

# The Analysis of Asda-Sainsbury's Merger/Acquisition

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## ABSTRACT

The merger of Sainsbury's and Asda caused huge impacts on Britain retail industry. Since the announcement that J Sainsbury plc would acquire Asda for £ 7.5 billion was published in April, 2018, the changes in the UK grocery market have been discussed and questioned. And the grocery market in UK will be reordered without doubt. This essay firstly introduces Sainsbury by using Pestle model, then aims to figure out the type and the benefits of this M&A, analyze the market response and how investors react to this event in the first two parts. In the third and the last part, we aim to explain why the CMA blocked the merge.

## 1. Pestle of Sainsbury

Sainsbury's is the second largest supermarket chain in the UK which was established in London 150 years ago. However, the supermarket has long been in fierce competition with other brands, such as market-leading Tesco or close competitor Asda. In such a difficult environment, it is vital that Sainsbury's pay close attention to its immediate business environment and how this may affect internal operations. Recalling affect the political, economic, social, cultural, technological, legal and environmental factors and that's what we have to do in this article is a method of identifying potential factors that could affect Sainsbury's is the PESTLE analysis.

### 1.1 Political——Brexit

In 2016, the UK voted to leave the European Union.

The move called "Brexit" has not yet happened. However, this might be Sainsbury's (Sainsbury's) and other British supermarket chains have serious consequences. The EU may make it difficult to leave the supermarket affordable products imported from abroad. Rising cost of foreign products may eventually be passed on to consumers, but this means that Sainsbury will have to strive to ensure that customers continue to consume as much as possible, in order to maximize profits.

### 1.2 Sociocultural

#### (1) Fierce competition

Sainsbury's faces fierce competition. There are many popular supermarket chains in the UK, including Tesco, Morisons, Waitrose, Lidl, Aldi, Asda, etc. Moreover, the country also has a large number of independent corner shops and other more specialized food stores, such as

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butchers and bakeries. The game showed no signs of regression, forcing Sainsbury's to innovate while minimizing the ability to make unreasonable profits.

(2) Healthy diet

The 21st century shows a clear socio-cultural trend of healthy eating. Unhealthy "junk" food is no longer popular, and salads, milkshakes and snacks are being replaced. The trend of constantly changing eating habits is an extremely important trend for supermarket chains like Sainsbury's, because adapting to consumer needs is essential for long-term success.

(3) Fair trade movement

Consumers are also becoming more aware of where their food comes from, so they are also paying attention to the fair-trade movement. This social initiative involves paying extra for food and beverages so that farmers can be assured of buying products at fairer prices. The fair trade movement is particularly popular in the context of coffee and chocolate, but it has a wide range of influence, affecting all products in the aisle.

### 1.3 Technical

(1) New Technology

Advances in analytical technology, such as the use of Big Data and Artificial Intelligence Principles, have enabled companies around the world to learn more about their operations. In the case of supermarkets such as Sainsbury's, advances in analysis can be used to build highly accurate models that describe the expected sale and prices of a given product.

(2) Online Shopping

Like most other supermarkets in the UK, Sainsbury's also offers online shopping options. More than ever, customers want to order groceries from the comfort of their homes. The emergence of e-commerce and its use in the food industry is still in its early stages. It will be very interesting to see how supermarkets make the most of this evolving technology.

### 1.4 Environmental—Carbon Footprint

Supermarket chain responsible for a large carbon footprint. Whether it is the transport of goods from one side to the other side of the country, or around the clock to make large supermarkets and warehouse lighting, Sainsbury's (Sainsbury's) will certainly create their share of carbon dioxide due. As concerns about environmental issues increase, companies around the world are expected to reduce their carbon footprints. Sainsbury (Sainsbury's) will need to find new ways to become more environmentally friendly, and seriously consider how to minimize the eco-

logical damage caused by the operations.

