IN THE COMPETITION TRIBUNAL
REPUBLIC OF SOUTH AFRICA

Case No: 78/LM/Jul00

In the large merger between:

JD Group Limited

and

Ellerine Holdings Limited

Reasons for Competition Tribunal's Decision

1. Prohibition

We prohibit the transaction between the JD Group Limited and Ellerines Holdings. The reasons for our decision are set out below.

2. The Transaction

This transaction involves the acquisition of control of Ellerines Holdings (EH) by the JD Group Limited (JD). This will entail JD acquiring the entire issued share capital in, and loan accounts of, all the underlying subsidiary companies of Ellerine Holdings including trademarks. The parties have agreed on an exchange ratio of 1 JD share for every 1,5 EH shares. This exchange will immediately make EH the largest shareholder – approximately 30,6% - in the newly constituted JD. However EH has undertaken to immediately unbundle its shareholding in JD, that is to distribute its interest in JD to its large range of underlying shareholders. Subsequent to this unbundling JD's shares will be held by a diversified range of shareholders – there will be no single controlling bloc of shareholders.

This is no ordinary transaction. It is the merging of two of South Africa's best known firms whose various trading brands are, it is no exaggeration to claim, household names. Literally millions of South Africans will, at one time or another, have entered an Ellerines or a Bradlows or a Russels or a Joshua Doore store. Few can have failed to notice the ubiquitous advertising campaigns of the two groups whether on film, television, radio or in the printed media. And, certainly a more important and lasting experience than any of the aforementioned, a vast number of South Africans first received credit when purchasing furniture or household appliances from one of the stores in these two groups.

Nor, despite their vast size, are Ellerines and the JD Group faceless corporations led by professional managers on behalf of passive shareholders. Both are, to this day, led by their respective founders, who number as two of the country's more innovative entrepreneurs.

Mr. Eric Ellerine entered the furniture business in 1950 when, at 16 years of age, he opened his first store in Cyrildene, Johannesburg. Legend has it that his first sale was a credit sale. From these small beginnings, Ellerines has developed into a major force in South African retailing. Remarkable to record in these days of growth by acquisition, Ellerines' growth is almost entirely organic. The group comprises some 489 stores grouped into five store brands, of which the Ellerines brand itself, comprising some 218 stores, is the largest. Although several stores are based in neighbouring countries, Ellerines remains, overwhelmingly, a South African company. It is also a major source of credit with a debtors' book of little under R2 billion comprising the accounts of some of South Africa's poorest consumers, many of whom do not even have access to a bank account.

Mr. David Sussman began his working life as an assistant accountant in Eric Ellerine's head office. He left Ellerines in 1983. The rise of Sussman's JD Group is even more meteoric than that of his mentor. A mere 15 years ago Sussman controlled two Price 'n Pride outlets in Johannesburg. At present the JD Group comprises 678 stores organized into 5 different brands. The JD Group, in contrast with Ellerines, has relied for its growth on mergers and acquisitions. However, the JD Group's success is deeply rooted in its innovative trading practices, many adapted from the role model provided by the Ellerines' experience, but also characterized by the introduction of sophisticated technology and state of the art business practices. The JD Group has recently spread its wings into Europe with the acquisition of a chain of Polish furniture and appliance stores.

The significance of this transaction from a competition perspective should not be underestimated. In contrast with many transactions that come before this Tribunal this is not simply a case of the market leader taking over its fading opposition. What we rather have here are two dynamic firms more than capable of withstanding the competitive challenges that face them. Mr. Sussman himself is at pains to distinguish this transaction from previous deals in which he bought up and rescued ailing companies – Ellerines is anything but an ailing company.

However the real competition significance of this transaction is to be found in the direct links between the parties and South African consumers. An anti-trust merger evaluation is always primarily concerned with an assessment of the impact of the transaction in question on consumers. However, many mergers involve firms producing arcane intermediate products with the final consumer located several links lower in the production chain. In these instances the consumers directly affected is often themselves well resourced downstream producers capable of mounting a sophisticated response to a merger that it deems threatening to their commercial interests.

In this case however the parties to the transaction are the final link with the consumers, and, at that, the poorest, least powerful of South African consumers. In other words, the interests directly affected by this merger are represented by millions of atomized, disorganized individuals incapable of defending their economic interests except to the extent that they are able to exercise a preference for one retail outlet over another. This evaluation will seek to assess whether the transaction has the potential to increase the power of the parties over the consumers that they serve and who are the source of their prosperity.

3. The Retail Furniture Trade: pertinent trends and features

3.1 Mergers and Acquisitions

There is a recent history of mergers and consolidation in the retail furniture industry and the consequent emergence of several large groups. In particular the growth of the JD Group, Profurn and Relyant has been driven by acquisition of existing chains. Ellerines' growth, on the other hand, is almost entirely organic. The composition and strategic direction of each of the large groups is briefly profiled.

The JD Group

Today's JD group has modest origins. Founder David Sussman commenced in 1983 with two Price 'n Pride stores. In 1986 he purchased the larger, then troubled, Joshua Doore chain from the Russell's grouping. In 1988 the firm acquired World and Bradlows from W&A, and the Score Furnishers chain. Then in 1993 JD acquired the Rusfurn Group.

The current composition of the JD Group is as follows:

Name of Store	Number of Stores	Age of Brand	Target Market
Bradlows	87(89)*	est 1900	LSM 5-8
Russels	173(183)	est 1943	LSM 4-7
Joshua Doore	125(133)	est 1973	LSM 4-7

Giddy's Electrical Express	90(95)	est 1958	LSM 4-7
Price'n Pride	203(159)**	est 1983	LSM 3-5
Score		est 1977	LSM 3-5

Total number of Stores: 678(659)

Notes

- * These figures are based on the totals in the 1999 Annual Report. The figures in brackets are those given to the Commission in May 2000 and reflect the changes since 1999.
- ** The store figures for Score and Price 'n Pride brands are combined.

Relyant Retail

The Relyant Group was formed in 1998 as a result of a merger between the former Beares and Amrel groups. In March this year it acquired Appliance City. It is currently composed as follows:

Name of Store	Number Stores	Age of Brand	Target Market
Geen and Richards	60(58) **	63	LSM(Upper 6 –lower8
Beares	169(203)	70	LSM 6
Furniture City	17(13)	20*	LSM(Middle 5-Upper 7)
Lubners	98(93)	36	LSM(5)
Fairdeal	93(75)	40	LSM(Lower 3 - middle5)
Savells	87(156)	40	LSM(Upper 3 – middle 4)

The total number of stores 524 (598)

* Furniture City was Amsterdam Furniture Store, which was started in 1963 and was then changed to its current name in 1980

**The first figure is from the Groups 1999 Annual Report. The figures in brackets are the 1998 figures provided for comparison.

The Relyant group's 1999 Annual Report specifically indicates that it has introduced strict credit granting criteria because at the time of the Amrel/ Beares merger the debtors' book was "significantly in arrear". The emphasis placed on credit management and new systems and the fact that staff performance will be measured against collection management indicates that Relyant's stores are likely to be less likely to grant credit to low income consumers than they were in the past. A 1999 report on the furniture retail trade by a stockbroking firm, Fleming Martin, says Beares and Savells (the latter being in the LSM3-4 category) have been deliberately contracting sales growth in order to improve the quality of their debtors' book. The closure of stores in these brands since 1998 is evidence of this. In addition the group has a higher debt equity ratio, 0.7 than analysts consider the desirable norm for this industry between 0.3 - 0.5. (This ratio is significantly higher than that of JD and Ellerines.)

Relyant has also been positioning its brands within their chosen markets reducing the number of their brands from 12 to 6.Each brand is being partnered by a top advertising agency. Relyant segments the markets at the lower end to a greater extent than the merging parties do. For instance the Annual Financial statements reflect that Savells is upper 3 middle 4, whilst Fairdeal is lower 4 and middle 5.

Profurn

The Profurn Group originates in a turnaround of the then Supreme Holdings which in 1992 had been in provisional liquidation. In 1997 the firm acquired Cape based Freedom Furniture which at the time had 12 stores. In 1998 it acquired the Morkels chain and, in 1999, the cash retailer, Hi Fi Corp.

Name of Store	Number of Stores	Age of Brand	Target Market
Morkels	150	50 years	LSM 5-8
Barnett's	71	103 years	LSM 3-5
Protea Furnishers	105	40 years	LSM 3-5
Freedom	33	5 years	LSM 3-5

The total of number of stores in South Africa at the end of 1999 was 359.

Profurn is engaged in aggressive expansion outside of South Africa. It has expanded into North Africa and Australia and intends opening up 43 stores outside of South Africa this year (Business Report 28/7/2000). The Financial Mail points out that although 2/3rds of its turnover is from SA it accounts for only 53% of its operating profits (Financial Mail Fox Column 12 May 2000). For this reason, overseas investment is said to be a major element of this group's expansion strategy.

The Fleming Martin report observes that " Profurn is growing from a much smaller SA store base (309) than its competitors….." The competitors mentioned are JD and Ellerines.

Profurn, like Relyant, also makes a point of how its debtors' book is improving due to strict credit granting and bad debt write off policies. According to the 1999 Annual report, “deposit rates now average 20% on credit deals” and they go onto state that they are “improving the quality of debtors whilst also enhancing cash flow.”

Ellerine Holdings

Ellerine’s, currently celebrating its 50th anniversary, owes its current size to organic growth rather than acquisition which distinguishes it from the three other listed chains referred to above.

Name of Store	Number of Stores	Age of Brand	Target Market
FurnCity	53(52)*	20 years	LSM 4-7
Ellerines	218(254)	50 years	LSM 3-5
Oxford	52(62)	30 year	LSM 3-5
Town Talk	114(116)	28 years	LSM 3-5
Royal	52(56)	25 years	LSM 3-5

Total number of stores 489

Notes

* The figures supplied by the parties to the Commission in May 2000. The figures in brackets are taken from the 1999 Annual Report.

