually committed rather than on the closing of the divestiture.¹⁰⁰⁷
- 18.46 The Parties said that they would continue to be incentivised to continue to invest in the divestiture assets in the period before completion, and that neglecting them or running them down would be damaging to their brands.¹⁰⁰⁸

Our assessment of the Parties' proposal

- 18.47 As discussed in paragraph 18.22, the Parties have proposed a divestiture remedy, which they believe to be effective, for a significantly smaller number of SLCs than we have identified. They have not made a specific submission on whether this remedy would address SLCs of the scale identified in the Provisional Findings¹⁰⁰⁹ or this Final Report. However, as discussed in paragraph 18.66 below, the Parties were clear at the Response Hearings that, for divestitures of a scale consistent with the SLC findings in the Provisional Findings, there was no commercially acceptable solution and this would be 'unremediable'. They further stated that 'there is no point in discussing a major divestment plan, it is not going to happen'.
- 18.48 Our duty is to remedy the SLCs that we find, on the basis of our analysis of the evidence, rather than those proposed to us by the Parties or third parties. Our Final Report sets out our conclusions on the extent to which the Merger gives rise to SLCs and identifies the specific markets in which we consider a remedy would be needed. We have therefore assessed the effectiveness of the Parties' proposal by reference to the SLCs identified in the Final Report, rather than by reference to an alternative, much smaller set of SLC findings.
- 18.49 It is clear that the remedies proposed by the Parties do not represent a comprehensive or effective solution to the SLCs that we have identified. This is because:
- (a) They only address a small proportion of the SLCs we have identified in in-store and online delivered groceries (whether arising from our national or local assessments).

¹⁰⁰⁶ Remedies Notice (20 February 2019).

¹⁰⁰⁷ Parties' response to the Remedies Notice, paragraphs 9.4 and 9.5.

¹⁰⁰⁸ Parties' response to the Remedies Notice, paragraph 9.7.

¹⁰⁰⁹ Provisional Findings (20 February 2019).

- (b) They do not seek to address in any way the SLCs we have identified on the basis of coordinated effects in online delivered groceries.
- (c) They only address a small proportion of the SLCs in local markets we have identified in relation to PFSs.
- (d) In the areas that are addressed, they are based on reducing GUPPI thresholds below a certain level, rather than comprehensively remedying the SLC by removing the overlap or otherwise restoring pre-merger conditions of competition (see paragraphs 18.72 to 18.79 below).

18.50 We noted the Parties' submissions on issues of principle and practicality such as purchaser suitability, inclusion of additional assets within the divestiture package and whether to allow a mix-and-match divestiture. However, these submissions were made in the context of their alternative set of SLCs and in the Response Hearing, the Parties told us that they were not willing to offer a view, and had done no analysis, on the scalability of their remedies to the number of SLCs we had identified.

Conclusion

18.51 We consider that the Parties' proposals address effectively neither the SLCs that we have found, nor the various risks and concerns regarding the effectiveness of a divestiture remedy that we set out in the Remedies Notice¹⁰¹⁰ and the Remedies Working Paper and discussed in the Response Hearings.

18.52 The large difference in scale and nature between the SLCs that we have found and the much smaller set that the Parties proposed in their alternative scenario also means that many of the Parties' comments on issues of principle and practicality have limited applicability to the situation where the SLCs cover a large part of the Parties' businesses, as we have concluded is the case.

18.53 Given the above, we therefore do not consider the Parties' divestiture proposal to be an effective remedy to the SLCs we have found.

¹⁰¹⁰ [Remedies Notice](#) (20 February 2019).

Other potential divestiture remedies

Introduction

- 18.54 In the Remedies Notice¹⁰¹¹ we considered whether it would be possible to identify a divestiture that could be effective in addressing the SLCs of the scale that we had provisionally found and set out the relevant considerations (both of principle and practicality) that would need to be addressed. We discussed this in more detail in the Remedies Working Paper. The number of SLCs we find in this Final Report is similar in scale and scope to the number which informed our Remedies Notice.
- 18.55 In this section we recap our initial views on a divestiture remedy as set out in the Remedies Notice and further developed in the Remedies Working Paper, and summarise responses to this from the Parties and third parties. We then discuss issues of principle relating to the design of an effective remedy, and then in turn discuss more practical issues and the associated risks to effectiveness of any remedy. Finally, we conclude on the effectiveness of a divestiture remedy in this case.

Description outlined in the Remedies Notice

- 18.56 Our initial view as expressed in the Remedies Notice¹⁰¹² was that in order for a divestiture package to be effective in addressing the SLCs we had provisionally identified it would need to contain the following:
- (a) sufficient assets and operations to enable any purchaser to compete effectively as a national in-store grocery retailer, including in all of the overlap areas, and so remedy the in-store groceries SLCs;
 - (b) sufficient assets and operations to enable any purchaser to compete effectively as an online delivered groceries retailer, including in all of the overlap areas, and so remedy the online delivered groceries SLCs; and
 - (c) one or more PFSs in each of the local fuel SLC areas.
- 18.57 We considered that, in each local market where we found an SLC, sufficient stores would need to be divested such that the SLC, and any adverse effect which may be expected to result from the SLC, was remedied, mitigated or prevented.¹⁰¹³ We recognised that, in some cases, the divestiture of one

¹⁰¹¹ Remedies Notice (20 February 2019).

¹⁰¹² Remedies Notice (20 February 2019).

¹⁰¹³ The Act, sections 36(2) and 36(3).

store could be sufficient to remedy, mitigate or prevent the SLC in more than one local market. However, in other local markets it might be necessary to divest more than one store in order to achieve an effective remedy.

- 18.58 The Parties operate their businesses on a national basis, with uniform prices in groceries (with Sainsbury's operating a separate but uniform price list for its convenience stores) and a single national brand and online proposition. We also found that there is a significant scale advantage, with larger groceries retailers able to obtain cheaper prices from suppliers.
- 18.59 A consequence of these supply-side features is that to provide an effective competitive constraint across all the markets where SLCs have been found, any purchaser would need sufficient scale and scope to provide similarly integrated, low cost operations to those of the Parties. For a divestiture remedy to be effective, our initial view was that this would be likely to necessitate the whole of any divestiture package being sold to a single purchaser.
- 18.60 In our Remedies Notice¹⁰¹⁴ we invited views on the following additional questions relating to the specification of a potential divestiture package:
- (a) Whether divestiture of the Sainsbury's or Asda brand would be required to ensure that the package of divested assets can compete effectively. Our initial view was that this would be the case, bearing in mind the need to achieve an effective remedy to the online and in-store SLCs that have been found based on both national and local assessments.
 - (b) Which assets and operations would need to be included in an effective divestiture package to remedy local online delivered groceries SLCs, and whether this would include additional stores to those found as local online delivered groceries SLCs, which might act as alternative Supply Points.
 - (c) Whether the divestiture of a store in a local in-store grocery SLC area would also require divestiture of its accompanying PFS. Our initial view was that this would be the case.
 - (d) Whether the divestiture of a PFS in a local fuel SLC area would also require divestiture of its accompanying store. Our initial view was that this would be the case.

¹⁰¹⁴ Remedies Notice (20 February 2019).

- (e) Whether divestiture of other assets such as supporting infrastructure (eg distribution centres), IT systems, or central operations (eg purchasing teams), would also be required, and if so which.
- (f) Whether divestiture of additional stores and/or PFSs and/or online Supply Points would also be required to ensure that the package of divested assets can exploit economies of scale or density in purchasing and distribution.

18.61 We also invited views on whether Sainsbury's and Asda should be allowed to propose which stores, PFSs and other assets required for online delivered groceries to divest in each SLC area, subject to the consent of the CMA in each case.

Views of interested parties

Third parties

18.62 [A supplier] told us that a divestiture remedy would require divestiture of a large number of stores including brand and related assets (such as distribution centres, IT systems, central operation, purchasing teams, e-commerce functions) to a single buyer. These assets would need to come from one Party as mix-and-matching stores and assets would create additional issues for any potential buyers and risk undermining the effectiveness of the remedy.¹⁰¹⁵ The supplier commented that given the expertise of the Parties in operating complex supply chains and the logistics of a grocery business with presence across the UK, there was likely to be a very limited pool of suitable purchasers that could demonstrate that they would be able to make a success of the divested business.¹⁰¹⁶ The supplier commented that a divestiture remedy was highly problematic in terms of guaranteeing effectiveness.¹⁰¹⁷

18.63 GMB told us that the scale of a divestiture remedy would be 'absolutely unprecedented' and would represent a major restructuring of the sector which it would be 'reckless in the extreme' to pursue. It commented that it did not believe there was a single buyer and that multiple buyers would create too much uncertainty.¹⁰¹⁸

¹⁰¹⁵ [Supplier F response to the Provisional Findings and the Remedies Notice](#), paragraph 6.4.

¹⁰¹⁶ [Supplier F response to the Provisional Findings and the Remedies Notice](#), paragraph 6.5.

¹⁰¹⁷ [Supplier F response to the Provisional Findings and the Remedies Notice](#), paragraph 1.7.

¹⁰¹⁸ [GMB Union response to the Provisional Findings and the Remedies Notice](#), paragraphs 6 and 7.

