

**COMPETITION TRIBUNAL  
REPUBLIC OF SOUTH AFRICA**

**Case No: 62/LM/Jul05**

In the large merger between:

**Massmart Holdings Limited**

**Acquiring Firm**

And

**Moresport Limited**

**Target Firm**

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**Reasons for Decision [NON-CONFIDENTIAL]**

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**PROHIBITION**

1. On 10 April 2006 the Competition Tribunal prohibited the merger between Massmart Holdings Limited and Moresport Limited in terms of section 16(2)(c) read with Rule 35(5) of the Competition Act. The reasons for this decision appear below.

**THE PARTIES**

2. The primary acquiring firm is Massmart Holdings Limited ("Massmart"), a public company listed on the JSE. Though it is not controlled by any one group, the major shareholders of Massmart are:
  - Old Mutual Group 14.22%
  - Public Investment Commission 5.42%
  - Participants of the Massmart Holdings Share Trust 5.18%
3. Massmart controls and operates various divisions, grouped as follows:

**Massmart Holdings**

<b>Massdiscounters</b>	<b>Masswarehouse</b>	<b>Massbuild</b>	<b>Masscash</b>
Game	Makro	Builders Warehouse	Shield
Dion		Federated Timbers	Furnex
		Servistar	CBW
		De la Rav's	Jumbo

4. Massmart is described by the merging parties as a high volume, low margin retailer of food, liquor and general merchandise. General merchandise encompasses a disparate array of products including office supplies, DIY equipment, hi-tech products, household appliances, sporting and recreational goods and categories of clothing.
5. While Massmart controls a number of chain stores across and retails a range of products, the relevant divisions for purposes of this transaction are its Masstores namely Makro, Game and Dion through which it retails a range of sports and recreational<sup>1</sup> goods
6. Massmart's rapid growth as a national retailer is to large extent due to a number of acquisitions it has made over the last 18 years.<sup>2</sup> Sporting and recreational goods, which are sold through its Masstores (Makro, Game and Dion) chain, account for nearly R675million of the group's annual turnover. Over the last decade the Massmart Group has become a significant national chain of sports and recreational goods with a credible and material offering in sports and outdoor merchandise.
7. The primary target firm is Moresport Limited ("Moresport"), a private company controlled by Vestacor Limited ("Vestacor")(28.8%), Nedcor Investments Limited ("Nedcor") (28.8%) and by a management consortium (40%).
8. Moresport sells sports and recreational goods through three branded chain stores:
  - Sportsmans Warehouse (SWH), the flagship store of the Moresport Group. It focuses on general sports and recreational apparel, footwear and equipment, with a large offering of functional sports equipment.
  - Outdoor Warehouse (OWH), which offers a range of sport and recreational apparel, footwear and equipment; and
  - Sports Shoe World (SSW), which sells sports and recreational footwear.
9. Moresport, over time, has also expanded its operations through a strategy of acquisition and growth. It had its origins in the Moregro Group, when it founded TotalSports in the mid-1980s. TotalSports grew to a size of 70-80 stores over a period of 10 years. Subsequently, it went through an acquisition and restructuring process. It bought Logan's Sportsmans Warehouse and Sports Shoe World in 1996. In 1998, Vestacor bought into the Moregro group and the structure was dismantled, with TotalSports being sold off, Outdoor

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<sup>1</sup> The word recreational is used interchangeably with outdoor goods and does not include goods such as computer games that could also be regarded as recreational.

<sup>2</sup> See pages 7-8 of Lamberti's witness statement.

Warehouse being injected and the entity being listed as Moresport. In 1999, Moresport purchased the Pro Shop and sold TotalSports the following year to the Foschini group. In 2000 the company de-listed and the Pro Shop was sold off in November 2003. Today the company consists of the three chains, SWH, OWH and SSW, which together form South Africa's largest and most dominant sports retail business.<sup>3</sup>

### **The Merger Transaction and Rationale**

10. In terms of the sale of shares agreement Massmart would acquire sole control of Moresport by acquiring 84,12% of the shares and issued share capital of Moresport, presently held by Nedcor Investments Limited, Vestacor Limited, Gerald Burken Rubenstein, Kevin Graham Hodgson, Elizabeth Antoinette Haarbarger, Roy William Ansel.
11. The remaining shares, which comprise approximately 15,88% of the issued share capital in Moresport, will remain vested in the following parties: Hodgson as to 7,42%, Haarbarger as to 4,77%, Ansel 1,69% and Rubenstein as to 2% of the entire shares.<sup>4</sup>
12. The stated rationale for the transaction is Massmart's intention to expand its business operations and increase its participation in the sports retail market. The parties submit that post merger the incumbent management of Moresport will be retained. Moresport has indicated that some of its shareholders wish to realise their investments in the company and its management is eager to expand its business operations beyond its current parameters.<sup>5</sup>

### **History of Proceedings**

13. The Commission's recommendation was filed on 14 October 2005. The matter was heard on the following dates: 30 January – 3 February, 20 February, 28 February, 6-7 March and 27 March 2006.
14. The following witnesses were led by the merging parties –
  - 14.1. Mr Mark Lamberti, the Chief Executive Officer of Massmart;
  - 14.2. Mr Kevin Hodgson, the Managing Director of Moresport; and
  - 14.3. Mr James Hodge, an expert from Genesis-Analytics.
15. The following witnesses were summoned by the Commission-
  - 15.1. Mr William Keet;
  - 15.2. Mr Paul Stone;

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<sup>3</sup> Nedbank valuation at Pages 267-270 of record.

<sup>4</sup> Note that 1% of Rubenstein's shares will vest in Kevin Lennett, 5% of Rubenstein's shares will vest in Bradley Moritz and 0,5% of Rubenstein's shares shall vest in Anthony Shaw.

<sup>5</sup> Page 55 of the Commission's Record File A.

- 15.3. Mr William Keet;
- 15.4. Mr Leroy Reynolds;
- 15.5. Mr Trevor Burger;
- 15.6. Mr Rhys Hughes; and
- 15.7. Mr Peter Reeves.

16. In the course of the proceedings, the merging parties submitted that they were not relying on an efficiency defence in the event that the Tribunal found that there was a substantial lessening of competition. The merging parties also submitted that they sought an outright approval or a prohibition from the Tribunal and did not seek a conditional approval.

### **Background to the sports and recreational industry**

17. The merging parties are both involved in the retailing of sports and recreational goods. Sports and recreational goods are considered to be discretionary goods, sought by people who wish to participate in such activities. These goods would include apparel, footwear and equipment utilised in a number of indoor and outdoor sporting and exercise activities such as tennis, cricket, rugby, hockey, running, swimming, cycling, hiking, camping and mountain climbing, table tennis and general exercise.

18. Consumers of sports and recreational goods are generally categorised as having some disposable income and a certain level of education. Children, in particular school children, are seen as important consumers in this industry (or rather the parents of school children) because they are likely to be involved in a number of sporting activities at school and may graduate in time to a more sophisticated level of, and therefore more expensive, product

**18.1. The sports and recreational market is not segmented along LSM levels. However products in each sports category could be distinguished along entry, middle and prime levels.<sup>6</sup> Entry-level products are directed at those sporting or outdoor consumers who are involved in the activity for purely recreational, leisure or social aspirations. The product quality and price levels are lower, since consumers at these levels are not so discerning and merely want a functional product. Mid level products are directed at consumers who regularly participate in a particular discipline. Product quality and price is higher than entry level, but not to the same degree as the next level of product. Prime or premium level products are typically of a higher quality, and are aimed at those consumers involved in the particular activity at an intense, competitive and professional level.**

19. The determination of where each level starts and ends is not that easy and is at times subjective. Experienced buyers, traders, participants or experts in a particular category best do such classification. In some categories prime level products are easier to identify because of the brands associated with them. In such cases the brand is associated only with prime level product. However many international brands (premium brands) such as Nike, Adidas, Gunn & Moore make product across all three levels. Moreover the same customer could buy product across all three levels. A father may purchase an entry-level tent for his son, a prime level hockey stick for his wife and a mid-level golf club for himself. An experienced hiker may purchase prime level hiking boots but an entry-mid level tennis racket. The purchases of customers may be a function of need and affordability. Whether these three levels are sufficiently distinct to constitute separate antitrust markets, as argued by the merging parties, is examined below.

20. Many changes have occurred in the retailing of sports and recreational goods especially in the last fifteen years. In the past sports and outdoor goods were sold by general sports traders who sold product across a range of sporting codes and levels and which did not belong to a national chain. These retailers were localised to a particular province or region or even suburb. Over time, this general sports retailer has been pushed out by the advent of the national retail chain store. The modern independent sports store is no longer a general retailer of sports and recreational goods but has become a specialist in one or two sporting categories. These stores focus on and are usually associated with a retired professional or expert in a specific sporting code, are usually smaller stores and owner managed, generally not found in major retail nodes but in

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<sup>6</sup> The prime level segment is often referred to as the premium segment, due to premium brands associated with such levels of product. We prefer to refer to the segments as entry-middle-prime and international brands as premium brands. However at times witnesses and the Tribunal refer to premium level which must be read to refer to the prime level segment.

suburbs or near sporting facilities and tend to provide expert advice in the particular sport in which they specialise. Among the specialist independents, we find one or two speciality stores wishing to expand their footprint across the country. Only a few independent *general* retailers exist in the country but these are found in one or two locations, either in a province or a region and are not part of a national chain.<sup>7</sup>

21. The national chains (general national chains) have, in this period, expanded the range of sport and recreational goods on their floors. These retailers are large and may, in addition to sports and recreational goods, sell a variety of other general merchandise. They are found in major shopping malls or in nearby retail value strip-malls. They employ a national pricing policy and national strategies and may or may not be part of a listed entity. They move large volumes of merchandise and are considered to be mass merchants. Amongst the offerings of the national retailers we find a difference of emphasis, with some of them focussing on apparel and footwear with a small offering in equipment, and others such as Massmart, which has a material offering in equipment.

### Commission's Recommendations

22. According to the Commission both parties are mass retailers and sell a number of overlapping products as set out below-

Retailer and Merging Party	Sports Footwear	Sports apparel	Sports equipment	Outdoor apparel	Outdoor footwear	Outdoor equipment
<b>Dion and Game</b> Massdiscounters (Massmart)	√	√	√	√	√	√
<b>Makro</b> Masswarehouse (Massmart)	√	√	√	√	√	√
<b>Sportsmans Warehouse</b> (Moresport)	√	√	√	√	√	√
<b>Outdoor Warehouse</b> (Moresport)				√	√	√
<b>Sportshoe</b>	√					

<sup>7</sup> See in general the evidence of Mr Keet, Stone, and Hodgson. Note also that there isn't a single independent general sports retailer in Johannesburg despite the size of its population.

<b>World</b> (Moresport)						
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23. The Commission concluded that the parties compete with each other in the following six relevant markets-

- 23.1. the market for the retailing of general sports footwear through national chains;
- 23.2. the market for the retailing of general sports apparel through national chains;
- 23.3. the market for the retailing of general sports equipment through national chains;
- 23.4. the market for the retailing of general outdoor apparel through national chains through national chains;
- 23.5. the market for the retailing of outdoor footwear through national chains; and
- 23.6. the market for the retailing of outdoor equipment through national chains;

**23.7. The Commission was of the view that no competition concerns arose in the sports apparel and footwear and outdoor apparel and footwear markets.<sup>8</sup> Competition concerns arise only in relation to the market for the retailing of general sports equipment through national chains and the market for the retailing of outdoor equipment through national chains.**

23.8. Within this market, the Commission recognises that sports and outdoor equipment may be divided into three levels – entry, middle and prime level products or professional grade products. The Commission asserts that though these three types of product categories differ according to quality and price, they are nevertheless functionally interchangeable. Whether these different product categories ought to be merged into one market should, asserts the Commission, be determined by the willingness of and extent to which the consumer and suppliers would switch entry, mid and professional grade products.

24. The Commission went on to conclude in its investigation that entry and mid level products are closer approximates to each other, than to prime/premium categories of product. It arrives at this conclusion on the basis that the movements in prices between the entry and mid level products are highly correlated and because they constrain each other in respect of price and quality and act as substitutes with respect to each other.

25. The Commission's view is that the general sports and recreational retailing,

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<sup>8</sup> The merging parties agree with the Commission on this issue.

market should be defined in a distinct and separate market to that of specialised sports and retailing, which falls within the ambit of independent sports retailers. The general sporting retailers, such as the merging parties, tend to focus more on the entry to mid- level, lesser-known brands and a lesser technical form of goods. The Commission therefore identifies segmentation into a general market (entry and mid levels) and a specialised market (prime or premium level) for sports and outdoor equipment.<sup>9</sup>

26. As far as independents are concerned, the Commission finds that there are two types of independents. The word “independent” itself is somewhat imprecise but seems to be understood by the industry. The first type of independent is the general retailer of sports and outdoor goods who offers a range of goods across different categories. The independent general retailers are not part of a national chain and are located regionally or locally and may or may not sell other general merchandise. Typically this type of independent is owner managed with one or two outlets.
27. The second type of independent store is the specialist store, which is focussed on one specific sports or outdoor category. These stores are often owner managed and at times associated with a professional or past champion in that particular sports category. They also sell a greater proportion of branded, technical range equipment and sporting products in one sporting discipline and therefore, according to the Commission, these specialists form part of the “prime” level of the market. Most of these specialist independents are located outside of major retail nodes and do not have a national footprint. However a few of them do have stores in more than one major city.
28. The Commission concludes that both these types of independents are not effective competitors to the merging parties and are not in the same relevant market.
29. According to the Commission the market participants and markets shares for the relevant markets would be as follows:

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<sup>9</sup> See Commission’s opening argument at page 8 of the transcript dated 30 January 2006.



**The market for the retailing of general sports equipment  
through national chains 10**

<b>Market Participants</b>	<b>Market share % (National market)</b>
<b>Moresport</b>	<b>30%</b>
<b>Massmart</b>	<b>51%</b>
Edcon	2%
Foschini (Totalsports)	8%
Pick 'n Pay	5%
Trade Centre	5%
Total	100%
<b>Merged Entity</b>	<b>81%</b>
<b>Pre-Merger HHI</b>	3639
<b>Post-Merger HHI</b>	6638
<b>Change in HHI</b>	2999

**The market for the retailing of outdoor equipment through  
national chains<sup>11</sup>**

<b>Market Participants</b>	<b>Market share % (national market)</b>
<b>Massmart</b>	<b>49.75%</b>
<b>Moresport</b>	<b>20.91%</b>
Trappers Trading	3.62%
Cape Union Mart	23.18%
Due South (Foschini)	2.15%
Total	100%
<b>Merged Entity</b>	<b>70.66%</b>
<b>Pre-Merger HHI</b>	3284
<b>Post-Merger HHI</b>	5548
<b>Change in HHI</b>	2264

30. In the sports equipment market the Commission held that market shares for the merged entity would be 81% with a change in HHI of 2999 showing a high degree of concentration. In the outdoor equipment market the Commission held that the market shares for the merged entity would be 70.66% with a change in HHI of 2264. For ease of convenience, the sports and outdoor markets will be referred to as the equipment markets.