<u>Great Universal Stores</u>

This U.K based group owns Lewis stores in South Africa and appliance group, Best Electric, which it formed in 1998. It also acquired furniture retailer Dan Hands but has since re-branded this small chain.

Name of Store	Number of Stores	Age of Brand *	Target Market
Lewis	430	approx.50-60 years	LSM4-6
Best Electric	30	2 years	LSM4-6

Total number of stores 460

An analysis of the groups profiled above reveals the following trends-

- Most have already diversified across LSM categories ranging from LSM 3 – 8.
- In diversifying across these LSM categories they have developed different brands for each category rather than aiming a brand across all categories
- There is a trend towards specialized appliance discounters in each group. Typically these brands cut across LSM segments. They are further distinguished from the traditional furniture and appliance stores serving the lower LSM categories in their larger cash to credit sales ratio. Profurn says its acquisition of HI FI Corp would increase its cash sales to credit from 25% to 40 %. (Financial Mail Top Companies 2000) These specialized appliance brands appear to operate primarily as discounters and tend to be based in the larger metropolitan areas. The establishment of specialized bedding stores is also a discernible recent trend.
- The brands in the furniture stores are all well established, some over 100 years old. Possibly because of the importance of brand recognition, the national chains tend to prefer (admittedly with some exceptions like Ellerine's FurnCity) acquiring established brands rather than starting new ones. Interestingly those businesses which tend to have the highest proportion of credit to cash as part of their sales mix tend to be long established brands. FurnCity's lack of success is thought to be due to lack of brand awareness.[1] The due diligence reflects that the Ellerine's brand, the older brand, is better known in the market place than JD's Score and Price'n Pride brands.
- The groups have portfolios of several hundred stores and are nationally dispersed. The annual statements reveal that the opening and closing of stores is a continual process and seems pivotal to the proper management and competitive strategies of the groups.
- Innovations by one competitor are matched particularly quickly by the others. Observe how all have moved into cell phone distribution, financial services and insurance packages.
- There is an observed tendency for the groups to contract with manufacturers for the production of exclusive products. See, by way of example, the Relyant Annual Report which refers to time spent with top suppliers to focus on "better value … *exclusivity*…". Both JD and Ellerines have similar arrangements with certain suppliers. This makes intra-brand pricing comparison more difficult for the consumer as we discuss elsewhere.
- The major groups are all expanding offshore either elsewhere in Africa or further afield (in Poland as with JD, or Australia as with Profurn)
- There is evidence of an increasing centralization of strategy and operations in the group or divisional head offices. Branch mangers are given less discretion

1 Ellerine Holdings Board Minutes, 2 May 2000

and are more rule-bound particularly in decisions to grant credit and set prices. Advertising (and hence pricing) is centrally conducted.

- Increasingly sophisticated IT systems to control costs, inventory and to manage debtors are being installed. This naturally leads to centralized management referred to above.
- The ability to squeeze suppliers for discounts, volume rebates and extension of payment terms. Correspondence with suppliers given to us by the parties indicates that JD with its size and volumes is considerably more successful at this than has been Ellerines. Since manufacturers are presumably less tied to LSM segments for their products than are their retailer clients a group with brands across a manufacture ranges has more negotiating leverage than a retailer confined to a smaller extent of the LSM spectrum.[2]
- The groups tend to warehouse stock regionally so that individual stores do not have to be too large but nevertheless ensuring that the stores do not run short of stock. To quote Profurn MD Gavin Walker: " It is a mistake to have too much stock - funding is expensive – but no less problematic to be under stocked."(Financial Mail Top Companies 2000)
- The groups are listed on the stock exchange (Lewis‘ parent is listed in the UK) and for this reason can fund acquisitions more easily (the proposed merger in this case involves a share swop with no cash component) and can raise capital more cheaply through rights issues.
- The groups appear generally concerned at too great an exposure at the lowest end of the market. Some like Relyant and Profurn are, as already observed, tightening up their credit granting policies. All the groups, as is borne out by comments in their annual financial statements, are concerned about the spending potential of consumers in this market as the retail spend on furniture and appliances is being eroded by competing claims from gambling and lottery, and cell phones. Furthermore the aids pandemic is likely to have a disproportionately large impact on these consumers and both JD and Ellerines have undertaken studies into its impact on their business.

3.2 Brand Diversity

The large chains are, as already noted, characterized by the diverse market segments occupied by their various brands. The precise significance of this segmentation for the purposes of this anti-trust evaluation is the source of significant difference between the parties and the Commission, the implications of which are examined below. Suffice for now to note that the various brands are commonly identified by their positioning within the market. A feature of JD, Profurn and Relyant is that they have brands positioned across the range of the

2 From an unpublished draft report prepared by Fleming Martin it appears that JD's 'accounts payable days' (that is on stock purchased) is approximately 150 days, whereas Ellerines is slightly under 80 days. Profurn and Relyant are at approximately the Ellerines level. This is supported by data from the due diligence which also reflects that JD has negotiated longer 'accounts payable' periods than Ellerines.

mass market.[3] Hence JD's Score and Price 'n Price brands are positioned at the lower end of the market, whereas Russell's is directed at the lower to middle and Bradlows' serves a higher income clientele. In Profurn and Relyant we see the same positoning of brand across the LSM range. The Lewis brand is positioned across a broader number of segments than that commonly occupied by a single brand.

The Ellerine's Group is, once again, something of an exception to this rule. It is comprised of five brands – however four of these, Ellerine's, its largest brand, Town Talk, Oxford and Royal are all directed at the lowest segment of the market while only Furn City, a small and reputedly unsuccessful chain, is directed at a higher segment. The Ellerines group is, then, to a far greater extent than its counterparts, focused on a single segment. It is suggested that the pedestrian performance of Ellerines Holdings in the recent past is attributable to this lack of brand diversity.

From a competitiveness perspective the key impetus underlying brand diversity seems to be the ability to exploit brand loyalty by moving customers upward through the groups stores. This is discussed in greater detail below.

In the past the racial identity of the customer base was the simple feature that distinguished one store brand from another. This was largely synonymous with income bands – hence low income stores were 'black stores' while those further up the income ladder were 'white stores'. While income and race are still, by and large, accurate markers of the positioning of the various store brands, in fact the methodology used nowadays to measure this diversity is considerably more complex and nuanced than simply race and income. The measure commonly employed is the Living Standards Measurement or LSM.

Living Standard Measures or LSM's refer to a method of segmenting consumers into profiles so that marketers can accurately identify their target markets. This is done by dividing the population into eight groups of approximately equal size. The LSM categories are divided according to living standards criteria such as education, residence, degree of urbanization, access to household electricity, motor vehicle ownership, preferences for appliances etc. The information is calculated from 20 variables and weighted for each respondent. Retailers use this information to form a picture of their target customers and so to provide for them accordingly. A retailer in the furniture industry who wants to target customers in the LSM 3-5 would study this data to get a picture of how much potential customers in this category spend, on what they spend their disposable income, which appliances they prefer, where they prefer to shop, etc. By way of example

3 The term 'mass market' and its precise significance is also a source of some contention. Here we use it simply to distinguish any of these stores from the high end design furniture boutiques serving the very wealthy.

we are told in documentation submitted to us that LSM 5's are more likely to decorate their homes internally than LSM 1-4. All the chains we have referred to classify their stores along these lines and determine prices, product mix, advertising and store location accordingly.

The distinction informs advertising strategy in very subtle ways as an amusing example alluded to during our proceedings shows. Ellerines in the LSM 3-5 market offer a free sheep worth R300 if goods above a specified amount are purchased. A graphic of a sheep is depicted in the advert. Bradlow's, the high end JD brand, also offers a free gift for customers purchasing above a specific amount. The gift, however, underlines the difference in social status of the LSM categories- Bradlow's offers not a free sheep, but a coffee table book on 101 ways to cook lamb!

4. The Evaluation

4.1 The Panel's Approach

The Competition Commission initially recommended outright rejection of the transaction. It has since recommended that the transaction be approved subject to certain conditions. While the parties naturally disagree and do not admit that the proposed transaction will impact negatively on competition, they have indicated that they are nevertheless willing to accept the conditions proposed by the Commission.

The panel of the Tribunal has approached the evaluation of the transaction in the following way:

We evaluate the transaction as notified to the Commission. Had we concluded that the transaction was unlikely to substantially prevent or lessen competition it would have been approved unconditionally. Under these circumstances the parties may nevertheless have elected to implement voluntarily the conditions agreed with the Commission.

However, given that we have found that the transaction as notified is likely to substantially prevent or lessen competition, and that there are no countervailing efficiency or public interest implications, we then proceeded to examine the proposed conditions.

4.2 The Relevant Market

As is frequently the case in merger evaluation, conflicting views on the impact of the transaction on competition begin with a disagreement on the precise definition of the relevant market.

The Commission holds that the relevant product market comprises furniture and appliances retailers serving the LSM 3-5 category and which provide credit to consumers. Furthermore the Commission holds that there are a large number of local relevant geographic markets corresponding to the geographic area to which consumers can practically turn for alternative sources of product.

The parties, on the other hand, argue that there are six distinguishable product markets at issue. These are furniture, bedding, white goods, brown goods, cellular telephones and financial services. Our reading of the Commission's understanding of 'furniture and appliances' is that it incorporates the first four markets identified by the parties, namely, furniture, bedding, white goods and brown goods. What is at contention is whether these be grouped as a composite product within a single product market (the Commission's view) or whether they be evaluated in relation to distinct product categories thereby including all stores which compete with the parties for the sale of one, more or all of the products (the parties' view).[4]

Furthermore the parties insist that there is one mass market for each of the products identified. In other words they reject the Commission's argument that the market, or, in their view, the markets are segmented into LSM categories.

It is common cause between the parties and the Commission that the vast majority of furniture and appliance sales to consumers in the LSM 3-5 category are on credit – approximately 99% of Ellerines sales are credit sales, and the equivalent figure for JD's LSM 3-5 purchasers is only marginally lower. For purposes of defining the relevant market we accept the segmentation into credit and cash markets and agree that our concern is with sales of product on credit.

