COMPETITION TRIBUNAL SOUTH AFRICA

Case NO: 04/LM/Jan09

In the matter between:

Masscash Holdings (Pty) Ltd	Acquiring Firm
And	
Finro Enterprises (Pty) Ltd t/a Finro Cash and Carry	Target Firm

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Panel	:	N Manoim (Presiding Member);
		M Mokuena (Tribunal Member); and
		A Wessels (Tribunal Member)
Heard during	:	19 August 2009 to 08 September 2009
Decided on	:	22 September 2009
Reasons Issued on	:	30 November 2009

REASONS

Approval

[1] On 22 September 2009 the Competition Tribunal ("Tribunal") approved the merger between Masscash Holdings (Pty) Ltd and Finro Enterprises (Pty) Ltd t/a Finro Cash and Carry. The reasons for this decision appear below.

Parties

[2] The primary acquiring firm is Masscash Holdings (Pty) Ltd ("Masscash"), a public company incorporated under the laws of the Republic of South Africa and a wholly owned subsidiary of Massmart Holdings Limited ("Massmart"). Massmart is a public company listed on the JSE Limited, South Africa and its shares are widely held. It

has in excess of 10 000 shareholders of which more than 7 000 are individuals.[1] As such it is not controlled by any firm. Massmart controls in excess of 70 firms. Relevant to this transaction is the fact that Massmart owns two grocery wholesalers in the Port Elizabeth area, a branch of its Makro chain and a cash and carry store trading as Weirs Cash and Carry ("Weirs").

[3] The primary target firm is Finro Enterprises (Pty) Ltd, trading as Finro Cash and Carry ("Finro"). Finro is not controlled by any firm. Its shareholders are Neil Son-Hing Family Trust (16.67%); Noeleen Mason Family Trust (16.67%); Gaynor Hung (16.67%); Glenn Mason Family Trust (7%); and Noel Son-Hing Family Trust (43%). Finro is a family owned (i.e. independent) wholesaler of grocery products located in Port Elizabeth.

Transaction

[4] The proposed acquisition constitutes a merger as defined in the Competition Act, 1998 (Act No. 89 of 1998). In terms of the proposed transaction Massmart, through Masscash, intends to acquire a 75% interest in the business of Finro as a going concern. Neil Lennith Son-Hing will post transaction hold the 25% remaining interest in Finro. Therefore, Massmart will have *de jure* control over Finro post transaction.

Rationale for the transaction

Massmart

[5] According to the acquiring firm, the Finro business will complement the Masscash wholesale grocery offering since its presence in specifically toiletries and general merchandise is significant compared to Masscash's current offering (also see paragraphs 41 and 42 below).

[6] Masscash submits that it is focussed on constructing and maintaining a supply chain to independent low-end retailers that is as competitive as the distribution centre models[2] of the large retailers, while maintaining service levels that the national grocery suppliers find difficult to maintain when dealing directly with smaller retailers.

[1] Source: Massmart group's 2008 annual report.

[2] The major grocery retail chains, such as Pick 'n Pay, have integrated distribution channels, i.e. grocery manufacturers supply products to the distribution centres of the multi-site retailers, who then organise their own integrated distribution from the centres to the individual stores. The traditional grocery wholesalers are thus excluded from this model.

Masscash describes this strategy as "*decentralised execution with centralised support*". According to Masscash, this philosophy recognizes that customers' needs differ between local regional markets, and allows for a flexible purchasing and marketing strategy that makes use of local and regional suppliers. Centralised support is provided in terms of *inter alia* accounting, systems, supplier relations and business management.

[7] Masscash furthermore submits that the proposed acquisition would facilitate the negotiation of more competitive prices from grocery suppliers at a regional level utilising regional volumes. Masscash also anticipates that the proposed deal would allow it to benefit from the scale economies of greater quantities of containerised goods shipped to Port Elizabeth (where the target firm, Finro, is based).

Finro

[8] Finro submits that certain members of the business (which is family owned) wish to exit the business; certain senior members of the family want to retire and the younger generation decided to emigrate.

Background to the hearing

Activities of the merging parties

Massmart

[9] Massmart is active throughout South Africa in both the wholesale and retail of grocery products, liquor and general merchandise. It is divided into four divisions according to target markets and business models, namely (i) Masscash; (ii) Masswarehouse; (iii) Massdiscounters; and (iv) Massbuild. The first two of the said divisions are of relevance to this transaction.

(i) *Masscash* comprises of CBW Holdings (Pty) Ltd ("CBW"), Jumbo Cash and Carry ("Jumbo") and Shield, each of which is described in brief below:

CBW

CBW comprises of 68 unbranded cash and carry stores that supply mainly grocery items to the lower-income consumer. CBW is overwhelmingly a wholesaler, but sells to a limited number of individual consumers. CBW has a presence in the Port Elizabeth area in the form of a Weirs Cash and Carry outlet.

Shield

Shield is a voluntary buying association serving independently owned grocery wholesale and independently owned grocery retail outlets aimed primarily at lower-income consumers. Shield has a number of members in the Port Elizabeth area, one of which is Finro. The members of the buying group are served directly by Shield's grocery suppliers, with Shield consolidating the account and facilitating the order via the provision of trade credit.

Jumbo

Jumbo has primarily been a wholesale distributor of cosmetics, toiletries and hair care products; more recently its product offering has been expanded to include a range of food and other groceries. However, there is no Jumbo store located in the Port Elizabeth and surrounding areas (also see paragraph 137 below).

(ii) *Masswarehouse* comprises of the Makro chain of wholesale outlets, which markets a broad range of food, liquor and general merchandise. Makro has a so-called "hybrid" format, which means that it sells its goods to resellers (i.e. retailers) as well as to end-consumers (i.e. individuals predominantly in the upper LSM[3] (6-10+) categories). The bulk of Makro's wholesale trading is in regard to food and other groceries; general merchandise is typically sold at retail level to upper-income consumers. In the Port Elizabeth and surrounding areas Makro has one store located in Port Elizabeth.