31. As the tables indicate, both the pre merger and post merger shares indicate a highly concentrated market and the changes in HHI also indicate a highly concentrated market. An HHI above 1800 is generally considered to be an indication of a highly concentrated market. Mergers that produce an increase of

<sup>10</sup> Page 39 of the Commission's Report.

<sup>11</sup> Page 42 of the Commission's Report.

more than 50 points are regarded by the US antitrust authorities as enhancing or creating market power.<sup>12</sup>

32. The Commission concluded that in the equipment markets the transaction would lead to a substantial lessening of competition. It further concluded that the parties had been unable to show any efficiencies resulting from this transaction or any public interest ground that could justify an approval despite the finding of a substantial lessening of competition. Furthermore the Commission concluded that a structural remedy for separating out the sports and outdoor equipment from the rest of the retail businesses of the two parties was not a viable solution in order to remedy the competition concern. Accordingly the Commission recommended that the transaction be prohibited.

### **The parties' submissions**

33. The merging parties have changed their definition of the relevant market between when they first notified the merger and during the hearing. In their competitiveness report, the merging parties submit that the relevant markets are those for sports and recreational footwear, sports and recreational apparel and sports and recreational equipment which consumers are able to buy from one store. The merging parties provided the Commission with market share figures of the merging parties based on turnover.

34. According to the merging parties the participants in the relevant market and their respective market shares were-

<b>Name of Firm</b>	<b>Estimated national market share (%): sports and recreational footwear</b>	<b>Estimated national market share (%): sports and recreational apparel</b>	<b>Estimated national market share (%): sports and recreational equipment</b>	<b>Total National Market share (%)</b>
<b>Moresport</b>	<b>13</b>	<b>4</b>	<b>18</b>	<b>11</b>
<b>Massmart</b>	<b>4</b>	<b>1</b>	<b>31</b>	<b>12</b>
Edcon	25	14	1	12
Foschini	21	13	5	12
Cape Union Mart	4	4	4	4
Shoe City	8	0	0	2
Pick 'n Pay	2	1	3	2
Trade Centre	2	0	3	1
The Pro Shop	2	1	11	5

<sup>12</sup> See the 1992 Horizontal Merger Guidelines of the US Department of Justice and the US Federal Trade Commission. See also for example, the following Tribunal cases: *JD/Ellerrines* Case No: 78/LM/JUL00, *Nampak Ltd/Malbak Ltd* Case No: 29/LM/MAY02, *Tongaat-Hulett and Transvaal Suiker Beperk* No: 83/LM/JUL00.

Golfers Club	0	0	4	2
Mia's	0	0	4	2
Independents	18	63	16	37
TOTAL	100	100	100	100

35. The post-merger market share of the merged entity in the equipment markets calculated by the merging parties would be 49%. Despite this high market share it was submitted by the parties that there was no lessening of competition because barriers to entry were low and customers had countervailing power.

36. However, during the hearing, the merging parties agreed with the Commission's segmentation into sports and outdoor goods, which are further divided into three categories namely apparel, footwear and equipment. However they argue for a further segmentation of the market into two sub-markets namely the market for entry level goods on the one hand and the market for middle-prime level goods on the other hand. In effect the merging parties argue for 12 sub-markets i.e. they argue that each of the Commission's relevant markets can be sub-divided into two further relevant markets. According to the merging parties, Massmart occupied the entry- level market and Moresport the middle-prime level market. In support of this contention the merging parties filed an expert report by Mr James Hodge of Genesis-Analytics.

37. It was argued by Mr James Hodge that Moresport may have an overlap of products with Massmart in the entry-level segment of sports and outdoor equipment but that this was not significant. He submitted that even though Moresport and Massmart were national chains and could be seen, at a broad level, to be competing with each other, Moresport occupied a different level of the market. Mr Hodge contends that Massmart was a general merchandiser and sold a range of merchandise including sports and recreational goods and was a high volume low margin business, focusing on entry level products, whereas Moresport was focussed only on sports and outdoor and was a high margin business focusing on middle-to-prime level products. Mr Hodge relied on a number of practical indicia, such as access to branded products, service levels, store design and aesthetics, advertising and promotion, differences in product levels sold (product segments), median pricing policy and margins to support the argument that Moresport occupied a different level of the market from Massmart. On the basis of this segmentation, it was argued further that there is no need for the Tribunal to decide conclusively on the boundaries of the geographic market or whether or who the other participants of this market were. All that the Tribunal had to decide was that Massmart and Moresport were *not* in the same relevant market. And similarly there was no need for them to give any market shares since there was no overlap.

#### **Note on outdoor**

38. It was agreed between the Commission and the merging parties that no competition concerns arose in relation to the sports and outdoor apparel and footwear markets. The reason for this was because there were a large number of competitors to the merging parties in these markets on a national basis. Competition concerns only arose in relation to the sports and outdoor equipment markets.
39. It was also common cause that the both Massmart and Moresport offer sports and outdoor equipment across a number of product categories, rather than specialising in one type of sports or outdoor activity.
40. Neither the merging parties nor the Commission led any evidence as to what would constitute outdoor and sports equipment and the delineation between the two. The merging parties, in their filing to the Commission clearly consider the sports and outdoor equipment markets as one market, namely sports and recreational equipment and have provided consolidated market shares in relation thereto. Subsequently they have accepted the distinction made by the Commission into sports and outdoor but have argued for market segmentation for both the sports and outdoor equipment markets on the basis of Mr Hodge's indicia.
41. At this stage it seems to us that the segmentation of the industry into sports and outdoor may be somewhat embryonic as evidenced by competitors specialising in one or other different format. Massmart for example offers both sports and outdoor equipment under one roof as do many other stores. Moresport offers it in a seemingly specialised format through Outdoor Warehouse (OWH) but still seems to offer some outdoor goods in SWH. However, in our view nothing much turns on the segmentation of the equipment markets between sports and outdoor. Unlike specialist stores specialising in one sport category or one type of outdoor activity, both merging parties offer sports and outdoor equipment across a number of categories. Both the merging parties and the Commission have agreed that competition concerns arise in relation to the equipment markets, wherever the line between sports and outdoor may be drawn. Hence we have reviewed the evidence led on the practical indicia, as being equally applicable to both the sports and outdoor equipment markets.
42. A further issue to note is that the merging parties have provided us with market shares in their competitiveness report for a market described as sports and recreational equipment. While no evidence was led as to what constitutes recreational goods, we have understood the merging parties, by accepting the Commission's distinction between sports and outdoor, as saying that sports and recreational is nothing more than sports and outdoor described in another

way. If we have misunderstood the merging parties<sup>13</sup> and recreational includes something more than outdoor, then we have been generous to the merging parties by relying on market share figures that possibly include more than sports and outdoor equipment in our competition analysis.

43. It is common cause that there are no vertical concerns in this transaction and that competition concerns arise only in relation to the equipment markets.
44. Prior to the commencement of the proceedings, the Tribunal requested a number of internal documents from both merging parties. During the course of the hearing, the Tribunal requested a number of additional documents and requested the Commission to conduct a price comparison of similar products in the relevant stores of the merging parties in order to obtain some price band comparison of the merging parties. The outcome of the Commission's shop-out was submitted to the Tribunal after all the evidence had been led. The Tribunal will also consider this documentary evidence together with that of key witnesses in defining the relevant market.

## **RELEVANT PRODUCT MARKET DETERMINATION**

45. The definition of a relevant product market for anti-trust purposes is not an easy exercise, particularly in markets where there is a high degree of product differentiation and the existence of non-price competition, such as in retail markets. Retail markets are dynamic and competitors are constantly striving to differentiate themselves from each other through a degree of non-price competition and product differentiation. Own brands and different model numbers on similar products are often used as "fighting brands". Store formats, promotions, branding, advertising and service levels may be used as competitive strategies to attract the customer. Price comparisons may tend to become increasingly difficult for consumers in such a context. Hence businesses may differ at their peripheries even though they may be effective competitors or appear similar even though they may not be effective competitors. In order to determine whether two businesses are in the same relevant market, competition authorities seek to find evidence of rivalry between merging parties.
46. In this fluid and dynamic environment, traditional tests utilised by competition authorities such as the SSNIP test do not necessarily provide accurate tools with which to predict the impact of a merger on consumer behaviour. Neither are cross-elasticities of demand easily calculated in such markets. In the absence of evidence on cross-elasticities of demand and in a consumer or demand driven market such as this one, reliance is placed on practical indicia to assist a competition authority in determining a relevant market.

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<sup>13</sup> This would be surprising since the merging parties raised no objection to the Commission's distinction or provided any further evidence or argument for use of the word recreational.

47. The merging parties accept the Commission's broad segmentation of the relevant market into the sports and outdoor markets, then into apparel, footwear and equipment. However as discussed above they argue that the markets are further segmented into entry-level and middle-prime level markets. They submit that while Massmart and Moresport have an overlap in entry-level products, this overlap was insignificant and that Massmart occupied the entry-level segment and Moresport occupied the middle-prime level segment, and accordingly no competition concerns arose. The merging parties rely on the approach of the court in *Brown Shoe*, which approach has been adopted by this Tribunal in *JD v Ellerines* and a number of subsequent mergers. In *Brown Shoe* the court held that broader economic markets could be segmented into relevant markets for anti-trust purposes by having regard to practical indicia. The practical indicia for determining whether a sub-market exists include "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, grades of material, quality of workmanship, distinct prices and specialised vendors."<sup>14</sup> The list of practical indicia was not exhaustive.<sup>15</sup>
48. While many lawyers and experts may argue that the definition of a relevant market for anti-trust purposes is not the same as that defined by laymen or business people, the definition of a relevant market for anti-trust purposes is not a theoretical notion not based in the reality of commerce. Practical indicia are considered by competition authorities not simply to determine that one business is different from another, but for the purpose of determining the market in which companies (businesses) strive for profit or where in fact competition exists.<sup>16</sup> Indeed the "determination of a relevant product market is a matter of business reality ... of how a market is perceived by those who strive for profit in it."<sup>17</sup> It is not an exercise whereby the practical indicia are simply enumerated in an exhaustive manner in order to highlight the similarities or differences between businesses but is rather an exercise in which competition authorities endeavour to identify from whom and from where a business faces competitive constraints or effective competition. It is for this reason, that competition authorities also have regard to the internal documents of each company, their pricing policies in relation to each other, the evidence of key executives or persons experienced in those businesses or in that industry, as well as the indicia listed by Mr Hodge, in order to define the relevant market.
49. Moreover competitive landscapes are dynamic in nature. The landscape in one retail market may not be the same over different time periods and one

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<sup>14</sup> See *Brown Shoe* 370 US 294; 82 .C.T. 1502 and *JD/Ellerines* Case No: 78/LM/Jul00 and the cases referred to there.

<sup>15</sup> See e.g. *FTC v Staples, Bon-Ton Stores Inc v May Department Stores* W.D.N.Y. 1994.

<sup>16</sup> *Federal Trade Commission v. Staples Inc. and Office Depot Inc.* 970 F. Supp. 1066.

<sup>17</sup> *Federal Trade Commission v. Swedish Match et al*, 131 F. Supp.2d 151 (D.D.C. 2000)

retail sector may differ from another, even though both may be located in a retail sector. Each case must be considered on its own facts and context. We turn to consider the internal documents of the merging parties, the evidence of key witnesses and outcomes of the shop-outs conducted by the Commission.

50. Most of the evidence considered hereafter is to assess whether such segmentation exists as argued by the merging parties, based on the approach of the court in *Brown Shoe*.

### **Strategic internal documents and evidence of key witnesses**

#### **50.1. Despite the suggestion by Mr Hodge, that Moresport has no competitors, the merging parties' own competitiveness report, states that the parties *do* compete;**

“The South African Sports market is made up of two main components; sports equipment and sports clothing and footwear. The sports equipment market is served by Game, Dion, Makro, Sportsman's Warehouse, Pick and Pay Hypermarket, Checkers Hyper, Trade Centre and a number of independent specialists, including the Pro Shop and Cycle Labs.”<sup>18</sup>

51. This view is echoed in a research report conducted by McGregor's “Who Owns Whom” which states that the retail section of the sports industry is dominated by the big three – Sportsmans Warehouse, TotalSports and Game and Dion.<sup>19</sup>

52. In the course of a valuation of Moresport conducted by Nedbank, the Massmart Group is identified as representing the largest competitor in the equipment space. Makro, Dion and Game are stated as having a material offering of entry-level sporting equipment at competitive prices and that management estimates that Massmart, TotalSports and Edgars make up the rest of the 80%-75% of the market in which SWH competes,<sup>20</sup> Massmart is seen as a competitor to Sportsmans Warehouse (SWH) and the Pro Shop at the entry level,<sup>21</sup> and a dominant competitor in the outdoor equipment market.<sup>22</sup> This valuation was done by Nedbank in 2003 on behalf of a management buy-out of Moresport. At that time the Pro Shop, a specialist golf shop, was still part of the Moresport group but was maintained as a separate business within the group. Further, in the athletic branded footwear market, Moresport is identified as competing “head-on with retailers such as Massmart, Foschini and

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18 See Commission Record File A at page 411, Massmart Board Approval of Acquisition of Moresport dated 4 April 2005.

19 See Commission's Record File C at page 184.

20 See Commission's Record File C at page 281.

21 See Commission's Record File C at page 286. At the time of this valuation, Pro Shop was still part of the Moresport group.

22 See Commission's Record File C at page 292.

Edgars”<sup>23</sup>. In the Nedbank valuation, only national chains, which offer a range of sports and outdoor goods, are identified as competitors. No mention is made of the independent general retailers. Mr Hodgson, the managing director of Moresport attempted to argue, unpersuasively to the Tribunal that the drafters of the valuation report were not necessarily qualified to identify Moresport’s key competitors. This despite the fact that the persons cited as authors of the report served as directors on the Board of Moresport and the report was compiled in consultation with Moresport management.

53. A closer inspection of the minutes of Moresport’s merchandise strategic meetings confirms the view that Massmart was considered to be a key competitor to Moresport across a *number* of sports categories. In minutes entitled “Strategic Drivers for FY03/04” and under the heading “Monthly competitors shop-out must be done (see Schedule A),” buyers in each department were required to do formal monthly shop-outs of competitors listed in a schedule to the minute. Massmart is listed as competitor in Footwear, Equipment 1,<sup>24</sup> Equipment 3,<sup>25</sup> Equipment 2<sup>26</sup> and Golf. Buyers were required to do formal monthly shop-outs and feed the information back into the strategic meetings. <sup>27</sup>

54. Massmart itself considers Moresport to be a key competitor in the sports equipment market. In the Massmart Board Approval report,<sup>28</sup> the sports equipment market is said to be served by Game, Dion, Makro, Sportsmans Warehouse, Pick n Pay Hypermarket, Checkers, Hyper, Trade Centre and a number of specialist independents including the Pro Shop and Cycle Lab. In its strategic documents entitled “Sports Department Strategy Update 2005” <sup>29</sup> Massmart reflects an assessment of its competitors. The document identifies its key competitors as Sportsmans Warehouse and the Pro Shop. Other national chains and independents are listed but not as key competitors. <sup>30</sup>

55. Hence, a consideration of the internal documents of the merging parties

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23 See Commission’s Record File C at page 294.