### 1.5 Final Thoughts

Sainsbury has a place in British supermarkets. However, the brand must deal with fierce competition, political uncertainty, rising fuel costs and salaries, and consumers' higher expectations for healthy eating choices, supplier benefits and environmental awareness. On the positive side, Sainsbury's has multiple ways to differentiate itself from other chains, and it can do this with the help of advanced analytics. It is also because of these challenges faced by Sainsbury's, it decided to adopt the method of mergers and acquisitions to enhance their size and strength.

## 2. Introduction of the Merger and acquisition between Sainsbury and Asda

On April 30, 2018, Sainsbury and Asda confirmed to the media that they had decided to invest more than £12 billion in a super-merger plan. Asda was founded in 1949 and was acquired by Wal-Mart in 1999. It is the first shopping mall in the UK. It clearly prohibits the use of artificial melanin and spices in foods and tea beverages produced by itself, and focuses on "zero pollution" food. It is one of the British retail giants. Asda is undoubtedly one of the key and reasonable layouts of Wal-Mart in the UK, but the development trend of this well-known shopping mall in recent years is not satisfactory. Strong competitors have released a lot of pressure on it, and Wal-Mart is also considering the next step, about Asda. Sainsbury is the second largest supermarket chain in the UK, accounting for approximately 16.9% of the market share. The company's stock is listed and traded on the London Stock Exchange and is a component of the FTSE 100 Index. Sainsbury's was founded in 1869 by John James Sainsbury as a store in Drury Lane, London, England. The company became the largest grocery retailer in the UK in 1922 and was an early adopter of the self-service retail industry in the UK. Meanwhile, they launched a price war to combat German low-cost supermarkets Aldi, Lidl and emerging threats from "super e-commerce" Amazon. Based on the market share of Sainsbury's and ASD the UK food retail industry (15.8% and 15.6% respectively), the combined new company would have 2,800 stores in the industry and nearly one third of the UK market share. According to The Guardian (2018), the new transaction meant the merger would become Britain's biggest supermarket chain, overtaking Tesco that was the 1st giant in the grocery market before. The M&A (M&A) mentioned in this paper mainly focus on the outcome, with all assets and liabilities of two

or more companies combined together, rather than the way how it be done, merging or purchasing. In this case, three different types can be adopted to help analyze most of real-world company cases: strategic M&A, financial M&A, and conglomerate M&A, among which, strategic M&A is normally subdivided into horizontal acquisition, vertical acquisition and tax motivated acquisition. Considering the situation of Sainsbury and Asda, it should belong to the horizontal type of strategic M&A. The synergy effect produced by this merger is a dominant reason to be deemed as the strategic type, because the two working together generate more value than the sum of the individual parts. In the meantime, as they produce and sell similar products in the same business sector, their merger action belongs to horizontal M&A. It means that synergy can be obtained through many forms such as cost savings, increased market share and exploring new market opportunities.

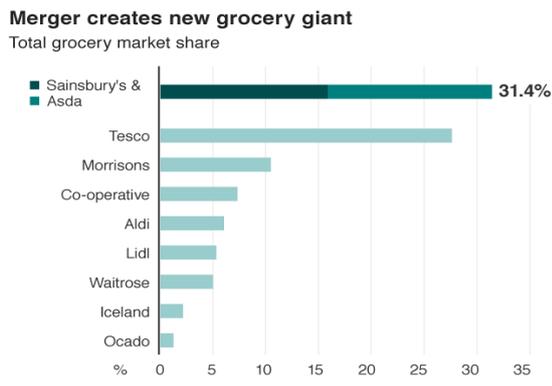


Figure 1. Merger creates new grocery giant (Source: Kantar Worldpanel. Market share 1)