(iii) *Massdiscounters* comprises retail discount stores trading under the names *Game*[4] and *Dion Wired*[5].

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[3] LSM is an acronym for 'Living Standards Measure'. This measure profiles the market into homogenous groups based on standards of living, rather than on income. The standard of living is measured by adding the weighting ascribed to certain household products, commodities or services which would typically be available to persons in those groups.

[4] *Game* offers a wide range of general merchandise and non-perishable groceries to end-consumers predominantly in the LSM 5-10 categories.

[5] *Dion Wired* offers an upper-end range of hi-tech appliances and auto and digital products.

(iv) *Massbuild* comprises of the *Builders Warehouse* and *Builders Trade Depot* (formerly Federated Timbers) chains, which sell building supplies, hardware and related products.

Finro

[10] As stated in paragraph 3 above, Finro is a wholesaler of groceries and general merchandise with a single outlet in Port Elizabeth. It does not sell any products on a retail basis. Finro's activities are focussed on selling to independent grocery retailers, who ultimately sell their products to consumers in the LSM 2-4 categories (i.e. middle- to low-income consumers).

[11] Finro's wholesale product offering covers a full range of edible and non-edible grocery products, including perishable (frozen and refrigerated) and non-perishable food, household cleaning products, toiletries, catering supplies, tobacco products, over the counter patent medicines, as well as a range of general merchandise such as toys, electrical goods, crockery, paint, stationery, ornaments, household utensils and fishing equipment.

Summary of views of the Competition Commission, competitors and customers

Competition Commission

[12] The Competition Commission ("Commission") has recommended that the proposed acquisition be prohibited, primarily on the grounds that the merging parties are close competitors and that the loss of competition between them will enable the merged entity profitably to significantly increase prices post merger, i.e. the proposed acquisition will give rise to anticompetitive unilateral effects. The Commission furthermore found that the proposed deal raises no public interest concerns (see paragraphs 200 to 209 below).

Customers

[13] No customers raised (competition or public interest) concerns in regard to the proposed deal. The only customer on record with a view regarding the effects of the proposed deal believes that the transaction is pro-competitive since it will "*benefit the trader who is looking for a deal*".[6]

[6] Submission from Daku Spar to the Commission dated 10 February 2009.

Direct and indirect competitors

[14] During the Commission's investigations direct and indirect competitors to the merging parties raised certain concerns:

(i) Mayibuye Wholesalers (Humansdorp) cc, trading as TradeValue Cash and Carry ("TradeValue") (a competitor of the merging parties) expressed the view that Masscash is aggressively removing independent competitors countrywide and that the proposed transaction will lessen competition in the Port Elizabeth market. However, it also states that it and "*other independent wholesalers in the region will try to find other means to maintain their market position, although this would be quite difficult as they will have less negotiating power with the suppliers than before*."[7]

(ii) Unitrade Management Services (Pty) (Ltd) ("UMS"), a voluntary buying group (of which TradeValue is a member), refers in its comments regarding the proposed deal to the broader issue of "*the loss of the independently owned supermarket or wholesale family businesses in this country*" and "*purging of the independent trade*". UMS suggests legislation aimed at the protection of these family owned businesses (also see paragraphs 202 to 209 dealing with SMME's below).[8]

Witnesses

[15] The following witnesses gave evidence at the hearing on behalf of the Commission and merging parties respectively:

For the Commission:

- Mr. Fermino Gomes ("Gomes") was called as factual witness. He is the executive general manager of UMS;
- Mr. Ryan David Hawthorne ("Hawthorne"), a Commission employee, gave testimony on the purpose and methodology of the Commission's customer survey and the assistance provided to the Commission in that regard;

[7] Meeting with the Commission on 29 January 2009, and submission to the Commission dated 30 January 2009.

[8] Submission of the CEO of UMS to the Commission (undated).

- Dr. Lizelle Fletcher ("Fletcher") was called as an expert witness on statistics. She is a statistician from Statomet, a bureau of the University of Pretoria; and
- Mr. Robin Noble ("Noble") from Oxera, an economics consultancy, testified as an economics expert.

For the merging parties:

- Mr. Robin Andrew Wright ("Wright"), the chief executive officer of Masscash, was called as factual witness; and
- Mr. Simon Baker ("Baker") from RBB Economics, an economics consultancy, testified as an economics expert.

Competition analysis

Market definition

Relevant product market

[16] As indicated above, Finro is a wholesaler of groceries and general merchandise with only one store located in Port Elizabeth. Massmart is active in the wholesale of groceries through its Masscash and Masswarehouse divisions, which are represented in the Port Elizabeth and surrounding areas by one CBW store trading as Weirs, and one Makro store respectively. Accordingly there is a horizontal overlap in the activities of the merging parties in regard to the wholesaling of grocery products. As is evident from paragraph 9 above, there is also a vertical relationship between the merging parties, since Finro is a current member of the Shield buying group.