24 Which included equipment for beach, fishing, games, outdoor, rugby, soccer and other.

25 Which included equipment for swimming, underwater and accessories

26 Which included hockey, cricket, squash, tennis, baseball and exercise equipment.

27 At pages 235-238 of Moresports’ additional documentation bundle. Also from pages 242-248 of same bundle. These documents were put to Mr Hodgson, the CEO of Moresport, during his testimony, by the Commission. His explanation was somewhat confused. He first stated that these documents while recording specific action items were never implemented. However when pressed by the panel as to the status of these documents, he conceded that they were in fact implemented as part of Moresport’s monitoring of competitors’ prices but that the list of competitors was merely illustrative. Even if we were to be persuaded by Mr Hodgson’s explanation, which we are not, that the list was merely illustrative, they can only be illustrative of Moresport’s competitors. The schedules list the Massmart stores as key competitors in the equipment space across a range of sports categories.

28 Page 410 ff of Commission’s Record File A.

29 Page 104 ff of Massmart’s additional documentation bundle.

30 Ibidem.



contained both in the record and those that were subsequently filed in the course of the proceedings indicate that both Massmart and Moresport consider each other as **key** competitors across a range of sports categories. While other national chains and independents are mentioned in relation to specific sports categories, both Massmart and Moresport consider each other as major rivals in the general sports and outdoor market and Massmart is listed by Moresport as a key competitor in the general sports equipment space and across a range of specific sports categories.

56. The evidence of key witnesses tends to confirm this. Mr Paul Stone and Mr William Keet had been called by the Commission under subpoena to testify before the Tribunal. Both are experienced buyers in the sports industry and specifically in sports equipment.

57. Mr Paul Stone, who was previously employed by Moresport as a buyer of several equipment departments until 2005 at Sportsmans Warehouse (SWH), and whose initials appear in the Moresport minutes referred to above as the person responsible for doing such shop-outs, confirmed that buyers did indeed conduct such shop-outs and that Massmart was considered to be a key competitor of Moresport. He explained that as part of their shop-outs buyers would go to their competitors' stores, look at the product in-store and also analyse the leaflets that were distributed. He testified that he himself had conducted such shop-outs and that the pricing information obtained by him would be fed back into Moresport meetings as part of the information utilised in setting their prices. The competitors they looked to were Massmart, TotalSports, Pro Shop and one or two larger independents in the Cape Town area. However, in his view Massmart and Moresport were the major players in the sports equipment market, with TotalSports, being a smaller player in the equipment space. Mr Stone also confirmed that in the area of *general sporting equipment*, namely a store that carries a wide range and not just one sporting code, there were only two other national chains, namely Massmart and TotalSports.<sup>31</sup>

58. Mr William Keet who had been a buyer for the Massmart group, principally on behalf of Game until September 2005, testified that in the sports equipment market Moresport was the only true competitor. Mr Keet was a buyer with the Massmart group since 1996 and has 17 years experience in the industry. He explained that from a Game perspective, his competitors were more Makro, Dion and SWH. After the merger of Game, Makro and Dion, only Sportsmans Warehouse was a true competitor in the sports equipment market.

*MR KEET: ...So those would have been the chains. Towards the end of my career it was really just what we were setting and Game and Dion and Makro was one, as you know. So it would have been Sportsman's Warehouse was my only true*

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<sup>31</sup> See page 107 of the transcript dated 1 February 2006.

*competitor that I could shop out and measure against.*<sup>32</sup>

And,

...Certainly the Massmart Group and Moresports. I mean that's a fact. You can't run away from it. Those are the two players. I mean who else do you see out there? Not Pro Shop.<sup>33</sup>

59. Mr Keet explained that he constantly monitored Moresport's prices and at the time that the SWOT analysis (strategy document referred to above) was compiled, there was a threat of Moresport "coming down" into the Massmart market. By the time he left Massmart, Massmart was certainly "playing in the Sportsmans Warehouse space." He also testified how, over time, his prices were moving closer to Sportsmans Warehouse and converging.<sup>34</sup>

**"You were forever comparing prices. You were getting ideas from them. They were market leaders in many instances. We followed. Sometimes we were maybe a market leader and maybe they followed."**<sup>35</sup>

60. The internal documents of the merging parties and the evidence of key witnesses suggest that both Massmart and Moresport were seen as *national general retailers of sports and outdoor goods*, and that both viewed the other as a *key competitor* in the equipment space across a number of sports categories. Both companies were described as wrestling for market leadership with each other.

61. Furthermore both Mr Keet and Mr Stone,<sup>36</sup> described a market that had changed considerably over the years, in which the independent general sports retailer had been pushed out of the market by the national chains and in which the independents were now more specialist stores. There were a few general independents but these were usually localised to a particular city, town or region. At a national chain level only Massmart, TotalSports and Moresport were seen as general sports retailers in the sports equipment market.

### **Extent of overlap, product segmentation and customer focus**

62. Mr Hodge, the expert witness for the merging parties, submits the overlap between Massmart and Moresport was only at entry level but this overlap was insignificant and that Moresport was more focused on middle-prime level

<sup>32</sup> See page 134-5 of the transcript dated 2 February 2006.

<sup>33</sup> See page 193 of the transcript dated 2 February 2006.

<sup>34</sup> See page 170 of the transcript dated 2 February 2006.

<sup>35</sup> See page 135 of the transcript dated 2 February 2006.

<sup>36</sup> See also the evidence of Mr Hodgson, and Mr Reeves on the demise of the independent general retailer.

segments while Massmart was focussed on entry level goods. However on being asked as to how he could determine the extent of the overlap and the difference between entry and the other levels, he replies –

*MR HODGE: Look, with all due respect, I don't consider myself a sports expert. I'm not. I'm not sure the extent to which the Commission is able to determine exact overlapping functional characteristics. I'm not sure who did this comparison, but I would question their expertise. I certainly learnt in a huge amount of walking around with a buyer on aspects that would not even occur to me. 37*

And further,

*MS KALLA: And in your analysis you didn't do anything to show this difference and/or similarity? Wouldn't you thought it was important for purposes of trying to define the market, to have that analysis? The Commission has done it to an extent and you've made criticisms of that analysis, yet your report is void of that same analysis?*

*MR HODGE: Well, I think that's because it's the difficulty. I as an economist cannot stand up here and say, this bike and that bike are exactly the same functionally. That's not my expertise and so for me to presumably try and do that in my report, really...*

*MS KALLA: But that information was available to you?*

*MR HODGE: Well, it couldn't be evidence through me. I can't make that. I'm not an expert. You know, maybe if we have a number of expert buyers here, they can make those judgements (our emphasis), but I'm certainly not in a position to. 38*

63. While much of the witness testimony around the contours of the relevant market was impressionistic, a discernable pattern emerged.

64. Mr Hodgson, the CEO of Moresport, suggested that the extent of the overlap was at entry-level product and was only approximately 10% of Moresports' business. However when he was asked by Ms Kalla on behalf of the Commission to discuss the overlap by category of sports it emerged that the overlap is not identical across all categories thus demonstrating that the extent of overlap varied from sports category to category and that there was a degree of fluidity in the overlap.

65. While no further evidence was led by the merging parties as to where the dividing line between entry level or middle level could be found, or how the figure of 10% was calculated, both Mr Stone and Mr Keet, testified that the overlap in product level sold by Massmart and Moresport varied from category

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37 See page 68 of the transcript dated 1 February 2006.

38 See page 71 of the transcript dated 1 February 2006.

to category and even though Massmart had lower entry price points and Moresport higher exit price points, the overlap was more an entry-to-middle level.<sup>39</sup> Both Mr Stone and Mr Keet were buyers of sports equipment and were closer to the business than either Mr Hodgson or Mr Lamberti, who were further removed from the business.<sup>40</sup>

66. Mr Keet and Mr Stone testified that as buyers they had the responsibility of sourcing products from suppliers, negotiating lower prices and setting selling prices, having regard to the departmental targets of margin and turnover.

67. Mr Stone testified that the overlap between Massmart and Moresport was much more than 10% sometimes reaching 80% in the categories in which he had direct experience. By way of example he stated that in the categories he purchased, such as swimming the overlap would be 80%- 90%, in underwater 50%, digital watches 50- 60%, there was no overlap in heart rate monitors and in golf it was about 60%.<sup>41</sup> He also testified that in some categories such as golf, Moresport was focussed on entry level to mid with a small offering in prime level in selected stores. Furthermore the products at entry level at the Massmart stores and the entry-level products at a Moresport store were functionally interchangeable even though they may have used different brands.<sup>42</sup> In this regard both he and Mr Keet explained that they would often obtain the same or similar product but with a different name or number from the same supplier.

68. Both Mr Stone and Mr Keet referred to *price points*, rather than product segmentation, as a measure of rivalry and target market.

69. Mr Stone explained that in the market there were opening price points and then middle and upper, as you go through the ranges. He stated that the store (referring to SWH) would offer mostly all three levels of entry, mid and premium but that the bulk of the market would be the opening or put another way the entry sort of price with a little bit of mid to top.<sup>43</sup> He stated that in each category there was a target market and in some categories there was a wider range of target. Golf for instance, the target was –

*“the entry level golfer, the guy that’s starting to play, who may be intimidated by the Pro Shop because it’s a very big store and the salespeople there are really good golfers generally. They play single figure handicaps and people had been intimidated by the Pro Shop. But then on golf accessories like gloves and tees and golf balls, there you could target anybody, because there’s no advantage to go into the Pro Shop. So there you could target any golfer. In swimming Moresport*

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<sup>39</sup> Both these witnesses had been subpoenaed by the Commission in support of its case.

<sup>40</sup> Mr Lamberti in fact says as much to the Tribunal. See Page 61 of the transcript dated 30 January 2006.

<sup>41</sup> See page 112 of the transcript dated 1 February 2006.

<sup>42</sup> See page 121 of the transcript dated 1 February 2006.

<sup>43</sup> See page 101 of the transcript dated 1 February 2006.

*catered for the entire market, from entry level right through to top-end. In underwater the target market was more recreational, rather than top end and was generally aimed at your average non-professional, not very serious, more educational type customer."*

And

*"We didn't do the scuba diving equipment. So we didn't really target that person and in fact in wetsuits we targeted the tunic and the surf suit. We actually got out of the whole diving suit market. So it was more a recreational use."*<sup>44</sup>

70. Under cross-examination by the merging parties, a fair amount of focus was placed on golf and exercise equipment to demonstrate that Moresport carried prime level products which Massmart didn't. However Mr Stone maintained that while Massmart may have entry level they have a bit of middle level and that in a category such as golf Moresport did focus on entry level and only kept a few premium brands in selected stores.<sup>45</sup>

71. Mr Stone's evidence is confirmed by Mr Hodgson who states that in a category such as golf, SWH did not have the same credibility as the Pro Shop or Golfer's Club and that the Moresport merchandise strategy was to offer a range of product to the new entrant.<sup>46</sup>

72. Mr Keet confirms that the overlap is category dependent but that Massmart and Moresport have been moving closer together in their product offerings. He testified that prior to the merger between Game and Makro, Massmart's focus was on entry level but that over time they had grown closer to SWH. They were constantly trying to push the boundaries of their traditional markets and price points. By the time that he had left Massmart in 2005, Massmart had an entry to mid level offering and that the "cross-over" with Moresport would be more in the middle entry to early middle levels. -

*MR KEET: Normally in the middle. One didn't want your entry price point to be your bestseller. There's normally a little less margin on it, although the exercise cycle was a different issue. It's nicer to sell more expensive stuff. You've got to sell a lot less of it to make your budgets. It's less pressure on the stores. So one would always generally ... the middle to upper for us were our best sellers, certainly in those categories.*<sup>47</sup>

...Once again it's category specific. I would probably say because they were always slightly higher than us, more our mid entry. The crossover was most

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<sup>44</sup> See page 111 of the transcript dated 1 February 2006.

<sup>45</sup> See page 144-6 of the transcript dated 1 February 2006.

<sup>46</sup> See page 31 of transcript dated 31 January 2006

<sup>47</sup> See page 166 of the transcript dated 2 February 2006.

probably more in mid entry as opposed to the real start or the entry price point product. 48

...So we certainly weren't an entry price point retailer because we had a range of 4, 5, 6, 7 treadmills on a range at any one varying time, starting at I think R3 999,00. When I left my last one I put into the business was probably about 10, or R11 999,00. Once again before my R12 000,00 treadmill came in, my best selling treadmill in the range was the R9 999,00 treadmill, not my R3 000,00 treadmill. So we certainly wouldn't be seen in that category of merchandise to be an entry price point retailer by no means, because *Sportsman's Warehouse certainly carried treadmills at the same price points with similar specifications or identical specifications.* 49

73. Under cross examination by the merging parties:

*ADV SUBEL: There was an overlap but it appears that theirs starts where almost you are exiting.*

*MR KEET: I think many years ago we didn't even get to them, but as the years have gone one, we're encroached onto their market and in a years time we would've been probably right in the middle of them, but currently there certainly is an overlap in that area.* 50

**74. He went on to state that in the area of exercise equipment for example, while some of their products were differentiated by the same suppliers providing them with different labels, the product was essentially the same.** 51 **He went on further to explain that the type of consumer that would buy a treadmill is a financial buyer and that the health equipment offered by Massmart was functionally interchangeable with that offered by Moresport even though Moresport would have a higher exit price. Since there was no internationally recognised brand that anyone aspired to in a treadmill, a buyer of a treadmill will purchase on the basis of their budget, the features and the benefits of the treadmill and on the basis of store location.** 52

**75. Mr Rhys Hughes, the joint managing director of the Pro Shop, testified that SWH dabbled with technical or top-end product and that while they carry a sprinkling of it, "its best a sprinkling of top-end merchandise and that they were not really serious in that business" and they were simply stocking these products as a showcase. According to him SWH was**

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48 See page 173 of the transcript dated 2 February 2006.

