BAD FOR BUSINESS

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American Postal Workers Union
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**Introduction**

Office supplies – from pens and paper to routers, printers and ink cartridges – are a necessary expense for any business, large or small. If America’s remaining two national office-supply superstores – Staples and Office Depot – merge into a single entity, what will happen to the prices paid by American businesses?

Prices will go up and choices will go down. That’s the inevitable result of creating a monopoly in an important sector of the economy.

This is the second in a series of reports from the American Postal Workers Union which analyze the potential impact of a merger between Staples and Office Depot, America’s only two remaining office-supply superstore (OSS) chains.

APWU represents more than 200,000 active and retired workers of the U.S. Postal Service, who are consumers of office supplies and who will be affected by this proposed merger. Members of our union first encountered Staples as a result of the company’s attempt to enter the postal business. Staples handles mail using low-wage, high turnover employees.

The company has been singled out by President Obama for criticism as a result of its policy limiting employees’ working hours in order to avoid providing them with health insurance.1

Our previous paper, “No Sale,”2 (apwu.org/no-sale) focused on the impact of a merger on retail consumers. This document analyzes the business-to-business (B2B) market.

In “No Sale,” we identified four specific negative impacts on consumers as a result of the potential merger:

1. **Mass market retailers, such as Target and Walmart, are not true office superstore competitors** and cannot meet the needs of many office supply customers.
2. **Once the office supply superstore market shrinks to a single company, it will never grow back.** The barriers to entry are too high. This will leave the combined Staples/Office Depot mega-corporation as a *de facto* monopoly.
3. **Internet retailers are not true competitors in the office supply market** because they can’t compete for business from the more than one in five U.S. households who do not have Internet access.
4. **Higher prices and reduced choices – the inevitable consequence of a monopoly market** – will cause disproportionate harm to communities of color and low-income households.

This paper identifies the impact on the contract market, where large businesses place bulk order for office supplies. Our findings:

1. **Our analysis suggests that the proposed merger will effectively end competition** for large and small commercial customers, as well as the general public.
2. **Regional players do not have the resources or capacity to compete on a national basis.** Niche players in the B2B market lack the capacity to offer meaningful competition with a combined Staples/Office Depot.
3. **Divesting OfficeMax Will Not Create a True Competitor:** To win regulatory approval, Staples/Office Depot may be asked to divest holdings of the former OfficeMax chain (absorbed by Office Depot in 2013). Even if this divestiture takes place, the data shows the combined entity will still be so large that meaningful competition will not be possible.
4. **Pre- vs. Post-Merger Landscape:** If the merger is allowed, a combined Staples/Office Depot will have nearly five times the sales of its nearest competitor. There will be no reasonable alternatives for large customers.

Given the potential harm to both retail and business customers, the FTC must subject this merger to the most rigorous competitive analysis. If

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the agency does so, we are confident it will find that a combined Staples/Office Depot would create exactly the kind of monopoly that America’s antitrust laws are intended to prevent.

The American Postal Workers Union has delivered this message directly to FTC lawyers and analysts at the agency’s Washington office. We also have shared our analysis with staff of state attorneys general across the country.

A Merger That Will Stifle Competition

In February 2015, Staples announced its intention to acquire Office Depot for more than $6 billion. When the merger was proposed, Office Depot suggested that the deal would allow the combined company to better serve customers, provide cost savings, and generate “significant value for shareholders.”3 In fact, the merger would create an office-supply superstore monopoly for the U.S. contract market, creating significant challenges for businesses, nonprofits, and public sector buyers.

The U.S. Justice Department views monopoly power (i.e., raising prices) as a threat to the economy. But in addition to monopoly power, the Staples-Office Depot combination would almost certainly increase Staples’s market power, or its ability to thoroughly control the prices it charges.4 No other U.S. office supply companies could come close to operating on the scale of the new Staples in the contract market. As University of Michigan business professor Erik Gordon has said, “The merger is a game changer.”5

Although most Americans are familiar with both companies through their retail outlets, a great impact of the merger will be felt in the contract markets. According to Amanda Wait, a former FTC litigator who now practices at the law firm Hunton & Williams, LLP, the retail market is the outlet for a customer looking to buy one stapler, but the contract market is “where a company can buy 10,000 staplers.”6 Large firms, including Fortune 100 companies that operate across the country and spend tens of millions of dollars annually on office supplies, will feel a dramatic loss of competition for their business with the Staples acquisition of Office Depot. Without any other large national office-supply alternatives, these customers will have no appreciable leverage to demand lower prices or select from a greater variety of products.