There is deep disagreement between the parties and the Commission with respect to the identification of the relevant geographic market. In contrast with the Commission's identification of a large number of local markets, the parties insist that the market is a national market.

Turning first to the product market(s), we examine the Commission's contention that these are stores operating in the market for 'furniture and appliances', as opposed to the parties' argument that holds that they are firms operating in four distinct product markets, furniture, bedding, white goods and brown goods. From the arguments presented, it is clear that the parties effectively identify two separate markets, namely furniture and appliances – certainly the competitors

4 The parties also market cellular telephones and financial services. It is not suggested that the proposed merger portends anti-competitive consequences in these latter two markets. Moreover they do, at this stage, comprise a relatively minor part of the groups' activities. Accordingly they will not form part of this evaluation.

identified by the parties in their various submission are easily recognized as sellers of furniture or appliances or both. Are we dealing with two distinct product markets for furniture and appliances or a composite furniture and appliances market?

The significance of the argument is clear: accepting the parties' argument implies, in their view, that account be taken of '..the innumerable other stores which compete with the parties in one, more or all of the aforesaid categories….there are 4961 retail stores which compete in the same market for the sale of one, more or all of the products'.[5] In the evidence submitted by the parties they attach particular significance to competition from the large appliance discounters, Game and Dion's, and then from the variety of stores selling a mix of furniture and appliances similar to that sold by the parties themselves. The Commission effectively argues that only the latter, stores selling household furniture and household appliances – stores colloquially referred to as 'furniture shops' – be included in the relevant market. This would not only exclude appliance specialists like Game but it may also exclude high end furniture retailers that do not include the traditional 'furniture shop' mix of audio equipment, television sets, washing machines, refrigerators and other household appliances in their product mix.

An intuitive answer to what a judgment in a US District Court termed the 'general question' to be answered in relevant market enquiries – "whether two products can be used for the same purpose, and if so, whether and to what extent purchasers are willing to substitute one for the other?"[6] – would almost certainly favour the parties' interpretation. After all a television set purchased from one of the parties' stores is functionally interchangeable with one purchased through any other store; a dining-room table is a dining-room table by another name – its functional characteristics are not altered by the fact that it is sold in a store that also deals in micro-wave ovens. And yet a number of important recent US and EU judgments have found that this apparently common-sense conclusion must be tempered by evidence suggesting that, despite the functional interchangability between the product offerings of the stores in question, different 'store types' frequently compete in distinct product markets.

The oft-cited case of <u>Federal Trade Commission v Staples Inc.</u>[7] relied upon econometric evidence that found that large format super stationery stores set their prices in relation to each other, effectively ignoring other retailers of identical stationery products. In explaining this counter-intuitive, but statistically robust, outcome the court in *Staples* relied upon the earlier Supreme Court decision in <u>Brown Shoe Co. v United States</u> which held that within a broad market "well-

5 *Memorandum* submitted by parties
6 Hayden Publishing Co. v. Cox Broadcasting cited *Staples* 1074
7 970 F.Supp. 1066 (D.D.C. 1997)

defined sub-markets may exist which, in themselves, constitute product markets for antitrust purposes".[8] The court in *Brown Shoe* identified a number of 'practical indicia' for determining whether a sub-market exists including "industry or public recognition of the sub-market as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors."

While sympathizing with the *Staples* judge's inability 'to fully articulate and explain all the ways in which superstores are unique' we too will follow the approach in *Brown Shoe* and examine whether or not there are 'practical indicia' that place 'furniture shops' – the term that we will use to describe the retail format employed by the parties – in a relevant market distinct from that of other sellers of similar or even identical products. This approach has been followed by a number of US Courts. In Bon-Ton Stores, Inc. v. May Department Stores[9], despite acknowledging that '..in a broad sense, traditional department stores do compete in a vast marketplace encompassing retailers in general', an enquiry into the 'practical indicia' of *Brown Shoe* nevertheless led to a rejection of the defendant's view that held that 'traditional department stores' referred to an excessively narrow market in that it excluded from consideration a range of other retail outlets selling products identical to those available from the 'traditional department stores': "Applying the *Brown Shoe* 'practical indicia', the court found that there were qualitative differences between traditional department stores and other retailers, including the physical appearance and layout of the stores, distinctive customers, the wide range of brand-name merchandise, and service." [10]

This approach was effectively followed by the European Commission in a recent matter involving the acquisition of the Dutch assets of the US super store toy retailer, Toys R Us, by a Dutch toy retailer, Blokker. Here the EC defined the relevant product market as 'the retail of toys through *specialized* toy retail outlets' thus rejecting the parties' plea to include all toy outlets – department stores, general stores, etc - in the relevant market.[11]

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8 S.Ct. 1502, 370 U.S., 8 L.Ed. 510

9 W.D.N.Y 1994

10 Cited *Staples* 1080. In *Bon Ton* the Judge noted: '..the fact that two vendors both sell a particular type of merchandise does not necessarily mean that they are in the same product market. If the market were defined that broadly, it is hard to conceive of any merger or acquisition involving retailers that would have an anti-competitive effect'. See also State of California ve American Stores; Alpha Beta Acqisition Corp.; Lucky Stores, Inc. (872 F. 2d 837, 57 USLW 2581 where the District Court accepted California's view that '..the relevant produce market was limited to supermarkets – full-line grocery stores with more than 10 000 square feet. The District Court reasoned that only such supermarkets compete for consumers' periodic grocery shopping needs.'

11 European Commission – Case No IV/M.890 – Blokker/Toys 'R' Us (98/663/EC)

We have not been supplied with econometric evidence that a'la *Staples* establishes that the furniture shops price their appliances only in relation to each other or, conversely, that they do not set their prices in relation to those set by the large appliance discounters. However, the Commission insists that these stores are not part of the relevant market while the parties, essentially relying upon the functional interchangability of the products offered, take the contrary view. We need to ask ourselves whether there are strong 'practical indicia' that serve to place furniture shops in a relevant market distinct from the large appliance discounter chains of which Game is the prime example?

In our view there is, indeed, evidence that these are segmented markets. The furniture shops and the appliance discounters do not appear to target the same market segments. There is first the question of location. The appliance discounters appear to target the large urban markets only, whereas the furniture shop chains have a presence throughout the country, in the large urban centers and in the large as well as smaller rural towns. Moreover, within the urban areas the discounters tend to locate on the peripheries of the cities – in marked contrast with the furniture shops they make no effort to locate themselves in areas convenient to customers who rely on public transport.

Secondly, although the discounters do offer credit their key competitive advantage lies in discounted cash prices, an advantage that the consumer loses in a credit purchase. Hence the ratio of cash to credit sales is considerably higher than that of the parties to this transaction and the discounters make no effort to locate in areas of town convenient to those who would not be able to afford a cash purchase. It appears that although credit is available, the scoring criteria used by the discounters for would be credit customers are considerably more stringent than those applied by the parties to this transaction – in short, the discounters are low price (low margin) and consequently risk averse; the furniture shops operate on relatively high margins and this gives them the ability to take on significantly greater levels of risk.

Thirdly, although there are definite areas of overlap in the products on offer from the discounters and the furniture shops, both are engaged in areas in which there is no overlap at all. Hence the range of appliances on offer from the discounters extends well beyond that offered by the furniture shops – where the discounters sell sports equipment, computer hardware and even CD's, the appliance range of the furniture shops is confined to the more traditional household white good range (large kitchen appliances like fridges and stoves, washing machines, etc) and to those appliances or 'brown goods' that are effectively part of the lounge furniture (music centers and television sets and VCRs). Hence even if functional interchangability is used as the basis for determining the relevant market, it is clear that it would remain confined to a select part of the respective activities of the retailers and furniture shops.

In short then we conclude that there are indeed powerful 'practical indicia' that indicate that the appliance discounters and the furniture shops do not occupy the same relevant market despite a degree of functional overlap in the products each offer. The appliance discounters and the furniture shops are not directed at the same market and this is reflected in their pricing strategies, their approach to credit, and their choice of location.[12] It has been suggested that this choice of market is also reflected in their respective levels of service, with the furniture shops more customer oriented in their service – they are, after all, generally establishing long term relationships with their predominantly credit customers. The discounters, on the other hand, are focused on high cash turnover and provide a notoriously rudimentary service.[13]

The distinction between the furniture shops and the discounters is sharpened if the relevant market is narrowed down, as the Commission proposes, to the LSM 3-5 range of customers. The discounters are not poor people's stores – they are stores aimed at price conscious middle-income consumers. By contrast, argues the Commission, the parties to this transaction are located in a market segment that serves low-income consumers. This view is rejected by the parties who argue that there is a single mass market for furniture and appliances, that is, that differently resourced participants in the market for appliances and furniture do not shop at particular stores to the exclusion of others, and, hence, do not serve to introduce an income or living standard based segment into the relevant market.

The assertion by the parties of a single mass market flies in the face of much of the evidence presented to us. For example the parties themselves use terms like 'traditional' and 'aspirational' to distinguish the market orientation of their brands; they have submitted considerable documentation in which they segment the market using the LSM criteria; the evidence submitted that elaborates how the JD Group decides whether to open a new store, where to position it, and which of its various brands to establish in any given location is clearly indicative of the importance that the parties themselves attach to the various living standards and

12 As noted above it appears that the large furniture chains are establishing specialized appliance discounters who may well be in the same relevant market as the discounters like Game.
13 These arguments are borne out in a recent interview with Mr. Allan Herman, the Managing Director of Massdiscounters, the discounters division of Massmart, incorporating Game and Dion's. *Business Report* (24 August 2000) reports that 'Herman said Game's winning formula was price leadership as well as price aggression and range. "Game offers the widest selection of merchandise under one roof" he said.'

income measurements.[14]

We have no doubt that these categories and the boundaries between them are dynamic, are constantly shifting. Their range of brands and the sheer number of their stores combined with the diverse formats of their stores (that is, in ascending order of scale, 'satellite stores', 'conventional stores' and 'super stores') gives the parties the ability to open and close stores relatively rapidly in response to changing market conditions and economic circumstances. We also readily accept that at the margins of each of the store brands there is a certain degree of intentional overlapping of product directed at several LSM levels – hence a consumer in the LSM 3-5 category will not always be confined to a store predominantly located in that market segment but will find that the lower priced products in the next category suit her pocket[15]; naturally consumers in higher brackets will frequently source product in lower categories. But none of this serves to deny the legitimacy of segmenting markets by income category or that store brands are specifically positioned to serve designated segments. In short the parties themselves effectively acknowledge the centrality of the LSM categories in the competitive positioning of their stores.