49 See page 164-5 of the transcript dated 2 February 2006.

50 See page 105 of the transcript dated 20 February 2006.

51 See page 132 of the transcript dated 2 February 2006.

52 See page 107 of the transcript dated 2 February 2006.

more active in the entry level or entry to lower mid.<sup>53</sup> In his view Moresport had remained static in the Golf category but that Massmart had experienced a flurry of improvement, even though in his last shop-out he was surprised to see a small offering at Massmart.<sup>54</sup> He testified that the overlap between Pro Shop, Massmart and Moresport in golf was entry to middle level. In explaining this he also testified that the products offered at Massmart, Moreport and Pro Shop at entry level at least were functionally interchangeable. While all three companies would not stock the same brands at entry level and would utilise a brand strategy to differentiate their products, they would all carry similar products in a category.<sup>55</sup>

76. From the testimony of these experienced industry participants, a picture emerges that Massmart and Moresport competed with each other even though the extent of the product overlap between them varied from category to category. Over time they in fact have grown closer together in product and price overlaps. In certain categories such as treadmills and exercise bikes Massmart went right to the top. In other categories such as golf Moresport kept a sprinkling of the top. There was a degree of fluidity in the extent of the overlap and their products were functionally interchangeable. By and large, they targeted the same customer, seemingly on the entry-to-middle levels of the market. School children were a significant component of their customer base.<sup>56</sup> In the case of Moresport, Mr Hodgson claims that their principal customers were children between the ages of 10 to 18 and that a significant part of their marketing strategy was oriented around school going children. <sup>57</sup> This target market can hardly be said to have a large number of advanced players. Moresport offered a few prime level products in certain categories but was not considered to be a serious player in this level of the market.

## **Pricing and margins**

77. Mr Hodge relies on the notion of median pricing and margins as a basis for market segmentation. The use of this methodology for market definition is unorthodox and we have not found it being mentioned by competition law

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<sup>53</sup> See page 259 of the transcript dated 20 February 2006.

<sup>54</sup> See page 314 of the transcript dated 20 February 2006. This could be because there had been a change in buyers but Massmart was still considered to be a key competitor for them to benchmark their entry-level offerings.

<sup>55</sup> For example, Makro may carry box sets under the Dunlop or Spalding brand and SWH may carry them under the Envil and Tony Penna brands and they may carry the similar product under Wilson.

<sup>56</sup> See evidence of Lamberti, Keet and Hodgson.

<sup>57</sup> See page 92 of the transcript dated 31 January 2006. This is also confirmed by Mr Stone who testified that school kids bought more entry to mid level products. See page 95 of the transcript dated 2 February 2006.

academics or competition agencies.<sup>58</sup> Much reliance was placed by Mr Hodge on the approach of the US court in *Federal Trade Commission v Staples Inc. and Office Depot Inc.*<sup>59</sup> and the approach of this Tribunal in *JD Group Limited and Ellerines Holdings Limited*.<sup>60</sup> We review his approach below.

### Pricing

78. Mr Hodge on behalf of the merging parties testified that the median price of Massmart and its margins on sports equipment were much lower than that of Moresport. This indicated that Moresport sold a very different basket of goods to a very different customer and that its focus was more on the mid-to-prime level segments of sports equipment whereas Massmart was concerned with low margins and high volumes. The median price calculated by Mr Hodge was not a mean or average price of a product in a category, but was seemingly an average price adjusted for volume. According to him a median price was calculated by looking at the middle price in range of products. So for example, if there was a range of 10 cricket bats sold by the company the price of cricket bat 5 would constitute the median price. He calculated median prices of selected products for both Massmart and Moresport and compared the two as shown in the table below.

### Hodge's Median price for sports equipment item sold at Game/Dion, Makro and Sportsmans Warehouse.<sup>61</sup>

Sports Discipline	Median price of sales			Median Price ratio	
	Game & Dion	Makro	SWH	SWH to Game/Dion	SWH to Makro
<b>Cricket</b>					
Cricket bats	R 154.58	R 110.15	R 386.72	2.5	3.5
<b>Cycling</b>					
Adult Bikes	R 588.00	R 491.08	R 2 035.17	3.5	4.1
Kids bikes /BMX	R 383.87	R 336.18	R 872.94	2.3	2.6
<b>Darts</b>					
Dart Boards	R 98.14	R 95.77	R 192.50	2.0	2.0
Dart sets	R 34.96	R 26.12	R 69.53	2.0	2.7
<b>Gym and aerobics/exercise</b>					
Exercise Benches	R 391.97	R 346.80	R 758.92	1.9	2.2
Exercise Bicycles	R 1 528.12	R 1 147.78	R 3 091.23	2.0	2.7
Home Gyms	R 1 710.56	R 1 556.57	R 6 820.44	4.0	4.4
Treadmills	R 4 626.67	R 4 398.24	R 9 514.64	2.1	2.2
<b>Fishing</b>					
Reels and Rods (combo)	R 43.68	R 62.39	R 143.73	3.3	2.3

<sup>58</sup> In this regard see the US Merger Guidelines, the ICN Merger Guidelines and, UK Guidelines and Professor Motto in *Competition Policy, Theory and Practice*, Cambridge, 2004

<sup>59</sup> 970 F.Supp.1066.

<sup>60</sup> Tribunal Case No: 78/LM/Jul00

<sup>61</sup> Page 14-15 of Hodge's Report



Fishing Reels	R 87.09	R 57.88	R 185.29	2.1	3.2
Rods	R 73.56	R 71.14	R 209.23	2.8	2.9
<b>Golf</b>					
Drivers	R 164.51	R 150.80	R 261.52	1.6	1.7
Package set – ladies	R 1 022.87	R 882.75	R 1 745.92	1.7	2.0
Package set – men	R 882.50	R 860.85	R 1 742.77	2.0	2.0
<b>Hockey</b>					
Hockey sticks –jnr	R 59.74	R 42.91	R 78.86	1.3	1.8
Hockey sticks – snr	R 113.40	R 87.08	R 350.57	3.1	4.0
<b>Netball</b>					
Balls	R 38.44	R 24.01	R 58.25	1.5	2.4
<b>Rugby</b>					
Rugby balls	R 34.77	R 27.22	R 52.48	1.5	1.9
<b>Skateboard/rollerblading</b>					
In-line Skates	R 104.25	R 87.49	R 349.89	3.4	4.0
Skateboards	R 75.46	R 33.27	R 174.94	2.3	5.3
<b>Soccer</b>					
Balls	R 24.62	R 20.80	R 69.84	2.8	3.4
<b>Squash</b>					
Squash racquet	R 128.34	R 106.79	R 459.86	3.6	4.3
<b>Table Tennis</b>					
Table Tennis Bats	R 43.38	R 27.11	R 68.89	1.6	2.5
Table Tennis Table	R 958.68	R 987.99	R 1 133.90	1.2	1.1
<b>Tennis</b>					
Tennis racquet – jnr	R 73.33	R 58.30	R 225.50	3.1	3.9
Tennis racquet – snr	R 112.53	R 78.48	R 403.13	3.6	5.1
<b>Volleyball</b>					
Balls	R 56.31	R 22.81	R 87.28	1.6	3.8
<b>Unweighted average</b>				<b>2.4</b>	<b>3.0</b>
<b>Sales-weighted average</b>				<b>2.5</b>	<b>3.1</b>

Source: Sales data for last financial year from Massmart and Moresport.

79. Mr Hodge argues that the median price analysis shows that Moresport sells more goods at a higher than a lower price. This, according to him, therefore leads to the conclusion that Moresport focuses on a different customer (it is selling to a different customer) than Massmart does. If Moresport sold more lower-priced goods than higher priced goods this would be reflected in a lower median price. Massmart on the other hand has a lower median price thereby suggesting that it sold to a more entry-level customer.

80. At the time that Mr Hodge submitted his median price analysis no actual price band comparisons had been done. The Commission had conducted a limited price band comparison.<sup>62</sup> Mr Hodge argued that the Commission's price comparison analysis was questionable since there was no certainty whether the products being compared were of equivalent quality. Instead he relied on the median prices of products to demonstrate that the median price of each category of sports equipment was evidence that SWH's average customer was

<sup>62</sup> See page 21 of the Commission's Report.

different to that of Massmart and that SWH was in a different, more middle-prime level, segment of the market.

81. Hodge's use of median prices has the effect of making price differences between Massmart and Moresport seem more marked than the actual prices. For example, his median price for a treadmill at Game is R4 626.67 but Game has a treadmill on offer at R12 999. Similarly his median price for squash rackets at Game is R128.34 but Game has a squash racket on offer at R629.99. As demonstrated by Ms Kalla in her cross-examination, the median price would be distorted by the depth of range carried by Moresport in a particular category. When asked by the Tribunal whether it wouldn't have been more useful for him to have conducted a price band comparison Mr Hodge was unable to provide a persuasive response.<sup>63</sup>

82. However defining markets on basis of price differences, whether they be actual prices or median prices may lead to error in market definition and we would suggest that this merger is just such a case. The theoretical literature cautions about the danger of adopting an approach, which says because products have different prices they must be different markets. In an examination of some EU cases, where this error occurred, Bishop and Walker remark:

**"Such logic may give the correct answers in some cases in other cases it will not. In particular, defining relevant markets on the basis of differences in prices will be flawed if price differences reflect (actual or perceived) quality differences. Wherever there are quality differences, consideration of absolute price levels will ignore the possibility of consumers making a trade off between price and quality. .... As another example consider the price differentials between two perfumes. While the contents of the two bottles may be similar, the fact that one is sold at a higher price may reflect perceived quality from the consumer's perspective. Thus, the price of the higher priced perfume could still be constrained by the price of the lower -priced perfume. Whether or not this is so is an empirical question."**<sup>64</sup>

83. A very similar approach is followed by Motta in his book. He too observes that using price differences as a criterion to define the relevant market is unsound. He observes that:

**"..products at the bottom of the scale may constrain the pricing behaviour of those at the top of the scale. Price differences are not a good indicator for the purpose of market delineation."**<sup>65</sup>

**84. Moresport asserts that it sells goods that range from entry- level prices to so-called premium prices for all its product ranges. It would only be able to do so if the consumer of say a cricket bat would perceive that the price differentials between the lower priced**

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<sup>63</sup> See page 63 of the transcript dated 2 February 2006.

<sup>64</sup> See Simon Bishop and Mike Walker, "Economics of European Competition Law: Concepts, Application and measurement." 1999, Sweet and Maxwell, page 61.

<sup>65</sup> See Massimo Motta, Competition Policy, Theory and Practice, Cambridge, 2004, pages 111-112.

bat and the higher one were attributable to some quality difference congruent to the price differential. <sup>66</sup> If not, it would not be able to sell the higher- priced bat. If competition between Massmart and Moresport constrains the pricing of entry and mid-level goods in Moresport, then we can see that it also constrains Moresport's prices of goods sold at price levels that are higher than those stocked presently in Massmart stores. Thus post merger with these constraints eliminated, the merged firm has the ability to raise prices, not only at the levels at which these firms' price offerings overlap, but also at levels that exceed the overlap. For this reason we find that the attempt to segment the markets based on price differentials is flawed.

85. Moreover, a reliance on *Staples* for using median price as a basis for segmentation is misplaced. In *Staples*, the court had at its disposal an enormous amount of econometric data, which is not the case in this matter. In addition, that court had found a market segmentation of office supply superstores on the basis of first identifying competitive *effect*, namely that in areas where Staples did not compete with other superstores it *charged* prices that were 5-15% higher than in areas where it faced competition from superstores. Those prices would of course be *selling* prices and not median prices.
86. Hodge's median price analysis is not meaningful because it tells us very little about competitive behaviour or constraints in a market. The customer has no knowledge about median prices and does not choose to shop at Massmart or Moresport on the basis of median prices (of which he has no knowledge). Neither do the merging parties advertise and compete for the customer in their advertising material on the basis of median prices.
87. In the absence of econometric data *ala Staples*, we turn to consider the pricing strategies of the merging parties in order to assess whether one exercises a pricing constraint on the other.
88. Both Mr Stone and Mr Keet testified that Massmart and Moresport would enter the market in a certain product at a particular price point and that they strove to match or better the entry price points of one another in a particular product, but that their best sellers were not necessarily at the lowest entry price point.
89. Mr Stone explained that prices at Moresport were set nationally. When a product was being introduced into the business, buyers would have a sense of what the product could possibly sell at in the market. They would then compare prices and ranges of the competitors by doing shop-outs and studying the advertising leaflets. After considering the department's targets for margins and turnover they would then set the price. While Moresport was always concerned about its margins they would always *match the entry price point of Massmart across all product categories*, even if they dropped their margin requirements. If they couldn't match the price for a particular product (either because they did

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<sup>66</sup> We know from the evidence, that Moresport's strategy is to stock entry level goods precisely to persuade customers once in the store to 'buy up' from their initial preference. Without being able to persuade customers that prices reflect quality differences such a strategy would fail.

not have it in store or what they had in store could not be sold at that price) they would introduce another product below that product in order to match the entry price point.<sup>67</sup> However their best sellers were not necessarily the lowest entry-level product. They usually sold up the level of that particular product.

90. Mr Keet explained that a buyer at Massmart would set the price of a product having regard to similar issues. They would procure a product, had a feel for what it may sell for in the market, compare it to competitors' prices and set a price. He would strive to match Moresport's entry price points but his best sellers were not necessarily at the entry price point but were usually further up. They would also have regard to margins that were set by their executives. Each year a buyer would sit down with his executive and determine both turnover and margin targets (budget). Margin targets were usually set by the company and a buyer had very little room for negotiation with his executive on margins. Margins were considered across an average for the department and some products had a higher margin than others. Targets for the department were set annually.

**91. Furthermore all of the witnesses seem to suggest that that there was a competitive constraint along the levels in a sports category. The prices of each level would constrain the next level. This is indeed confirmed by Mr Hughes who explained that the prices at one level would discipline prices at other levels mid-level because customers would want to know what quality product they are getting for their money –**

**MR MANOIM: Is the consumer, even for goods that are not priced in the same band, is the consumer concerned about why there should be a difference between an entry-level price and a mid-level price?**

**MR HUGHES: Yes....So if something sells at R1000,00 and something sells at R1500, 00 and then something sells at R2000,00 they will enquire what the difference is and what they are going to get for the price they are going to pay.<sup>68</sup>**

92. There would be no need for Massmart and Moresport to wrestle with each other and match their entry price points if neither was constrained by the other's entry price points across all levels

93. Mr Hodgson, while trying to downplay the reason why Moresport offered any entry level product, confirms that Moresport would ensure that they matched entry price points of Massmart by either matching the price or introducing another product, to ensure that they offered the "value for money on a basket

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<sup>67</sup> At pages 41-47 of the transcript of 2 February 2006.

<sup>68</sup> See page 304 of the transcript date 20 February 2006.

of goods” to their customer.<sup>69</sup>

94. From this evidence we see that while Massmart may have lower entry price points and Moresport higher exit price points, and the extent of overlap varied from category to category, they strove to match each other’s price points, with prices at each level asserting a competitive discipline on the next level. In general the crossover was in the entry to middle and both of their best sellers were often not at the lowest entry price point but higher up the level.
95. We also see, contrary to that suggested by Mr Hodge, that Moresport did not consider itself to occupy a different segment of the market or set its prices without reference to the prices of any of its key competitors namely Massmart. Instead we find an active and consistent policy of monitoring the prices of the Massmart group and matching or beating such prices.

