Sainsbury's live well for less

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Ms Rachel Reeves MP
Chair
Business, Energy and Industrial Strategy Committee
House of Commons
London
SW1A 0AA

Dear Rachel,

Thank you very much for your letter of 2nd May relating to the proposed combination of Sainsbury's and Asda.

I have sought to address the Committee's questions in the letter below, as well as providing some additional information that I hope will be useful. I am able to answer only on behalf of Sainsbury's and encourage you to contact Asda directly for any information on their business. Where there are questions that I cannot answer at this stage I have tried to explain why, but please do let me know if there is anything else you would like to follow up on.

Customers

There are two crucial pieces of context to the announcement that we made on 30th April.

Firstly, our customers are struggling with the cost of living and food prices have been going up due to an increase in the cost of raw materials and higher exchange rates over the past 18 months. Higher food prices are particularly hard for low income households to cope with because they spend a greater proportion of their income on food. Inevitably, more expensive food means less money available to spend elsewhere. Research by *The Grocer* magazine this weekend (which we did not know about before its publication) found that 84.8% of shoppers thought the combination of Sainsbury's and Asda would be good news if it leads to lower prices.

Secondly, the retail sector is going through significant and rapid change and there is more competition than ever before across food, clothing and general merchandise. For example, the rise of Aldi and Lidl, which now set the value benchmark on food and grocery and major online players such as Amazon, which is transforming the general merchandise market as customers seek ever greater value, choice and convenience. Sainsbury's and Asda both serve the broadest possible customer base and seek to make shopping accessible for all.

In this fast-moving environment, standing still is not an option. Bringing Sainsbury's and Asda together will result in a more competitive and more resilient business that will be better able to invest in lower prices, improved quality and range. The combined business will also benefit from new technology and be better able to create more flexible ways for all customers to shop in stores and online.

We believe the combination is great news for customers, colleagues, suppliers and shareholders of both businesses. It is also great news for the British economy as it will enable us to continue our strong record as one of the UK's largest employers and one of the highest UK corporate taxpayers.

How we can lower prices

The proposed combination with Asda would create synergies that would enable both businesses to lower prices more than each business is able to do individually.

The proposed combination will generate significant synergies and we intend to pass a substantial proportion of these savings onto customers by lowering prices on essential items by around 10%.

The largest part of these synergies come from buying benefits. Our supplier base is highly concentrated, with a small number of large - often multinational – companies accounting for the vast majority of what we buy. We plan to create the synergies by equalising the cost prices that Sainsbury's and Asda pay these companies for the same product. Put simply, if Asda is paying a supplier 98p for a product and Sainsbury's is paying 99p for it, or vice versa, then the combined business would aim to pay 98p for it.

We understand concerns that have been raised about how suppliers will be impacted by these changes, but to give some context for this - for every £1 that a customer spent in Sainsbury's last year, we made 2p profit. If you compare that with large suppliers, they generally make more than 10p profit for every pound we spend with them.

Working with suppliers

We have a strong record of managing supplier relationships and paid our suppliers on time 98% of the time in 2016/17. The Advantage Group Mirror Survey, an independent report which ranks supermarkets based on feedback from their own suppliers, shows that we are the leading supermarket when it comes to payment processes.

I understand that there are concerns around the impact of this combination on smaller suppliers – and want to give my reassurance that we have a good track record of working with and nurturing smaller suppliers and I would intend for this to continue. We have a number of examples of businesses that have partnered exclusively with Sainsbury's and gone on to become household names. We also have a number of small suppliers who we work with currently who would be happy to talk to you to give more information on how we work with them, if that would be helpful.

Sainsbury's Dairy Development Group (SDDG) is a good example of where we work with small suppliers and with farmers in particular. Now in its eleventh year, our cost of production model takes account of the price of feed, food and fertiliser every three months to ensure that every one of the 270 farmers in the group receives a profit for every pint of milk they sell to us. We also offer a bonus to incentivise continuous improvement which helps farmers to invest in their businesses and make them more sustainable.

You asked how working with a bigger company would help our suppliers to streamline their businesses. Examples of where we have done this previously include working in partnership with suppliers to reduce the number of deliveries to depots. This means their lorries are fuller and they can reduce their costs as well as their environmental impact.

I can confirm that we have had an initial discussion with the Groceries Code Adjudicator and were encouraged by her comments to the Environment, Food and Rural Affairs Committee last week. We have also had initial contact with the National Farmers Union and the Small Business Commissioner. Additionally, we wrote to our suppliers on 30th April after the announcement was made. We will keep communicating with them as appropriate throughout the process.

Head office locations

We operate from a number of office locations across the UK – London, Milton Keynes, Manchester, Coventry and Edinburgh. As part of our acquisition of Argos in 2016, we committed to maintaining an office in Milton Keynes, where Argos is based. Since then we have invested £10m in the building and are committed to keeping it open long term.