However, possibly the strongest evidence of clear market segmentation is found in the pricing strategies employed by both groups in the lower segment relative to those employed in higher segments. Evidence submitted by the parties clearly establishes that the gross margins in the LSM 3-5 segment are significantly higher than those charged in the segments immediately above. This is clearly associated with the greater risk attached to providing credit and speaks clearly to a marked differentiation or segmentation of the market.

14In its presentation to the Tribunal on the 10th August the Commission supported its arguments by citing numerous statements made by representatives of the parties. For example Mr. Eric Ellerine, in responding positively to the transaction, is quoted as saying: "JD are the market leaders in the middle income group (LSM Market 4 to 8) through their Russels, Bradlows, Joshua Doore and Giddy's Electric Express. We are the market leaders in the lower income group (LSM 3 to 5)". And in an interview with the Commission Mr. David Sussman stated: "Score/Price&Pride on the bottom end of the pyramid – clearly LSM 3-5". And again: "JD Group envisaged creating a new chain of stores – maybe targeted between Bradlows and lower segment or above Score/Price&Pride segment". In documentation submitted to this enquiry the parties noted: 'It intended that, over time, the new JD Group will reposition certain by converting in the region of 100 of the total 436 Ellerines stores currently serving the LSM 3-5 market upwards to target the LSM 4-7 markets'. And further: 'It should also be observed that the consumer market is a dynamic one in which the consumers are constantly changing their store preferences as their income levels rise.'

15 This appears to be part of a deliberate and eminently sensible strategy aimed at enabling consumers to 'migrate upwards' – it ensures that the migration upwards takes place along a continuous upward slope rather than a discontinuous leap (see notes of David Sussman's interview with Commission: 'Entry market – credit risk high and therefore risk market is limited. As customers establish a credit record, they are able to migrate upwards'). Note further, Mr. Sussman's statement: 'What I think will happen is that where we have got an abundance of stores competing against each other in a town or an area we will have to look at what is best for the overall group whether it be a JD, a Bradlows, an Ellerines, a Royal or an Oxford. *We have got so many brands to play with and the bridge of merger is if you go up the brand ladder the volumes increase.'* (our emphasis)

In summary then we conclude that the relevant market is composed of furniture shops (with a product mix of furniture and appliances) directed at credit sales to consumers in the LSM3-5 category.

The final element in defining the relevant market relates to the geographic component of the definition. The parties insist that the market is national, while the Commission argues that there are a large number of local markets.

The geographic market is conventionally understood to refer to that geographic area to which consumers can practically turn for alternative sources of product and in which the antitrust defendant faces competition.

In concluding that the geographic market is local, or, more correctly, that there are a large number of local markets, the Commission has placed emphasis on the first part of the definition, that is, the geographic area in which consumers can practically turn for alternative sources of product. A bulky product like furniture will generally be purchased as close as possible to the location at which it is utilized, the more so when it is bought on credit and the consumers, many 'unbanked' and therefore without access to convenient stop order facilities, have to present themselves at the store each month to pay their credit installment. The parties point out that, in a country where it is still not uncommon for breadwinners to work some distance from their family homes, the preferred site of purchase is one proximate to the place of work precisely to enable the breadwinner to affect the monthly payment. The extensive network of stores then allows the delivery of the product to be affected by a store in the residential neighbourhood.

It is the second element of the definition – that the merging parties should face competition in the local market – that gives greater pause for thought. The parties insist that prices and credit conditions are set nationally – prices, they aver, are set by the head office managers of the respective chains, while credit conditions are set at group level within the strict parameters laid down by national legislation. This implies that the parties – both national groups comprising national chains of stores – do not respond to competition at the local level, or, conversely, that their key competitive strategies, including pricing and credit policies, are determined in relation to those of other national chains. Note, that the parties make this assertion when defining the relevant market and yet, in their assessment of the competitive impact of their transaction, claim that the regional independents loom large in setting limits to the potential exercise of market power on the part of the national chains. The implications of this inconsistency are explored more fully below.

The Commission argues that while national pricing *parameters* are clearly established, regional and branch managers are given considerable latitude to respond to competitive conditions at the local level. As the Commission points out, the parties conceded that, in the JD Group at least, every store manager may discount products down to cost plus VAT in order to take a sale away from a competitor.

Detailed econometric analysis may provide a definitive answer to this question. It is common cause that regional and branch managers have a degree of latitude in responding to local competitive condition. However in order to decide whether *competition* takes place within the geographic boundaries for which these branch and regional managers have responsibility we must rely on evidence demonstrating the precise extent of this local discretion and identifying when it is used. The JD Group has, in fact, provided detailed evidence suggesting that revenues earned from promotions and other discounted sales account for a relatively insignificant proportion of total revenues.

On the face of it, maintaining rigid national control of prices does not make commercial sense. It means effectively that the national chains are prepared to forego sales to the regional independents in order to maintain centralized national control over pricing and other key competitive variables. Surely it would be preferable to impose turnover or profit targets on local managers and allow them to compete on terms dictated by their local competition? After all, as already discussed, the ability of the consumers to physically purchase product outside of limited geographic boundaries is circumscribed by the nature of the product.

On the other hand, we have presented with persuasive commercial reasons for maintaining national control over or, at least, strict national co-ordination of these key competitive variables. Maintaining the integrity of the brand is one reason advanced by the parties; massive economies of scale in national advertising is another. Mr. David Sussman acknowledged that the national group gave up sales to local independents as a result of its insistence on maintaining a national competitive strategy. However, in Sussman's estimation, it would be 'absolutely impossible to manage a chain if managers were given greater discretion' – in his view 'absolute chaos' was the likely outcome of a decentralized approach to pricing. He noted that, in the absence of national controls, store managers and sales staff, who, he noted, were not entrepreneurs, would be tempted to secure each and every sale to the detriment of the interests of the overall business.[16]

It is also possible – and this will be elaborated below – that this centralized strategy may simply reflect the market power of the national chains. In other

16 see transcript of Tribunal hearing of the 21 August 2000, pp. 21-3. Mr. Sussman's statement indicates clearly that he does not permit his managers to respond to competitive initiatives from local furniture stores: ''Sales people and branch managers would normally take the line of least resistance and just say 'oh well, to do business we had to drop our prices or we had to cut prices or we had to sell at cost plus VAT' and so on and so forth. So we discourage this to a very large extent.''

words, despite the nature of the product, the market may be truly national and dominance by national brands over local markets ensures that the advantages of eliminating all local competition are outweighed by the costs of compromising the other advantages of a national approach to competition. Certainly the European Commission is comfortable with finding a national market in circumstances broadly similar to the case in point. In *Blokker/Toys 'R' Us,* the European Commission pointed out that "In earlier decisions concerning retail operations, the Commission has generally taken the view that retail markets can be defined as national under certain circumstances". It continued:

> "Although the catchment area of a retail outlet, which can be based on the distance a consumer is willing to travel to reach it, is of a local or regional scale, the catchment area does not necessarily determine the geographic market. In a situation where several retail chains operate networks of stores on a national scale, the important parameters of competition are determined on a national scale. Therefore, from the viewpoint of the catchment area, what may be a local or regional market has to be aggregated to a national market in these circumstances."

On the evidence before us, we conclude that the parties to this transaction do, indeed, set prices and key trading conditions nationally. The Executive Chairman of JD has specifically conceded that the group loses sales to local independents in order to maintain national control over its competitive strategies. While the parties have acknowledged that regional and branch managers have a certain discretion with respect to pricing, deviations from national prices have to be sanctioned at the national level and we have been presented with evidence that establishes that this only occurs in exceptional instances. In short, the parties acknowledge that they do not set prices and trading conditions in response to competition from local independents but only in response to other national players. The local independents do not then comprise part of the relevant national market.

Accordingly we find that the relevant market is the sale of furniture and appliances on credit to consumers in the LSM3-5 category through national chains of 'furniture shops'.

4.3 The likely impact on competition in the relevant market

> We are enjoined by Section 16(1) of the Act to determine whether or not the transaction 'is likely to substantially prevent or lessen competition' in the relevant market.

A firm's market share reflects the amount of economic activity for which it is responsible in the relevant market. The US Supreme Court has declared that the "amount of annual sales is relevant as a prediction of future competitive strength" and is "the primary index of market power".[17] However, where the structure of the industry or special practices suggest that market share calculations based on sales figures would be misleading in assessing the impact of the merger, the US Courts, have also used other data, for example production and capacity figures, in order to calculate concentration.[18]

There are a number of widely accepted empirical indicators of market power. The most common among these is the Herfindahl-Hirschman index and the four-firm concentration ratios. Both are naturally heavily conditioned by the quality of the data used to calculate them and, above all, by the parameters of the relevant market.

The parties have presented us with two sets of HHI measures, the one based on the total furniture and household appliance credit market, the second based on the LSM 3-5 income group market (see tables 1 and 2 below) that, on their data, indicate relatively low levels of concentration and little change in concentration as a result of the merger.