### *Margins*

96. Mr Hodge went on to demonstrate that Moresport’s margins across selected sports categories were much higher than that of Massmart. He relied on the higher margins as a basis for market segmentation.
97. Mr Hodge explained his methodology saying that he had taken the actual annual sales of equipment in a particular category and had divided that figure to arrive at the average price. So for example in tennis rackets he took the annual actual turnover figures, which would include discounts and promotions and divided that by the number sold to arrive at an average price.<sup>70</sup> He would then obtain the cost price for these sales and obtain the average gross profit margin for that category. He then arrived at the gross and net margins to show that Moresport’s margins were higher than those of Massmart consistently across all categories.<sup>71</sup>
98. After Mr Hodge had testified, he was recalled to testify to the underlying figures that he had used in preparation for his report. Mr Hodge attempted to explain his methodology again and submitted a number of tables<sup>72</sup> to the Tribunal. He effected corrections to some of the figures and explained that he had obtained the figures on a spreadsheet from the merging parties who had extracted the information from their databases. When asked by the Tribunal about negative sales figures reflected for some of the items he could not provide an explanation, nor could he explain why some selling prices were extremely low

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<sup>69</sup> See page 21 of the transcript of 31 January 2006.

<sup>70</sup> Because Massmart and Moresport had different financial years the annual turnover figures were adjusted to take this into account.

<sup>71</sup> See graph on page 17 of Hodge’s Report.

<sup>72</sup> Exhibit 6.

(e.g. a treadmill for R79 or an exercise bike for R44).<sup>73</sup> He himself had not done an audit or a verification of the underlying figures. He also stated that the figures for treadmills had been adjusted in that they had removed items that had a negative figure and where they had sold only one or two.

99. He also confirmed to the Tribunal that he had not done the calculations of the gross margins himself and that was part of the extract that he had received from the merging parties.<sup>74</sup>

100. Interestingly enough we were not provided with individual selling prices for most sports equipment except exercise bicycles, home gyms and treadmills. For all categories other than treadmills, home gyms and exercise bikes the figures looked as follows:

Table: Tennis racquet (snr) sales at SWH South African Stores (Last Financial Year – Mar 04 to Feb05) <sup>75</sup>

Units sold	Sales value (exc VAT)	Price (exc VAT)	Sales Cost	Unit Sales cost
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101. We turn to consider Mr Hodge's submission on the margins. In our view, while Mr Hodge's calculations, prima facie showed that Massmart made lower margins than Moresport on the selection of products listed in the exhibits, the evidence submitted by him did not provide the Tribunal with an accurate or full economic picture.

102. In the first instance, apart from the prices listed in exercise bikes and treadmills, the individual selling prices of products were not listed and no comparison of price bands in any other category was provided. Second, there was a dispute as to whether some of the information listed for selling prices was in fact accurate by buyers who had actual experience in those stores. In considering the selling prices for exercise bikes and treadmills contained in Mr Hodge's schedule (Exhibit 6), Mr Keet testified that most of the products that were listed in those exhibits were old models.<sup>76</sup> He was adamant that Massmart had a treadmill selling at approximately R12000 and that they would never have sold an exercise bike for R79 as was listed in the exhibit. In his view there was "something wrong" with the prices that had been provided to Mr Hodge. Mr Stone expressed a similar concern with some of the prices listed in the exhibits.<sup>77</sup>

103. While Mr Hodge and some employees of the respective stores affirmed on

<sup>73</sup> A few possible reasons for these were later provided. It was suggested that negative sales figures could be due to returns and the low prices due to staff sales or sale of redundant items.

<sup>74</sup> Pages 10-19 of the transcript of 2 February 2006.

<sup>75</sup> Exhibit 6.

<sup>76</sup> Page 136ff of the transcript dated 20 February 2006.

<sup>77</sup> Page 8-10 of the transcript of 2 February 2006.

affidavit as to the methodology used and the source of the figures, the data itself had not been verified by Mr Hodge nor does it appear from the affidavits of the employees as to how the cost of sales or margins were calculated. In his report Mr Hodge states that the cost of sales would commonly include *inter alia* “margin reductions for discounts [and] rebates from suppliers,”<sup>78</sup> but no verification of this was provided. He himself had not calculated the cost of sales. Hence, it was not clear how common costs were allocated across products and whether such costs could have been allocated to each product on the basis of percentage or rand value. Nor was it clear whether these common costs would have been allocated in the same manner across different product categories e.g. golf sets and golf balls if these were transported together or sold on the same invoice.

104. Nor was it clear as to how rebates impacted upon the calculation of the cost of sales for each company. The evidence showed that buyers of each company would negotiate with suppliers for the best possible cost price.<sup>79</sup> This cost price was calculated on the basis of a selling (retail) price offered by the supplier less a margin. The selling price would then become the list price. However in addition to this margin, suppliers would grant rebates to companies. But buyers who negotiated with suppliers for the best possible prices were not involved in the negotiations for rebates and settlement discounts. Rebates were negotiated and managed by a separate department at group level.<sup>80</sup> They were usually negotiated at the beginning of the year and could possibly apply to all sales with a particular supplier.<sup>81</sup> There was no clarity as to whether rebates were treated in a similar accounting manner by both companies or whether they were taken into account in the calculation of the cost of sales.

105. In fact we see that even Massmart was struggling to understand how rebates were treated by Moresport. In the financial overview of Moresport contained in the Massmart due diligence of Moresport, the report attempts to explain the issue of rebates without reaching a conclusive finding.<sup>82</sup> Further we see a line in a table in the same report headed “*Unearned rebates*” with an amount of “R1,935,264.”<sup>83</sup> Mr Keet himself says about Mr Hodge’s margins:

“but that is just a trading margin. We don’t know how much money is below the line.”<sup>84</sup>

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<sup>78</sup> Page 16 of Hodge’s Report contained in footnote 26.

<sup>79</sup> See testimony of Lamberti, Keet and Stone.

<sup>80</sup> See testimony of Lamberti, Hodgson, Keet and Stone.

<sup>81</sup> See evidence of Lamberti, Hodgson and Reeves.

<sup>82</sup> See page 28 of the due diligence report.

<sup>83</sup> See page 27 of the due diligence report.

<sup>84</sup> Page 184 of the transcript dated 20 February 2006.

106. All of this suggests that the accounting treatment of the cost of sales is not at all transparent or comparable in this particular matter.
107. The use of margins by Mr Hodge to segment the market and demonstrate a different customer focus is not particularly helpful because we do not have enough or accurate knowledge about the profitability of each company. The higher margins of Moresport could be due to any number of factors including a different accounting treatment of the cost of sales between the companies, better cost prices, better rebates or lower overheads.
108. The evidence of key witnesses has shown quite the contrary to what is being suggested by Mr Hodge and they suggest that the prices of Massmart and Moresport are indeed constrained by each other and that they target by and large the same customer. These witnesses also provide possible explanations for the apparent higher margins of Moresport.
109. Mr Keet insisted that he was making much higher margins than was suggested by Mr Hodge on some equipment while he was still at Massmart. He testified that while margins in Massmart's sports equipment were low in the past and there was a lot more emphasis on volume at that time, since the merger between Game, Dion and Makro, Massmart has improved its margins considerably. He could not provide an explanation for Moresport's higher margins but suggested that this may be due to them obtaining a better cost price with suppliers<sup>85</sup> because suppliers generally knew what margin they were required to make at Massmart and would negotiate a higher cost price with Massmart.<sup>86</sup>
110. While we do not decide on the extent of the difference between the margins of Massmart and Moresport, we note that the Massmart margins in recent documents submitted by the merging parties were higher than those suggested by Mr Hodge. After hearing evidence from Mr Keet, the Tribunal requested copies of the shop-outs, amongst other documents, that Mr Keet had apparently left behind when he left the employ of Massmart. The merging parties submitted a document, exhibit 9, and led a witness Ms Mandisha Maraj to explain the nature of the document.<sup>87</sup> Ms Maraj explained to the Tribunal that she was employed to conduct shop-outs for the entire sports department at Mass Discounters. After she conducted these shop-outs she would record the information in the scheduled provided to us. It seems that the purpose of these shop-outs was to rank a particular buyer in terms of price leadership against competitors. However because competitors didn't necessarily offer identical products or brands in certain categories, Ms Maraj was unable to do a price comparison and simply inserted the Game price in the competitor's

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<sup>85</sup> See page 224 of the transcript dated 20 February 2006.

<sup>86</sup> Page 224-226 of the transcript of 20 February 2006.

<sup>87</sup> See pages 54ff transcript dated 6 March 2006.



column. So for example she would insert the Game price for an exercise bike in the SWH column because SWH did not offer the same brand as Game.

111. The Tribunal questioned the usefulness of this document and the results of the shop-outs conducted by Ms Maraj. Nevertheless, Ms Maraj conceded that she was not qualified to conduct a shop-out between products that were of similar function but not identical in brand - only buyers were experienced enough to do such shop-outs and indeed did so on their own (i.e. they did not ask her to do it).<sup>88</sup> In those schedules Ms Maraj had also recorded the margins of the selected products in a column next to each product. A cursory glance at those margins clearly indicates that they are much higher than those suggested by Mr Hodge.
112. Mr Hodgson himself explains that Moresport's apparent higher margins are not because they target a different customer but because they *need* higher margins to cover their *higher* overheads.
113. In explaining Moresport's apparent higher margins, he traces its history and explains that the group had to consider three aspects of the business when it started expanding in order to ensure profitability. First it had to ensure that it was able to get its store sizes and locations right, then it had to obtain better cost prices from suppliers by re-negotiating margins and importing directly from overseas (cutting out the middle man).<sup>89</sup> This is confirmed in the Nedbank valuation<sup>90</sup> where it is stated that the removal of the middleman has resulted in a margin layer to the benefit of Moresport. He also explains that Moresport needs to make the higher margin in order to cover the higher overhead structure of Moresport including all their "selling aids".<sup>91</sup> In the third area, and in 2005, they recognise that they are not going to become more profitable by improving margins and cutting overheads and are currently focused on driving turnover.
114. So while Moresport's higher margins may have resulted historically from better negotiations with suppliers and direct imports, Mr Hodgson confirms that Moresport is required to make the higher margins because it has a higher overhead structure, not because it targets a different or distinct customer. He also confirms that turnover or volumes are as important to Moresport and that currently the business was volume driven.
115. In trying to explain that post-merger Moresport will be maintained as a separate business, he further confirms that Moresport is in "the business of growing our turnover and we're in the business of trying to take customers

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<sup>88</sup> From pages 64ff of the transcript dated 6 March 2006.

<sup>89</sup> See page 112 of the transcript dated 31 January 2006.

<sup>90</sup> At page 295 of the Commission's Record, File C.

<sup>91</sup> Page 130 of the transcript dated 30 January 2006.

away from everybody that we compete against”.<sup>92</sup> In the Massmart due diligence, Moresport is described as a mass merchant, indicating that it was also in the business of doing volume.

116. We find that the use of a median price and margins does not really give us a complete economic picture of market segmentation or an indication of whether Massmart and Moresport are *not* effective competitors and are *not* constrained in their selling prices (i.e. in striving to reach the customer in the market for sports and outdoor equipment).

117. There are too many variables contained in the determination of margins, probably explaining why margins have not been used by competition agencies in other jurisdictions, for purposes of market segmentation. While references were made to margins in *JD/Elferines* these seem to have been discussed in a different context. Margins do not tell us anything about competitive behaviour or constraints.<sup>93</sup>

118. The testimony of the buyers who were directly involved in the business of the merging parties tells a different story namely that Massmart and Moresport considered each other as key competitors across a range of products. They would compare prices with each other and would respond to lower prices either by dropping their price or bringing in a new product at a lower price, hence indicating that they targeted the same customer. They would take lower margins but would ensure that they would match entry price points. Prices at the lower level would serve to exercise a discipline on the next level. A large amount of time, money and people were invested in monitoring each other's prices and product ranges thus suggesting that these parties considered themselves as key competitors in the same relevant market rather than occupying separate segments of the market.

## Brands

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<sup>92</sup> Indeed both Mr Lamberti and Mr Hodgson hold a curious position, namely that pre-merger they do not compete with each other but post-merger they will ensure that Moresport remains a separate business, will not adopt the pricing policy of Massmart and will compete with Massmart.

<sup>93</sup> See for instance Robert Lind and Mike Walker “The (Mis)use of Profitability analysis in Competition Law cases” *European Competition Law Review*, 2004 at page 439. Although the authors here are primarily addressing themselves to criticising the use of profitability analysis as proof of market power, they make the point of how different allocations of common costs can alter the apparent profitability of a product line. They argue that the way that common costs are allocated can have important implications for calculations of profitability. (See page 444). But their critique goes further than the problems of meaningful calculation. They state, “*In addition economic theory does not imply that highly competitive economic environments necessarily are associated with low profits. Therefore even if you could measure profits in an economically meaningful way, they could not tell you about the state of competition or, equally important, whether regulatory intervention would be appropriate. That is why the USA and the EU are correct in not using profitability as a measure of competition.*” (See page 445).

119. The merging parties submit that the differences between the brands offered by Moresport and Massmart supports the contention that Moresport is in a different, more mid-prime level segment than Massmart. One of the reasons given by Mr Lamberti for the difference in brands offered by the two companies was that certain suppliers would not supply Massdiscounters as part of their brand protection strategy. This seemingly was one of the reasons that restricted Massmart from moving into the mid-prime level segments.<sup>94</sup> Mr Hodge went further and stated that because Massmart did not have access to mid-to-premium brands and Moresport did, this indicated that they were in different markets. Moresport was more like a specialist sports store and had access to premium brands.

120. However the evidence of experienced witnesses and a supplier indicates that while there may be a few premium brands in golf and possibly cycling that Massmart would not have access to, brand access and supplier strategy has not remained static over the years.

121. Mr Keet explained that in the past it may have been the case that Massmart could not access certain premium brands because some suppliers did not supply Massmart. However that had changed over time and suppliers had become more aware of who could move their volumes. According to him, apart from a few premium brands in golf, Massmart had access to most international brands across the sports categories. The decision as to which brands were offered in the store was a business decision based on strategic objectives at the time.<sup>95</sup> Mr Reeves, the managing director of Leisure Holdings who supplies both Massmart and Moresport, confirms that within the branded business of sports equipment, apart from certain brands such as Mizuno, he supplies everyone, albeit at different price points of the market. Mizuno, a golf premium brand, would not allow him to supply to Massmart or Pick n Pay. <sup>96</sup> He also states that the decision as to which brands would be offered was made by a business in advance, for that trading year. Mr Stone testified that there was an overlap in the brands that Moresport and Massmart offered and that there were certain premium brands in golf such as Calloway and Taylor Made that were not offered by Massmart. However Moresport itself only kept 3 or 4 premium brands in golf and that was also not in all their stores.<sup>97</sup> Mr Hodgson himself referred to the fluidity in access to brands and that access to brands and supplier attitudes have not remained static. He referred to a brand, "Oakley," which about five years ago did not want to supply Moresport but now does.<sup>98</sup>

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<sup>94</sup> Hence the argument goes, Massmart had to acquire Moresport if it wanted to expand its sports department into the middle-prime level segments.

