

Retail Therapy

COMPETITION WATCHDOG BREAKS NEW GROUND IN APPROVING TESCO-BOOKER MERGER

In December the UK Competition and Markets Authority (CMA) gave unconditional clearance to the anticipated merger between Tesco, the country's largest grocery retailer, and Booker, its largest wholesaler. The clearance followed an 11-month, in-depth Phase 2 probe by the CMA. The watchdog had to investigate the potential competitive impact of the tie-up on food suppliers as well as on other wholesalers in the market. A further particular focus was whether the merger might result in a poorer deal for customers in areas where there are both Tesco stores and independent grocery shops supplied by Booker. The CMA concluded that "competition is sufficiently strong in both the wholesale and retail grocery sectors to ensure that the merger between Tesco and Booker will not lead to higher prices or a reduced service for supermarket and convenience shoppers".

Frontier Economics advised Tesco and Booker throughout the process on issues of strategy, synergies assessment and competition engagement. Simon Gaysford, a director in Frontier's Retail and Consumer practice, said: "The food market is changing rapidly. Competition in the sector has always been about finding new ways to serve customers, and rethinking the end-to-end supply chains that get food to customers. We are pleased that the CMA has been able to look through the stakeholder concerns and get to the fundamentals. This deal is about creating new opportunities for two of the biggest food businesses in the UK to serve customers better, and finding new avenues for future growth."

The CMA's verdict marked a new theoretical development for the regulator, according to Dave Foster, a director in Frontier's Competition practice. "Using the model we put forward, the CMA has done its most detailed analysis yet of how to look at the incentive to raise prices in a 'vertical' merger, dealing with the fact that Booker does not control the retail stores that compete with Tesco," Foster said. "This was central to the decision, and I expect that it will set the benchmark for how similar mergers are assessed in future."

There has been extensive coverage of the implications of the CMA's decision for the grocery market, with some commentators declaring there was now an 'open season' for further consolidation. However, this reasoning may be wide of the mark. In particular:

1. This was a 'vertical' rather than a 'horizontal' merger. Booker does not own or control the stores it supplies; the independent retailers that source from Booker (and other wholesalers) are free to set their prices and decide which products to stock. It would be wrong, therefore, to draw too many inferences from this case for potential consolidation between retailers that own their stores (i.e., a traditional 'horizontal' merger).
2. Booker operates a looser 'symbol' model than other operators, some of which are closer to a franchise arrangement. Two important inputs to the CMA's incentives analysis were the level of (i) wholesale switching and (ii) pass-through by independent retailers (in the face of the theoretical deterioration in price or service offered by Booker that the CMA considered). For

symbol retailers that operate a tighter model, these input parameters may be different, with different outcomes from any incentives analysis.

3. Tesco and Booker-supplied stores are not close competitors. Consumer 'diversion' from one to the other would be low (following a theoretical deterioration at either). Instead, consumers would be much more likely to switch to other, closer competitors. This has important implications for the analysis regarding incentives to lower the quality of the customer offer. However, the same considerations might not apply in mergers where consumer diversion between closer competitors is much higher.

With continued strong competition in the market, plus new entrants (e.g., Amazon/Whole Foods) and potential mergers (e.g., Co-op/Nisa) on the horizon, 2018 looks set to be another busy year for grocery retail. For Tesco and Booker, having satisfied the authorities, their focus now shifts to the job of unlocking the growth opportunities presented by the deal.



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