The expected benefits of supermarket leading companies' transactions can be easily noticed in many ways. It is apparent that one of the most significant signs, stock price of Sainsbury, soared 20% on the second day of the media's affirmation, rising to its highest level since 2014, while the shares of its main competitors Tesco and Morrisons had fallen back. The super company said that due to its superior market control capabilities, it is preparing to reduce the price of the two branded supermarkets by 10%. This benefited not only optical investors, but also the ordinary shoppers, resulting from a supermarket price war caused by the £12 billion large-scale merger. Besides, there are possible benefits from reduced competition resulting from the acquisition of a competitive competitor, through the cooperation of ready-made production lines, rapidly formed production capacity, and enlarged market share, thereby enhancing their competitiveness. In addition, achieving economies of scale, they can reduce costs, increase the economic benefit and risk resistance of enterprises, to improve the industry concentration. Horizontal

mergers can also bring about an increase in industry risks and the use of monopoly power to increase corporate profits. As what Sainsbury's said on Twitter (Digital spy, 2018), "We plan to operate a dual-brand strategy in grocery, with the scale to invest in the areas that matter most to customers: price, quality and more flexible ways to shop." On the one hand, ASDA will be used to compete with German low-priced supermarket brands Lidl and Aldi; on the other hand, Sainsbury's price cuts are weakening the market competitiveness of high-end food retailers such as M&S and Waitrose. Through the combined sales of up to 500,000 online payments per week from the two supermarkets, the new company also hopes to put pressure on online food retailer Amazon.

### 3. Market Response and investors' views on this M&A

According to Financial Times, before declaring the super-merger plan with Asda, Salisbury's has experienced a slump in stock for at least a year, just as nearly all of the UK retailers were facing such an issue. (2018) However, the deal between Asda and Salisbury's gave rise to a significant increase in share price of Salisbury's, which was bought to the highest level ever since 2015 and are still reaming at a high level as compared to the share price in last 3 years. While the share prices of rival retailers of Salisbury's, such as Tesco and Morris's, fell after the declaration. In addition, till December 2018, share prices of Salisbury's is still the highest.



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Figure 2. Market Response and investors' views on this M&A

source: «London stock Exchange»

There are two methods for empirical research on the performance of listed companies' M&A. The two methods based on stock price which is called event study methodology (Fama, Fisher, Jensen and Roll, 1969) and another one is financial indicator method. The event study methodology is based on the stock price changes before

and after the merger, based on the stock price, and tests the responses of the securities market before and after the company's M&A. The price of a stock is related to the company's behavior. If the event has a significant impact, the company's stock price will change a lot. (Fama, Fisher, Jensen 1969). This approach generally represents the expected future earnings of the business. If the market expects M&A to improve the profitability of the company, then the company's stock will generally rise. If the M&A cannot benefit the company, even it will damage the profitability of the company, then in general, the company's stock will fall.

Stock price is a threshold indicator that reflect how the investors view the operating activities of a company. In this M&A case, the premium price of the stock price of Sainsbury's can be deemed to be the value that the synergy effect will generate in the future. Since the stock price increased dramatically, it is rational to infer that investors anticipate the synergy effect of M/A could bring about future gains to the company and to the investors. Besides, the financial option can signal company's attitude to the merge and acquisition. In terms of the M/A deal between Asda and Salisbury's, Walmart, the US parent company of Asda, will obtain 42% share capital after corporate combination with the addition of GBP 2.98 billion in cash. (Financial Times, 2018) But that no debt involves in this M/A activities cannot be thought as the gist of that the involved companies in the M/A might not have as strong confidence of successful combination as investors expected, since leveraged buyouts are generally not considered in strategic acquisitions. Instead, that many major shareholders of Salisbury's supported the deal could be a sign of strong confidence in achieving the M/A. (Financial Times, 2018)

Based on the rise in stock price of Salisbury's, it is reasonable to make a point that investors have confidence in that the M&A will be achieved and that the stock of Salisbury's is currently undervalued. Moreover, because the stock prices of its competitors decreased and are by far lower than the price of its stock, after the M/A, the combined organization of Asda and Salisbury's will be more competitive in the retailer market and able to generate great value by taking advantages of synergy.