<sup>95</sup> See pages 156-7 of the transcript dated 2 February and also Mr Stone's evidence from page 93ff of the same transcript.

<sup>96</sup> Page 4 of the transcript dated 28 February 2006.

<sup>97</sup> Page 141 of the transcript dated 30 January 2006.

<sup>98</sup> See page 149 of the transcript dated 30 January 2006.

122. There was a large overlap in brands between Massmart and Moresport as seen in the revised shop-outs even though Moresport had higher exit prices. Although the minutes of the Moresport strategic drivers for FY05 reflect a number of premium brands for golf under a discussion headed “Brand Strategy”<sup>99</sup> very few of these brands were found in the revised shop-outs, again possibly demonstrating the fluidity of the brand offerings in each company. (See below).

### **Price band and brand comparison: Revised Shop-outs**

123. At the time that Mr Hodge’s evidence was led, the merging parties had not conducted a price band comparison. The Commission had conducted a limited price band comparison which is reflected in the Commission’s recommendation.<sup>100</sup>

124. On 28 February 2006 the Tribunal requested further documents from the merging parties and requested the Commission to conduct a comparative shop-out between the merging parties chains. The shop-out was limited to certain sports categories because these had been discussed at great length during these proceedings. The categories were cricket bats, racquets (including tennis, squash and badminton), hockey sticks, soccer balls, rugby balls, treadmills, exercise bicycles and golf clubs (including box sets). The Commission conducted a shop-out at Game in Menlyn, Dion in Sandton, Makro in Woodmead and SWH in Woodmead. The Commission filed the outcome of its shop-outs and these were labelled as Exhibits 8 a, b, c and d. The shop-outs were recorded in tables and consisted of a number of columns which indicated a description of the product and a price in a category. There was a table for each Massstore namely Game, Dion and Makro in each category and this was compared to a table consisting of prices at SWH. The merging parties challenged some of the information recorded in the shop-out and Mr Hodge, on behalf of the merging parties, filed a report in this regard. In his report Mr Hodge presented the Tribunal with what he deems to be the corrected versions of the shop-outs. We refer to these collectively as the **revised shop-outs**.

125. In considering the information obtained in the shop-outs the Tribunal has relied on the revised shop-outs namely those re-worked by Mr Hodge. We have also considered the Massmart range of products and prices across the three chains collectively since they are part of the same group and sell certain products at a price agreed upon at group level as explained by Mr Keet and verified in exhibit 9 (price agreements).<sup>101</sup>

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<sup>99</sup> See page 211 of the Moresport additional documentation bundle.

<sup>100</sup> At page 21 of the Commission’s recommendation.

<sup>101</sup> Page 11 of Exhibit 9.

126.A typical table is annexed hereto as APPENDIX A.

127.In summary we see that there is an overlap of brands carried by the merging parties in almost all categories and an overlap in price points in almost all categories, the exception being exercise bicycles and treadmills. Generally Massmart will start at a lower price point than SWH and SWH will exit at a higher price point in all categories.

128.In cricket bats there is an overlap in brands in Gunn & Moore, Grey Nicholls and Slazenger. SWH only has two more brands than Massmart. The price range overlap is from R199 to R899.<sup>102</sup> Massmart starts at a lower price of R49.99 but then quickly moves up to R899, in five step changes. SWH starts at R199 then moves slowly up to R899 (13 step change). SWH purports to carry a wider range but it is difficult to see what differences of quality there would be between bats priced at R 549, R559 and R599. SWH then moves up to R2999 in 8 steps but again at times at a R50 - R100 difference.

129.In golf there is an overlap in brands of Dunlop and an overlap in prices in almost all categories including packaged sets. <sup>103</sup> We note that in golf there is only one Taylor Made (in woods), no Calloway and no Ping<sup>104</sup> listed on the SWH shop-out. SWH has a few Mizuno & Wilson and but by far the majority of the range is in Dunlop or Top Flite. The highest price for a senior set that SWH has is R2699. The highest price it has for iron sets is R2299, Game has it for R2290. The highest price SWH has for a wood is R1299 but the prices below it are R799, Game has R499. These revised shop-outs do not show the tens of thousands of rands differences in prices between Massmart and SWH in golf that were being suggested by the merging parties and which would be apparent if SWH had a mid-to-prime level focus. These shop-outs suggest that SWH does not have a credible offering in prime level golf equipment as suggested by the merging parties and tends to confirm Mr Stone's and Mr Hughes' evidence. The revised shop-outs also show the fluidity in brands that may be stocked at a given moment in time

130.In tennis rackets, there is an overlap in brands of Dunlop, Prince and Wilson (Game) and a price range overlap of R179- R599 (Makro). Massmart has a Pro-Kennex label and SWH has a Pro-Swing label. SWH has only one additional brand called Head. In squash rackets we see Dunlop and Prince with price overlap being R179 (Game) to R399 (Makro). SWH has in addition Wilson and Head. In Hockey there is an overlap of brands in Grays, Slazenger & Kookabura with price overlap of R59 (Dion) to R599 (Makro). SWH has three other brands. In balls there is an overlap in brands of Dunlop, Mitre, Adidas, Nike, Gilbert (Dion) with price overlap in each of rugby, tennis and

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<sup>102</sup> For Game. This confirms both Keet's and Stone's evidence.

<sup>103</sup> Makro and Dion have a wider selection

<sup>104</sup> Apparently the premium or prime brands in golf equipment

soccer. Both SWH and Massmart have a few more different brands.

131. There are no internationally recognised brands in exercise bikes and treadmills and it is common cause that these usually are in-house brands. If we look at the price ranges we see that Massmart has treadmills from R2799 (Game) to R12999 (Game). This confirms Mr Keet's evidence and that of the Massmart documents. SWH has treadmills from R6999 –R18999, with the overlap in price being R6999-R9999. SWH has only three higher treadmills (R13 999, R16 599 and R18 999). In exercise bikes, we see that Massmart has a price range of R699 (Makro) to R3299 (Game) and SWH has R3149 – R6344 but Massmart has a wider range.

132. An analysis of the shop-outs confirms both Mr Keet's and Stone's evidence that there was a large degree of overlap in the price ranges of the merging parties across the categories listed. If we were to accept for purposes of argument, that price was an indicator of the level of the segment or quality of product, then that overlap is certainly not limited to entry level and is much more than 10% across most categories.

133. While we accept the revised shop-outs are only a snapshot of the prices and ranges available at the stores of the merging parties at a given moment in time, we find that they represent a more accurate and relevant snapshot of competition and competitive constraints in a market than either of the median price and margin analysis suggested by Mr Hodge. Consumers are attracted to retailers on the basis of the prices of their goods. Median prices and margins are not transparent to them and hence cannot account for how consumers respond. For this reason the evidence concerning the overlap of price bands of goods in stores is instructive - it explains why consumers would see Massmart and Moresport stores as competitors. Both offer a range of goods in a sufficiently comparable price band to make it worth the consumer of sports goods while, to look to them as alternatives. Conversely margins and median prices offer a misleading picture.

## **Advertising**

134. Mr Hodge on behalf of the merging parties relies on advertising as practical indicia in order to segment Moresport from Massmart. According to Mr Hodge, there are sufficient differences between Massmart's advertising material and that of Moresport to warrant market segmentation for anti-trust purposes. He says that a cursory study of the broadsheet leaflets distributed by Massmart shows that it focussed largely on price thus indicating that it was targeting the entry-level market. Moresport on the other hand simply made the consumer aware of the extent of its offerings.

135. The underlying materials used by Mr Hodge had not been presented to the

Tribunal at the time that Mr Hodge had testified. Under cross-examination by Ms Kalla, an advertising leaflet of Moresport was shown to Mr Hodge. Ms Kalla referred him to the number of times the words “Our Price” and “Save” appeared next to the items showcased in the leaflet.

136. On 28 February 2006 the Tribunal requested the merging parties to submit advertising leaflets for the periods 2003-2004 for both Massmart and Moresport.

137. An analysis of the advertising material of Massmart and Moresport reveals more similarities than differences. We note that although the promotional periods of Moresport and Massmart do not correspond exactly (Moresport tends to have promotions over longer periods than Massmart), promotional products over the same period of promotion were compared. We also note that the products show-cased in the leaflets do not necessarily reflect the extent of the range or price ranges of the category that each party may have in its stores.

138. Both Massmart and Moresport use a broadsheet leaflet to advertise their offerings. This leaflet is distributed through national and community newspapers. Contrary to Mr Hodge’s submissions, the Moresport broadsheet does not appear simply to make the customer aware of the product. While brand names and symbols are shown, immediate attention is not drawn to them. Instead the reader’s attention is drawn more to the price of the product on promotion, by bold letters and colours, and how much savings a consumer could expect to make on the purchase of the product. The pamphlets are littered with expressions such as “Winning Deal”, and “Our Price” and “Save” near the product. All products ranging from footwear, apparel and equipment are showcased on the pamphlet across all sports categories. The appearance of the Moresport leaflet does not suggest a mid-premium focussed entity. In fact it appears not very different to the Game or Makro pamphlets which draw attention to the price of the product on promotion by bold letters and colouring such as “Killer Deal” and the savings that could be made by the reader being told the difference between the “Normal Price” and the promotional price. While Game and Makro advertise other general merchandise along with their sports equipment, the sports and outdoor goods are usually grouped together and easy to locate on the leaflet. In fact the Makro broadsheets tend to be glossier, easier to read, bigger and thicker than Moresport’s or Game’s.

139. Hence, while the advertising material appears different in some respects, (which one would expect), we cannot find the extent of differences suggested by Mr Hodge and conclude that we are not persuaded that these support market segmentation. In fact, the similarities suggest that the merging parties are targeting the same customer utilising similar advertising strategies and therefore competing in the same relevant market.

## Store format, store location and space, allocation

140. Mr Hodge testified that the format and appearance of the Moresport stores distinguished Moresport sufficiently from Massmart for anti-trust purposes. Massmart's store formats were that of a Massdiscounter, "stack them high watch them fly" type. Massmart did not have the fixtures and fittings that Moresport had. For example, Moresport would have a cricket bat knocking in machine and a putting green to test golf clubs. In addition Moresport had proper racks and fixtures for cycles and rackets, none of which Massmart had. Moresport allocated much more floor space to its sports equipment than Massmart did. We note that the floor space that may be allocated to sports equipment could be smaller in a Game store than in a SWH. However this would be patently due to the fact that Game or Massmart sell other general merchandise and SWH sells only sports and outdoor or outdoor merchandise.

141. While we cannot be certain that all SWH stores or all the chains in the Moresport group had the same formats, features and appearances throughout the country, we note that there are differences in format and appearance between SWH and Game.

142. However, Moresport stores do not resemble TotalSports or the specialist sports stores or even Cape Union Mart Stores, as being suggested by Mr Hodge. They are closer in feel and location to Massmart stores than they are to TotalSports or the specialist stores. They, like the Massmart group, have large warehouse type stores and also differentiate between the SWH, Outdoor Warehouse and Sport Shoe World stores. They are located in value markets or retail fringes and in malls. SWH, Outdoor Warehouse are also regarded as destination stores.<sup>105</sup>

143. Despite the differences in format and appearance of the stores, both parties' stores are located within close proximity of each other and follow each other's national footprints.

Gauteng store location	
Makro location	Sportsmans Warehouse
Centurion	Centurion
Crown Mines	South Gate
Germiston	Boksburg
Woodmead	Woodmead
Strubensvallei	Roodepoort
Wonderboom	Zambezi

Source: Page 22 of the Commission's Report

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<sup>105</sup> See Nedbank valuation from Page 264 of the Commission's Record, File C.



144. In our view the national footprint and store location of the Moresport stores follows the Massmart footprint. They may differ in fixtures and fittings from each other but they both have a warehouse or discount feel to them and are found near each other either in value marts or in malls.

### **Service levels**

145. Mr Hodge argued that the service levels offered at a Moresport store differed to a large extent from that of Massmart stores. Massmart stores offered a rudimentary service and were more a self-service type store. At Moresport however a customer would be able to knock in his cricket bat, test his golf putter and would receive the attention of a salesperson that would be able to advise him on the features and quality of the equipment that was being purchased.

**146. Mr Keet contests the level of service offered by Moresport. He states that at his last visit to a SWH store, he was not offered any assistance in the manner submitted by the merging parties. In his view Moresport may have in the past offered that kind of service but that is no longer the case. This is echoed in the due diligence report on Moresport 106 which notes that service levels at most stores fell short.**

147. Mr Hughes testified that there was a difference between the service levels offered by Moresport and Massmart and that Moresport was seen to have better service levels. However in his view Moresport's service levels were not that of a specialist sports store and that they would not be able to provide the technical services that a customer for prime level equipment would require. In order to sell prime level equipment like Callaways and Ping they would need swing analysis equipment, they would have to do trade-ins and give 30 day trials, none of which they offer.<sup>107</sup>

148. We note that there may be some differences in the service levels of Moresport and Massmart. However these differences are not material. Rather we find that the other indicia considered above such as internal documents of the parties, evidence of key witnesses, pricing policies and extent of overlap all point against segmentation.

149. In short the practical indicia, where material, point against segmentation. Where non-material indicia such as service levels, may point in its favour, these are insufficient to justify segmentation.

### *Conclusion on relevant product market*

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<sup>106</sup> At pages 31-32 of the due diligence report.

<sup>107</sup> See page 259 of the transcript dated 20 February 2006.

150. We find that the relevant product market is the retailing of general sports and outdoor equipment.
151. While there may be differences in store format, appearance and service levels, we find that the documentary evidence taken together with the evidence of key witnesses and the evidence of the revised shop-outs confirm that the merging parties are both general retailers selling a range of sports and outdoor equipment.
152. For purposes of market definition we disagree with the Commission that the market is segmented between entry-middle on the one hand and prime/premium on the other hand. Segmentation in a particular product category is dependent to a large extent on the experience of the sportsperson and experienced buyers or traders. However we find that for general retailers such as the merging parties, who offer products across a number of categories and levels, there is fluidity in the overlap of product offering across categories offered by both parties and prices in one level exercise a competitive constraint on the next level. Hence whether the merging parties move up and down the three levels in their product overlap, they are constrained by each other both in their pricing in relation to each other (inter-company) and within the product itself along levels (inter-product).
153. We also disagree with Mr Hodge that his segmentation leads him to conclude that Moresport is a monopoly. The internal documents of the merging parties and evidence of key witness confirms that Moresport perceives itself to have a number of competitors, with Massmart being identified most consistently across all categories as the key rival.