Parties' views

- 18.64 As discussed in paragraph 18.22 the Parties' remedy proposals do not address the SLCs we have identified. As a result, many of the issues relating to a divestiture remedy to address SLCs of that scale were not directly addressed by the Parties. Moreover, they did not address the SLCs arising from our national assessment as they believed national concerns would be fully addressed by addressing their smaller number of SLCs arising from our local assessment.
- 18.65 The Parties said that the fact that our Remedies Working Paper was focused only on SLCs of the scale identified in the Provisional Findings precluded any meaningful engagement. They considered that our conclusions regarding the effectiveness of their proposed remedy package did not therefore address the question of whether it would be an effective remedy to the SLCs that they believed should be ultimately identified.
- 18.66 In the Response Hearing, the Parties declined to offer a view on the 'scalability' of their proposed remedies above the level of alternative SLCs they were proposing. Sainsbury's said that the alternative SLCs represented the 'minimum GUPPI that you can apply' and that SLC numbers above that were 'completely academic'. At a level closer to the scale of divestiture associated with the SLCs the CMA provisionally identified it would be 'inexecutable'. They commented that a remedy where the scale of divestitures was more consistent with the SLC findings as set out in the Provisional Findings was 'unremediable and that there was no point in continuing the conversation if that was the case'. They also said that 'there is no point in discussing a major divestment plan, it is not going to happen'. Finally, they said that this was not so much a question of market capacity as of their own fiduciary duty in terms of returns to shareholders. Asda said that a divestiture at the levels set out in the Remedies Notice was 'an effective prohibition as it is not solvable', and 'commercially it is unviable'.
- 18.67 The Parties' written response did not address the provisional finding of an SLC as a result of coordinated effects in online delivered groceries. In the Response Hearing Asda said that they understood the coordinated effects to be in connection with delivery charges in a relatively small number of areas, and that if this continued to be a concern there would be a possibility of discussing this further. Given the time available for the remedies analysis in a merger investigation, and the sufficient opportunities the Parties have had to discuss these issues in their Response Hearing and in written response to the Remedies Notice and the Remedies Working Paper, we do not consider the suggestion of possible further discussions reflected substantive engagement with the concerns we had identified.

Issues of principle relating to remedy design

- 18.68 In assessing the effectiveness of remedies in addressing the SLCs and resulting adverse effects, we have considered several issues. In line with our Remedies Guidance, we have borne in mind the impact of the proposed remedy on the SLCs and resulting adverse effects, the appropriate duration and timing for any remedy as well as its practicality, and whether the risk profile is acceptable.¹⁰¹⁹
- 18.69 In considering whether it is possible to develop a divestiture package that could be effective in addressing a combination of SLCs of such a substantial scale and breadth, we identified a number of issues of principle, as well as some of the practical issues that might arise in applying those principles. These issues of principle and practicality are not mutually exclusive – an issue of principle, for example the role of branding in retail markets, might then have practical implications for identification of a suitable purchaser. However, we have found it useful to separate these two classes of issue.
- 18.70 We first consider the key principles that we must consider in designing effective remedies, namely:
- (a) criteria to assess the effectiveness of a divestiture package. This is a particular issue in this case given the scale and scope of divestiture that would be needed to achieve a comprehensive and effective solution to the range of SLCs identified and their adverse effects;
 - (b) interaction between remedies to the SLCs derived from our local assessment and remedies to the SLCs derived from our national assessment;
 - (c) the importance of requiring a single purchaser for all or most of the divestiture package; and
 - (d) the role of branding and the potential need for a brand divestiture.
- 18.71 We then turn to some more practical issues relating to the potential risks to effectiveness associated with a divestiture remedy in the following subsection.

¹⁰¹⁹ CC8, paragraph 1.8.

Criteria to assess the effectiveness of a divestiture package

- 18.72 Where the CMA has found an SLC, it is required to take action to remedy, mitigate or prevent the SLC,¹⁰²⁰ and in doing so, achieve as comprehensive a solution as is reasonable and practicable.¹⁰²¹
- 18.73 When considering the effectiveness of a remedy to an SLC, the Remedies Guidance explains that '[r]estoring this process of rivalry through remedies that re-establish the structure of the market expected in the absence of the merger (so-called structural remedies such as divestitures) should be expected to address the adverse effects at source'.¹⁰²² In the context of a divestiture remedy, the Remedies Guidance states that '[a] successful divestiture will effectively address at source the loss of rivalry resulting from the merger by changing or restoring the structure of the market'.¹⁰²³ The Remedies Guidance also states that the CMA will take divestiture of all or part of the acquired business as its starting point because 'restoration of the pre-merger situation in the markets subject to an SLC will generally represent a straightforward remedy'.¹⁰²⁴

Parties' views

- 18.74 In the context of in-store groceries, the Parties' proposed approach involved the divestiture of one or more stores such that the GUPPI estimate in each local area was brought below the threshold used to identify SLCs in the local assessment.¹⁰²⁵ They argued that this would mean that each area 'no longer raises an expectation of an SLC to the balance of probabilities standard'¹⁰²⁶ and that this would 'comprehensively and effectively remedy each Revised SLC area because each area will, as a result of the divestment, be below a conservative threshold for identifying an SLC and would thus be "cleared" on a substantive review'.¹⁰²⁷
- 18.75 The Parties stated that the CMA had used this approach to identify effective remedies in Ladbrokes/Coral previously.¹⁰²⁸

¹⁰²⁰ The Act, [section 41\(2\)](#).

¹⁰²¹ The Act, [section 41\(4\)](#).

¹⁰²² [CC8](#), paragraph 1.8(a).

¹⁰²³ [CC8](#), paragraph 2.6.

¹⁰²⁴ [CC8](#), paragraph 3.6. The guidance notes that this approach was upheld by the Competition Appeal Tribunal in the *Somerfield PLC v CC* case (2006).

¹⁰²⁵ [Parties' response to the Remedies Notice](#), paragraph 5.3.

¹⁰²⁶ [Parties' response to the Remedies Notice](#), paragraph 5.1.

¹⁰²⁷ [Parties' response to the Remedies Notice](#), paragraph 5.7.2.

¹⁰²⁸ [Parties' response to the Remedies Notice](#), paragraph 5.2.

Our assessment

- 18.76 In assessing possible remedies, we consider whether they will restore pre-merger levels of competition (ie to re-establish the level of competition which would exist in the counterfactual).¹⁰²⁹ Where there is more than one effective remedy, we will then identify the least intrusive remedy that would be effective in achieving a comprehensive solution to remedy the SLCs and any adverse effects resulting from these. The approach is not (as suggested by the Parties) to reintroduce just enough competition that no SLC would have been found on a balance of probabilities threshold. Moreover, identifying an effective solution is not simply a matter of calculation, but includes a significant element of judgement on the part of the CMA.
- 18.77 Given the time available for the remedies assessment in an investigation, it is not practicable for the CMA to re-run its competition analysis (eg by calculating new diversion ratios and GUPPI figures) to assess different divestment packages that might lead to a new competitive outcome which differs from the pre-Merger position. The onus is placed on the Parties to provide evidence to satisfy us that the pre-Merger position can be departed from in the particular circumstances, which they have not done in this case for the reasons set out in paragraph 18.66 above.¹⁰³⁰
- 18.78 The Parties described the CMA's approach in the Ladbrokes/Coral merger inquiry as being to re-run the competitive assessment methodology to a post-divestiture set of stores. This is an incorrect description as it omits key aspects of the approach, which ensured that the SLCs were comprehensively remedied in that case. For example, in Ladbrokes/Coral:
- (a) the CMA explicitly acknowledged that it would need to consider whether a particular divestiture would be effective at remedying the SLC even if divestiture of local sites would result in a situation where it would not have found an SLC on the basis of the methodology used to identify competition concerns;¹⁰³¹ and

¹⁰²⁹ [CC8](#), paragraphs 1.8(a) and 3.6.

¹⁰³⁰ See: [Ryanair v CMA](#) [2015] EWCA Civ 83, paragraph 57; [BSkyB v CC](#) [2008] CAT 25, paragraph 293; [Somerville v CC](#) [2006] CAT 4, paragraphs 99–101.

¹⁰³¹ 'We also note that, in considering whether a proposed remedy is acceptable, the CMA must have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the SLC and any adverse effects resulting from it. This exercise includes a 'significant element of judgment' on the part of the authority and 'is not simply a matter of calculation'. Therefore, we would consider whether there are factors that could undermine the effectiveness of the proposed remedy even if divestment of the LBOs selected by the Parties would result in a situation where we would not have found an SLC on the basis of the WSS methodology we used to identify competition concerns', Ladbrokes/Coral merger inquiry (26 July 2016), [Final Report](#), paragraph 14.81.

(b) the CMA applied criteria to the package of divested sites as a result of this issue (eg relating to restrictions on divesting unprofitable sites, those on short leases, etc).¹⁰³²

18.79 If a divestiture to remedy a SLC resulted in a GUPPI estimate of just below the decision-rule threshold in a local area, then it is quite possible that consumers in these areas would still suffer a degree of harm from a loss of competition resulting from the Merger. As a result, we could not be satisfied that it had comprehensively remedied the SLC in that area. In addition, given the scale of divestitures required to remedy the SLCs we have identified, an in-depth area-by-area consideration of the competitive effects of each potential remedy package is not practicable. Therefore, it is necessary to establish criteria for assessing the effectiveness of the whole divestiture package, consistent with the approach in Ladbrokes/Coral. In doing so, we take account of the need to ensure a comprehensive remedy for the SLCs identified in our local and national assessments, and the associated risks to the effectiveness of the proposed remedy.

Interaction between remedies to the SLCs derived from our local assessment and remedies to the SLCs derived from our national assessment

18.80 We undertook both local and national assessments of competition in in-store and online delivered groceries (inter alia). The national assessments examine the incentive on the Parties to deteriorate elements of PQRS across all of their stores and online supply points which is the result of changes in incentives at the local level. The local assessments examine the incentives on the Parties to deteriorate elements of PQRS in individual stores. The national assessments reflect an aggregation of local effects, but the SLCs found are not an aggregation of the SLCs found in our local assessments. Our assessments are set out in Chapters 8 to 11.

18.81 This sub-section examines how a divestiture remedy might comprehensively address both sets of SLCs.

Parties' views

18.82 The Parties submitted that grocery competition is fundamentally local as 'where competitive decision making is driven by the level of competition faced locally, national decisions will be based on the aggregate of those local incentives'.

¹⁰³² Ladbrokes/Coral merger inquiry (26 July 2016), [Final Report](#), paragraph 14.83.