Table 1: HHI based on total Turnover of Furniture and Household Goods:

Company	**Turnover R/million**	**Market Share**	**HHI Pre-merger**	**HHI Post-merger**	**Change in HHI**
JD Group	1,832	9.5	90.9	184.8	
Game/Dion	1,966	10.2	104.7	104.7	

17 See United states v General Dynamics Corp., 415 U.S. 486, 501 (1974) and Brown Shoe Co. v United States, 370 U.S. 294, 322 n.38 (1969)
18 United States v. Amax, Inc., 402 F. Supp. 956 (D. Conn. 1975)

Profurn	1,704	8.9	78.7	78.7	
Relyant	1,573	8.2	67.0	67.0	
Makro	1,450	7.5	57.0	57.0	
Ellerines	780	4.1	16.5		
Lewis	1,815	9.4	89.2	89.2	
OK/Hyperama	798	4.2	17.3	17.3	
Pick 'n Pay Hypermarket	650	3.4	11.4	11.4	
Independents	6 645	34,6			
TOTAL	**19,213**	**100**	**532.7**	**610.1**	**77.4**

Source: Commissioned by the parties from AC Nielsen

A major difficulty in agreeing upon sales figures is that the bases for calculating these figures differ as between the various groups with some reflecting turnover values based on cash price sales while others include finance and insurance charges in their turnover. According to AC Nielsen they scrutinised the annual financial statements of each of the listed groups for the financial year 1999 and extracted from that what they regarded as the common denominator in the definition of "turnover", that is sales at cash price.

> There are a number of telling errors in the basic data used. For example, the Lewis figures are from their 2000 Annual Report while the others are all drawn from the 1999 Annual Reports. Moreover, the Lewis figures do not account for the fact that 90% of Lewis's sales are on credit, as stated in the GUS annual report. Assuming a finance charge income at 22% the correct figure should amount to R 1 303 million and not R1 815 million. Given that the figure for the independents is a residual calculated as the difference between the official figure for total sales and those attributed to the groups cited in the table, the effect of this correction is to increase sales attributable to independents by a further R512 million.

Moreover there are certain stores that clearly do not belong in the relevant market – the 'right' to purchase from Makro is restricted to card holders and the Pick 'n Pay Hypermarket is a cash only store.

> However, the HHI calculation in Table 1 is most severely distorted by a serious methodological error: The parties cannot, on the one hand, insist that prices and key purchase conditions are set nationally with minimal discretion given to the local managers, and, yet, on the other hand, insist that for HHI purposes the turnover attributable to the independents be included in the size of the market. Setting price nationally implies, per definition, and this is borne out by statements cited above, that the parties do *not* respond to local competition, that, in other words, it is *not relevant* in their market. It implies that those who set their prices

nationally have accepted that a share of the market will always belong to the independents, because an all-out pursuit of the independents' sales would involve sacrificing the commercial advantages of centralization. It also has the potential of spilling over into a price war between the national chains. This scenario is not mere conjecture; it is established by the parties' own insistence that their competitive strategies are nationally driven. Stripping the independents out of the data used for calculating the HHI data raises it significantly.

Moreover, these HHI's measure concentration in a product market that we consider broader than the relevant market. In particular, as elaborated above, we have concluded that the appliance discounters are not part of the relevant market.

The second HHI calculation submitted by the parties is of the LSM 3-5 market. As already discussed the parties argue strongly for a single mass market. They have however submitted an HHI calculation of the LSM 3-5 in order to demonstrate that, even on this assumption, the HHI still reveals low levels of concentration.

Table 2: HHI based on total turnover of Furniture and Household Goods in LSM 3-5 market:

	Turnover R/million	**Market Share**	**HHI Pre-merger**	**HHI Post-merger**	**Change in HHI**
Lewis	1 815	22.9	525.0	525.0	
Profurn	530	6.7	44.8	44.8	
Relyant	712	9.0	80.8	80.8	
Ellerines	680	8.6	73.7	173.1	
JD	362	4.6	20.9		
OK	500	6.3	39.8	39.8	
Independents	3 322	41.9			
TOTAL	**7 921**	**100**	**785.7**	**863.5**	**78.5**

Source: Commissioned by the parties from AC Nielsen

However, this calculation suffers from the same methodological flaw as the single mass market HHI reflected in Table 1. That is, the independents are again included despite the parties' insistence that the market is national.

Second, is the surprising inclusion of the Lewis turnover in this data set. In evidence submitted by the parties themselves they have not seen fit to include Lewis in the LSM 3-5 rather placing them in the next market segment. In a later submission the parties indicated that, in their estimation, Lewis spanned the range of LSM 3 through to LSM 8. However for the purposes of this calculation all of

Lewis' considerable turnover is placed in the LSM 3-5 range. Note Mr. Eric Ellerine's confident assertion cited earlier: 'We are the market leaders in the lower income group (LSM 3-5') – and yet for the purposes of calculating the HHI for this segment Lewis' turnover in this market is represented as three times higher than Ellerines![19]

Based upon this critique of the HHI calculations submitted by the parties, we have reworked the HHI for the relevant market, as defined in section 4.2 above, as follows:

Table 3: HHI based on turnover of furniture and appliance shops directed at credit sales in LSM 3-5 excluding independents:

Company	**Turnover R/million**	**Market Share**	**HHI Pre-merger**	**HHI Post-merger**	**Change in HHI**
Profurn	530	17.2	295.8	295.8	
Relyant	712	23.1	533.6	533.6	
Ellerines	680	22.0	**484.0**	**1135.7**	
JD	362	11.7	**136.9**		
OK/Hyperama	500	16.2	262.4	262.4	
Lewis*	300	9.8	96.0	96.0	
TOTAL	**3084**	**100**	**1809**	**2324**	**515**

Source: own calculation

* Note that, cognizant of Lewis' spread across the LSM segments, based on a cash sales turnover figure of approximately R1,3 billion, we have included a figure of R400 million for Lewis in our re-calculated HHI. This is an estimated LSM3-5 turnover figure for Lewis based upon a similar LSM3-5 sales to total sales ratio for Profurn.

A post-merger HHI above 1800 is generally considered to be highly concentrated. Mergers that produce an increase of more than 50 points as in the above calculation clearly raise significant competitive concerns.

The Competition Commission also calculated the HHI in its recommendation. However, it followed a different approach by calculating concentration based on the number of stores of each of the participants in the various local geographic markets excluding the independents. They identified 500 local markets but only calculated HHI's for a sample of 12 markets, 2 major cities in each province[20]. They conclude that in the 12 markets

19 Note diagram in Appendix A. This was submitted by the parties and places Lewis outside of the LSM3-5 segment.
20 Johannesburg, Pretoria, Port Elizabeth, Cape Town, Bloemfontein, Pieter Maritzburg, Rustenburg, Nelspruit, Durban, Kimberley

analysed the merged entity will have a market share of 60% in one market, between 50-60% in four markets and between 40-50% in four markets. In the remaining three markets, the market shares of the merged entity will exceed 30%.[21]

Another method used to calculate concentration is the four firm concentration ratio, CR4 test. It measures the portion of the market accounted for by a given number of leading firms, in this case the four leading firms. If we take the market shares of the top four companies in the LSM 3-5 as calculated in table 3 above the four top firms concentration figure would be as follows:

Table 4: 4-firm concentration ratio

Profurn	19,5%
Relyant	26,2%
Ellerines	25,0%
JD	13.3%
Total	**84%**

Source: Own calculation

The merged firm will therefore supply 38,3% of the relevant market. Competition authorities are, as a general rule, very sceptical of a merger where the combined share of the four largest firms will exceed 75% and the merged firm will supply at least 15% of the relevant market.

In summary, we have used various methods and information to calculate concentration in the relevant market and have found shortcomings and flaws in each of the methods used.

In the premises, given the widely disparate HHI calculations, we are not willing to place complete reliance on any of these measures. Nor do we believe that the HHI, even when a relatively straightforward calculation, should, on its own, constitute the basis for deciding on the outcome of a merger investigation. The HHIs are *indicative* statistical measures; they are not determinant. They must always be bolstered a deeper, qualitative enquiry in order to arrive at a realistic assessment of the impact of the transaction on competition in the relevant market.

21 The parties criticized the Commission's attempt to base its concentration measure on the number of stores, pointing out that this lumped together a large variety of distinct stores, conventional stores together with the considerably smaller satellite stores and the significantly larger super stores. While we agree that store numbers is not an ideal measure of concentration, if the market is national and, if one accepts that each of the national chains is similarly composed of store format varieties, then the measure should be seen as providing an indicative measure of concentration.

Several factors serve to reinforce these statistical indications that the transaction has the potential to impact adversely upon competition:

The first concerns our difficulty in identifying the very basis of competition between the national chains in the relevant market. We have perused the reams of advertising material submitted by the parties. It is unusually difficult to compare cash prices and this because the various participants in the relevant market appear to make a determined effort to bedevil any attempt to compare cash prices at one store with those offered by it various competitors. For example while the specifications of many of the brands on offer are identical the various stores appear to be at pains to ensure that they do not offer the same branded products as those offered by their competitors - television sets are a good example here. Or alternately the precise specifications of the advertised products are shrouded in names that disguise more than they reveal – lounge suites are a good example of this practice. As noted above, the manufacturers produce in-house brands for the large chains and this also bedevils inter-store price comparison. If price comparison has eluded the resources of a competition authority, we can only conclude that the average LSM 3-5 customer is in an even more disadvantageous position in choosing from among the apparently vast array of options on offer.[22]

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22 Note that, in any event, consumer behavior in the LSM 3-5 market is not as responsive to price as the parties suggest. This is because in the typical sale the sale price is considerably less than the total cost to the customer. A typical purchase comprises the payment of a 10% deposit and then installments for the balance payable monthly over 24 months. Added to the sale price are-

- Delivery charges of R350.
- finance charges of approximately 22% of the principal debt (i.e. the sale price less the deposit)
- insurance (in Ellerines case 10,5% and in JD's 12% per annum of the sale price).
- Then JD but not Ellerines includes -
  - retrenchment insurance 6% of the outstanding balance (the principal debt plus finance charges) per annum; and
  - its magazine R 209.65 plus VAT.