### **Geographic market**

154. The Commission finds the geographic market to be national. The Commission arrives at this conclusion on the basis that the merging parties follow a national pricing policy, as well as the fact that they operate a national set of chains.
155. The merging parties' view in its competitiveness report was that the market could be defined as national, regional or local because of the presence of independents. Subsequently, Mr Hodge argued that the precise boundaries of the relevant geographical market are irrelevant, since Massmart and Moresport operate in different relevant markets.
156. We agree with the Commission that the geographic market is a national market. Both parties have a national pricing policy which they would not easily adjust proactively in response to an independent general retailer or an independent specialist.<sup>108</sup> They mainly have reference to the prices, range of

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<sup>108</sup> See evidence of Mr Lamberti, Mr Hodgson, Keet and Stone.

product and advertising of other national chains and have a number of stores across the country located in close proximity to each other and other national stores, in major urban retail nodes. Store managers have limited discretion in setting prices since prices are set nationally. However they may at times match the price of a local or regional competitor.<sup>109</sup> This price matching policy is a commercial decision made by the store manager for a particular customer in the event that that customer is able to show that a competitor is offering the same product at a lower price. However, this is a reactive policy and does not necessarily result in lower prices of that product for all other customers.

## **Conclusion on relevant market**

157. We conclude that the relevant market is that for the *national* retailing of general sports and outdoor equipment.

## **IMPACT ON COMPETITION**

### **Market Participants**

#### *National retailers*

158. On the basis of the definition of the relevant market, national chains retailing general sports and outdoor equipment would obviously be included as market participants. However both Mr Stone and Mr Keet testified that in the market for national general sports and outdoor equipment, only Massmart, Moresport and TotalSports offered any significant competition to each other.<sup>110</sup> National retailers such as Pick n Pay and Trade Centre provided very limited competition to these stores because they carried an insignificant offering in equipment markets.<sup>111</sup>

159. Mr Keet also provides an explanation as to why Pick n Pay or Edcon are unlikely to become significant competitors to Massmart in the equipment space in the near future. According to him, the merger of Game, Dion and Makro had provided Massmart with an opportunity to take market share from these national stores.<sup>112</sup> These stores would not increase their equipment offering especially sports equipment in the near future because of the opportunity costs and high risk involved in doing that. Sports was space hungry and required both space and capital. Pick n Pay would have to give up a lot more other

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<sup>109</sup> See evidence of Mr Lamberti & Mr Hodgson.

<sup>110</sup> Confirmed by the merging parties internal documents.

<sup>111</sup> See also the Commission's investigation on pages 30-34

<sup>112</sup> Mr Keet explains that Massmart had engaged in predatory pricing (discounting) and had taken market share. It has since improved its margins and prices. However its ability to maintain low prices at entry price points serves as a barrier to entry. See page 165ff of the transcript of 2 February 2006.

merchandise to offer a credible and material offering in sports equipment. 113

160. Mr Lamberti himself confirms that such opportunity costs and risk exist for the current national players. In justifying why Massmart seeks to expand its already credible offering in sports equipment through the acquisition of Moresport rather than organic growth he states that the opportunity costs and risk of organic growth are too high –

“ It could take 5, 6 years to build up a portfolio of stores of that nature (referring to Moresport) and the risk particularly in the front end would be very high.”<sup>114</sup>

And,

“ we would have to turn at least half of the Game and Dion store into sports and we would thereby totally undermine and have to eliminate the other product categories that we stock”. <sup>115</sup>

161. However we note that because most of these national entities offer sports and outdoor equipment, which are integrated with apparel and footwear in their businesses, it may be difficult to separate out the precise extent of the competition posed by them in the equipment markets or in each of the equipment markets. Hence entities such as Pick n Pay, Edcon, Foschini (both TotalSports and Due South), Cape Union Mart<sup>116</sup> and Trade Centre are included as market participants in the national general sports and outdoor equipment market.<sup>117</sup> We also include Trapper's Trading as a national competitor to the merging parties. Trappers Trading was referred to as a competitor by the merging parties, although no market shares were provided for it.<sup>118</sup> We err on the side of benefiting the merging parties and include Trappers Trading, taking its market share from the Commission's table on Outdoor Equipment.<sup>119</sup>

162. Based on the market share information provided to us by the merging parties (and including Trappers Trading), the national general market participants and their relative market shares would be as follows –

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<sup>113</sup> Page 155 of the transcript dated 2 February 2006.

<sup>114</sup> Page 33 of the transcript dated 30 January 2006.

<sup>115</sup> Page 34 of the transcript dated 30 January 2006.

<sup>116</sup> Indeed Mr Reynolds, from Cape Union Mart, confirms that they consider Massmart and Moresport as competitors despite the fact that Cape Union Mart occupies a niche segment of the outdoor market.

<sup>117</sup> Merging parties' estimates and page 39 of the Commission's recommendation.

<sup>118</sup> The Commission lists it as a competitor in outdoor equipment and the merging parties refer to it on page 157 File C

<sup>119</sup> We understand the Commission's estimates are derived from those provided by the merging parties.

<b>Firm</b>	<b>Market shares (%)</b>
<b>Moresport</b>	<b>26.18</b>
<b>Massmart</b>	<b>45.10</b>
Edcon	1.45
Foschini (Totalsports)	7.28
Cape Union Mart	5.83
Pick n Pay	4.36
Trade Centre	4.36
The Pro Shop	-
Golfers Club	-
Mia's	-
Independents	-
Trappers Trading	5.46
Total	100
<b>Merged entity</b>	<b>71.28</b>
<b>Pre Merger HHI</b>	<b>2876</b>
<b>Post Merger HHI</b>	<b>5237</b>
<b>Change in HHI</b>	<b>2361</b>

#### *Independents in general*

163. We turn to consider whether the independents are to be included in the relevant market. As discussed above we find that there are two types of independents, namely the independent general retailers and the independent specialist retailers.

164. The evidence of most of the witnesses<sup>120</sup> indicated that independent general retailers of sports and outdoor equipment (those that sell equipment across a number of sports categories or a range of outdoor activities) were being pushed out of the market and there were only a few left who were locally or regionally based. Independents were increasingly becoming specialist stores in that they specialised in one sports category (or one outdoor activity) and were owner managed or run. These specialist independents were generally located outside the major retail nodes, in suburbs or near sporting facilities.

165. In their competitiveness report the merging parties submitted that they competed with independents. In support of this they filed a list of independent stores. However this list was nothing more than a mailing list of the publication "Sports Trader".<sup>121</sup> It may be that that list had been utilised by the merging parties in their efforts to estimate market shares. However no evidence was led as to whether the stores contained in that list presented any competitive constraint on the merging parties. Indeed some of the entities listed in that annexure were in neighbouring countries.

<sup>120</sup> See evidence of Hodgson, Keet, Stone, Hughes and Reeves.

<sup>121</sup> Paragraph 4.1.7 on page 72 of the Commission's record, File A. See also page 325 of same file.

166. During the proceedings, Mr Hodgson testified that Moresport was constrained by a number of independent stores across the country. He referred the Tribunal to a list of independents that had been prepared by him and had been provided to the Commission by the merging parties.<sup>122</sup> The list was not exhaustive but included a number of national chains and specialist independents across the country. It was submitted by Mr Hodgson that the list showed the extent of competition in the market and that these were the competitors whose prices Moresport management would monitor.<sup>123</sup> Companies such as Dischem and Virgin Active Stores were all listed as competitors in the equipment space. Upon closer examination however it emerged that the list had been compiled by Mr Hodgson and his colleagues on the basis of a number of assumptions made by them.<sup>124</sup> In the first instance the turnover figures of each entity on the list had been a figure assumed by them and no actual or objective references were available to them. Then this estimated turnover was broken down into apparel, footwear and equipment in a ratio that was seemingly based on Moresport's own breakdown. If a company did not sell any apparel or footwear then its entire assumed turnover was placed under equipment. Hence, Dischem, which is a discount pharmacy chain store, and which was listed as a competitor to the merging parties in the sports supplement market<sup>125</sup> was transformed into a competitor in the equipment market. In our view the basis upon which the turnovers and classification had been done by Mr Hodgson and his team are highly unreliable and not supported by any objective criteria. The Tribunal finds this list very unhelpful in assessing whether *in fact* the independent retailers effectively pose a competitive constraint on the merging parties in the relevant market or even in the market described by the merging parties in their competitiveness report.

167. We agree with the Commission that both types of independents, namely the general retailer and the specialist retailer do not act as a competitive constraint on the merging parties. The general independents are not national chains, are generally located in one town or a region, outside of major retail nodes. Customers of the merging parties cannot practicably turn to them as alternatives to a merged entity. The pricing policies of the merging parties confirm that these independents do not pose a competitive constraint on their pricing. While they may react to the prices of these independents in a particular instance, this is a reactive policy. The specialist independents specialise in one sport or one type of outdoor activity,<sup>126</sup> are generally seen to be experts offering prime level goods, do not carry a range of sports categories

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<sup>122</sup> See page 157 of the Commission's record File C.

<sup>123</sup> See page 5ff of the transcript dated 31 January 2006.

<sup>124</sup> This was done sometime in the last quarter of 2005 and was submitted to the Commission after the filing of the merger.

<sup>125</sup> Even though Moresport's offering in the supplement market was experimental and limited to one store. See page 5 of the transcript dated 31 January 2006.

<sup>126</sup> Mia's for example is a fishing specialist located only in Gauteng.

and are also generally located outside of major retail nodes or are limited to a local or regional geographic area. <sup>127</sup> The only exception to this seems to be the Pro Shop and Golfers Club (see below).

168. With the exception of the Pro Shop and Golfers Club, we accept that on the periphery of their businesses or in one particular sports category or in some region the merging parties may have regard to the prices and the ranges of some of the larger or regional independents. However the merging parties are closer in rivalry to each other than they are to the independents. The independents offer some fringe competition to the merging parties but they are not significant due to either being focussed on one sporting category or placed regionally or locally. The merging parties consider each other as major rivals and *in fact* compete with each other in this market.<sup>128</sup>

#### *Pro Shop and Golfers Club*

169. We note that several witnesses and internal documents of the merging parties referred to the Pro Shop as a competitor in golf. Golf has obviously become a fast growing sport and the sport seems to be rapidly changing into more entry and prime levels, with the middle level disappearing. The Pro Shop, while being a specialist sports store, has a national footprint with stores in at least most provinces. <sup>129</sup> Golfers Club does not have a similar brick and mortar footprint but has a nationwide online trading facility.<sup>130</sup>

170. The Pro Shop occupies a unique position in this transaction. Unlike the other independents the Pro Shop has historically been part of the Moresport group until it was sold in November 2003 to Moregolf. While it was still part of the Moresport group it was positioned as a premium golf specialist. Since then the Pro Shop has expanded its stores to 4 company-owned and 5 franchises, throughout the country and positions itself as a national specialist golf store, following a national pricing policy.

171. Mr Rhys Hughes the joint managing director of the Pro Shop indicated that, while he did not consider Moresport as a competitor in the prime level of golf, he did consider Massmart and Moresport as competitors in the entry-mid levels and that he would match their entry price points.

172. If for purposes of argument, we included the Pro Shop as an effective competitor to the merging parties, the market shares of the merged entity would be as shown in the table below and would still be extremely high:

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<sup>127</sup> See evidence of Mr Rhys Hughes, Mr Keet and Mr Stone

<sup>128</sup> See evidence of Mr Keet and Mr Stone and Nedbank valuation.

<sup>129</sup> See website of Pro Shop.

<sup>130</sup> See Golfers' Club website.

<b>Firm</b>	<b>Market shares (%)</b>
<b>Moresport</b>	<b>21.49</b>
<b>Massmart</b>	<b>37.07</b>
Edcon	1.19
Foschini (Totalsports)	5.97
Cape Union Mart	4.78
Pick n Pay	3.58
Trade Centre	3.58
The Pro Shop	13.13
Golfers Club	4.78
Mia's	-
Independents	-
Trappers Trading	4.48
Total	100
<b>Merged entity</b>	<b>58.56</b>
<b>Pre Merger HHI</b>	<b>2136</b>
<b>Post Merger HHI</b>	<b>3730</b>
<b>Change in HHI</b>	<b>1594</b>

173. Even if we were to conclude that all the independents were effective competitors and were part of the relevant market, the market shares - as provided by the merging parties to the Commission, and which we consider to be the best estimates of market shares in the industry- of the merged entity would still be alarmingly high in the sports and outdoor equipment market.

174. However we are of the view that we need not make a precise finding on the market share figures for the merged entity or on the identities of the market participants. We find that the market share figures will range between those provided to us by the merging parties (plus Trappers Trading) and those provided to us by the Commission depending on whether we exclude the independents and include the Pro Shop and Golfers Club as depicted in the consolidated table below.

<b>Firm</b>	<b>Market shares (%)</b>
<b>Moresport</b>	<b>17.35</b>
<b>Massmart</b>	<b>29.88</b>
Edcon	0.96
Foschini (Totalsports)	4.82
Cape Union Mart	3.86
Pick n Pay	2.89
Trade Centre	2.89
The Pro Shop	10.60
Golfers Club	3.86
Mia's	3.86



Independents	15.42
Trappers Trading	3.62
Total	100
<b>Merged entity</b>	<b>47.23</b>
<b>Pre Merger HHI</b>	<b>1642</b>
<b>Post Merger HHI</b>	<b>2679</b>
<b>Change in HHI</b>	<b>1037</b>

175. The market shares of the merged entity in the sports and outdoor equipment market range from 81%<sup>131</sup> to 47.2%, all of which are alarmingly high. The pre-merger HHI figures range from 3639 to 1642. The post-merger HHI figures range from 6638 to 2679. The differences in HHI figures range from 2999 to 1037. All of these figures are indicative of a highly concentrated market and raise significant competition concerns. Whichever market share figures are considered, the analysis of the impact on competition is not altered in any way.

176. We turn to consider the impact on competition.

## Barriers to Entry

177. The Commission regards the barriers to entry in the relevant market as being high. The Commission proceeds from the basis of assessing whether, in the event of a merger between the parties, entry into the relevant market could be timely, likely and sufficient to offset any potential anti-competitive effects of the merger. While evidence was led on the capital requirements of setting up a single store, the Commission viewed the barriers to entry of establishing a *national chain* as being high.

178. In their competitiveness report the merging parties submit that the barriers to entry are low. In the course of the proceedings it was suggested by the merging parties' witnesses and counsel that barriers to entry in relation to access to products, experienced buyers and capital were low and hence no competition concerns arise from the high concentration in the relevant market.

179. Mr Keet suggested that there were further barriers to entry such as unavailability of experienced buyers in the equipment market,<sup>132</sup> access to appropriate and quality products from factories in the far-east, retail sites and opportunity costs.

