Sainsbury's-Asda Merger in Doubt over 'Extensive Competition Concerns': Critical Analysis of Article in the Guardian

Introduction

An article published on 20 February 2019 by the Guardian discusses the concerns associated with the merger of two supermarket giants, ASDA and Sainsbury’s. The article resolves around Competition and Markets Authority (CMA) finding “extensive competition concerns” while investigating the proposed deal. Media has raised an issue concerning consumers and welfare, which are threatened by the potential merger. Many industrial economics topics are implied in the article, these include horizontal merger, welfare, market definition, etc. In this essay I will aim to focus on welfare implications and why anticompetitive mergers are of serious concern to the regulatory authorities. First, this essay will explore the extensive economics literature regarding the subject, then analyse the article with empirical evidence. ASDA and Sainsbury’s have currently put the deal on hold, in attempt to resolve the issues.

Horizontal merger is a merger or business consolidation that occurs between two or more firms in the same industry, that were previously competitors. Generally, firms merge to maximise efficiency, productivity and sizable gains. This can be achieved through price manipulation and monopolising a local market. By merging, firms aim to exploit their strength and newly obtained market share to maximise profits. Economic theory suggests that consumers always suffer welfare losses, specifically for larger horizontal mergers.

Literature review

Economic literature regarding the drawbacks and dangers of horizontal mergers indicate two major issues. The two main hypotheses “consumer protection” and “market concentration hurdle” (Ning Gao, Ni Peng, Norman Strong, 2017) are the anticompetitive products of the merger. Competition authorities are interested in both, protection of the customers and the market. In a more empirical approach (Tiago Pires, Andre´ Trindade, 2017) focuses on the effects on variety and prices, which will clearly be affected. In economic theory, such a major market consolidation is almost certainly going to increase the prices across all firms in the market. In a study by (Robin A., Prager T. and Timothy, 1998) price effects are empirically examined in mergers which substantially increase market concentration. Their findings illustrate an increase in market price and a significant shift in market power caused by the merger. In a different study conducted by (Emilie Dargaud and Carlo Reggiani, 2015) both positive and zero price effects are said to be possible outcomes of a horizontal merger. In the groceries and general merchandise market it is unlikely that no effect on the market price will be observed, due to high competition on prices and their volatility.

Product variety is another important aspect regarding horizontal merger frequently covered in economics literature. Theoretically a horizontal merger should decrease the product variety, as the jointly owned stations have no more incentive to compete. (Steven T. Berry and Joel Waldfogel, 2001) discover that theory alone cannot predict the effect on variety. Using an OLS regression the study discovers the opposite, indicating that consolidation promotes product variety. Another study in industrial organisation argues that a successful horizontal merger decreases product variety but becomes more efficient and concise, alternatively there will be an inefficient increase in product variety (Haimanti Bhattacharya and Robert Innes, 2016). In the context of a merger between two sophisticated and experienced giants, such as ASDA and Sainsbury's the latter is unlikely. There are many competing theories regardless this subject. The outcome is very market dependent and situational. Product variety promotes consumer welfare, but high prices do not. The effect on welfare therefore can be very complex and difficult to predict.

Another important measure of success is efficiency. Intuitively a merger should have increased efficiency. Economic theory suggests that improved efficiency is expected, mostly because of economies of scale. Market power can grant lower operating costs as well as more resources to optimise the supply chain. In a recent study by (Alison Chapin and Stephen Schmidt, 2019) it is pointed out that when larger firms horizontally merge, they often exceed the efficient scale. In economics theory at a certain point beyond economies of scale, a firm becomes more inefficient with each extra unit of output. (Gamal Atallah, 2016) conducts a very relative subject, focusing on oligopolistic markets with homogenous goods. He finds that in such cases generally all mergers lead generates efficiency gains. The newly merged entity can gain different types of efficiencies: technological, scale, supply chain. In industrial organisation these may result in long term reduction of marginal costs and operating costs, sustaining long term efficiency gains.

A study on antitrust case selection among horizontal mergers, (Ning Gao, Ni Peng, Norman Strong, 2017) argues that there is strong empirical evidence suggesting that horizontal mergers are most often motivated by efficiency gains rather than anticompetitive purposes. Competition is what protects customer surplus, however in the groceries and general merchandise market with only few firms dominating the market consumers might suffer due to anticompetitive behaviour. The gain in market power can easily drive up the prices and boost producer surplus at the expense of consumer surplus. Literature suggests that consumer protection is most likely not of high priority to the competition authorities.

Article analysis

The article focuses on Competition and Markets Authority's concern of the merger causing numerous anticompetitive issues in the market. "CMA said the merger would create a 'substantial lessening of competition at both a national and local level'" (The Guardian, 2019). ASDA is a British supermarket retailer owned by the US Walmart. According to Kantar Worldpanel data, ASDA currently has 15.5% UK's grocery market share. Sainsbury's has control of 15.7%, resulting in the potential merged entity's market share of 31.2%, which would overtake the current dominant giant Tesco's with its 27.7%. CMA is concerned with having almost 60% of the market split between two firms.

Although economic theory suggests an increase in market price, Mike Coupe, the chief executive of Sainsbury's promises a 10% price reduction. This can be achieved through efficiency gains obtained from the merger, as the marginal costs can decrease significantly. However, this promise, according to industrial economics literature, will not be kept in the long run. With such a drastic change in market consolidation, the prices will inevitably increase, perhaps negating the initial 10% price cut.

The CMA laid out limited options for the two firms to follow. These include calling off the deal all together or “requiring the merging companies to sell off a significant number of stores and other assets” (The Guardian, 2019). The requirement is slightly farfetched and aggressive by the competitive authorities. Despite the legislation that can be put against the deal ASDA and Sainsbury’s say that they will press on with the deal. Such conflict can be very detrimental for the two giants.

The article also points out that the merger can lead to a reduction in the quality of choice for the consumers. I do not agree with that statement, as mentioned by (Haimanti Bhattacharya and Robert Innes, 2016) variety will most likely decrease but impove the efficiency and quality of the products. The merged entity will most definitely not make such a mistake in the short run specifically as they will be vulnerable to losing the newly obtained market share with the added pressure from the media and CMA.

The article suggests that the merger will be harmful to consumers, however CMA does not seem to be as invested in protecting consumers as it is in protecting the overall UK’s grocery market balance. The study conducted by (Ning Gao, Ni Peng, Norman Strong, 2017) supports the argument that the merged entity is most likely focused on efficiency and market gains rather than disrupting the competitive nature of the market.

The fourth largest firm in the grocery market Morrisons, which occupies 10.5% of the market share (Kantar Worldpanel data, 2019), raised its concerns of the proposed deal to the CMA. Morrisons argued that the new entity would lead to a duopoly in the market and severely damage the competition (RetailGazzette, 2018). Morrisons, supported by economic theory, believes that prices would spike and the competition between the newly two leaders in the market could become less fierce. Tesco has also made a comment about the merger, mentioning that there would be very few customer benefits and no incentives to lower the prices. Economic theory suggests that if substantial efficiency gains can be achieved a reduction in prices is possible in order to increase the competitive advantage.

Conclusion

The 10-12bn pound deal is certainly going to impact UK’s market for groceries and general merchandise. Despite the extensive literature on horizontal mergers and its implications it is hard to predict how the merger will influence the prices, efficiency and consumer welfare. I think that the newly merged entity, if the deal does happen, will reduce its prices in the short run to attract investors, please the consumers and CMA. In the long run the anticompetitive issues will most likely arise as two firms will own 60% of the market.