18.83 The Parties submitted that, as national competition is the sum of local competition, remedying every local SLC will remedy a national SLC and that there are not specific national parameters of competition. Given this, they did not consider that the scale of a purchaser should be a consideration or that a single purchaser was required. They commented that the ‘CMA’s analysis focuses disproportionately on the “Big 4” and does not reflect the extent to which the Parties take other competitors into account when setting PQRS’.

Our assessment

- 18.84 We have considered the requirement to comprehensively remedy the SLCs found in our national assessments, the requirement to comprehensively remedy the SLCs found in our local assessments, and the practical constraints preventing a detailed individual area-by-area assessment of the effectiveness of local divestitures.
- 18.85 We note that the SLCs found in our national assessments of in-store and online delivered groceries arise in every local area where one of the Parties is present.¹⁰³³ The SLCs found in our local assessments do not arise in every local area, and so represent a smaller total number of local area SLCs than those found in our national assessments.
- 18.86 In principle, a divestiture package aimed at remedying each SLC found in our local assessments could comprehensively remedy the SLCs found on the basis of our national assessments, for example if the purchaser or purchasers were able to operate as an effective national operator so as to constrain the Parties.
- 18.87 However, our view is that this would not be possible in practice in the circumstances of this case unless:
- (a) sufficient stores, supply points, and potentially other assets are included in the divestiture package to comprehensively remedy the SLCs identified in our national assessment; and
 - (b) the purchaser criteria are carefully designed so as to re-establish an operator (or possibly operators) who will compete effectively in local

¹⁰³³ The SLCs found in our national assessments of online delivered groceries arise in all 531 delivery areas served by one or both of the Parties, as a result of the effects identified on a national basis in in-store groceries, as well as in all 286 delivery areas served by Asda, as a result of a national reduction in competition between the Parties’ online offerings.

markets across the country and not give rise to new competition concerns.¹⁰³⁴

- 18.88 We discuss these issues further in the section on practical issues in remedy design (paragraphs 18.114 to 18.127 and paragraphs 18.164 to 18.179).
- 18.89 We will first assess whether a divestiture remedy could effectively address the SLCs found in our local assessments. This is set out in the section beginning at paragraph 18.188. We then consider the conditions set out in paragraphs 18.86 and 18.87 above in determining whether the SLCs found in our national assessments could also be remedied. However, if there is no effective divestiture remedy for the SLCs found in our local assessments, it follows that there will be no effective divestiture remedy for the greater number of SLCs found in our national assessments.

The importance of a single purchaser for all or most of the divestiture package

- 18.90 Consideration of the size and effectiveness of the divestiture package leads to the question of whether any divestiture package should be sold to a single purchaser or whether assets could be sold to multiple purchasers.

Parties' views

- 18.91 The Parties' view is that requiring a single purchaser is disproportionate and would reduce their ability to conduct a sales process.
- 18.92 The Parties cited the CMA's provisional findings on buyer power to suggest that an increase in purchasing power will have a greater impact on smaller volume retailers than large ones.
- 18.93 The Parties do not believe that a multi-channel offer or a strong national brand is necessary, based on their view that single channel operators such as Aldi and Lidl can apply a considerable competitive constraint, and that 'brand is no more than a composite reflection of more tangible competitive variables such as price, quality, range, service and convenience experienced by customers. As each of these factors is determined by local competition, brand competition is an aggregation of that local competition'.

¹⁰³⁴ CC8, paragraph 2.2.

Our assessment

- 18.94 Our analysis has shown that there are material scale advantages in wholesale purchasing of groceries. In order to provide an effective competitive constraint and thus comprehensively remedy the SLCs found on the basis of our national and local assessments, any purchaser of divested assets would need to be able to exploit scale. Therefore, it follows that a sale of assets to multiple purchasers would risk diluting that scale advantage, unless each of those purchasers had sufficient scale themselves to provide the necessary constraint.
- 18.95 We agree with the Parties' submission regarding greater volumes having a greater positive impact on purchasing power for smaller volume retailers, but this does not mean that smaller volume retailers would be able to compete as effectively as larger ones and hence apply a comparable level of constraint as the Parties.
- 18.96 In order to comprehensively remedy the SLCs we have identified, an effective divestiture package would need to re-create the national characteristics referred to in paragraph 18.87. This is likely to involve sufficient assets to enable any purchaser to operate at a scale and scope that is broadly similar to that of the operator of those assets in pre-Merger conditions.
- 18.97 Given these factors, our conclusion is that the entire divestiture package (ie the assets and operations necessary to remedy all of the SLCs that we have identified), would either need to be sold to a single new entrant, or to one or more existing national operators with sufficient existing scale to re-create the competitive constraints that would be substantially lessened by the Merger. The practical issues involved in a process involving multiple purchasers or in identifying suitable national operators who do not raise competition concerns in their own right are discussed further in paragraphs 18.164 to 18.179 below.

The role of branding and the potential need for a brand divestiture

- 18.98 As noted in paragraph 18.58 above, the Parties have strong, very widely-recognised national brands. These brands are supported by extensive national marketing and promotional campaigns.

Parties' views

- 18.99 We noted the Parties' responses to the Remedies Notice and to the Remedies Working Paper, in which they said that in previous retail cases the CMA had not required brand divestiture. They also said that retailers

frequently divested or swapped stores and that it was relatively straightforward to re-fit and re-brand a newly purchased store.

18.100 Sainsbury's said that it would not contemplate a remedy which involved brand divestiture.

18.101 The Parties commented that sale to an existing competitor would not require brand divestiture as the purchaser would use their own brand. For sale to a new entrant they argued that divestiture of a brand would be disproportionate and unnecessary, stating that their proposed remedy package would be large enough to allow a new entrant to gain scale and brand recognition and cited B&M as an example of a brand that has grown quickly.

Third Parties' views

18.102 Iceland told us a brand would definitely be needed for a new entrant. It noted that it has taken Aldi and Lidl c.20 to 25 years to properly establish their brands in the UK.

18.103 Morrisons told us that if it were to acquire divested stores, then it would not want to acquire a brand with those stores as it would rebrand to Morrisons.

18.104 Tesco told us it was not sure that the inclusion of a brand within a divestiture package would be vital, but it might be attractive to customers. Tesco noted that it can be difficult even for well-known brands from other countries to establish themselves in new jurisdictions. It also noted that it took Aldi and Lidl 25 years to grow and they only really broke through during the economic crisis. When Tesco expands internationally, it usually retains a local brand either exclusively or alongside its own brand. Tesco also commented that Walmart had decided to keep the Asda brand in the UK, rather than replace it with the Walmart brand. For a new entrant, the value of a divestiture package would likely be higher with a brand and it would help retain a 'Big 4' competition.

Our assessment

18.105 While previous groceries cases might not have required brand divestiture, these have comprised divestitures at a far smaller scale than we have been considering and have not been aimed at recreating an effective constraint across a very large number of local markets. For example, in *Somerfield/Morrisons* the assets to be divested comprised 12 stores. As such, those stores could be integrated into an existing retailer or brand, without creating new competition concerns. With a divestiture of the scale and scope that would be necessary in this case, it is unlikely that an existing

UK groceries retailer with a strong customer-facing brand could acquire a significant part of the divested operations without creating further competition problems.

18.106 We also note that the nature of the groceries retailing market is such that newer groceries operators in the UK such as Aldi, Lidl, Ocado and B&M have required many years to build and position their brands, even where they were well established outside the UK. Any new entrant purchasing divestiture assets under its own brand would have, at least initially and for some period of time, a weaker brand which might not exert such a strong competitive constraint.

18.107 We note the Parties' points, and representations from third parties, and accept that for some existing national operators divestiture of a brand might not be required.

18.108 We are much less persuaded by the Parties' arguments regarding the importance to new entrants of acquiring a brand. In our competitive assessment we noted that the Parties, and other national players, have strong, very widely-recognised national brands. Acquisition of a very substantial divestiture package by a new entrant without a strong and recognisable UK brand (be it acquired or pre-existing) would pose a significant risk to the purchaser's ability to provide an effective constraint over the period of our assessment.

18.109 In our view, SLCs of the scale that we have identified in online markets mean that for any remedy to be effective in online it might need to include one of the Parties' brands, depending on the purchaser. We consider this further in paragraphs 18.138 to 18.148 below.

18.110 Given the scale and scope of the SLCs we have identified and the characteristics of in-store and online groceries markets, our conclusion is that the purchaser of the package of assets to be divested would require a nationally recognised grocery brand to provide an effective competitive constraint. Depending on the purchaser, therefore, divestiture of a brand – i.e. either the Asda or Sainsbury's brand – could be a necessary component of any effective divestiture remedy package.

Practical issues relating to remedy design

18.111 In addition to the issues of principle set out above, a divestiture remedy should also give us confidence that practical risks relating to the effectiveness of its design and implementation can be properly addressed.

18.112 CMA Remedies Guidance sets out a number of risks to the effectiveness of divestiture remedies. These comprise three broad categories:

- (c) *Composition risks*—these are risks that the scope of the divestiture package may be too constrained or not appropriately configured to attract a suitable purchaser or may not allow a purchaser to operate as an effective competitor in the market.
- (d) *Purchaser risks*—these are risks that a suitable purchaser is not available or that the merger parties will dispose to a weak or otherwise inappropriate purchaser.
- (e) *Asset risks*—these are risks that the competitive capability of a divestiture package will deteriorate before completion of divestiture, for example through loss of customers or key members of staff.¹⁰³⁵

Composition risks

18.113 A divestiture package that is effective in remedying the SLCs we have found is likely to include, among other things, hundreds of stores and supply points, a significant number of PFSs, and potentially substantial other assets. There are a large number of composition risks associated with specifying a remedy package of such a large scale and scope. In this case, these fall under four broad headings:

- (a) issues in identifying the assets needed for an effective divestiture;
- (b) issues relating to a mix-and-match package of operations from both Parties;
- (c) specific issues relating to online divestitures; and
- (d) specific issues relating to divestitures of PFSs.