We believe that alternatively there are no regional suppliers capable of adequately serving this national contract market. We are not alone in this belief. The Capitol Forum interviewed a chief procurement officer from a Fortune 500 company earlier this year. A main concern for this procurement officer was lack of competition. He noted that after Office Depot bought Office Max, his company’s leverage to reduce prices began to shrink. If Staples acquires Office Depot, he said their leverage would be “much less, almost zero” and there would be “no competition for [his company] anymore.”7

Other procurement officers have also spoken out on the merger. The National Association of Education Procurement recently surveyed their members on the proposed deal. More than 100 members responded; more than 60% thought the merger should not be allowed. Comments included:

- “Not only will this [the merger] eliminate all competition in my region for these services, my only alternative will be a method that is more expensive and less efficient for us to manage...in other words, a step backwards instead of forwards.”
- “It should not be allowed. I understand that Staples/OD [Office Depot] has constructed an argument that they compete with Walmart/Sam’s Club and Amazon. But from a practical

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4 Ibid.
B2B [business-to-business] perspective (corporate procurement), those competitors are NOT viable alternatives for the kind of service and support we need for this commodity. We would be very concerned that prices will rise and quality of service will fall.8

National superstores, including Walmart, Target, and Amazon, are not significant players in this market and cannot be considered meaningful competitors. The result is that robust competition will cease to exist.

The Wall Street Journal reported that the FTC was seeking sworn statements from market participants about how this proposed merger could impact the office supply sector. The Journal article included a telling comment from the Royal Bank of Canada, which spends $75 million per year on office supplies. The bank’s procurement chief said he prefers to have three or four strong players in the marketplace and when it gets too consolidated, “you don’t have much choice.”9

Like US regulators, the European Union is investigating the merger. The EU is currently reviewing the proposed deal and has opened up an in-depth inquiry. There is worry that a Staples takeover of Office Depot could lead to increased prices. Commissioner Margrethe Vestager, in charge of competition policy, said the EU wants “to make sure that the merger of two of the main suppliers of office products will not have a negative effect on competition.”10

Hedge Fund Involvement

Less than two years ago, another significant merger — between Office Depot and OfficeMax — concluded.11 In early 2015, Office Depot and OfficeMax were still in the process of integrat-

ing their businesses; in fact, Office Depot was still using OfficeMax brands. Currently, Office Depot is working on its strategy for closing hundreds of stores.12 To some outside observers, Staples’s pursuit of a new merger looks premature, at the very least. Why did Staples move so quickly to merge with the new Office Depot?

The answer appears to be influenced more by hedge fund managers than by business strategists. In December 2014, two months before a merger announcement, the activist hedge fund Starboard Value took a six percent stake in Staples and increased its control of Office Depot to 10 percent. The fund reportedly already controlled three of 11 Office Depot Board of Directors seats and was clearly interested in a change. In the past, Starboard Value advocated strongly for a Yahoo-AOL merger and engaged in a battle with Darden Restaurants that resulted in Starboard CEO Jeffrey Smith becoming Darden’s board chairman.13

On January 20, 2015, Starboard Value made its intentions clear by releasing a letter to Staples CEO Ron Sargent stating that the hedge fund believed the best way to “maximize value for Staples’ shareholders” would be to seek a merger with Office Depot. Starboard argued that a merger would double the company’s operating profit and make Staples more competitive with larger retailers and online competitors.14 It is important to highlight that the letter did not address the contract market. Starboard emphasized the retail sector, where it argues that competition will still exist. (Our analysis in “No Sale” calls this into serious question.) But Jeffrey Smith and his management team must surely recognize that a combination of the two companies means the end of credible competition for large commercial customers.