In a working example prepared by Investec on two goods both with a sale price of R4999 the total cost to an Ellerines purchaser is R7968,82 a monthly installment of R332.03. The total cost to the JD customer is even more at R 8060,49, a monthly installment, of R391.75 . Investec arrives at two conclusions. JD with its additional expenses could charge R1000 less on the sale price and the consumer would still pay the same monthly installment as that charged by Ellerines. More importantly they say that Ellerines insurance charges are lower than the rest of the industry and they could profitably raise them from 10,5 % to 17,5%. If Investec is correct, this on its own is an indication of the potential for market power to be exercised post merger more so if JD is already able to charge 18% on insurances pre-merger. The following statement from the JD Group Board meeting of the 24 May is testament to the anti-competitive potential of this opaque method of pricing product: '(Mr. Strauss – the JD MD) noted that *other income levels at Ellerines could be boosted by at least 5% by the introduction of retrenchment insurance, furniture club membership fees and extended guarantees'*.

On the other hand credit terms and conditions appear identical across the various LSM 3-5 chains. This is to be expected given the level of statutory regulation of credit terms and conditions to which we have already alluded. However, it appears that an area of considerable competition centers upon the relative ease of access to credit available through the various competing groups of stores. This factor, above all, appears to act as the principle instrument for attracting custom in the LSM 3-5 category.[23]

However, easy access to credit is clearly a drawcard that has to be managed with consummate care – several major chains have already fallen prey to the dangers of a poorly managed debtors book. While all of the key players in the LSM 3-5 market offer credit on relatively easy terms, Ellerine's longstanding reputation for granting entry level credit and the quality of management of its vast debtor's book is unparalleled. Moreover the unusual strength of Ellerine Holding's balance sheet – primarily because, in contrast with the other national chains, it has not been an aggressive acquisitor, it is ungeared - enables it to extend consumer credit with considerably greater ease than its competitors.

Secondly, and this has a strong relationship to the use of credit facilities in this segment of the retail furniture trade, there is the question of brand loyalty. Brand loyalty here refers to the observed tendency of customers to remain with a single chain or, at least, within a single group of chains. The parties have questioned the extent of brand loyalty but this is at odds with other assessments of customer behaviour in this sector, many of which specifically refer to evidence of strong brand loyalty.[24] A common sense reading of the furniture retail trade would favour those who identify strong brand loyalty – credit accounts for much including a strong interdependence between debtor and creditor.

The upshot is that in acquiring Ellerines, the JD Group does not merely acquire one of the country's best retail brands and the various material assets owned by the company – it actually acquires customers in the form of the large debtors book and, moreover, customers who are likely to remain loyal to the acquiring party. Furthermore, because of the observed, and perfectly understandable tendency (arising again out of the nature of the credit) of *group* (as opposed to mere brand) loyalty the acquisition of Ellerines will not only increase JD's customer base at the LSM 3-5 segment but will provide it with customers who are liable, in Mr.

23 Note Raphael Kaplinsky and Claudia Manning – Concentration, Competition Policy and the Role of Small and Medium-Sized Enterprises in South Africa's Industrial Development (Journal of Development Studies, Vol. 35, No.1, October 1998): 'Several of the (furniture retail) chains' marketing directors – whom we interviewed – ….informed us that black consumers (the main users of consumer credit) are not 'price sensitive', since they are primarily concerned with getting access to credit..'(p153-4)

24 Diverse sources remark upon the extent of brand loyalty in this trade. See, for example, the Commission's submission and also the Fleming Martin report on the sector. See also the divisional review of Protea Furnishers in the Profurn Annual Report: 'The division furthermore boasts a total of 340 000 accounts or customers *of which 40% contribute to repeat business.'*

Sussman's words, to 'migrate upwards' to other brands in the group. This is why brands in the lower segment are referred to as 'entry level' brands and those in the higher segments as 'aspirational'.

We should underline that the loyalty described above is not to be taken for granted in most merger transactions – on the contrary competition regulators are generally able to assume that a combined entity will *lose* a certain proportion of its combined customer base to existing competitors. In this case, however, the likelihood is that the merged entity will not only retain the combined LSM 3-5 customer base but will also simultaneously increase the customer base for its higher segment brands. This unusual outcome derives from the fact that the Ellerine's customers and those of Price 'n Price and Score, JD's existing LSM 3-5 stores, are poor people with highly limited access to credit, subject, in other words, to a powerful incentive to remain with those from whom they have already received credit.

Thirdly, we do not share the parties' assessment that entry barriers are low. Information submitted by the parties establishes that the introduction of new national store brands is, by and large, the effective prerogative of the existing national chains.[25] This is not surprising. The economies derived from membership of a large, established group are clearly considerable and relate, most obviously, to IT costs, advertising, supplier discounts and warehousing expenses. The ease with which the established groups are able to open new stores within an established brand must act as a significant deterrent to would be new entrants who, on the evidence presented, would have every reason to expect that any lucrative market will soon attract one of the established brands. Store leases, we are told by the parties, are generally of five years duration and so the sunk cost are significant.

Above all new entrants are constrained by the requirements of running a large debtor's book. The parties assert that this entry barrier only pertains to an entrant that wants to run its own debtors book and it notes the availability of credit from other financial institutions, including some dedicated to providing credit to purchasers of furniture. However, we are persuaded by the evidence gathered by the Commission to the effect that this credit is both limited, a veritable drop in the ocean compared to the parties ability to extend credit, and costly.[26]

25 Nor should the difficulty of establishing new brands, even for the established groups, be underestimated. A glance at the length of time for which many of the established furniture brands have been in existence (see profiles of the groups presented above) bears testament to the difficulties that new entrants will face. On the other hand the Commission's sample survey of independents and their inability to even track down a significant proportion of those in a large sample indicates that new entrants are subject to a high failure rate and tend to exit very rapidly.

26 See Commission's presentation to the Tribunal hearing of the 10 August 2000. Credcor, the largest source of credit for customers of the independents, has a debtors book totaling R90 million in respect of furniture and appliance retailers, while the parties alone have a combined book of the R2,8 billion.

The remarkably high margins, particularly in the LSM 3-5 range, are themselves indicative of market power and of high barriers to entry. Ellerine's gross margins are 53,5%. In the LSM 3-5 brands the JD Group's gross margins are 44% and in the LSM 6-8 they go down to between 27% and 33%. We accept that the margins reflect the exceptional degree of risk that the participants are willing to assume in this low income, credit-based market. But they clearly establish that not many others are willing to assume this risk even at margins strikingly higher than those generally available in the retail trade. Pick 'n Pay's response to the Commission to the effect that it would only consider entering this market if prices went up by 10% is indicative of the hurdles that even this experienced and well resourced retailer perceives in the low income furniture market.

Finally, there is no doubt that the transaction results in the removal of an effective competitor. As already noted David Sussman himself has been at pains to acknowledge the strength of Ellerines. The Financial Mail reports: "At JD they regarded Ellerines as serious rivals. 'In the market we're their biggest rival', says Sussman. 'We weren't as concentrated at the entry level (lower end of the market) as Ellerines are. But we were really slogging it out toe to toe'"

We accordingly find that the transaction is likely to substantially lessen competition in the relevant market. This conclusion is based on the share that the merged entity will have of the LSM 3-5 market in combination with the role played by credit allocation in attracting and maintaining a customer base, Ellerine's unusually powerful position in the business of granting credit, high levels of brand loyalty, high barriers to entry, and that fact that the transaction will result in the removal of an extremely effective competitor.

We should note that we give no credence to the notion that because the Ellerine's brand will be retained it will continue to provide the same level of competition to the existing JD brands. Although different brands, they will be subject to a single controlling mind and to view them as competitors for anti-trust purposes is without precedent and, we respectfully submit, good sense.[27]

4.4 A note on the independent furniture retailers

We have identified South Africa as the relevant geographic market. The effect of this is to exclude the local independent stores from the relevant market – as

Moreover, Credcor derives its income not only from interest on the credit it extends but it also levies a fee on the retailer thus raising the cost of credit sourced through Credcor. Furthermore, the Commission avers that the credit checks imposed by Credcor are stricter than those applied by the parties.

27 The parties have stated that the base price of products in the JD Group is the same for each business unit in the Group. (Par 5.2.4.1 of their filing made on 3rd August) This contradicts their assertions elsewhere (Par 5.1.12) that individual units compete with one another.

already elaborated, the parties themselves aver that they do not respond to competitive initiatives from this quarter. However, despite the glaring inconsistency in their approach, the parties nevertheless attempt to make much of the alleged competitive presence of the independents.

The Commission, for its part, finds local geographic markets but then, also exhibiting a certain inconsistency in its approach, finds that the independents are not a significant source of competition in these markets.

Our finding that the relevant market is national relies principally on evidence submitted by the parties. We accept, as outlined above, that there are rational commercial grounds why large national chains should value centralized, national determination of their key competitive strategies and, conversely, why they should not respond to initiatives from the local independents. However, if this issue is examined from the perspective of the current competitive strength and future prospects of the independents, then it is not difficult to see why they are all but ignored by the participants in the relevant market – the large national chains – in the preparation of their competitive strategies.

There appear to be two types of independent operators. The first, the vast majority, operate a conventional store format . The second operate a very large super store format. Some of the independents group two or three stores but most are single store operations. They are owner-managed enterprises.

The evidence gathered by the Commission regarding the former grouping of independents is striking. The parties informed the Commission investigators that there were 1251 independents in the 99 local markets in which both parties compete. A survey conducted by the Commission of 202 of these independents in the Eastern Cape, Northern Province and the Free State established that 93 were no longer in business, 12 were not in the relevant product market, and four declined to respond to the Commission's queries. Of the remaining 93 only 13 – 6,5% of the sample surveyed - serve the low-income market and provide credit.

The parties also referred to Furnex, a company that buys products and obtains financial services on behalf of its members all of whom are independent retailers. The parties argue that Furnex's collective buying power constitutes its members as a real competitive threat to the large national chains. We disagree. Furnex's members may be able to use their collective purchasing power to reduce the cost of their product, but there is no indication that firms graduate from Furnex membership to become significant chains. Indeed each Furnex member controls, on average, a trifling 1,5 stores.