180. Mr Hodge on behalf of the merging parties submits that the market in which

<sup>131</sup> See Commission's table of market shares for the market for retailing of general sports equipment through national chains in paragraph 32 of these reasons.

<sup>132</sup> Mr Keet himself was under a restraint which restrained him from seeking employment with any of Massmart's competitors which included Moresport.

Massmart operated was a contestable market (entry level segment) which was constrained by hit-and-run type entry. Barriers to entry were non-existent. He echoed Mr Lamberti's concern that Pick n Pay and other competitors could easily contract or expand their offering.<sup>133</sup>

181.However the Commission's view is supported by none other than the merging parties themselves. Mr Lamberti testified as to the high barriers to entry of establishing a national chain, saying that it was expensive to build a new brand from scratch and took very long. He explains in providing the background to Massmart's growth that

*MR LAMBERTI: Counsel if I may,...it was impossible to grow Makro on its own to more than 12 or 14 stores. We therefore had to make acquisitions to get the size we needed to compete. That size was important for procurement. It was important for amortizing costs across a broader base..."*<sup>134</sup>

182.And further, in explaining the rationale for the transaction, confirms that despite having an acquisition strategy rather than an organic growth strategy it has taken Massmart 18 years to get to this point. He says—

*"We have always seen new brand building as expensive. Starting out from scratch to establish a new brand in the mind of a consumer is an expensive undertaking. And we believed it was quicker and cheaper [to embark on an acquisition strategy]. Those last two facts are borne out by the fact that today Massmart is the size of Pick n Pay in South Africa and we have done that in half the time it took to create Pick n Pay... over 18 years we've done 15 acquisitions and our organic growth has been 39%. Moresport makes a further development but not a departure from that essential strategy..."*<sup>135</sup>

183.Moresport's own growth over the last decade is testimony to how long it has taken to establish a national chain. In the Nedbank valuation of Moresport conducted in 2003 and referred to above, national store coverage and the resultant critical mass in terms of ability to negotiate with suppliers and landlords, in-house training, specialist knowledge of products are also cited as barriers to entry.

184.Thus Mr Lamberti provides an explanation as to the time and money it would take for a new entrant to establish a national footprint.

185.Mr Lamberti also provides insights into why barriers to entry are high for existing national players such as Massmart who already have a credible offering in sports equipment. In responding to the Tribunal's question as to why Massmart, who already has an offering of sports equipment, could simply

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<sup>133</sup> Mr Lamberti stated that this concern gave him sleepless nights.

<sup>134</sup> Page 18 of the transcript dated 30 January 2006.

<sup>135</sup> Page 19 of the transcript dated 30 January 2006.

not increase that offering by making investments in their current business to achieve their growth objectives, instead of acquiring Moresport, Mr Lamberti responds as follows –

“ It would require us getting new stores and so on. It’s not a strategy I would contemplate easily. It could take 5, 6 years to build up a portfolio of stores of that nature (referring to Moresport) and the risk particularly in the front end would be very high.”<sup>136</sup>

186. And further, when asked by counsel for merging parties why it would be difficult for Game or Dion to move into the middle-to-premium segment he says-

“ we would have to turn at least half of the Game and Dion store into sports and we would thereby totally undermine and have to eliminate the other product categories that we stock”. <sup>137</sup>

187. Thus Mr Lamberti confirms that it would take a long time and would be a lot more expensive for an existing player such as Massmart or even Pick n Pay to establish a national chain store such as Moresport.

188. An interesting fact that emerged in these proceedings was that **[CONFIDENTIAL]** had initially approached Moresport and had conducted a due diligence with the intention of purchasing the business. However that deal fell through and Moresport concluded a sale of shares agreement with Massmart on seemingly better terms.<sup>138</sup>

189. Mr Stone, who had previously been employed as a buyer at Moresport, testified that he was currently employed by **[CONFIDENTIAL]** as a buyer. **[CONFIDENTIAL]** had indicated its intention to enter the sports and outdoor market by establishing separate stand-alone sports store.

190. Mr Stone testified that while **[CONFIDENTIAL]** had indicated it will enter the market in 2006, it had committed itself to establishing only two stores in the country. Its focus in the stores would be more on apparel and footwear with a limited offering of entry-level equipment. While the intention was to increase these offerings in the long terms, they would focus on maybe **[CONFIDENTIAL]** brands and **[CONFIDENTIAL]** categories initially. They would also be doing a lot of **[CONFIDENTIAL]**.

191. We find that the barriers to entry are indeed high and the entry of a national effective competitor to the merged entity would take anywhere between 5 – 18

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<sup>136</sup> Page 33 of the transcript dated 30 January 2006.

<sup>137</sup> Page 34 of the transcript dated 30 January 2006.

<sup>138</sup> See Hodgson evidence.

years, depending on whether it would have an existing national footprint or not, would be much more costly than organic growth and that even though **[CONFIDENTIAL]** is likely to enter this market, the likelihood of only two stores presenting effective competition to the merged entity on a national basis is very small.

## **Countervailing Power**

192. We agree with the Commission that the merging parties are mass merchants and retail to individual consumers who have very little countervailing power.

## **Removal of an effective competitor**

193. The evidence of key witnesses and the documentary evidence in this matter have revealed that the merging parties actively and proactively compete with each other as general national retailers of sports and outdoor equipment. While they may regard to some larger independents they are closer to each other as rivals than they are to the independents. They are seen by industry participants and each other as the two largest general retailers of sports and outdoor equipment. They constantly strive to offer a better product to consumers at a lower price. Massmart in particular has continuously attempted to increase its product offering and prices due to the competitive pressure it faces from Moresport and has over time moved closer to the Moresport offering than any other national chain. They match each other's entry price points either by lowering their prices or by introducing a new product across all categories. Both of them compete on a national basis for price leadership in entry price points and use own brands to fight each other across all product categories. Moresport like Massmart uses its different chains as defensive strategies in the market. <sup>139</sup> Both utilise low prices as "barriers to entry" in that they try to discourage other players, including each other, from competing in that product market. They constantly strive to find innovative product offerings at lower prices for consumers. They have a large national footprint which with stores located in large retail nodes in close proximity to each other. They are by far the largest competitors to each other than any other participants in the market for sports and outdoor equipment. Moresport represents a vibrant and effective competitor to Massmart, as does Massmart to Moresport.

194. During the proceedings both Mr Lamberti and Mr Hodgson were at pains to point out that post-merger, Moresport will be retained as a separate business and will still compete with Massmart, a somewhat curious position to hold – on the one hand arguing that they are in separate segments of the market and do not compete pre-merger and then arguing that post-merger they will continue to compete. However, both acknowledge that the merger will enable them to

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<sup>139</sup> See Due diligence page 13 which suggests that Moresport uses Sports Shoe World as defensive competitive strategy. See Mr Keet on Game's barriers to entry strategy with low prices.

source product together and save on transport costs because they would be shipping more volumes.<sup>140</sup> Both source product at group level for distribution across their chains. As was testified by Mr Keet, even though Massmart has pursued a strategy of maintaining its chains as separate businesses, buyers would often travel together to overseas suppliers to source products and buyers between the chains were required to sign price agreements in terms of which they would agree to sell a specific product at the same price.<sup>141</sup> This was not disputed by Mr Lamberti directly. Nor is it surprising that this would occur since they are all part of the same business. It is likely then that once the Moresport chains have been acquired by Massmart, price agreements would be concluded between the chains. It is also likely that, as we have seen with Massmart after the merger with Game and Makro,<sup>142</sup> that we would see a general upward movement in prices, either in the Moresport chains or in the Massmart chains or in both since the competitive pressure they bring to bear on each other will have been removed.

195. It is also likely that the merged entity, with its large volumes, extensive footprint and price leadership at entry price points, will utilise predatory pricing and targeted strategies against a new **[CONFIDENTIAL]** entrant such as **[CONFIDENTIAL]**, thereby increasing barriers for the new entrant and reducing the benefits of a new competitor for consumers. Mr Stone on behalf of **[CONFIDENTIAL]** indicated that while the intended strategy of **[CONFIDENTIAL]** was to use **[CONFIDENTIAL]** as much as possible, they expected to meet a fairly aggressive response from both Massmart and Moresport to their entry into the market. <sup>143</sup>

196. In our view the removal of a dynamic and effective national competitor to Massmart (or Moresport) in a market such as this is likely to lead to a substantial preventing or lessening of competition. The merged entity is likely to face very little competition from other existing national chains due to the high barriers to entry in the relevant market. In the event of a price increase by the merged entity, consumers will have very few credible national general retailers to whom they could practically turn.

## Efficiencies

197. The parties have submitted that they do not rely on an efficiency defence in the event that the Tribunal has found a substantial lessening or prevention of

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<sup>140</sup> While the merging parties refer to savings arising from the merger in the area of importing goods from overseas, in IT and in the experience that each can bring to the merged entity they do not rely on any efficiencies to offset a finding of a lessening of competition. See page 72 of the transcript dated 27 March 2006.

<sup>141</sup> This was confirmed by documentary evidence requested from the merging parties.

<sup>142</sup> See in this regard Mr Keet's evidence that the Massmart prices and margins improved post merger with Makro and Dion. Page 131- 137 of the transcript dated 2 February 2006.

<sup>143</sup> See page 116 of the transcript dated 2 February 2006.

competition in the relevant market.<sup>144</sup> The only financial benefits of this transaction for the merging parties seem to be the in the order of savings on shipping and transport costs for large volumes imported from overseas and some savings in IT systems. None of these can be considered as pro-competitive efficiencies in the event of a finding of a substantial lessening of competition.<sup>145</sup> No other pro-competitive gains were identified by the merging parties.

## **Public Interest**

198. There are no public interest concerns raised by this transaction.

## **CONCLUSION**

199. We have found that the merging parties attempts to further segment the market vertically, unpersuasive. Not only is the methodology used to establish this unreliable and unusual, but it flies in the face of the evidence of rivalry between the firms, both as documented and through the oral evidence of those in the market. There is thus then a national market for the general retailing of sports and outdoor equipment, which is not capable of further segmentation. Granted Moresport stocks a wider range of goods than does Massmart, and typically it stocks goods at prices going beyond the overlapping price brands, but this does not mean that either (1) it operates in a separate antitrust segment of the market to Massmart or (2) that even for those goods it sells at supra overlap prices, these prices are independent of competitive constraint from consumer comparisons with lower priced goods similar in function.

200. As the economic literature we have referred to, and the evidence in the case confirms this, goods can only be priced at higher levels if consumers perceive a quality difference congruent in some respect with the price difference. In this market it is common cause the consumer group is homogenous in terms of its purchasing ability. If their demand for higher priced sports goods is not satisfied by a perceived difference in value a significant number, granted not all, would be willing to shift their demand to cheaper goods. What the merger does is to weaken the constraining effect of the rivalry between the firms in terms of the price ranges where they overlap, which the shop-outs show to be by no means trivial, and secondly to lessen the extent to which lower prices constrain higher prices.

201. The attempt at segmentation suffers from further error, as it requires a stagnant market in these segments in order to be correct. What the evidence

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<sup>144</sup> See page 72 of the transcript dated 27 March 2006.

<sup>145</sup> *Trident Steel (Pty) Ltd v Dorbyl Ltd* Case No: 89/LM/Oct00.

shows, particularly the testimony of Mr Keet is that the market is dynamic and evolving – it evolves not only across price bands, but brands stocked. What accounts for this dynamism is competition between firms in particular the merging parties, each responding to the behaviour of the other.

202. Having identified the relevant market we have found that the merging parties will post merger have a very large share of it. This observation remains, regardless of whether we define the market to include those few competitors that the Commission recognises as being part of that market or on the broader market definition of the merging parties in their filing. Clearly, as we have indicated in the tables, whether one includes outdoor specialists in the same market or throws in all species of independents, has some bearing on the broadening of the market. But even on the most inclusive construction of the market i.e. that most favourable to the merging parties because it most dilutes their aggregate market shares, we still have a disturbingly concentrated market.

203. What is clear from this case is that all those presently in the market, considered as rivals to the merged firm, are limited to some extent either by size, location, speciality or commitment to compete. Expressed differently, post merger the existing rivalry between the merged firms is not replaced by one that is equally compelling. The size of the merged firm in relation to its next largest competitor also tells its own tale.

204. Existing players in the market, as our analysis shows, are unlikely to become the source of a new rivalry to replace the erstwhile rivalry between the merging firms. What then of new entry? While barriers to entry to small firms may not be high, this type of entry is not likely to constrain the merged firm's market power. Entry by a firm with an equivalent range of products and footprint to the merged firm, while not wholly inconceivable is not likely in the short-term.<sup>146</sup> Thus those likely to enter timeously will not be sufficient, those who may enter sufficiently will not enter timeously. The greater the extent of entry, the less likely it will be, especially post merger, with an entrant faced with the range of store brands, buying power and locational advantage available to the merged firm. With the number of store brands available to it post merger, the merged entity could target a new entrant with one of its brands in one area without having to worry about pricing levels elsewhere.<sup>147</sup> With six established brands

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<sup>146</sup> The US merger guidelines examine entry by asking three questions; is it going to be timely, likely and sufficient. We have followed this approach in some of our decisions, see for instance *Xstrata South Africa (Proprietary) Limited and Egalite (Proprietary) Limited and International Carbon Holdings (Proprietary)* Case No: 54/LM/Jul04.

<sup>147</sup> **There is evidence already that Moresport has used such a strategy in sports**

the merged firm would be able to position one brand as a fighting brand against an entrant.

205. But most importantly of all in our consideration, is that the merger would lead to the elimination of rivalry between the two largest, strongest, most committed and experienced players in this market. It is a rivalry that to date has benefited consumers; post merger its elimination will lead to a substantial prevention and lessening of competition.

206. The merger's anti-competitive effects are not remedied either by efficiencies or any substantial public interest consideration.

207. In our view the merged firm would acquire the power to exercise market power in the relevant market unilaterally and without significant constraint from existing players or new entrants for an appreciable time.

## **Prohibition**

208. We conclude that the merger is likely to lead to a substantial prevention or lessening of competition in the national markets for the general retailing of sports and outdoor equipment. Since the merging parties have not made any offer of conditionality to remedy such finding, the transaction is accordingly prohibited.

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Y Carrim

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12 May 2006  
Date

shoes, although in Massmart's opinion ineffectively. See Page 32 of the due diligence report and see Page 333 and 336 of Moresport's additional documentation. *"Our aggressive strategy with regard to competitors in the same shopping centers must be intensified."*



Concurring: N Manoim and T Orleyn

For the merging parties: Adv. A. Subel SC and Adv J Blou, instructed by Edward Nathan (Pty) Ltd.

For the Commission: A. Kalla and W Mkwanzani (Legal Services) and M Van Hoven (Mergers and Acquisitions).