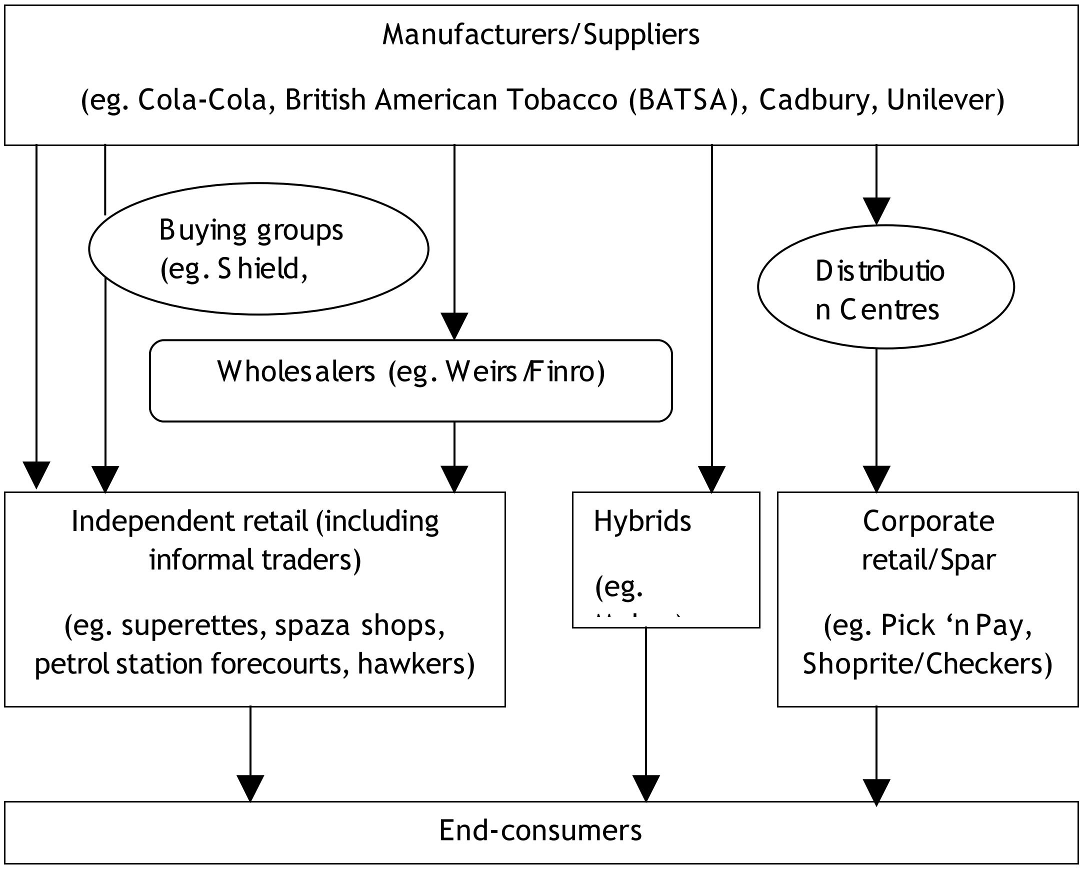
[17] In line with existing Tribunal decisions, the wholesale of grocery products is regarded as a separate relevant product market from the retail of grocery products. In Massmart Holdings and Jumbo Cash and Carry[9] the Tribunal makes this distinction and articulates it as follows: "*The parties ... effectively serve as the intermediaries between, on the one hand, a vast number of manufacturers of a wide range of products and, on the other, the consumers of those products. Certain of their customers are the final consumers of the product – this describes the retailing activities of the parties. In other instances the customers are themselves retail*

[9] Case no. 39/LM/Jul01, 'Large merger between Massmart Holdings Ltd and Jumbo Cash and Carry (Pty) Ltd', see paragraphs 9 to 13.

outlets who purchase the products for on-sale to the final consumer. The latter activity describes the wholesaling activities of the parties."

[18] Thus, wholesalers provide a link between manufacturers and retailers in the grocery supply value chain by which products are ultimately marketed to end-consumers. Insofar as the end-consumer is concerned, competition primarily takes place at the retail level. However, the grocery supply chain is more complex than a stylised manufacturer-wholesaler-retailer model, as illustrated in **Diagram 1** below.

Diagram 1 Typical supply chain of grocery products



[19] In the same decision as quoted in paragraph 17 above, the Tribunal stated that "[g]*rocery products encompass food, cigarettes, health and beauty products and non-edible consumables such as detergents and house care products*". In the context of this transaction, the broad term 'groceries' also includes general merchandise to the extent that it is stocked by the wholesalers in question.

[20] The merging parties submitted information that shows that various customers of the "full-line" wholesalers (such as Finro, Weirs, Metcash[10] and others), are willing and able to shop at the more specialised wholesalers who offer a limited range of products. Gomes in this regard confirms that "*some other customers such as spaza shop owners and superette owners can generally afford to shop around between different wholesalers within individual grocery categories, such as confectionary and they do not necessarily buy all of their products from one store*". The merging parties also submitted examples of requests sent out by a number of grocery retailers to wholesalers for quotes on specific product lines, which the retailers then proceed to purchase on a product line-specific basis.

[21] For a proper understanding of the potential competition and public interest issues in this matter, it is important to be acutely aware of the distinction between (i) the customers at wholesale level (the level at which Finro, Weirs and Makro[11] are active), and (ii) the end-consumers of grocery products at retail level (the level at which the customers of the merging parties are active). The customers at the wholesale level comprise a diverse array of outlets, including superettes, market traders, hawkers, spaza shops, independent convenience stores, organised convenience stores and petrol station forecourts. End-consumers purchase their grocery products from these outlets, or from the large formal retailers such as Pick 'n Pay, Shoprite/Checkers and Spar.

[22] It is noted that hawkers do not form a material part of the customer basis of either of the merging parties, nor do any of the merging parties' stores have a preferential location for access by such customers to their stores (also see paragraph 131 below).[12] Gomes confirmed that "*Weirs certainly hasn't got a huge spaza, particularly spaza clientele and Finro would also have limited customers, very few customers that would, although he does have spazas and hawkers, but it is not a big component of his business no*". This is an important fact since the available evidence suggests that specifically hawkers cannot shop around for their product needs due to time and other constraints and therefore usually only buy from a single wholesaler, i.e. they do so-called "one-time" shopping.