At the beginning of essay, the M&A of Asda and Sainsbury's companies have been introduced as horizontal mergers and acquisitions. Horizontal mergers and acquisitions refer to mergers and acquisitions between enterprises in the same industry or in the same production sector. The purpose is to expand the scale of business operations, generate economies of scale, increase production efficiency, and reduce production costs, and increase market share

and competitiveness. It is obviously that after the merger, the market reaction indicates that the stock price has risen, the suppression of other competitors and the increase in competitiveness in this industry. All the indicators show that the merger has achieved the expected goals. This response of this merger is typical for horizontal mergers.

#### **4. Anti-Trust and Blocking the Takeover**

Trust is one of the advanced forms of monopoly organization, which is composed of many enterprises that produce similar commodities or products closely related to the merger of enterprises. (Dwight, Theodore 1888.) From the overall point of view of social and economic development, mergers and acquisition of enterprises can optimize the allocation of resources, enhance the productive efficiency of society, and promote the consumer welfare. However, when mergers and acquisition reach a certain scale, leading to a sharp increase of market power of a market subject, monopoly may emerge as a result of a distorted market competition structure (Li, Rita Yi Man; Li, Yi Lutz, 2013). Anti-trust bodies refer to those administrative agencies which specialize in anti-trust law enforcement or whose main duties are anti-monopoly law enforcement. Anti-trust law can be simply defined as the general term of legal norms that regulate business behavior and maintain market competition. Its content mainly includes: Control the anti-competitive behavior of negotiation between two or more operators; Control the abuse of market dominance by a single dominant enterprise in a certain market; Control the excessive concentration of industrial structure caused by mergers and acquisitions. Since the basic means and mode of allocating social resources in market economy countries are market competition, and market competition order is the basic economic order, anti-trust bodies have great independence and high status in market economy. (Taylor, Martyn D., 2006).

Salisbury's ranked second in Britain among super-market chains, followed by Asda, the third largest super-market. As Salisbury's merged with Asda, the combined enterprise would have a total valuation of £15 billion, and their market share would exceed Tesco, the currently largest supermarket in UK. David Taylor, the chairman of the J Sainsbury plc board who is going to retire, said that the main purpose of this merge is to save costs and reduce selling prices for customers. However, when analyzing the impacts of this merger, we should consider various aspects. Since the combined enterprise could be the largest grocer in UK with significantly lower selling prices of goods than other stores, customers would only choose to go to Salisbury-Asda supermarkets rather than others. This trend will be harmful for those other supermarkets,

as well as for the entire market competition. What's more, it should be noticed that as the new company occupies the market at lower prices, the wholesale prices that suppliers have to face will be reduced too. It is easy to understand this trend. After the integration of resources, the amount of goods purchased from suppliers will increase. Even if the profit space for suppliers is compressed significantly, they just have to accept the orders with low prices, leading to vicious competitions among suppliers ultimately. Therefore, in order to assess the negative effects that the merger could have on the markets, the Competition and Markets Authority should scrutinize the proposed merger carefully.

## 5. Effects and Risks this M&A Could Have on Various Stakeholders

The announcement of Merge has had a certain impact on different stakeholders, including British Retail industry, Shareholders and the two company themselves.

The M&A of Sainsbury's and Asda can have huge impacts on British retail industry. Lots of various stakeholders will be affected in this event more or less. As the benefits mentioned before, the share price experienced longstanding influence. On 30 April, after Salisbury's announced that it would acquire Asda Group Ltd, the share price of J Salisbury's plc was stimulated by the trading news, rising nearly 20% on that day. The share price opened at 322.00 pence, up 19.3% from last Friday's closing price of 269.80 pence. And afterwards, investors' sentiment pushed the share price up to 327.10 pence. (Financial Times, 2018). For the shareholders of both acquirer firm and target firm, the positive returns of share prices are what they expect to happen and they will be satisfied with their rising share prices. In fact, customers will also benefit from the M&A of the two supermarkets. As J Sainsbury plc committed, the combined supermarkets will cut the selling prices by 10% in order to strengthen the price competitiveness. Therefore, the Sainsbury's-Asda enterprises can attract much more customers to go shopping than before, and customers will regard the newly combined supermarket as their priority in order to save costs when determining which stores to go shopping. Thus, from the customers' perspectives, the merger could bring convenience for them. In addition, from the perspectives of Sainsbury's and Asda, the M&A can help them to gain much competitiveness against Germany low-priced supermarket brands Lidl and Aldi. David Taylor once talked about the fact that German rivals Aldi and Lidl had been grabbing shares in the UK market in recent years. He believed that the two grocery retailers got succeed be-