The parties made much of the competition from the large format independents. They provided four examples. Although found in very few areas, these are undoubtedly very large stores. However these stores are a particular manifestation of South Africa's past and the conditions for expansion of these stores and for new entry by large format independent have disappeared.

The four stores used by the parties are indicative of this. They are owned by Indian entrepreneurs whom the Group Areas Act confined to particular locales of the large rural towns in which they are all based. These were generally located in proximity to the transport routes from the African townships, precisely the sites now favoured by the parties and the other large national chains in the low income segment of the market. These stores, managed by extremely able entrepreneurs, were prevented by the Group Areas Act and by restrictions on raising capital, from expanding out of their prescribed bases. Had they not been restricted by apartheid they may well have been in the position occupied today by the parties to this transaction. However, the unfortunate truth is that they remain confined to their original bases, they remain family-owned and managed with all the limitations that implies for rapid expansion, and they now have to contend with added competition from the multi-store chains. We asked the parties whether any of the stores cited by them as examples of large independent super stores had been in existence for less than 10 years. They have not been. We would indeed be surprised if any had been in existence for less than 20, even 30 years. This confirms that new entry at this scale of operation is not feasible. This, combined with the obstacles in the way of expansion on the part of the existing players, leads us to conclude that they are, at most, significant in a small number of regions and that the extent of competitive pressure from this source is, if anything, likely to decline rapidly.

4.5 The Impact of the transaction on the manufacturers of furniture

A constant refrain running through the investigation and evaluation of this transaction concerns its possible impact on relations between, on the one hand, the manufacturers of furniture and, on the other, the retailers. Various concerns have been expressed: more powerful retailers, operating in a less competitive retail market, are better able to squeeze the profit margins of the manufacturers; the preponderance of large national retail outlets with centralized purchasing departments inevitably means that the volumes ordered will exceed the capacities of the smaller manufacturers; the close relationship alleged to exist between the JD Group and the Steinhoff Group, much the largest manufacturer of furniture in South Africa, would further underpin the progressive exclusion of the smaller manufacturers from large parts of the market; the additional purchasing power of the new group combined with its allegedly close relationship with Steinhoff would give JD a competitive edge over other furniture retailers.[28] [29]

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28 Cf. footnote 2, above. This provides evidence suggesting that the JD Group already received payment terms from the manufacturers that are preferable to those available to the other chains.

29 Note Kaplinsky and Manning (op cit) whose analysis of the industrial structure of the furniture

A group of small furniture manufacturers submitted a statement of their concerns to the Commission. However, they requested that they not be identified and the Tribunal has accordingly had no regard to their statements.

The parties, for their part, have furnished the Tribunal with more than 120 letters from manufacturers expressing support of the transaction. A Commission investigator has submitted an affidavit in which she attests that certain manufacturers have reported (and again declined to be named) that they were pressurized by senior representatives of the parties to submit these letters. The parties have denied these allegations. The Tribunal must again decline to accept anonymous submissions, though it records that the alacrity with which the manufacturers responded to the request for support and the near unanimity of the response ((there was a single detractor) suggests that the parties do command a not inconsiderable degree of power vis a vis the manufacturers.

However given that we could not rely on the anonymous grievances submitted, this issue has not influenced the outcome of the Tribunal's evaluation of this transaction. We do note though that the purchasing power – market power, in other words – of the large retailers vis 'a vis the smaller producers is cause for concern and calls for vigilance on the part of the competition authority. We also note the parties' undertaking to maintain existing supplier relations.

4.6 Pro-competitive gain

The parties have not identified pro-competitive gains in the relevant market. On the contrary, as already noted, Mr. Sussman has been at pains to distinguish this transaction from previous acquisitions by the JD Group. In the other transactions JD acquired ailing chains and turned them around. These pecuniary gains have not been claimed in this transaction, where the target company is identified as a well managed, thriving group.

The only efficiency claims made are in respect of the parties' activities in financial services. These are examined under public interest.

4.7 Public Interest

In undertaking a merger evaluation we are enjoined by Section 16(3) of the Act to consider specified public interest issues. Where, as in the case, the merger has

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manufacturing industry bears out many of these fears: 'The retail chains we interviewed all informed us that they could not source from small producers because the latter could not produce sufficient quantities. Consequently the bulk of the retailers' purchases came from large enterprises.' This research them bears out the central argument in their paper, namely, 'that the process of retail concentration serves to undermine the market access opportunities of smaller producers.' (p152-3) been found to diminish competition, we enquire whether a positive impact on public interest outweighs the negative impact on competition, thus permitting approval of the merger. Note that the Act specifies the public interest grounds that the Tribunal may consider these being the impact of the merger on a particular sector or region, on employment, on the ability of small businesses and firms controlled by historically disadvantaged persons to become competitive, and the ability of national industries to compete in international markets. Note too that the mere existence of a public interest ground is not enough in itself. The Act requires the public interest ground to be substantial.

In this merger the merging parties have, whilst not conceding the merger is anticompetitive, raised under the public interest rubric an aspect of the deal affecting their respective financial service arms, which they say, is in the public interest.

4.7.1 Financial Services

The parties have raised the increase in their ability to offer financial services as a public interest ground in that they are helping bank the "unbanked".

They say that with an increased store base of approximately 1250 outlets in SA they will be in a better position to do so. They also stated that certain stores could be converted into franchises particularly in the Electrical Express Chain and that this would be beneficial for small business and create employment opportunities.

All these objectives are very laudable, but what we have to assess is whether the parties require the merger in order to implement them. Nothing the parties have told us suggests they cannot implement these strategies without the merger.

We turn first to the claims regarding financial services and note at the outset that it is not clear under which of the specified public interest grounds this claim is made. However, that having been noted, we will nevertheless proceed to examine the substance of the claim.

The parties claim that the additional store base will lower the costs of rolling out their financial services arm. However, both Ellerines and JD have extensive and often overlapping networks of stores. Neither party needs a merger to reduce the costs of rollout.

Nor do they require the merger to increase their ability to raise capital. Both have already embarked on expanding into financial services prior to contemplation of the deal and are already operating divisions, have marketing strategies in place and, in the case of Ellerines, have developed a separate brand in Rainbow Loans. If anything the market for these loans will become less competitive if two competitors providing these products are merged. We do not base our decision to find the merger lessens competition on this, we merely use this to reject the suggestion that the merger brings with it a substantial public interest.

In short, the parties do not need this merger to enter this market - they have already entered and are better resourced than most to sustain that entry.

The suggestion that these activities bring banking to the unbanked must also be treated with some skepticism. The financial services offered do not replicate the traditional services of the banking sector i.e. local branches for savings accounts etc, that is, they do not 'bank the unbanked'. They extend credit and stimulate consumption – they do not facilitate or encourage savings. Moreover, as the evidence of the parties clearly indicates, micro loan schemes are ubiquitous and there is no suggestion that these services, as opposed to the more traditional banking services, are not getting to the "unbanked".

As to the suggestion that the parties may involve themselves in franchising, although not stated expressly we assume the motivation is based on 16(3) (ii) and (iii) of the Act, which deal respectively with employment and the ability of small business and businesses owned by HDI's to become competitive. The 'offer' to promote franchising is vague. Moreover, we should point out that franchising is a business strategy aimed at spreading risk and we presume that this would be the basis of a decision to franchise certain brands. Franchising will not be embarked upon in order to promote the public interest. Furthermore if the parties wish to pursue franchising there is no apparent reason why this is contingent upon the merger.

4.7.2 Employment

Undertakings were made to the employees and we are satisfied that the merger raises no concerns on this ground

4.7.3 Other Public Interest Grounds

None of the other public interest issues were raised by either the merging parties or the Commission and so we do not need to consider them.

4.8 The Proposed Conditional Acceptance

The Commission initially recommended prohibition of the transaction. However, it subsequently reconsidered its position and has recommended that the transaction be approved subject to a number of conditions. Although the parties do not admit that their transaction will substantially reduce competition and, accordingly, that the imposition of conditions is warranted, it has agreed to accept the conditions in order to secure approval of the transaction.

The panel is empowered to approve the transaction conditionally. We will, accordingly, examine the proposed conditions.

The core condition is that, within 9 months of the date of approval of the transaction (or, with the Commission's agreement, a further 3 months), the merged entity will divest itself of 150 stores in the LSM 3-5 category. The stores selected for divestiture must be acceptable to the Commission. The purchaser shall preferably be a Black Economic Empowerment Group approved by the Commission, or, failing that, another buyer approved by the Commission. Furthermore, once the stores are selected for divestiture, the merged entity undertakes to manage the chosen stores efficiently 'so as to ensure that the new purchaser shall become a viable competitor of the JD Group after the sale by the JD Group'. The statement of conditions submitted by the Commission specifically records that, in determining the identity of the purchaser, 'its ongoing viability must be paramount'. The Standard Bank will be appointed at JD's expense to monitor compliance with the conditions.

Finally, it is noted that, 'Section 14(5) shall be applicable to all the aforesaid conditions'. Section 14(5) allows the Commission to revoke its decision to approve or conditionally approve an intermediate merger, in the event of, inter alia, a breach of any obligation attached to the decision.

A number of other conditions relating to employment and the parties' involvement in financial services are proposed. However, important though they may be, they do not impact on the competition concerns that have led us to prohibit the transaction. Accordingly, the imposition of these conditions would not cause us to reverse our finding. However the conditions relating to the divestiture of certain of the stores in the portfolio of the merged entity are manifestly intended to address the competition concerns arising from the merger. We will accordingly confine our decision to these conditions.