[10] Metcash submits that there are approximately [...]common lines that both it and the merging parties trade in.
[11] As stated in paragraph 9 above, Makro is a hybrid store with both wholesale and retail functions.
[12] The Commission's customer survey of 399 customers of Weirs and Finro (although the Finro customer data include only the top 1 000 customers) mirrors this: only 2 of the 399 responses obtained were from hawkers.

[23] Both the Commission and the merging parties conclude in their closing arguments that the applicable relevant product market for the assessment of the proposed acquisition is the wholesaling of grocery products, which includes a variety of food and non-food items.

[24] Based on the above, we conclude that the relevant product market is the wholesale of grocery products, including a variety of food and non-food items as well as general merchandise to the extent that it is supplied by the wholesale.

[25] As stated in paragraph 18 above, the grocery supply chain is more complex than a stylised manufacturer-wholesaler-retailer model. The complex relationships in this sector are sketched in **Diagram 1** above and relate to *inter alia*:

(i) direct supply by grocery manufacturers to independent grocery retailers (thus bypassing the wholesale);

(ii) procurement of grocery products by independent grocery wholesalers and independent grocery retailers through buying associations or groups; and

(iii) internal distribution of grocery products by the large corporate retail to its various individual stores.

[26] Each of the issues mentioned in paragraph 25 above, will be dealt with in detail below as part of the analysis of the likely competitive effects of the proposed acquisition (see paragraphs 154 to 183 below).

Relevant geographic market

[27] As already indicated above, the activities of Finro are confined to one store in Port Elizabeth; Massmart is represented in the broader Port Elizabeth area by one Makro store and one Weirs store.

[28] Finro submits that the majority of its customers are located in the Port Elizabeth area, with some customers from towns such as Despatch, Uitenhage, Humansdorp and Jeffreys Bay. It further submits that [80 - 100]% of its products are sold to customers based in Port Elizabeth within a 50 kilometre radius from the store's

location. The local nature of the relevant market is also underscored by Masscash's philosophy of a "*[...] are specifically tailored for the individual requirements of local customers and local markets*".[13]

[29] Furthermore, the Commission's customer survey results indicate that approximately 90% of the respondents travel up to 150 kilometres to their main wholesale shopping location; and that the furthest distance that 88% of the respondents travelled to do their wholesale shopping is also a maximum of 150 kilometres.

[30] Based on the above, the relevant geographic market for the purposes of assessing this acquisition is defined as Port Elizabeth and its regional surroundings, including Despatch, Humansdorp, Jeffreys Bay and Uitenhage. The merging parties and the Commission do not contest this geographic market definition.

Analysis

[31] As indicated in paragraph 16 above, the proposed acquisition has both horizontal and vertical dimensions. To assess the likely effects of the proposed transaction on competition, three potential theories of harm are relevant, namely (i) horizontal unilateral effects[14]; (ii) horizontal coordinated effects; and (iii) vertical effects. The potential vertical aspects are first dealt with below, followed by the unilateral aspects.

[32] There is no evidence that suggests that the proposed transaction is likely to result in coordinated effects, and since this is not contested by either the Commission or the merging parties, these Reasons will focus on the likely unilateral (non-coordinated) effects of the proposed deal.

Vertical analysis

[33] Although Finro has certain direct supply agreements with its suppliers of toiletries, general merchandise and confectionary, it has since 1986 been a member of the Shield buying group, purchasing a proportion of its supplies through Shield. In 2008 Finro purchased grocery products from Shield to the value of approximately R[...] million. This accounts for approximately [0 - 20]% of Finro's total stock purchases in 2008.

[13] Source: Masscash strategic documents.

[14] Unilateral effects occur when a merger enhances the ability of the merged firm to exercise market power independently.

[34] Masscash submits that Finro will post merger no longer require the services of Shield, as it will be able to source stock directly from grocery suppliers as part of the Massmart group. Post transaction suppliers would thus continue to supply Finro, albeit directly. Therefore, even if Finro would post merger purchase 100% of its stock from Shield, it would not be foreclosing other buying groups to a greater extent than in the pre-merger scenario. Clearly customer foreclosure is not likely.

[35] There are a number of alternative buying groups to Shield present in the relevant market under consideration, including significant sized groups such as UMS and OK Foods/MegaSave (also see paragraph 163 below). Shield's estimated market share of buying groups in the Port Elizabeth and surrounding area is less than 30%. Thus, the proposed deal is also highly unlikely to result in input foreclosure.

[36] Based on the above, it is concluded that it is unlikely that the proposed deal would result in either input or customer foreclosure. This conclusion is not contested by either the Commission or the merging parties.

Horizontal unilateral effects analysis

[37] The rest of these Reasons will focus on the pertinent theory of harm hypothesis, namely anticompetitive unilateral effects. The characteristics of the relevant market are first discussed below; followed by market share and concentration analysis; an analysis of the closeness of competition between the merging parties including diversion ratio analysis; the Commission's economic modelling of likely post merger price effects; certain supply-side factors that affect the competitive landscape; and efficiency considerations.

Market characteristics

[38] To a greater or lesser degree virtually all markets involve some element of product or service differentiation. If significant differentiation is present, this would affect the analysis of the likely competitive effects of a proposed merger. In the instant case the available evidence clearly indicates that the relevant market is characterised by a considerable degree of differentiation, as explained in detail below. This fact is attested to by Gomes, Wright, Noble and Baker.

[39] The differentiating factors in the relevant market relate to individual firms altering their wholesale grocery offerings in terms of price, overall product ranges, ranges of products within particular product categories, relative strength/focus of product lines, store location, as well as levels of service such as delivery (including the option to have products delivered, delivery charges and delivery times) and the terms of business (for example the supply of credit and credit terms).

[40] The available qualitative information on the relative differences between the merging parties' product and service offerings at wholesale level, or put differently the closeness of horizontal competition between the merging firms, is summarised below.

