What CPOs Should do Right Now About the Pending Staples-Office Depot Merger

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You may have read our earlier installments of this series (here, here, here, here), but I've been speaking to a lot of people about the pending merger and it continues to get more fascinating – and concerning.

Yesterday, I chatted with a sell-side analyst who has a lot of hedge fund clients who are *very interested* in which way the Federal Trade Commission's (FTC) upcoming ruling will go in terms of whether to legally challenge the merger. I was sharing some of the feedback that I had gotten from procurement practitioners, ex-industry sourcing consultants and group purchasing organization (GPO) firms that are intimately knowledgeable on the matter. In particular, I was mentioning some of the feedback I received from an ex-VP at an office products retailer who, let's just say, knows GPO pricing "very well." He mentioned a lot of the intricacies about margin structures, performance incentives, pricing/sales tactics and how the office supplies reps sell into enterprises (and guarantee they make money on them). Still, the most fundamental takeaway was really not so much about who is left to provide a network of big box sites for a national Fortune 500 firm with a multi-site footprint, but rather:

1) who has the buying power concentrated within the supply chain to get top notch pricing, and

2) who will serve the enterprise buyer and their evolving complex needs.

If you start with No. 2, obviously you have Staples and Office Depot, multi-category merchants – Wal-Mart, Costco, Sam's Club – and the big wholesale distribution firms like Essendant (formerly United Stationers) and Veritiv (formerly xpedx). You also have Amazon to a lesser extent, but while its business pricing might be very good for a small enterprise, it's not likely to be world-class pricing that a large enterprise would want. And when you apply No. 1, Amazon disappears completely, and everyone basically disappears except for the Big 2 (or Big 1, potentially).

So, unless a mega-mass-market merchant like Wal-Mart decides to serve the B2B market (unlikely), there are no "white knights" apparent to me. Look behind the curtain at the regional players like WB Mason and others and you'll likely see the big wholesalers' supply chains and pricing. That pricing "ain't gonna hunt." Amazon, for its part, would also need to get some retail bricks and not just clicks – and it just doesn't seem to have the volume to drive the rebates, nor the appetite to own thousands of stores. Will Amazon go there eventually? Maybe, but doubtful. What about if Big 2 wholesalers start going direct and compete against their customers? Unlikely. These are all big hypotheticals. But, what I could opine with a fair amount of certainty is that Staples management probably agrees with Peter Thiel that monopolies are for winners and that "monopoly status is a feature, not a bug!"

Please don't construe that I'm anti-Staples here. The firm is being a rational economic actor looking to maximize value. I do, however, like competition and would like to see at least 2 meaningful players – SAP versus Oracle, Wal-Mart versus Target, yin versus yang – and since the battle is not for the “box” (i.e., the retail store), but for the broader supply chain, there would have to be a “carve out,” but I can't think of a plausible scenario that wouldn’t invoke the deal’s poison pill. So, the FTC is basically looking at a take-it-or-leave-it offer.

What CPOs Should Do

As such, CPOs have to consider both scenarios and plan accordingly, but before they even do that, they need to realize that they can have an influence on the FTC decision. The FTC is staffed by economists and attorneys, not procurement experts. So, CPOs need to contact them if they’d like to increase the chances that the FTC will file an injunction against the merger and increase the odds of it happening. If you talk to the FTC, you can share your concerns confidentially, or you can also give sworn testimony. (I can imagine the former being a more likely scenario!) I called the FTC and they said that if you want to share your concerns, then you should contact Stelios Xenakis at **sxenakis [at] ftc [dot] gov** or use its website.

The other set of things CPOs should do now is make sure your pricing is locked up tight contractually, and this includes your GPO provider contracts. There are a lot of aspects to this, and we’ll discuss this in a future PRO article and/or webcast. For example, Staples and Office Depot are also planning for both outcomes and you can use this to your advantage. In fact, I bet you’ll find that if you go to bid the business between the 2 right now, and you try to lock down long-term pricing with real rigor, you might get some strong pushback. This will tell you something! On the other hand, you may also find out that one of the providers is in fact ready to price very opportunistically, especially if you consider that they may be hedging just in case the deal falls through. Either outcome is good for you.

The bottom line is that you need to dust off your category strategy, take a hard look at this situation immediately and not just assume that your tactics that worked in past for this category will work in the future. Hint: unbundling paper and toner might be less effective than you might think. I talked to a hedge fund manager who interviewed more than 30 procurement leaders, and he found that most didn’t seem too concerned. This mirrors my discussions – and it’s a bit puzzling. In fact, all the category experts I’ve talked to feel that procurement groups are overestimating the ease of dealing with the price increases that will likely be coming their way. Maybe they’re hoping for the best and taking a wait-and-see approach.

But, hope isn’t a strategy, and it’s certainly not a category strategy.

What do you think? I’d love to get your thoughts on the matter. And if you’re a practitioner and want to talk to some of the gurus that I’ve been talking to, send me an e-mail and I can connect you.