Turning to the substantive conditions proposed, we note that it is not uncommon for the competition authorities or the courts in other jurisdictions to impose divestiture as a condition for the approval of a merger. Under the previous competition law regime in South Africa divestiture agreements were struck in the context of merger investigations. There are many examples of successful divestiture arrangements, that is, divestiture arrangements that have permitted a revised transaction, one that meets the requirements of both the parties and the competition regulators, to go ahead. Merger regulation must recognize that many mergers are efficiency enhancing and, in general, part of the legitimate conduct of business. Accordingly, if an anti-competitive merger can be 'rescued' by excising those aspects that generate concern, then the Commission and the parties are encouraged to seek out these solutions. Furthermore, a structural solution such as divestiture, is generally to be preferred to a behavioural condition that requires constant monitoring by the competiton authorities or, expressed otherwise, ongoing regulatory intervention in the affairs of the merged entity.

However, not every anti-competitive merger can be cured by a divestiture order. Or, conversely, it is not simply any divestiture order that will cure an anti-competitive merger. The finer details – the precise assets to be divested, the identity of the purchaser, the price, the length of time taken to effect the divestiture, the post-divestiture relationship between the merged and divested entities – are all important. However, the conditions proposed here contain only the barest of detail. On the other hand there is persuasive evidence that suggests that a divestment has only a slim prospect of overcoming the anti-competitive consequences of this transaction.

The litmus test of the effectiveness of divestiture is whether it maintains competition in the post-merger relevant market, or, in the language of the Act, whether or not it permits of a transaction that does not 'substantially prevent or lessen competition'. The Federal Trade Commission holds that

> "The order, the divestiture contract, the buyer and the buyer's business plan should be evaluated in terms of whether the divestiture will restore competition in the complaint market. This means that the divested entity must have the same potential and incentives to expand and innovate as the firm that disappeared. It should not be a firm that has continuing dependency on the respondent or that is frozen in a static product or locked in a narrow competitive niche." [30]

In other words, the practical measure of the effectiveness of a pro-competitive divestiture is whether or not the divested assets constitute the basis for introducing a new competitor into the market, or for strengthening the competitiveness of an established participant. This test imposes a conflicting set of incentives on the merging parties – on the one hand, they are eager to proceed with the transaction and are, therefore, encouraged to find a buyer who meets these criteria; on the other hand, they would not wish, in the process, to create a powerful new opposing competitive force, to sow, as it were, the potential seeds of its own future destruction.

The Competition Commission is clearly cognizant of these considerations, of these conflicting incentives. This is presumably why the Commission makes much of the requirement that the purchaser of the divested assets be 'viable', why the merged entity is specifically enjoined to facilitate the viability of the purchasers, and why a merchant bank is employed to ensure that these conditions

30 Federal Trade Commission (1999) – A Study of the Commission's Divestiture Process (p.37)

are respected.

However we are not persuaded that these conditions reverse the dangers to competition that have caused us to prohibit the transaction.

Firstly, precious little detail has been provided. Indeed there is as yet simply no detail to provide. With respect to the assets divested it is clear that the value that attaches to the stores is to be found in the brand or brands, the staff and the management systems, the debtors book, and, to a varying extent, the store leases.

On the face of it, there is nothing to suggest that a chain of this size and this structure will be viable. Certainly there is no successful role model. The other national chains, against whom the new entity will compete, all have LSM 3-5 interests larger than that represented by the 150 stores and, possibly more important, all have major interests in other segments of the market. It is suggested by the parties themselves that even Ellerine's Holdings, with its powerful LSM 3-5 stake, suffered in consequence of its limited presence in the other market segments. It will lack the purchasing power that brings its competitors critical advantages on the supply side and it will lack the diversity that allows the other chains to view its LSM 3-5 brand as its entry level clients ultimately to be 'migrated' into the lower risk, cash-oriented segments of the market. In our view the stake offered is at once too small and too undiversified to compete successfully against the established retail groups.

However, it is simultaneously too large to be managed by interests with no experience of this highly specialized and risky trade. A strong conclusion of the Federal Trade Commission's review of its experience of divestiture conditions is that 'the most successful buyers are the most knowledgeable. Buyers who are making geographic extension mergers of ongoing businesses are the most successful'.[31] In this instance nothing is known of the prospective purchaser except that a Black empowerment group is preferred. The only significant Black ownership in the furniture retail trade is to be found among the few large independents and a sale to these interests may be the only way of ensuring that these assets remain competitive. We have, however, been given no indication that any of these parties may be interested, nor do we envisage that the new JD Group will respond enthusiastically to the prospect of selling to one of these companies.

A certain level of experience will be available to the new owners if the current management of those stores and the brands that are sold is retained. However, there are solid grounds for skepticism here. The key managers of the sold assets clearly enjoyed substantial career prospects when their stores and brands were under the umbrella of one of the large, expanding chains. This prospect is now eliminated and even if the merged JD/Ellerines Group behaved in good faith and

31 op cit p38

resisted the temptation to poach the best of the staff, there is no reason to expect the competitor chains to play by these rules. We note that the parties have assured us that they will put in place an ownership incentive scheme aimed at retaining key personnel but the success of this scheme will depend crucially on the staff's assessment of the potential of the new group.

Moreover, and possibly more important, the skill, experience and entrepreneurship of the group leadership clearly makes a powerful contribution to the competitiveness of each of the brands. Mr Sussman, himself, observes that his branch and regional managers are not entrepreneurs and that it is partly for this reason that key decisions over pricing and credit are made in head office, frequently in the group head office. Other key aspect of the infrastructure of management – some, like JD's sophisticated IT system, very costly and skill intensive – are centralized in the group. It is unlikely that these will be available to the new entity post-divestiture and, from a competition perspective, nor is it desirable for two competitors to be sharing these critical competitive resources.

A purchaser that may successfully overcome all of these problems could come from one of the existing national furniture chains, although this is unlikely to meet the test of maintaining competition at pre-merger levels. A retail chain not currently involved in the relevant market would be well placed to manage the chains. However, there is no indication of any interest from this quarter and it is unlikely that the assets on offer are of sufficient size to attract interest from one of the large retail chains. For a Pick 'n Pay or Shoprite or Massmart intent upon entering the furniture retail trade, Ellerines Holdings itself may constitute an attractive purchase. However, there is no reason to expect that the assets on offer will attract interest from this quarter.

Nor will the lengthy time period allowed for the divestiture enhance the prospect of a competitive new entrant. Again the Federal Trade Commission's experience is apposite:

> "In order to eliminate competitive harm, the Commission has greatly shortened the period by which a required divestiture must be completed in more recent orders. The working rule now is that the divestiture must be accomplished within six months after the consent order is signed. Earlier orders typically gave the respondent 12 months or more from the date the order became final to divest. To further reduce or eliminate interim harm by obtaining quicker divestitures, recent orders have required 'up-front' divestitures. The up-front divestiture not only reduces the opportunity for interim competitive harm by expediting the divestiture process, but it assures at the outset that there will be an acceptable buyer for the to-be divested assets."[32]

32 op cit p39. In the case of an order requiring an up-front divestiture the merger may not be consummated

In this instance concern regarding the 9-12 month period permitted for the divestiture to take place also goes to the potential impact on the viability of the divested assets. We note that the Commission proposes that the conditions to be imposed require the merged entity 'to manage these stores efficiently and according to sound business practices'. We also note that the Commission asks that a merchant bank be appointed at the merged entity's expense to monitor compliance with this and other conditions.

While we note the JD Group's acceptance of these conditions and do not question its sincerity in making the undertaking, we do not believe that it is capable of fulfillment. We have little doubt that those basic, visible factors that influence the competitiveness of the assets to be divested will be maintained in place – we are confident that advertising spend will be maintained, that relationships with suppliers will be kept in place, that the stores will remain price competitive, and that the debtor's book will be effectively managed.

However there is much that cannot be observed and it has to do with the way in which the JD Group manages the stores that it will *not* be divesting. The new JD Group will be intimately familiar with the stores to be divested. It is bound to manage its own assets strategically so as to blunt the competitive impact of the divestiture on its own performance. We cannot accept that JD, renowned for its robust competitive presence, would behave any differently. Nor can this be easily observed. To attempt to monitor JD's conduct in this regard would require a degree of intervention in its affairs that we would not wish to impose upon its management. And, in any event, given the 'information asymmetry', the disparity in the information to which the monitor and monitored would be privy, it would simply not be possible to vouch for JD's compliance in this regard.

Accordingly we find that the conditions relating to divestiture that are proposed by the Commission and that have been accepted by the parties do not reverse the anti-competitive effects of the transaction.

We considered the possibility of imposing additional conditions but have not been able to identify any that would reverse the anti-competitive consequences of the transaction. Acceptable conditions hinge critically on the viability of the divested assets. In order to assess this, the conditions would have to incorporate a considerably more developed description of the assets involved and of the purchaser. The divestiture would also have to be accomplished in a considerably shorter time frame than that permitted here. The Tribunal is clearly not able to develop a set of conditions at the required level of detail. This would have to be negotiated between the parties, the Commission and an identified purchaser. We

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until an acceptable buyer is found and the buyer has conducted a due diligence and submitted its business plan to the competition authority note here that the panel had proposed to the parties and the Commission that we postpone our decision in order to allow the parties to identify a buyer and develop a more detailed set of proposals. However, this was not acceptable to the parties.

We note the specific reference to Section 14(5) (more correctly Section 15(3)) of the Act and the view of Mr. Katz, for the parties, that, any risk arising out of non-compliance (for example, the failure to find a viable purchaser) resides with the parties given that, in the event of a breach of the conditions, the right to withdraw the approval is retained by the competition authority. We are however not persuaded by this argument. It would not be possible to unwind this transaction a possible full year after its consummation. This path portends massive uncertainty, an extremely burdensome supervisory task for the competition authorities, likely litigation and the effective imposition of a shackle on the competitive process.

We emphasise that our conclusion is based on the facts of this case and on the conditions proposed. It does not, in any sense, suggest a general hostility towards conditional approvals or the place of divestiture in these conditions.

________________ 30 August 2000
D.H. Lewis Date

Concurring: P. Maponya and N.M. Manoim