Product range and product mix

[41] CBW has insignificant offerings in regard to general merchandise and a limited range of cosmetics. Weirs currently has product strengths in commodities, liquor and non-edible groceries (for example washing powder, candles, matches, cleaning detergents and the like). Finro, on the other hand, has particular strengths in cosmetics (including pharmacy and toiletries), confectionary and general merchandise (specifically hardware) compared to Massmart's current product mix in Port Elizabeth.

[42] The product mix of Finro and Weirs is compared in **Table 1** below:

Table 1 Product mix of Finro in comparison to Weirs

Product line	Finro	Weirs (PE)
Food	[…]% (of which confectionary comprises […]%)	[…]% (of which confectionary comprises […]%)
General merchandise	[…]%	[…]%
Cosmetics	[…]%	[…]%

Customer profiles

[43] Weirs targets larger, high-spending customers, whilst Finro's customer base is generally made up of smaller lower-spending customers. [60 - 100]% of Weirs' sales are derived from high-spending customers whose purchases exceed R950 000 per annum; the comparative figure for Finro is [0 - 10]%. Conversely, lower-spending

customers whose purchases (at the relevant party) are less than R36 000 per annum account for approximately [0 - 30]% of Finro's sales, but only [0 - 10]% of the sales of Weirs.

Prices

[44] "Snapshot" pricing information[15] submitted by the merging parties regarding a basket of products sold by *inter alia* Finro, Weirs and Makro at their individual stores in the relevant market indicates notable overall price differences in the aggregate basket of grocery products sold by each store, as well as on an individual grocery item basis sold by each store.

Margins

[45] In general, grocery wholesalers operate on a low cost structure model and margins are on average below 10%, but can differ significantly per product category. For example, margins on cigarette sales, relatively speaking, tend to be very low whilst margins on meat and fruit and vegetables tend to be higher.

[46] A review of the annual accounts of Masscash and Finro for 2008 shows that their aggregate gross margins were [...]% and [...]% respectively.

Location

[47] The competitors in the relevant market operate from two main geographical areas, namely Port Elizabeth and Uitenhage. Finro and Weirs both operate in Port Elizabeth, but they are no closer to each other than they are to the other five wholesale stores active in the main hub. Makro is situated in downtown Port Elizabeth, approximately eight kilometres from the main cluster of wholesalers.

Delivery

[48] Weirs operates a more comprehensive delivery service through a fleet of trucks compared to Finro; Finro is primarily a cash and carry store with limited deliveries. This is attested to by Wright who states that Finro has "*a small fleet of pretty much 4-tonners whereas we [Weirs] have a large fleet of 8 and 14-tonners delivered to a much wider radius*".

[15] Massmart performed a "shop out" at a number of wholesalers in the relevant market during a specific week of July 2009, .i.e. it bought one unit each of some 140 products from each supplier and compared those prices.

[49] Masscash submitted figures that show that approximately [50 - 100]% of Weirs' sales in the relevant market are delivered to its customers and approximately [50 - 100]% of Makro's sales in Port Elizabeth are delivered; the corresponding figure for Finro is only [0 - 10]%.

Credit terms

[50] The merging parties submitted information that indicates that some [80 - 100]% of Weirs' sales are made on credit; in contrast: approximately [80 - 100]% of Finro's sales are cash sales.

Conclusion

[51] As is evident from the above comparison, Finro and Weirs are significantly differentiated and therefore from a qualitative information perspective, cannot be said to be close competitors.

Market shares and concentration levels

[52] The merging parties submit that the size of the wholesale grocery market in the greater Port Elizabeth area is in the region of R2 billion.[16]

[53] The Commission's and the merging parties' estimates of the market shares of the players in the relevant market are summarised in **Table 2** below. Note that these market share estimates exclude sales by buying groups.

Table 2 Market shares of firms in the wholesale grocery market in the greater Port Elizabeth area

Firm	**Commission's estimate (%)**	**Merging parties' estimate (%)**
Weirs	[10 - 20]	*[10 - 20]
Makro	[10 - 20]	*[10 - 20]
Massmart total	[20 - 30]	[20 - 30]
Finro	[10 - 20]	*[10 - 20]
Merged entity	**[30 - 40]**	**[30 - 40]**
Alliance Cash and Carry	[0 - 10]	*[10 - 20]
D F Scott	[0 - 10]	*[0 -10]

[16] As comparison: TradeValue, in its submission to the Commission dated 30 January 2009, alleges that the overall size of this market is in the region of R2.5 billion (as per its discussions with suppliers). However, there is no valid reason to believe that the size of the relevant market is larger than that indicated by the merging parties.

Metcash total[17]	[10 - 20]	[10 - 20]
TradeValue	[10 - 20]	*[10 - 20]
Springbok	14	11
United Cash and Carry	8	6
Keens Wholesalers	5	4
Afri-Save Cash and Carry	4	3
Other (including Orient)	9	8
Total	**100**	**100**
HHIs		
Pre-merger HHI	1 284[18]	1 426[19]
Post-merger HHI	1 856	2 024
Change in HHI	572	598

* Based on actual turnover figures for 2008 as provided by the relevant firms (also see footnote 17 below).

[54] Wholesale market shares calculated by the Commission based on (limited) information supplied by a number of large grocery suppliers (i.e. share of inputs purchased) are likely to be distorted and are therefore less reliable. Be that as it may, the latter methodology yields only a marginally higher post merger market share for the merged entity than that quoted in Table 2 above, namely [30 - 40]% (compared to [30 - 40]%). There is however no reason in this case to deviate from the orthodox approach to market share calculation based on the actual turnovers of the players in the relevant market as a reliable information source.

[55] It should be noted that TradeValue has one outlet in Port Elizabeth and one in Humansdorp. Metcash Trading Limited ("Metcash") has two stores in the relevant market: one located in Port Elizabeth (D F Scott) and one located in Uitenhage (Alliance Cash and Carry).