cause of significant cost-effectiveness. Sainsbury's hoped to merge with Asda to reach economy of scale in order to reduce their purchase costs to the same level as those of the two grocery retailers mentioned above.

## 6. Result of this Merge and Acquisition

At first, a merger between Sainsbury's and Asda was initially rebuffed by British regulators, who did not stop the deal altogether, but panicked investors dumped their shares. The Competition and Markets Authority, the Competition and Markets Authority, said on Wednesday it was concerned that a monopoly created by the merger would drive up prices while reducing the quality of products sold, in addition to concerns about higher oil prices and a poor consumer experience. The CMA survey found that the merger would not only affect in-store customers, but also lead to higher prices and lower quality of service, such as fewer delivery methods for online shopping. In addition, it will cause motorists to pay more at 125 locations close to Sainsbury's and Asda petrol stations. CMA independent investigation group Chairman Stuart McIntosh said in a statement that it was the agency's responsibility to conduct a thorough review of transactions to ensure that the industry remained competitive and that consumers did not suffer as a result. In a statement, CMA proposed an alternative solution to its immediate concerns -- the sale of a number of combined stores and other assets, including Sainsbury's or one of Asda's brands. In response to the CMA statement, Sainsbury's and Asda said the CMA investigation had "completely misread" the intense competition in the UK grocery market, adding that a merger between Sainsbury's and Asda would "streamline a lot of costs and reduce prices". "We are surprised that the CMA has chosen to reject the opportunity to put money directly into customers' pockets, especially at a time of economic uncertainty. "In a trading statement last year, Sainsbury's and Asda said synergies and joint sourcing could cut the combined company's commodity prices by 10 percent. Shares of J Sainsbury PLC (SBRY.L) tumbled 18.55 percent to close at 234.50 pence Wednesday, more than six times volume, while SHARES of Asda Group Ltd. Asda parent Walmart Inc. (NYSE: WMT ) closed down 2.27 percent at \$99.88 on Wednesday, giving up a gain of more than 2 percent after Posting its best quarterly results in nine years on Tuesday.

April 25, 2019, The Competition and Markets Authority (CMA) finally rejected the merger of British supermarket giant Sainsbury's-Asda, believing that the transaction will make the experience of British consumers and car users worse. Reasons it is the merger that will push up price increases and lower quality, making the overall shopping

experience worse.

Stuart McIntosh, the head of the investigation team, said in the CMA's decision statement that a wide range of issues have been examined in detail, including increased competition from discount stores such as Lidl and Aldi, and the potential impact of new or expanding competitors on the retail market. And after the impact of the online retail market, although the review committee carefully considered the development of the industry, the committee did not alleviate the concerns that the merger would seriously hinder competition.

## 7. Conclusion

In this essay, we analyzed the type of and the market response to this merger, and what influence the CMA may have on this event, including the measurement that CMA may ask the newly combined enterprise to do in order to prevent the distortion of market competition. Finally, we find out the possible effects this merger could have on various stakeholders. In conclusion, this unusual merger has both positive effects (soaring share prices, lower selling prices, economy of scale...) and negative effects (layoffs of many staff, possible distort market competition...). However, CMA has chosen to reject the opportunity, we are not able to make more prediction about the future development about Sainsbury and Asda now, Sainsbury may take new measures to increase their strengths.

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