I can confirm that, following the combination of Sainsbury's and Asda, we would continue to have a strong presence in Leeds, alongside our existing office locations. This makes good strategic sense given the three core UK retail talent pools are based on the M62 corridor, the Midlands and in London.

Maintaining the store profile of the combined group

Our ideal scenario is to maintain and operate a complementary network of more than 2,800 Sainsbury's, Asda and Argos stores, trading as three distinct brands. There has been speculation that the Competition & Markets Authority (CMA) will require us to divest some stores. We cannot pre-empt the CMA process, but I am sure that you and the Committee appreciate that, in the instance of divestment, we would be required to sell stores as a going concern to an appropriate competitor. Put simply, if the CMA requires us to divest a store, it must continue to trade and cannot be closed.

It is impossible to make a blanket commitment to not closing stores in the future, because we will open and close stores throughout our ordinary course of business, for example when a lease expires on a property. However, our stores and Asda stores are popular with customers and highly cash generative and we have a track record of opening many more stores each year than we close.

Our record as an employer and addressing concern about possible job losses

We aim to be an employer where colleagues love to work and we know that customer services is a key point of differentiation for us. Our colleagues are regularly recognised as providing outstanding service and we have been awarded The Grocer Gold Awards for Service and Availability five years in a row.

Investment in our colleagues is a focus for us. We have increased our base rate of store colleague pay by 30% over the last four years and have recently proposed to pay store colleagues a market-leading rate of pay of £9.20 an hour from September 2018. We do not offer any zero hour contracts. We are also committed to training and development and have over 1,000 apprentices in our pipeline.

We have been encouraged by the reaction of colleagues to the proposed combination — and we were pleased to see The Grocer report that employees in both businesses are "warming" to the proposal and that they are excited by our aim to reduce prices by around 10% on everyday items because it will make their customers happy and make us more competitive.

We recognise, however, that a merger inevitably raises questions and concerns amongst colleagues of the businesses involved; and no company can guarantee that absolutely every job across its business will stay unchanged forever. We would expect that a very low number of well-paid managerial roles will be duplicated across the Group. It is too early to speculate on where these will be and we would aim to manage these via natural attrition where possible. As a result of the Argos acquisition, we have removed duplication in our central offices and also created new roles where we have put Argos stores in Sainsbury's. Overall, we have created 1,000 new Argos retail roles since acquiring the business in September 2016.

I can confirm that none of the synergies in our plan are based on us closing any stores or distribution centres. The nature of work in our business and the retail sector is changing and we are constantly looking for ways to help our colleagues become more efficient and for our customers to save time. For example, the growth of online shopping means that we will regularly need more delivery drivers and in-store pickers. However, we have no plans to increase the level of automation as a result of this transaction and if we are successful, we will continue to grow our business and employ more people.

We have been engaging with our trade unions and colleagues since our announcement and will continue to do so in the weeks and months ahead.

Tax

As a UK PLC, we are subject to the highest standards of corporate governance. The Exchequer will benefit from us being one of the largest taxpayers in the UK. Sainsbury's is the 66th largest company in the FTSE100, but it is the seventh largest tax contributor in the UK (according to the PwC 2017 Total Taxes Contribution survey). In 2017/18, Sainsbury's paid £2.1 billion in tax. Of that, £1 billion was a direct cost to the business including over £550 million in business rates, which support local communities by contributing to the cost of local services. The remaining £1.1 billion represents taxes collected on behalf of our colleagues, customers and suppliers, including colleague income tax and national insurance. Our effective tax rate for 2017/18 was 24.4% compared with a UK statutory tax rate of 19%.

The proposed combined Group's corporate and business taxes would, of course, be paid in the UK to the UK Exchequer, which is not a claim that every company operating in or supplying the retail sector can make. The proposed combined group is expected to contribute around £1bn in business rates alone and it would have over 330,000 employees who will generate substantial income tax and national insurance receipts for the Exchequer.

Pensions

We take our obligations to our current and former employees very seriously. The proposed combination is good news for pension holders because it would strengthen the covenant of both Asda and Sainsbury's pension schemes. Sainsbury's has also taken action to make our pension scheme more secure. We have a comprehensive recovery plan in place, paying in over £124million a year and the scheme deficit fell by more than £500m last year.

Competition and merger control

Your letter mentions competition and merger control in the context of the Government's industrial strategy. We accept, without reservation, that the merger of two large players in the sector requires careful review by the CMA. To facilitate that, we are requesting a fast track to a Phase II review from the CMA. We are confident in our regulatory case and anticipate that there will be a period of time required to secure the necessary regulatory approvals and are not anticipating closing the transaction before the second half of calendar year 2019.

I hope that you find this information useful. Sainsbury's and Asda are both important businesses and big employers on whom millions of customers rely, so I fully appreciate the level of interest in this proposed combination. If there is anything on which you would like more information, please do let me know.

Yours sincerely

Mike Coupe
Group Chief Executive Officer, Sainsbury's