[56] From **Table 2** above it is evident that the merged entity's post merger market share in the relevant market is [30 - 40]%.

[57] It is also evident from **Table 2** above that there are at least nine players (including Orient) active in the relevant market pre-merger, operating from at least 12 outlets. Post merger there would still be three significant rivals to the merged entity with market shares in excess of 10%, namely Metcash, TradeValue and Springbok, as

[17] The Commission and the merging parties disagree on the Metcash total market share since it is not clear if the turnover figures provided by Metcash include grocery sales only. As a result, the Commission's estimated market share for Metcash is lower than that estimated by the merging parties.
[18] Assumes that the "other" category comprises of five firms: four with market shares of 2% each; and one with a market share of 1%.
[19] Assumes that the "other" category comprises of four firms with market shares of 2% each.

well as four smaller competitors. One of these smaller competitors, namely Orient, merits further mention: there is undisputed evidence that Orient will in future become a significant player in the relevant market, as testified to by Gomes (see paragraphs 140 to 142 below).

[58] The Herfindahl-Hirschman index (HHI) calculations contained in **Table 2** above show that the relevant market is highly concentrated post merger and that the increase in concentration as a result of the proposed deal is significant. These results imply that further, more detailed analysis is required to determine whether or not the proposed acquisition is likely to substantially prevent or lessen competition in the relevant market considering *inter alia* the characteristics of the relevant market in question, specifically the degree of market differentiation. One cannot simply infer a substantial lessening of competition (SLC) from a highly concentrated market or from a significant increase in market concentration in a relevant market such as that under consideration which is undisputedly notably differentiated (see paragraphs 38 to 51 above).

[59] It is well established in economic literature that in significantly differentiated markets, market shares and/or market concentration levels are less informative of the degree of rivalry between firms and therefore of the merged entity's potential post merger market power.[20] Economic theory suggests that unilateral anticompetitive effects are more likely in situations where differentiated-product firms compete closely, each representing the best alternative to the other for a substantial volume of business. Two firms might be very close competitors because they supply products and services that are seen as very similar by customers, and a merger between such firms might create a larger reduction in rivalry than would a merger between more differentiated firms.

[60] Ultimately, unilateral anticompetitive effects are based in the following logic: As the price of the goods of Firm A (for example of Finro) rises, some customers will shift from Firm A to Firm B (for example from Finro to Weirs). Prior to the merger these revenues would (due to customer diversion) be lost to Firm A. Post merger however Firm A and Firm B have the same owner and thus do not lose these revenues. As a result, the price increase is more profitable to the merged entity.

[20] See, for example, Shapiro (1996), 'Mergers with Differentiated Products', *Antitrust*, Spring issue.

[61] Therefore, in assessing the likely competitive effects of the instant transaction it is relevant to consider whether or not the parties to the merger can, based on quantitative evidence, be regarded as close competitors.

Closeness of competition: diversion ratio analysis

[62] It is standard practice in differentiated-good markets to determine diversion ratios as a quantitative measure of the closeness of competition between the individual parties to a merger, and to then combine it with information about pre-merger gross margins to ultimately through economic modelling predict the potential price-raising consequences of a merger. This was also the approach adopted by the Commission in this case.

[63] The concept underlying diversion ratio analysis is easily comprehensible: If Firm A (say Finro) raised its price, what fraction of its customers will turn to its rival, Firm B (now merger partner, say Weirs)? This analysis is then repeated for Firm B. The diversion ratios thus measure the degree to which the parties to the merger are competitors.

[64] Two types of diversion ratios can be determined:

(i) Customer diversion ratios (CDRs)

This ratio simply measures the number of customers that would switch/divert (in response to a small but significant price increase) from a focal supplier to another supplier (say from Finro to Weirs), as a proportion of the total number of customers; and

(ii) Revenue diversion ratios (RDRs)

This ratio measures the amount of sales revenue that would divert (in response to a small but significant price increase) from a focal supplier to another supplier as a proportion of the total sales revenue. Thus, the relative size of the customer's demand is taken into account.

[65] Economic theory predicts that the loss of a competitive constraint between the merging parties will alter the profit-maximising incentives faced by the firms. Post merger the merged entity will capture the sales revenue that would otherwise have

been lost to one another in response to a small but significant price increase. Thus, the key to the profitability of any post merger price increase implemented by one of the merging firms is (i) the proportion of demand that is retained; (ii) the proportion of any diverted sales revenue to the other merging party; and (iii) the additional profits made by that party as a result.

[66] It is important to highlight the fact that in the instant case the sales revenues of the merging parties are not distributed evenly across their customers, i.e. their individual customers differ significantly in terms of the quantum and value of their purchases - this is likely to be the case in many markets. Therefore, not only must the proportionate number of customers that would divert be considered but - more importantly - the proportionate value of the sales revenue that would divert. The RDRs (as opposed to the CDRs) are thus the appropriate diversion measure to use in this context since it more accurately captures the likely impact of the proposed acquisition on unilateral market power. The latter fact is testified to by Baker and conceded to by Noble. It is noted that the appropriate measure of diversion must be assessed on a case-by-case basis: CDR evidence may be considered reliable in markets characterised by insignificant differences in the merging firms' sales revenue distribution amongst their individual customers (which clearly is not the case here).

Customer survey, statistical analysis and economic modelling evidence

Background

[67] The Commission embarked on a customer survey and statistical data analysis exercise to determine the degree of closeness of competition between the merging parties. This analysis includes diversion ratio analysis and economic modelling of the likely post merger price effects.