Assets and operations required for effective divestiture

18.114 In the Remedies Notice we expressed the view that there are risks that the scope of a divestiture package focussed on selling assets to tackle individual SLCs may be too constrained or not appropriately configured to attract a suitable purchaser or may not allow a purchaser to replace the competitive constraint lost by the Merger. If this were the case, it would be necessary to require further divestiture of additional assets and operations, whether inside

¹⁰³⁵ CC8, paragraph 3.3.

or outside the SLC areas, sufficient to enable any purchaser to compete effectively at both a local and national level. We invited views on a number of potential issues in this regard – these are set out in paragraph 18.60 above.

- *Parties' views*

18.115 As previously noted in paragraph 18.49 above, the Parties' view, which is predicated on the much smaller number of their alternative SLCs, is that additional assets would not be required to effectively remedy the SLCs.

18.116 Citing previous cases, the Parties commented that existing competitors could expand existing supporting assets and that they would expect them to have excess capacity in their logistics networks. This could be further supported by use of third parties and by transitional arrangements.

18.117 The Parties also stated that as far as they were aware there were not UK or European precedents for divestiture of logistics and distribution assets being required in a grocery, fuel or retail merger in the UK or EU.

- *Third Parties' views*

18.118 Iceland's view was that additional assets would be required. Third parties could provide outsourced services, but it would be very challenging at this scale. Transitional arrangements could help and would probably be required, but these would have to be offered at cost.

18.119 Morrisons told us an existing player would have most of the assets that would be required to operate any divested assets, depending on the scale of the package and geography of the stores. In the event that it acquired stores Morrisons would perhaps want a mixture of assets, potentially including some additional assets. A new entrant would need a comprehensive package of supporting assets to maintain service. Third parties may be able to provide ancillary services, such as warehousing and distribution, but given the divested operations would be going concerns, continuity is key. Transitional arrangements may be well intended and viable in certain circumstances, but given how much management time would be taken up with the merger, there is a practical issue on bandwidth, plus a question as to the actual incentives to assist a competitor with the integration of any divested stores.

18.120 Tesco said that the need for additional assets would depend on the proposed divestiture package. Any buyer would need to have ordering and systems capabilities, distribution, central expertise in ranging and merchandise as well as other capabilities such as customer engagement centres. In some of these cases, transitional services are available, but these are usually only used on

very short-term basis. For the size of divestiture package that may be involved in this case a purchaser would likely be concerned about a transitional services arrangement as they would be making a large investment but relying on somebody else to provide those services when they are critical to the success of the business. This would require a large risk appetite on the part of the purchaser.

- *Our assessment*

18.121 Previous cases cited by the Parties¹⁰³⁶ are difficult to compare directly to the Merger.

(a) In the case of Ladbrokes/Coral in 2015 the merger was in a different industry where logistics and infrastructure were not core to the business in the same way as they are for the grocery market, and the stores being sold were small-scale operations which did not have the scale and inherent complexity of supermarkets.

(b) The Somerfield/Morrisons merger in 2004 was much smaller in scale, with 115 stores being acquired by a major national operator which would already have had supporting infrastructure. 12 local SLCs were identified and 12 divestitures were required.

18.122 The Parties' confidence in being able to manage a sales process and in receiving purchaser interest is predicated on the much smaller number of their alternative SLCs and has very limited relevance to the SLCs and thus potential divestitures of the considerably larger scale and scope that we have identified.

18.123 Given the large number of store divestitures that would be needed to remedy the SLCs we have identified, we consider it very unlikely that these stores could be operated effectively without substantial supporting assets and operations. Any purchaser that is not an existing large-scale retailer is unlikely to have sufficient distribution and warehousing capacity to support the operations of an additional substantial portfolio, potentially comprising hundreds of stores. Any new entrant would also require this essential supporting infrastructure and systems from day one. Our view is that, depending on the existing capabilities of the potential purchaser, additional assets and operations such as warehousing, distribution, IT systems and purchasing might also be required as part of a divestiture package. These additional assets would be complex and would take any prospective

¹⁰³⁶ Parties' response to the Remedies Notice, paragraph 5.9.

purchaser time to assess, leading to increased risk of delay and uncertainty around the eventual outcome and the effectiveness of the remedy.

18.124 We note that the Parties offered to provide transitional services for operations such as IT, logistics and purchasing might potentially assist a new entrant or smaller retailer.¹⁰³⁷ We are concerned that there is a risk of misaligned incentives were the Parties to be supplying such services to a competitor as well as internally, and that the potential length of the divestiture period increases this risk.

18.125 The Parties suggested that third party providers of distribution and logistics capability and wholesalers would be able to help a purchaser.¹⁰³⁸ We understand that the large retailers do use third parties in addition to their own logistics and distribution capabilities, but consider that third parties would be unlikely to have the additional capacity to support a divestiture of the scale suggested by the SLCs we have identified.

18.126 Whether these services were provided as part of a transitional arrangement by the Parties or were able to be outsourced, our view is that the complexity of procuring and integrating these services would lead to additional risk that the divestiture would not be executed effectively.

18.127 In conclusion, we consider that there are material risks relating to the specification of assets in a divestiture package, given the scale and complexity of the operations and assets to be divested, even for a retailer with significant existing operations. We are not convinced that these risks to effectiveness could be mitigated by the Parties' proposals.

Mix-and-match of assets and operations

18.128 We considered whether Sainsbury's and Asda should be allowed to propose which stores, PFSs and other assets required for online delivered groceries to divest in each SLC area, subject to the consent of the CMA in each case.

- *Parties' views*

18.129 The Parties set out in their response and in the Response Hearing how they would address our concern that a mix-and-match approach would allow them to select the weaker store in any given local market, thus reducing the

¹⁰³⁷ [Parties' response to the Remedies Notice](#), paragraph 5.8.

¹⁰³⁸ [Parties' response to the Remedies Notice](#), paragraph 5.8.

comprehensiveness of the remedy. They said that the choice of store in a local area would be determined [§].

18.130 The Parties submitted that there should be no limitation on the extent of mix-and-match, as they consider this would be more attractive to purchasers and as they do not consider possible divestiture of a brand (which would potentially be harder if the divestiture package was not substantially from that brand) is required.

- *Third Parties' views*

18.131 Iceland told us a sale process would be easier if mix-and-match were allowed as one brand's stores will not be divestible in all locations. There are potential composition challenges for the purchaser in combining the stores of different brands – store formats, systems, contractors, etc – but it is possible. Iceland told us that if brand divestment is required then mix-and-match becomes more problematic compared to just taking that brand as a coherent package.

18.132 Morrisons told us that as a potential purchaser, it would prefer a mix-and-match divestiture as it would want to be able to pick the best store in each location. A new entrant would probably feel differently, and it would be quicker and culturally easier for a new entrant to acquire stores from one brand. Also, there were ancillary issues with mix-and-match around distribution and supplier channels. Mix-and-match would create additional issues – staff culture mix and continuity of customers coming from different types.

18.133 Tesco said that the extent to which mix-and-match could present a problem would depend on the package of assets. If the Parties were able to choose less profitable stores, then the package would be unattractive in any case and may be uneconomic to continue to operate in future. Subject to that point, then Tesco would be less concerned regarding mix-and-match. Creating a new national brand may be harder from a mix-and-match portfolio although Tesco were not convinced that all stores would need to be from one of the Parties to create a national brand. However, mix-and-match would create bigger integration issues regarding logistics, distribution systems, relationships with suppliers and IT systems.

- *Our assessment*

18.134 Our Remedies Guidance states that there is a preference for all of the divested assets to come from one Party, unless it can be demonstrated that there is no significant increase in risk to the effectiveness of the remedy from

a mix-and-match alternative.¹⁰³⁹ In this case, the scale of the divestitures required, the need to comprehensively remedy SLCs, the integrated nature of the Parties' operations and the differences in proposition could lead, in our view, to a significant increase in composition risk were the divestiture assets to come from more than one Party. This risk is increased when a brand is being divested as it would require rebranding of a significant number of Sainsbury's stores to Asda or vice versa.

18.135 We have found that divestiture of the Sainsbury's or Asda brand might be required to effectively remedy the SLCs. If this were to be the case, a mix-and-match approach might further compromise the effectiveness of the remedy – a divestiture of assets entirely from the brand being divested would enable customers to move seamlessly to the purchaser whilst not changing the brand of their supermarket. A mix-and-match approach in this situation could lead to extra expense to, and risk for, the purchaser with regard to store rebranding if a brand were also to be divested.

18.136 It may be the case that, in some local areas, a store from a different brand might effectively remedy the SLC in that area and be more proportionate. We also note evidence from third parties that a mix-and-match divestiture package may be more attractive to a potential purchaser.

18.137 In conclusion, we accept that flexibility in accepting assets from both Parties might make a suitable package easier to specify and negotiate. However, for the reasons set out above, we consider that, in this case, any significant mix-and-match of assets could present an additional risk to the effectiveness of a divestiture remedy for a package of this size particularly if the purchaser were to be a new entrant or if a brand divestiture were to be required.

Online divestitures

18.138 In our Remedies Notice¹⁰⁴⁰ and Remedies Working Paper, we highlighted particular challenges regarding the specification of divestiture as a remedy for the SLCs that have been found in online delivered groceries. In addition to the physical assets and supporting infrastructure required to operate such a proposition, there is the additional question of whether existing online customers would choose to remain with the divested operations, particularly if the Parties continue to operate an online offering for both brands and to deliver to those customers from different supply points.

¹⁰³⁹ CC8, paragraph 3.12.

¹⁰⁴⁰ Remedies Notice (20 February 2019).

18.139 Our concern was that it was likely that many customers would wish to continue to use the existing web offerings regardless of the supply points by which the Parties provided the service behind those offerings. The website would remain unchanged and customers would have a purchasing history on that site to inform and expedite their future purchases. As a result, incumbency potentially confers a greater advantage in online markets than in stores. We found that it may not be possible to achieve an effective solution to these SLCs without also divesting one or other of the Asda or Sainsbury's brands, in addition to physical assets and operations.