The financial services firm The Motley Fool points out that Starboard has significant stakes

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in both Staples and Office Depot. Therefore, the hedge fund wins, whether the deal is approved or not. Its stake in Office Depot will allow Starboard to profit from any merger premium that Staples might offer. If the merger is denied, and Staples is forced to pay a break-up fee, Starboard will be ahead of the game because it owns a larger stake in Office Depot than in Staples.15

Under close examination by the Federal Trade Commission, the monopoly and market power of a merged Staples in the contract market should be apparent. The FTC’s review should confirm the fact that over 950 of the top 1,000 commercial businesses in the United States and Canada have purchasing relationships with Office Depot and Staples. Currently, there are no equivalent competitors for this market. Although Amazon is sometimes suggested as a potential player, the online superstore does not have enough presence in the contract market. Industry reports say that purchasing managers do not believe Amazon could properly meet their needs.16

The industry publication The Independent Dealer recently interviewed dozens of company representatives. Each one reportedly stated that Amazon could not “replace their current office products supplier any time soon.”17

We believe the primary motivation for the Staples-Office Depot combination is the pressure of activist investors, including Starboard Value.

There might be a suitable environment for a Staples-Office Depot merger in the future, but as we will explain below, the time is not now.

Surveying The Marketplace

Following the consolidation of OfficeMax and Office Depot two years ago, just two companies dominate the market for commercial sales of office supplies in the United States: Staples and Office Depot.

According to a 2014 report issued by Boyar Research, Staples’s North American commercial business (its contract market), serves over 60 percent of Fortune 100 companies and has more than 200,000 mid-market customers in North America.18 Boyar notes that Office Depot maintains a strong presence in the mid-market sector of Fortune 1000 companies.19

The Regional Player Alternative

W.B. Mason, a regional player primarily in the Northeast, is one of the only other companies of any significant size in the commercial office supply market. But W.B. Mason is not a significant competitor to either Staples or Office Depot. In 2014, Office Depot’s commercial sales were more than four times greater than all of W. B. Mason’s annual sales, with Staples’s commercial sales more than six times larger.20

(See Figure 1 below.)

Figure 1

With the merger of Staples and Office Depot, the annual sales gap between W.B. Mason and Staples-Office Depot reaches 90 percent. Under these circumstances, W.B. Mason should not be considered a competitive counterbalance to the new Staples. (See Figure 2 on next page.)
There are many who share our concerns. As Kantar Retail analyst David Marcotte has said: “Who’s left to be a competitor?”

Brian Yarbrough, a senior analyst at Edward Jones, questions whether if given the market opening – W.B. Mason could actually handle a bigger piece of contract business. The company only has a strong presence regionally, not nationally. Currently, only about one-third of W.B. Mason’s annual sales come from large business and government contracts.

The American Antitrust Institute has said the next largest rivals to Staples and Office Depot would be unable to compete on the scale and scope of the merging parties. Furthermore, post-merger price increases by a merged Staples would not likely be defeated.

Examining a few large markets, one can easily see that W.B. Mason does not have the footprint or exposure to compete on an even playing field with Staples or Office Depot outside the northeastern United States. (See Figure 3 top right.)

To be fair, W.B. Mason does have over 40 locations throughout the country and says its warehouses can serve customers in all 50 states. However, it is still difficult to see how W.B. Mason could be truly competitive on the full national level. Examining the company’s current job openings, only 4 percent of 167 positions are located outside the Northeast.

The GPO Alternative

To fully understand the business landscape, we must look beyond the next biggest stand-alone office supply operator. Several large group purchasing organizations (GPOs) could offer alternatives for some commercial customers. Two such groups are Independent Stationers and TriMega Purchasing Association.

Independent Stationers is based in Indianapolis and serves approximately 400 member companies that sell office and school supplies across the United States and Caribbean.

TriMega Purchasing Association is a not-for-profit cooperative of 585 member companies whose annual sales range from $1 million to more than $80 million.