[68] The Commission contracted external assistance for the field work, sample framework, questionnaire design and data analysis:

- A.C. Nielsen Marketing and Media (Pty) Ltd ("Nielsen") conducted the survey, which consisted of 'computer aided telephonic interviews' (CATI).
- Dr. Lizelle Fletcher and Prof. Deon Van Zyl from Statomet analysed the data, prepared the design of the sample of customers to be contacted for the survey and assisted the Commission with the drafting of the survey

questionnaire. As stated in paragraph 15 above, Fletcher was called by the Commission as an expert witness on statistics.

- Oxera, an economics consultancy, was contracted to interpret the survey data in the context of the proposed acquisition and to predict the likely post merger price effects through economic simulation.

Data and statistical analysis

Survey sample design

[69] For the purpose of the Commission's customer survey, it requested customer data from the merging parties. Finro submitted a list of a subset of Finro customers compiled from Finro's list of debtors (limited to the top 1 000 customers); Weirs provided a full list of Weirs customers. The Commission submits that, in view of the very small number of retail customers in the Shield list and the limited sample of Makro customers provided by the merging parties, it did not include the Shield and Makro customers in the sample of customers to be surveyed. Therefore, the sample was drawn from the full list of Weirs customers and the top 1 000 customer list of Finro.

[70] The Commission determined the total sample size as 399. In the case of Weirs 253 customers[21] were selected and in the case of Finro 146 customers[22]. Customers were furthermore divided into four groups according to the relative value of their purchases during 2008, namely (i) very large; (ii) large; (iii) medium; and (iv) small.[23] This allowed for the testing of correlations between customer responses to specific questions and the relative size of the customers.

[71] It is noted that sample size is an extremely important factor in understanding the issues pertaining to the statistical analysis in this case. More specifically, it is essential to note the extent to which the original sample size of 399 shrinks with subsequent splicing of the data, as explained in more detail in the paragraphs below.

[72] The Commission determined the total sample size from all available Weirs and Finro customer data such that the sample proportion of all Weirs and Finro customers with

[21] 10.3% of all Weirs customers.
[22] 14.7% of all Finro customers.
[23] 'Very large' in this context means purchases of more than R950 000 per annum; 'large' means between R370 000 and R950 000; 'medium' means between R70 000 and R370 000; and 'small' means up to R70 000 of purchases per annum.

a specific attribute is within 0.05 (i.e. 5%) of the proportion with that attribute among all Weirs and Finro customers with a probability of at least 0.95. The Commission thus set out to be at least 95% certain that the sample proportion differs by less than 0.05 of the population proportion (also see paragraph 86 below).

[73] Regarding the sizes of the customers included in the sample, the Commission states that "*due to the relatively larger effects of the large customers' actions on the merging parties' business than the effects of smaller customers' actions, we endeavoured to ensure that large customers in particular were reached during the course of the survey*". This approach ties in with the fact that the relatively larger customers, in terms of the value of their annual purchases from the merging parties, have a proportionately larger effect on the RDRs than the smaller customers. However, although this approach is correct from a RDR calculation perspective (i.e. a quantitative approach), it is not particularly sympathetic towards the potential effects of the proposed acquisition on the smaller customers, who from a public interest (i.e. SMME) perspective, may be the most vulnerable (see paragraphs 202 to 209 below that deal with SMMEs).

Diversion ratio data and analysis

[74] For an understanding of certain pertinent issues in this case, *inter alia* survey design/construction and execution and the testing of the empirical robustness of the statistical data (i.e. statistical inference), it is important to quote the relevant survey questions that were used in or influenced the Commission's calculations of the diversion ratios. These questions are quoted below:

- Question 2:
  "*Whose customer*".
  This indicates from which store list, either Finro or Weirs, the respondent was drawn. Note that this question was not asked from respondents, i.e. it was not "read out", but taken from the data provided by the merging parties.
- Question 5:
  "*Total spend of customer in 2008".*
  This is the amount spent by the respondent at either Finro or Weirs in 2008. Note that this question was also not asked/read out, but taken from the data submitted by Finro and Weirs.
- Question 11:

"*Which of the following stores do you mainly buy your groceries for your shop from*?"

- Question 30:

  "*If [insert whichever is applicable from [the answer to] question 11] was no longer available what would your next best alternative be for buying groceries for your shop?"*

  Note that this question is the central question in the Commission's determination of customer diversion and therefore it is discussed in more detail below (see paragraphs 97 to 100).

[75] From the above-mentioned survey questions and background discussion of diversion analysis, it is evident that the unknown population parameter in the present case is the CDR, or more appropriately the RDR (see paragraph 66 above). The Commission calculated both the CDRs and RDRs.

CDRs

[76] As can be inferred from the quoted survey question 30 above, the CDRs show the distribution of the proportion of customers who would divert from Finro should the store no longer be available, and from Weirs in response to it no longer being available.

[77] Regarding the CDR sample size it is important to note that the dataset used to calculate the CDRs reduced significantly compared to the total sample size: the CDRs were calculated based on 276 responses compared to the total sample size of 399 (see paragraph 71 above).[24]

[78] Since the appropriate measure of diversion in the instant case is the RDRs as opposed to the CDRs (as concluded in paragraph 66 above), the latter will not be discussed any further in these Reasons.

RDRs

[79] In the Commission's calculations, the RDR for customers who buy mainly from Finro to Weirs is the ratio of the total revenue from all customers in the population who buy mainly from Finro to the total revenue of these customers that would divert to Weirs should Finro "*no longer be available*". To estimate this ratio from the sample, the

[24] The 276 responses include 160 customers who shop mainly at Finro and 116 who shop mainly at Weirs (see question 11 quoted in paragraph 74 above). 94 of the 399 respondents did not answer question 11. A further 29 respondents indicated that they shop mainly at other stores and not at Finro and/or Weirs.