- *Parties' views*

18.140 The Parties did not originally suggest any remedies for online SLCs as they did not believe they would be required, based on their alternative findings (see paragraphs 18.33 to 18.36).

18.141 However, in their response to the Remedies Working Paper, the Parties commented that a brand divestiture in online was not required given the availability of purchasers with strong grocery brands, online offerings and ambitions to expand in to online delivered groceries (Aldi and Lidl were cited here). The Parties proposed that if we did find local online SLCs, divestiture of the local supply point and, to the extent required, supporting delivery infrastructure, would be sufficient to allow a purchaser to compete effectively.

18.142 The Parties submitted that concerns around customer migration are misplaced as divestiture of supply points will ensure competition in any given market and the purchasers will then 'follow their strong natural commercial imperative to win customers'.

18.143 For clarity, we note that any divestiture package that addressed the SLCs arising from unilateral effects in online delivered groceries, which cover every local area, would therefore also address the SLCs arising from online coordinated effects.

- *Third Parties' views*

18.144 Iceland told us that for online, it is vital to have transport, a website, an ordering system, and customer service. This represents a very considerable logistical challenge and is very costly. Customer database, previous orders, and favourites etc are also a major factor and would be difficult to migrate – for example, a buyer would need explicit customer permission under GDPR. Entering online from scratch would mean being at a considerable disadvantage compared to an incumbent.

18.145 Morrisons told us that it had not given a great deal of thought to an online remedy, but said that with a strong brand a non-store-pick model like Ocado could work up to a certain scale. For a larger package or weaker brand store pick was more practical. The purchaser would need very strong IT and distribution capabilities, and these would have to be included with the divestiture package if the buyer did not have their own assets. Strong customer service would be vital to a competitor being successful in the online sector. Morrisons considered it would probably not be a necessity to sell a brand for online, and this would be hard to do in any event as brands are associated with particular propositions that a new buyer might struggle to maintain.

18.146 Tesco commented that brand is particularly important in online.

- *Our assessment*

18.147 Our concerns regarding the composition of assets to remedy online SLCs remain. We consider that an effective divestiture remedy would need to include the relevant supply points and delivery assets. However, unlike in-store groceries, store location is not relevant to customers' decisions of where to shop online. There are significant risks that divestiture of only physical assets would not be effective, because customers would continue to shop with the Parties, making use of personalised elements such as saved lists and purchasing history that a Purchaser might not be able to offer. This risk could be mitigated by the Purchaser having a strong existing brand.

18.148 In conclusion, we would expect that any purchaser that did not have an existing strong branded offering would require additional assets to enable it to compete effectively. This might include one of the Parties' brands and possibly that brand's online groceries website. However, some flexibility could be allowed for commercial negotiations subject to oversight by the CMA in this regard.

PFS divestitures

18.149 In our Remedies Notice we set out our initial view that supermarkets and PFSs should continue under common ownership, even if an SLC had not been found at the PFS.¹⁰⁴¹

¹⁰⁴¹ Remedies Notice (20 February 2019).

- *Parties' views*

18.150 The Parties response said that PFSs could be sold to standalone buyers to effectively remedy SLCs at that local market for fuel or instore groceries.¹⁰⁴²

18.151 The Parties consider that their proposed subsidy for divested PFSs would enable these to be divested without the accompanying store.

18.152 In our Remedies Working Paper we highlighted a number of concerns with this approach:

- (a) While the proposed subsidy might, in theory, provide an incentive on a purchaser to retain a strategy of low prices and high volume, it is not clear how this might interact with a purchaser's PFSs in other locations that might pursue different strategies.
- (b) We understand that the subsidy is intended to be a fixed amount per litre. As a result, its impact is likely to reduce with time and inflation.
- (c) A standalone PFS would potentially preclude cross-promotions such as fuel savings with a large grocery purchase or vice versa, or loyalty club points, and could therefore be less attractive to consumers and be a weaker competitive constraint on other supermarket PFSs.
- (d) The Parties' compliance with the subsidy would require monitoring over a long period.
- (e) Additionally, we understand that many supermarket PFSs are configured to have a much smaller retail space than most standalone PFSs, in particular, many Asda PFSs are unmanned self-service and do not have any significant retail area.¹⁰⁴³ We therefore have concerns around the attractiveness of these PFSs as standalone propositions to would-be purchasers.

18.153 The Parties responded to these concerns in their response to our Remedies Working Paper.

- (a) They pointed out that fuel retailers do vary prices widely across their estates.
- (b) The Parties did not believe that the subsidy should be inflation linked against a background of falling supermarket margins. However, they

¹⁰⁴² [Parties' response to the Remedies Notice](#), paragraph 5.8.

¹⁰⁴³ Catalyst data.

would be willing to re-consider details of the mechanism, presumably including an inflation link.

(c) The Parties said that cross-promotions have become less frequent across all supermarket PFS in recent years, and in any case have generally been to encourage purchase of groceries, not fuel which is lower margin. They proposed to allow any purchaser of a Sainsbury's PFS to offer Nectar points on fuel purchases.

(d) The Parties did not believe that monitoring would be required as this would be a simple mechanism covered by a contractual term in any sale agreement.

(e) [REDACTED].

- *Third Parties' views*

18.154 Morrisons commented that it was not absolutely necessary for a PFS on a supermarket site to be the same brand as the supermarket.

18.155 Tesco said that having the same brand for the store and the PFS brings benefits as staff can be moved from one to the other as required, there can be cross-channel promotions, and loyalty cards can be used in both PFS and in-store.

- *Our assessment*

18.156 We note that the Parties state that supermarket PFSs are typically not in 'premium' locations favoured by oil majors and independent PFS operators.¹⁰⁴⁴ The Parties said that this will encourage purchasers to price at a non-premium level, and that this behaviour would further be encouraged by their proposed subsidy of [REDACTED]pppl of fuel sold. This subsidy is different to the Public Commitments¹⁰⁴⁵ the Parties have also made (discussed in Chapter 16) in that it is intended to assist in remedying the fuel SLCs.

18.157 We note the Parties' arguments regarding their proposed subsidy, and accept that it may act as an incentive to purchasers of standalone PFSs. However, we also note the third-party comments regarding cross-channel promotions and staffing. We still consider that, in a changing fuel retail market, a fixed

¹⁰⁴⁴ Parties' response to the Remedies Notice, paragraph 7.4.

¹⁰⁴⁵ Parties' response to the Remedies Notice, paragraph 4.6 and *Sainsbury's and Asda commit to £1 billion of grocery savings and fuel cap* (19 March 2019).

subsidy would potentially become ineffective over time. We also note possible cost implications of ongoing monitoring.

Conclusion on composition risks

- 18.158 Given the number and scope of the SLCs that we have found, any effective divestiture package would need to comprise hundreds of stores and online supply points, a significant number of PFSs, and likely other operational assets to ensure that the divestiture package represented a viable and competitive business. The size and complexity of this package would be significantly greater than for any previous UK retail sector merger remedy.
- 18.159 There are material risks to the effectiveness of a divestiture remedy around the specification of such additional assets, as well the feasibility of a purchaser being able to add them to an existing business or operate them in a way that continues to provide an appropriate competitive constraint. There are further risks around transitional arrangements or third-party outsourcing in a transaction of this size.
- 18.160 While the inclusion of assets from both Parties (a mix-and-match approach) in a divestiture package may make it more attractive to potential purchasers, this needs to be balanced against the increased complexity of such an approach and the effectiveness risks that it brings.
- 18.161 There are further material effectiveness risks around the specification of assets and operations relating to online delivered groceries. In particular, a package consisting only of supply points and associated delivery assets risks being ineffective as customers could continue to be served by the Parties from alternative supply points. A Purchaser with a strong existing online brand may be able to overcome this risk. However, in the absence of this brand, we consider that one of the Parties' brands and online grocery websites would probably need to be divested.
- 18.162 We also consider there to be risks around the divestiture of PFSs on a standalone basis and the Purchaser's incentives to re-create the competitive constraint exerted by the Parties. While the Parties' proposed subsidy may mitigate these risks, we have concerns about its effectiveness over time.
- 18.163 In summary, we have found substantial composition risks inherent in a divestiture package of this size, scope and complexity. We will take these into account in our overall assessment of the effectiveness of divestiture as a remedy.

Purchaser Risks

18.164 In our Remedies Notice¹⁰⁴⁶ we set out criteria for a suitable purchaser. This included the criteria set out in our Remedies Guidance that any prospective purchaser:

- (a) is independent of the Parties;
- (b) has the necessary capability to compete;
- (c) is committed to competing in the relevant markets; and
- (d) will not create further competition concerns.¹⁰⁴⁷

18.165 We also said that we would need to be satisfied that any purchaser has a strong management team with a proven track record in UK groceries retailing, can demonstrate a commitment to competing across all the relevant markets, and is able to demonstrate an ability to compete effectively by reference to a credible business plan.

18.166 We said that we might also take into account the current scale of any purchaser's operations, in the UK and abroad, to determine whether its business (including the acquired assets) would be able to provide an effective competitive constraint and whether there might be separate competition concerns relating to the purchase of the divested assets.

- *Parties' views*

18.167 The Parties disagreed with the need for a single purchaser and, based on their alternative SLC calculations and the much smaller number of SLCs they believe to be correct, considered that Tesco and/or Morrisons could be purchasers of a substantial package of stores, alongside other potentially interested parties. They did not consider there was a need for a 'fourth player'.

18.168 The Parties views on the need in principle for a single purchaser, and our assessment of this, are discussed in more detail in paragraphs 18.90 to 18.97 above.

¹⁰⁴⁶ Remedies Notice (20 February 2019).

¹⁰⁴⁷ CC8, paragraph 3.15.