Yet even these large coalitions look like woefully small as Davids in comparison with the Staples Goliath. Looking at them in the aggregate, their annual sales add up to only 10 percent of those of a merged Staples. (See Figure 4 next page.)
Not only do independent retailers have small revenue size; the number of their locations would pale by comparison to a new Staples. Using the same markets included in Figure 3, it is clear that the member companies of TriMega and Independent Stationers simply don’t have the presence to be considered serious national competition to a larger Staples.28 (See Figure 5 below.)

**Figure 5**

The Divestment Alternative

There has been a suggestion that the FTC could allow a merger if Staples were to divest itself of what was OfficeMax. Some argue that this might pave the way for a more competitive environment for commercial sales, but we find this is not the case. The last annual filing of OfficeMax made before it became part of Office Depot showed annual sales at just under $7 billion, with just over 50 percent of this total from commercial sales.29

If the new Staples divested itself of the former OfficeMax, and the company lost approximately $7 billion per year in revenues, Staples would still have more than $30 billion in annual sales. Such a move does not improve the competitive balance.

And where would this $7 billion go? TriMega and Independent Stationers are themselves planning a merger, forming EPIC Business Essentials.30 The new EPIC Business Essentials would be composed of roughly 1,000 member companies. EPIC’s sales would be only 26 percent of a new Staples’ sales. (See Figure 6 below.)

**Figure 6**

The divestment could not be diverted to them, nor could it easily be diverted to W.B. Mason. What company could handle a sudden four-fold increase in their sales? This does not appear to be a credible strategy.

A combined Staples-Office Depot will, according to most reports, want to retain as much of the highly profitable contract side of the business as possible. Why would Staples choose to make a concession by divesting OfficeMax? So far, Staples has essentially agreed to divest business that generated up to $1.25 billion of Office Depot’s 2014 U.S. revenues. But there are limits, and the company has not committed that it will do whatever is necessary to close this deal.31

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A complete divestiture of what was OfficeMax is clearly much greater than $1.25 billion. Even limiting the divestiture to contract sales would result in losses much higher than Staples is likely willing to entertain.

There is not an easy answer to this problem. Or is there?

The Best Alternative: No Merger

In the current office supplies landscape, competition does exist. Staples and Office Depot often fight for the same large national commercial clients. For mid-sized regional clients, especially operating in the Mid-Atlantic and New England, W.B. Mason is a strong alternative. In other instances, the GPOs offer options that increase competition. In the contract market, we see a strong and balanced situation. (See Figure 7 below.)

Figure 7

If the FTC agrees to the merger, this landscape would change dramatically, even with the pending joint venture relationship between TriMega and Independent Stationers. Once combined, their member companies will have approximately $8 billion in annual end-user sales. Although $8 billion is a significant figure for annual revenues, it would still amount to only 50 percent of Office Depot’s 2014 sales. With a Staples-Office Depot merger, EPIC’s annual sales might fall to less than 25 percent of the expected level for the new combined entity. EPIC has already stated that it is not likely to focus on Fortune 1000 customers. (See Figure 8 top right.)

Figure 8

Again, we see no reasonable alternatives to the new Staples for large customers, and that lack of competition can only hurt the economy.

Conclusion

Especially when you look at the contract market . . . this is a merger-to-monopoly. And nothing raises as much concern as that.
—David Balto, FTC Former Policy Director

A Staples-Office Depot combination is not in the best interest of competition in the retail sector or the contract market.

The question of whether the purchase of Office Depot by Staples should move forward requires the FTC to answer a vital question: Will the combination result in Staples gaining a monopoly and market power in its industry?

The role of the FTC is to protect American customers, large and small. A mother spending $50 on school supplies for her kids or a procurement chief at a Fortune 100 company spending a million dollars on office supplies for employees across a dozen states are equally entitled to fair treatment and fair competition.

The data clearly demonstrate the need for competition and multiple suppliers. Big-box and online retailers cannot provide adequate competition for Staples once Office Depot disappears.

A Staples-Office Depot will lead to less competition and higher prices, and will hurt consumers in both the retail and B2B markets. The merger fails the test of fairness, and it is imperative that the FTC takes a stand against it.