- *Third Parties' views*

- 18.169 Iceland told us that finding a suitable purchaser which did not give rise to competition concerns would be problematic. It also commented that a smaller player would find it difficult to compete from a standing start even if they purchased a large package of assets.
- 18.170 Morrisons told us it would understand a view that there needs to be a fourth large player in the UK groceries market as it seemed self-evident that four players would be more competitive than three. However, it would potentially be difficult for a new entrant to be credible and have a critical mass. Morrisons said that it agreed with the CMA's purchaser criteria as set out in the Remedies Notice. Morrisons noted that the UK is a very challenging market to enter and a purchaser would need experience. Buying in management was a possibility but it would potentially be risky to create a whole new management team and could pose a question as to credibility at this scale on an untried proposition.
- 18.171 With regard to the requirement for a purchaser to have multi-channel capability, Morrisons told us that increasingly, shoppers want to purchase online and instore, and given the types of stores the Parties operate and the integrated nature of their brand, stores would generally be of a type that is expected to also include a PFS (eg due to an out of town location). Online is part of the package as it can fill the gaps between physical stores. Whilst a new entrant could be single channel, that would not be the same as replacing a multi-channel offer.
- 18.172 Tesco said that the need for a fourth national player depends on the scale of SLCs the CMA finally determines. There may be a worry that removing one of the 'Big 4' would change the competitive dynamic and that would be hard to recreate, in which case local divestments alone would not restore the competitive situation. Tesco agreed with the CMA's proposed purchaser criteria as set out in the Remedies Notice. Tesco commented that operating large stores requires specific expertise and is very different from a small store format, therefore track record is important. Regarding private equity investment, this introduces an additional layer of risk. Private equity owners will look to see a route for a profitable exit, and where they cannot make it work may be more willing to close the business quickly. Tesco said that the

failure of My Local is a recent case study of what can go wrong.¹⁰⁴⁸ They stated that this is a difficult market with low margins and high volumes.

18.173 Tesco told us that any purchaser would have to be able to operate a multi-channel business. They also commented that the ability to achieve scale is clearly important as there may be an impact on purchasing, capability, and logistics. It is also important to consider scale in the context of distribution networks and the risk of being less competitive. To a large extent, businesses can scale the fixed costs they need to the size and shape of the business (e.g. in choices about configuring distribution networks), but this must be carefully designed to avoid rising costs per store for smaller groups.

- *Our assessment*

18.174 As set out in paragraph 18.90 to 18.97 above, we consider that an effective divestiture would need to create a similar constraint to that which the Parties currently impose on each other. In each market where we have identified an SLC this would mean that a suitable purchaser would need to have the scale to be able to compete on PQRS in a similar way to how the Parties currently compete. This would entail any purchaser having large-scale UK operations offering a consistent, multi-channel proposition with a strong brand.

18.175 Although our view in principle is that a single purchaser may not be required and divestitures could be made to more than one of the Parties' existing national competitors, we have identified a number of reasons why this might not be effective in practice.

18.176 We consider it unlikely that a divestiture package of the size that we are considering could be sold to a close competitor such as Tesco or Morrisons (or split between them) as this is likely to create new competition concerns locally and potentially nationally. Even for other UK grocery retailers the potential exists for competition concerns to be present in certain local markets.

18.177 In paragraph 18.94 we noted that there are scale advantages in purchasing wholesale groceries and that the divestiture package comprised a significant number of stores and supply points. Dividing the divestiture package between multiple purchasers would lessen the effect of this scale, giving rise to a risk

¹⁰⁴⁸ MLCG Ltd (trading as My Local) bought 140 convenience stores from Morrisons in September 2015. It entered administration in June 2016 (see BBC (29 June 2016), [My Local enters administration with 1,000 jobs at risk](#)).

that each purchaser would be unable to re-create the competitive constraint provided by the Parties in each local area.

18.178 In addition, we consider that the scale and scope of divestitures that would be required would create a very high degree of complexity and risk in the sale process. This complexity would be significantly increased if multiple purchasers were involved.

- *Conclusion on purchaser risks*

18.179 Given the interaction of these two factors, our view is that there is a material risk that suitably qualified purchasers would not be able to be identified within an acceptable timescale. We will consider these purchaser risks in our overall assessment of the effectiveness of a divestiture remedy.

Asset risks

18.180 In our Remedies Notice we said that we would expect an upfront buyer of divested assets to complete any purchase before the Parties would be permitted to merge. We also invited views on how asset degradation risk might be managed.¹⁰⁴⁹

- *Parties' views*

18.181 The Parties strongly disagreed with this view, stating that it is standard in divestiture remedies for the seller to run stores until the time of divestiture and that any decline in quality of offering would negatively impact their own brands.

18.182 The Parties submitted that the complexity of a sale process would not be off-putting to potential purchasers and are confident that Sale and Purchase Agreements could be agreed in good time.

- *Our assessment*

18.183 We accept that the Parties might not intentionally seek to diminish the quality of the offering in stores to be divested that were still trading under their brands. Notwithstanding this, we consider that an incentive could exist to reduce the quality of divested operations, for example by reducing recruitment or restocking less often. We also take the view that a divestiture process of the scale and scope that would be required to address the SLCs

¹⁰⁴⁹ Remedies Notice (20 February 2019).

we have identified would be complex and time-consuming, and that this potentially prolonged uncertainty could have a negative effect on staff morale and general performance in stores that were divestiture candidates.

18.184 While these concerns could in theory be addressed by the imposition of an Interim Order and appointment of a Monitoring Trustee, the size of divestiture means that monitoring and enforcing compliance of these quality standards across multiple hundreds of stores, supply points, PFSs and potentially other assets would be impractical.

18.185 We also note that the Parties said that we should not impose any specified divestiture period, but that if a period was imposed it should be no less than six months.¹⁰⁵⁰ This was based on the Parties' proposals to divest 125–150 stores and a small number of PFSs and convenience stores. The divestiture package we are considering would be substantially bigger than this and so it is reasonable to believe that a longer period would be required. The risks of asset and operational deterioration over this longer period would be likely to increase.

18.186 In their response to the Remedies Notice the Parties said that the Merger should be allowed to proceed when an upfront purchaser or purchasers were contractually committed rather than when the divestiture(s) were complete.¹⁰⁵¹ While the CMA does sometimes allow this condition, allowing the merger to proceed at this earlier stage would increase the effectiveness risk of the divestiture as the risk of it unwinding would no longer fall on the Parties.

Conclusion on asset risk

18.187 Despite the Parties' stated incentive to maintain the quality of offering in their operations to be divested, we consider there to be material risks around the ongoing effectiveness of these operations, which are likely to increase over the long period of time necessary for such a large and complex divestiture process. We will take these risks into account in our overall assessment of the effectiveness of a divestiture remedy.

Conclusions on the effectiveness of divestiture remedies

18.188 We have considered the assets and operations that would be required for a divestiture package to represent a comprehensive and effective solution to

¹⁰⁵⁰ [Parties' response to the Remedies Notice](#), paragraphs 9.2 and 9.3.

¹⁰⁵¹ [Parties' response to the Remedies Notice](#), paragraphs 9.4–9.10.

SLCs of the scale and nature we identified, and the risk that a divestiture remedy would be ineffective.

18.189 Our national assessments found SLCs in the supply of groceries in supermarkets in every local area in which one or both of the Parties is present, in the supply of online delivered groceries in every local area in which one or both of the Parties are present,¹⁰⁵² and in the supply of groceries in convenience stores in every local area where Asda is present.

18.190 Our local assessments found SLCs in the supply of groceries in supermarkets in 537 local areas where both Parties are present, in the supply of groceries in convenience stores in 18 local areas where both Parties are present, the supply of online delivered groceries on a local basis in 143 of the local areas where both Parties provide online delivered groceries services, the supply of online delivered groceries on a local basis in 108 of the local areas in which both Parties and Tesco are present in the UK through coordinated effects, and the supply of fuel on a local basis in 127 of the local areas where both Parties operate petrol filling stations.

18.191 We first consider whether a divestiture remedy would be effective in addressing the SLCs found in our local assessments. We then consider whether a divestiture remedy would be effective in addressing the SLCs found in our national assessments.

Effectiveness of divestiture remedies to the SLCs found in our local assessments

18.192 In order to comprehensively remedy all the SLCs found in our local assessments, an effective divestiture package would need to re-establish the effective competition lost as a result of the Merger as described in our local assessments.

Issues of principle

18.193 Considering issues of principle, we identified three important criteria to assess the effectiveness of a divestiture package that would remedy the SLCs found in our local assessments:

- (a) First, and in accordance with our statutory requirement to comprehensively remedy SLCs we have found, we took the view that local remedies which reduce the GUPPI in that area to just below the

¹⁰⁵² The SLCs found in our national assessments of online delivered groceries arise in all 531 delivery areas served by one or both of the Parties, as a result of the effects identified on a national basis in in-store groceries, as well as in all 286 delivery areas served by Asda, as a result of a national reduction in competition between the Parties' online offerings.

threshold we have applied to identify SLCs would be unlikely to be sufficient to provide an effective remedy to that SLC. This applies to supermarkets, online delivered groceries and convenience stores.

- (b) Secondly, the purchaser criteria must be carefully designed so as to re-establish an operator who will compete effectively in each local market. Such an operator would need sufficient purchasing scale, and experience of running integrated, multi-channel operations to provide an effective and equivalent competitive constraint. Given this, our view is that the entire divestiture package, or at least a very substantial proportion thereof, would need to be sold to a single purchaser or to existing national operators with multi-channel experience or capability (see paragraphs 18.96 and 18.97 above).
- (c) Thirdly, because of the nature of the groceries markets in the UK, and specifically the importance of brand to customers instore and online, we consider that the purchaser of the assets to be divested would require a nationally recognised grocery brand to provide an effective competitive constraint. Depending on the purchaser, therefore, divestiture of a brand – i.e. either the Asda or Sainsbury’s brand – might be a necessary component of any effective divestiture remedy package (see paragraph 18.110 above).

Practical issues

18.194 We also considered several practical aspects of a divestiture remedy in this case and how these aspects affected the risk to the effectiveness of such a remedy.

- (a) In order to provide a competitive constraint across the markets in which we have identified SLCs arising from our local assessments, any divestiture package is likely to require additional assets and operations. The composition of assets between Sainsbury’s or Asda (ie mix-and-match) would not necessarily need to comprise solely Sainsbury’s or solely Asda assets, although significant mix-and-match could present an additional risk to the effectiveness of a divestiture remedy particularly if the purchaser were to be a new entrant or if a brand divestiture were to be required. Some flexibility could be allowed in this regard for commercial negotiations subject to oversight by the CMA.
- (b) The scale and scope of the divestiture package and the requirements for any purchaser to compete effectively means that it could be very difficult for an existing national multi-channel grocery retailer in the UK to

purchase a significant proportion of the divested assets without raising additional competition concerns.

- (c) A standalone purchaser of a PFS (ie without also acquiring the relevant store) might be able to provide an effective constraint if they were to receive the payment of the subsidy proposed by the Parties, but we have residual concerns over the cost and longer-term effectiveness of this aspect of the Parties' proposed remedy. As a result, we would expect that where there is an SLC in the PFS as well as the associated store, both the store and the PFS should be divested to a single purchaser.
- (d) With regard to online delivered groceries, there are a number of particular risks regarding the specification of divestiture as a remedy for the SLCs arising from our local assessment of unilateral and co-ordinated effects. In addition to the physical assets and supporting infrastructure required to operate such a proposition, there is the additional question of whether existing online customers would choose to remain with the divested operations, particularly if the Parties continue to operate an online offering for both brands and to deliver to those customers from different Supply Points. Our view is that, depending on the purchaser, an effective remedy to the online SLCs might involve not only divestiture of physical assets such as the supply point store, but also, if the purchaser did not have a strong online national brand, one of the Parties' brands and online groceries website.
- (e) The sheer size and complexity of the divestiture process for a package of the scale necessary to remedy the SLCs found in our local assessment gives rise to substantial execution risk. Having more than one Purchaser would also significantly increase complexity and execution risk. A long disposal period would be likely, increasing the risk of operational deterioration.

Conclusion on the effectiveness of divestiture remedies to the SLCs found in our local assessments

18.195 Given the scale and scope of the SLCs we have identified we are not sufficiently confident that a suitable package of assets, or a suitable purchaser, could be found to provide an effective and comprehensive remedy to the SLCs found in our local assessments.

18.196 In addition, there are further effectiveness risks associated with the practicability of implementing such a package. We consider it unlikely that a divestiture remedy could take place within a reasonable period of time.

18.197 As a result, we consider that any divestiture remedy would not be an effective remedy for the scale and scope of SLCs that we have found in our local assessments of in-store groceries in supermarkets, in-store groceries in convenience stores, online delivered groceries, fuel and co-ordinated effects in online delivered groceries.

Effectiveness of divestiture remedies to the SLCs found in our national assessment

18.198 In order to comprehensively remedy all the SLCs found in our national assessments of in-store and online groceries, an effective divestiture package would need to re-establish the effective competition lost as a result of the Merger as described in our national assessments.

18.199 The SLCs found in our national assessments cover a significantly greater number of local areas than the SLCs found in our local assessments. We would therefore expect that any divestiture package would necessarily be larger and more complex, increasing the composition, purchaser and asset risks and rendering it more likely to be ineffective.

18.200 We consider that a divestiture package that could effectively and comprehensively remedy the SLCs found in our national assessments is likely to require sufficient assets to enable any purchaser to operate at a scale and scope that is broadly similar to that of the operator of those assets in pre-Merger conditions.

18.201 In determining its effectiveness, any such divestiture package will also face the other issues of principle and practice identified in this chapter.

18.202 We note the conclusion in paragraphs 18.195 to 18.197 above that we have not found an effective divestiture remedy for the smaller number of SLCs found in our local assessments. As noted at paragraph 18.89, since we have not identified any effective divestiture remedy for the SLCs found in our local assessments, it follows that there will be no effective divestiture remedy for the greater number of SLCs found in our national assessments.

Conclusion on the effectiveness of divestiture remedies to the SLCs found in our national assessments

18.203 Given the scale and scope of the SLCs we have identified, we are not sufficiently confident that a suitable package of assets could be found, or a suitable purchaser found, to provide an effective and comprehensive remedy to the SLCs found in our national assessments of in-store groceries, online delivered groceries, or both.

18.204 In addition, there are further effectiveness risks associated with the practicability of implementing such a package and with identifying a suitable purchaser to operate the divested assets. We consider it unlikely that a divestiture remedy could take place within a reasonable period of time.

18.205 As a result, we consider that any divestiture remedy would not be an effective remedy for the SLCs that we have found from our national assessments of in-store and online delivered groceries.

Conclusion

18.206 Given the scale and scope of the SLCs we have identified, we are not sufficiently confident that a suitable package of assets could be found, or a suitable purchaser found, to provide an effective and comprehensive remedy either to the SLCs found in our local assessments, or in our national in-store assessments, or in our national online assessments, or to the SLCs as a whole.

18.207 In addition, there are further effectiveness risks associated with the practicability of implementing such a package and with identifying a suitable single purchaser to operate the divested assets. We consider it unlikely that a divestiture remedy could take place within a reasonable period of time.

18.208 Customers or suppliers of merger parties should not bear significant risks that remedies will not have the requisite impact on the SLC or its adverse effects.¹⁰⁵³

18.209 In conclusion, there are significant risks to the effectiveness of any divestiture remedy, in particular regarding the scope and composition of a divestiture package, the identification of a suitable purchaser and the practicalities of executing such a large divestiture. As discussed in paragraph 18.24 the Parties have not proposed any divestiture remedy that would address these risks. We have not been able to identify any divestiture remedy that would effectively address SLCs of the scale and scope that we have found. This conclusion applies separately to the SLCs found in our local assessments, to the SLCs found in our national in-store assessments, and to the SLCs found in our national online assessments, as well as to all SLCs when viewed as a whole.

¹⁰⁵³ CC8, paragraph 1.8(d).

Behavioural remedies

- 18.210 As set out in paragraph 18.13 above, our initial view was that a behavioural remedy would not be an effective remedy to the SLCs or any resulting adverse effects that we provisionally found. We provisionally 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.
- 18.211 However, we made clear that we would consider any behavioural remedies put forward as part of this consultation.
- 18.212 The Parties have proposed a subsidy for a potential PFS purchaser, as discussed in paragraphs 18.151 to 18.157. We accept that this may act as an incentive to purchasers of standalone PFSs but do not consider that this remedy, which only applies to PFSs being sold on a standalone basis, would be effective in remedying the relevant SLCs on its own.
- 18.213 The Parties have also made various Public Commitments¹⁰⁵⁴ around price savings, a fuel margin cap and supplier payment terms. They confirmed that these are not intended to be remedies, and that the SLCs would be remedied by divestiture. We therefore address them in Chapter 16 and in paragraphs 18.227 to 18.232.
- 18.214 Tesco noted that the Parties' proposed behavioural remedies were dependent on the Parties achieving their synergies goals, and that Tesco had already commented on the challenges of achieving those synergies largely from price harmonisation and particularly in the present case where the growth story necessary to encourage suppliers to invest was not obviously present. In any event, Tesco told us it did not know how such remedies would be policed and, in particular, how one could distinguish price cuts in the ordinary course of business from specific commitments following a merger.
- 18.215 No other behavioural remedies have been proposed. We therefore do not consider that any behavioural measure will be effective in remedying the SLCs we have identified.

¹⁰⁵⁴ Parties' response to the Remedies Notice, paragraph 4.6 and *Sainsbury's and Asda commit to £1 billion of grocery savings and fuel cap* (19 March 2019).

Conclusion on effectiveness of remedy options

18.216 In the Remedies Notice, we set out two potential structural remedies for the SLCs that we had identified for the Merger:

- (a) prohibition of the Merger; and
- (b) requiring the divestiture to a suitable party (or parties) of assets and operations sufficient to address effectively each of the SLCs identified in the Provisional Findings.¹⁰⁵⁵

18.217 As set out in paragraph 18.21, 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.

18.218 In paragraph 18.209 we concluded that there were significant risks regarding the scope and composition of a divestiture package, the identification of a suitable purchaser and the practicalities of executing such a large divestiture.

18.219 For the reasons outlined above, the Parties' proposed remedies are clearly insufficient to resolve SLCs covering a large part of their businesses, and we have found no suitable behavioural remedies in this case.

18.220 Having considered the issues and taking into account the views of the Parties and third parties, we have not identified a divestiture remedy that would effectively address SLCs covering a large part of the Parties' businesses (whether to address the SLCs found in our local assessments, the SLCs found in our national in-store assessments, the SLCs found in our national online assessments, or to address all SLCs when viewed as a whole).

18.221 As a result, we conclude that the only effective remedy to SLCs of the scale we have found is prohibition of the Merger. We consider the proportionality of this remedy in a later section.

¹⁰⁵⁵ Remedies Notice (20 February 2019).

Relevant customer benefits (RCBs)

Legal framework

18.222 In considering remedies, the CMA may have regard to the effects of remedial action on any RCBs, within the meaning of section 30 of the Act, arising from the Merger. RCBs are limited by the Act to benefits to relevant customers in the form of lower prices, higher quality, greater choice of goods or services, or greater innovation in relation to goods or services.¹⁰⁵⁶

18.223 As laid out in the Act, a benefit is only an RCB if the CMA believes that:¹⁰⁵⁷

- (a) the benefit has accrued as a result of the creation of the relevant merger situation concerned or may be expected to accrue within a reasonable period as a result of the creation of that situation; and
- (b) the benefit was, or is, unlikely to accrue without the creation of that situation or a similar lessening of competition.

18.224 In determining the costs associated with any remedy, the CMA may have regard to the effect of any remedial action on any RCBs arising from the Merger. In essence, any RCBs that will be foregone due to the implementation of a particular remedy may be considered as costs of that remedy.¹⁰⁵⁸

18.225 Our Remedies Guidance notes that the merger parties will be expected to provide convincing evidence regarding the nature and scale of RCBs that they claim to result from the merger and to demonstrate that these fall within the Act's definition of such benefits.¹⁰⁵⁹

Parties' views

18.226 The Parties stated that prohibiting the Merger would prevent their estimated efficiency savings of £1.6 billion being generated, and as such prevent the significant reductions in prices to be made by the Parties as a result of the Proposed Merger and corresponding market-wide improvements in rivalry. They consider that this would correspond to a loss in RCBs, which the CMA would need to take into account.¹⁰⁶⁰

¹⁰⁵⁶ The Act, [section 36\(4\)](#).

¹⁰⁵⁷ The Act, [section 36\(4\)](#).

¹⁰⁵⁸ [CC8](#), paragraph 1.15.

¹⁰⁵⁹ [CC8](#), paragraph 1.17.

¹⁰⁶⁰ [Parties' response to the Remedies Notice](#), paragraph 2.2.

18.227 The Parties emphasised that as a result of the synergies available from the Merger, they have made Public Commitments to reduce prices by £1 billion per annum, to implement a margin cap on Sainsbury's fuel prices, to maintain the existing Asda fuel pricing strategy, and to pay smaller suppliers more promptly.¹⁰⁶¹

Our assessment

18.228 In our Provisional Findings, we provisionally concluded that post-Merger the Parties would be likely to generate rivalry-enhancing efficiencies in the form of procurement savings, which they would have the incentive to pass onto customers. We note that price reductions (or changes in other competitive parameters) would only be expected to benefit customers where the downwards pricing pressure from efficiencies is larger than the upward pricing pressure from reduced competition.¹⁰⁶²

18.229 In response to the Provisional Findings, the Parties made additional arguments around the specific level of these rivalry-enhancing efficiencies which we have considered in reaching our Final Report.

18.230 We consider that any rivalry-enhancing efficiencies resulting from the Merger have the potential to give rise to RCBs. This is because we have found that these are Merger-specific savings which would act as an incentive on the Parties to improve their offer to customers (eg through lower prices, higher quality, greater choice of goods or service) in a timely manner. However, this incentive would only be likely to result in RCBs if it outweighs the Parties' incentive to raise prices as a result of the loss of rivalry.

18.231 We are not aware of any additional RCBs beyond these rivalry-enhancing efficiencies. In particular, we consider that:

- (a) We have taken account of the Public Commitments in determining the level of rivalry-enhancing efficiencies which we have incorporated in the competitive assessment in Chapter 16. We do not consider that the Public Commitments themselves would give rise to additional RCBs beyond the likely level of rivalry-enhancing efficiencies arising from the Merger;¹⁰⁶³ and

¹⁰⁶¹ [Parties' response to the Remedies Notice](#), paragraph 4.6 and [Sainsbury's and Asda commit to £1 billion of grocery savings and fuel cap](#) (19 March 2019).

¹⁰⁶² We note that this is based on a symmetric expectation of pass-through applying to both efficiencies and changes in competitive pressure.

¹⁰⁶³ Our concerns with the Public Commitments are set out in paragraphs 16.208 to 16.218.

- (b) If there are other potential synergies which might arise from the Merger (eg fixed cost savings), they should not be considered an RCB, as the Parties have not demonstrated that they would pass these onto customers. This is consistent with our approach in the Provisional Findings, where we provisionally concluded that they would not have the incentive to do so.

18.232 The gross estimate of rivalry-enhancing efficiencies that we have identified is £500 million. Any net decrease in prices (or other relevant improvements in the competitive offer) arising from this downwards pressure, after taking into account the detriment found in the SLCs, would represent an RCB.¹⁰⁶⁴ We will therefore consider this below, in the context of proportionality.

Proportionality

Legal framework

18.233 Having considered the effectiveness of remedy options, we now consider the costs of those remedies that we expect would be effective in addressing the SLC and resulting adverse effects.¹⁰⁶⁵

18.234 In order to be reasonable and proportionate, the CMA will seek to select the least costly remedy, or package of remedies, that it considers will be effective. If the CMA is choosing between two remedies which it considers will be equally effective, it will select the remedy that imposes the least cost or that is least restrictive. In addition, the CMA will seek to ensure that no remedy is disproportionate in relation to the SLC and its adverse effects.¹⁰⁶⁶

18.235 When considering the costs associated with a remedy, the CMA's considerations may include (but are not limited to):

- (a) distortions in market outcomes;¹⁰⁶⁷
- (b) compliance and monitoring costs incurred by the Parties, third parties, or the CMA;¹⁰⁶⁸ and

¹⁰⁶⁴ These rivalry-enhancing efficiencies were included as an offsetting factor within the GUPPI formulation when assessing whether an SLC was likely to occur, and so have already been incorporated into our analysis.

¹⁰⁶⁵ CC8, paragraph 1.9.

¹⁰⁶⁶ CC8, paragraph 1.9.

¹⁰⁶⁷ CC8, paragraph 1.11.

¹⁰⁶⁸ CC8, paragraphs 1.11.

(c) the loss of any RCBs that may arise from the Merger which are foregone as a result of the remedy (as discussed above).¹⁰⁶⁹

18.236 In addition, as the Parties had the choice of whether or not to proceed with the Merger, the CMA will generally attribute less significance to the costs of a remedy that will be incurred by the Parties than costs that will be imposed on other relevant entities.¹⁰⁷⁰

Parties' views

18.237 The Parties stated that prohibition would be disproportionate. They state that the CMA could effectively address the SLCs through what they consider to be a less intrusive and less costly divestiture package as set out in paragraphs 18.22 to 18.27 above.¹⁰⁷¹ In particular, they state that prohibition would eliminate RCBs entirely.

Our assessment

Selecting the least costly effective remedy

18.238 As discussed in paragraphs 18.216 to 18.221 above, we have concluded that prohibition would be the only effective remedy to the SLCs identified in this Final Report. Accordingly, prohibition would represent the least costly effective remedy.

18.239 The Parties stated that any divestiture to address SLCs of the scale identified in the Provisional Findings would not be possible, describing those SLCs as 'unremediable'.

18.240 The scale and scope of the SLCs that we have identified in this Final Report are similar to those that we set out in the Provisional Findings and the Remedies Working Paper, and fundamentally different to those alternative SLCs that the Parties submitted and for which they proposed a remedy.

Proportionality to the SLCs and their adverse effects

18.241 Having concluded that prohibition represents the least costly effective remedy, we now consider whether it would be proportionate to the SLCs and their adverse effects. In doing so, we are required to compare the level of

¹⁰⁶⁹ [CC8](#), paragraphs 1.11 and 1.14–1.20.

¹⁰⁷⁰ [CC8](#), paragraph 1.10.

¹⁰⁷¹ [Parties' response to the Remedies Notice](#), paragraphs 2.1–2.5.

harm which is likely to arise from the SLCs that we have identified with the relevant costs of the proposed remedy.¹⁰⁷²

- 18.242 In the context of an anticipated merger, prohibiting the transaction is unlikely to result in significant operational costs (eg from unwinding agreements or selling assets),¹⁰⁷³ and by preventing the proposed structural changes to the market, it would avoid any risk of distortions in market outcomes while incurring no compliance or monitoring costs. In addition, the Parties stated there were no additional costs (other than the loss of RCBs) that should be included when we are considering proportionality.
- 18.243 During our competitive assessment, we took into account the effect of £500 million of rivalry-enhancing efficiencies in determining the SLCs.¹⁰⁷⁴ As discussed above, any net decrease in prices (or other relevant improvements in the competitive offer) arising from the resulting downwards pressure from the Merger would represent an RCB. However, even when taking the effects of these downward pricing pressures into account, we concluded that the loss of rivalry was sufficiently large as to substantially outweigh these effects and result in SLCs at the national level (ie in every local market for in-store groceries and online groceries).
- 18.244 We therefore consider that the adverse effects of the SLCs are substantially larger than the level of RCBs arising from the Merger, and customers would suffer significantly more harm if the Merger was allowed to complete, compared with the loss of RCBs resulting from Prohibition.
- 18.245 Finally, we note that by its nature, prohibition is an intrusive intervention in that it prevents the Parties from achieving their strategic aims in relation to the Merger. However, given the expected level of consumer harm which would arise from the SLCs as a result of the Merger, we consider that this intrusion is justified.
- 18.246 Therefore, we conclude that prohibition as a remedy is proportionate in relation to the SLCs and their adverse effects. This conclusion applies separately to the SLCs found in our local assessments, to the SLCs found in our national in-store assessments, and to the SLCs found in our national online assessments, as well as to all SLCs when viewed as a whole.

¹⁰⁷² [CC8](#), paragraphs 1.10-1.11.

¹⁰⁷³ We note that, as the Parties had the choice of whether or not to proceed with the Merger, the CMA will generally attribute less significance to the costs of a remedy that will be incurred by the Parties than costs that will be imposed on other relevant entities (see [CC8](#), paragraph 1.10).

¹⁰⁷⁴ These rivalry-enhancing efficiencies were included as an offsetting factor within the GUPPI formulation when assessing whether an SLC was likely to occur.

Conclusions on proportionality

18.247 On the basis of our reasoning as explained above, we conclude that prohibition is the least costly effective remedy and is not disproportionate to the SLCs and their adverse effects.

18.248 Therefore, we conclude that prohibition represents a proportionate remedy to SLCs of the scale identified in this Final Report.

Remedy Implementation

18.249 In our Remedies Working Paper, we said we would consider accepting undertakings under section 82 of the Act if the Parties were to offer them.¹⁰⁷⁵ No such offer has been made. We therefore expect to implement the prohibition remedy by making an Order under section 84 of the Act, which will prohibit the Merger and prevent the Parties from attempting to merge within the next ten years, absent a change of circumstances.¹⁰⁷⁶

Decision on remedies

18.250 In light of the above we have found that prohibition of the Merger represents the only effective remedy to the SLCs we have found. We have also found that this remedy is proportionate in relation to the SLCs and their adverse effects.

¹⁰⁷⁵ The Act, [section 82](#).

¹⁰⁷⁶ The Act, [section 84](#).