Commission used unbiased estimates of the total revenue and the revenue that would divert. The ratio of these two unbiased estimators gives the estimated RDR.[25]

[80] Again it is crucial to reflect on the size of that dataset that the Commission used for the calculation of the RDRs. For customers selected from the Finro debtors list only the revenue to Finro (i.e. the amount spent at the store in 2008) was available. The implicit assumption was made that the figures on the Finro top 1 000 customer list represent the revenue derived from their customers. Similarly, for customers selected from the Weirs list only the revenue for Weirs was available. The RDR from Finro can therefore only be determined using customers from the Finro list; and the RDR from Weirs can only be determined using customers on the Weirs list. Furthermore, to calculate the RDRs only the responses for which survey question 2 and survey question 11 matched could be used since the annual spend from survey question 5 directly related to the response to survey question 2 rather than survey question 11.

[81] As a result the dataset used for calculating the RDRs is significantly smaller than that used for calculating the CDRs - in total a sample size of 211 responses[26] (compared to 276 responses in the case of calculating the CDRs and the total sample size of 399) (see paragraphs 71 and 77 above).

[82] This splicing of the data significantly influences the level of confidence which as a result becomes lower at 90% (also see paragraph 86 below), as well as the confidence intervals which become significantly wide (see paragraphs 87 and 88 below), as reflected in **Table 3** below:

Table 3 Commission's estimated RDRs, confidence level and confidence intervals

	RDR **(Column A)**	**90% confidence interval** **(Column B)**
From Finro		
to Weirs	0.165	(0.073; 0.281)

[25] This estimate is equivalent to a weighted mean of the RDRs for each stratum where the weight for a stratum is an unbiased estimate of the total revenue from customers in that stratum who buy mainly from Finro divided by an unbiased estimator of the total revenue from customers in the whole population who buy mainly from Finro.

[26] The RDR calculations were based on those customers coming from the Finro debtors list who mainly shop at Finro (99 respondents), and those customers coming from the Weirs' customer list who mainly shop at Weirs (112 respondents).

to Makro	0.412	(0.250; 0.616)
to Weirs or Makro	0.576	(0.390; 0.812)
From Weirs		
to Finro	0.561	(0.041; 1.000)

Interpreting estimates calculated from sample data

Confidence level, intervals and limits

[83] It is well accepted in statistics literature and practice that one requires an assessment of the accuracy of statistical estimates. The field of statistics can be split into descriptive statistics[27] and statistical inference. Statistical inference deals with estimating (or "inferring") unknown population parameters from sample data - that is statistical inference aims to say something about the overall population by looking only at a particular subset of that population.

[84] There are two types of estimates in statistical inference: a 'point estimate' (the values in **Column A** of **Table 3** above, which are single values) and an 'interval estimate' (the values in **Column B** of **Table 3** above, with an upper and a lower bound). A point estimate predicts the relevant population parameter. The confidence interval estimate measures the accuracy of the point estimate. Accuracy refers here to how close the point estimate is to the true population parameter. Fletcher explains during her testimony that in calculating diversion ratios from sample data, you get a relative frequency and when you interpret it as a proportion, "*what you really saying is this proportion from this sample is representing the population*".

[85] In plain language definition: the confidence interval is the likely range of the true value of the population. Note that there is only one true value for the population and that the confidence interval defines the range where it is most likely to be. The wider the confidence interval, the less the precision. The confidence limits refer to the two extremes of the range, i.e. the values at each end of the interval.

[86] Furthermore, the interval estimate is usually constructed such that the probability of it containing the true population parameter is high, say 95%. This is known as the confidence level. The higher one sets the level of confidence, the wider will be the

[27] Descriptive statistics deals with the description of the behaviour of a particular dataset, highlighting where the data are concentrated and how variable it is.

confidence interval, i.e. the confidence level and interval are inversely related. As stated in paragraph 72 above, the Commission originally constructed the survey sample to indicate with 95% confidence that the margin of error would be 5% or less, or put differently that the precision is within 5%. However, for the RDR calculations in **Table 3** above, the Commission lowered this confidence level to 90%.

[87] Fletcher makes an important observation (as quoted below) regarding the confidence intervals of the CDRs and, furthermore, confirms under oath that exactly the same principle would apply to the confidence intervals of the RDRs:

> "*the lower limit* [of the confidence interval] *is perhaps of more interest as it indicates, with at least 90% certainty, the minimum CDR if the stores were no longer available*."

[88] Fletcher furthermore acknowledges that the confidence interval of the RDR from Weirs to Finro is from 4% to 100% (at a 90% level of confidence) (see **Column B** of **Table 3** above). This is a direct result of the data splicing that occurred (see paragraphs 77 and 80 to 82 above). In this regard Fletcher testifies that she "*cautioned against splicing, because it is diluting the sample to the extent that you now get an estimator that is really ... very unstable* ...".

[89] When considering the relative roles of point and interval estimates it is perhaps more appropriate to think in terms of a continuum: where the sample is large and the population fairly homogenous, the confidence intervals are likely to be quite narrow – so that the point estimate is fairly accurate. As the sample size dwindles and/or the population becomes more heterogeneous, the confidence interval becomes wider and one's confidence in the point estimate's ability to accurately forecast the population parameter becomes smaller. It is therefore evident that the issue of statistical robustness is case specific and must be assessed on a case-by-case basis.

[90] In this case the overall sample size was not chosen with the intent of accurately estimating RDRs and Fletcher as statistics expert conceded that the sample size for the calculation of the RDRs was problematic. Therefore, there are sufficient statistical grounds to be sceptical of the accuracy of the point estimates.

[91] Regarding the issue of sample size it is noted that it is a relative concept: statistical literature does not suggest that any absolute sample size number is sufficient. Indeed, an appropriate sample size will *inter alia* depend on the nature of the

population, i.e. whether it is homogenous or heterogeneous. Under conditions of significant population heterogeneity, a larger sample is preferable. Sample size in the case of stratified sampling is more complicated, but in all cases it is necessary to match the sample size choice with the ultimate aim of the analysis.

[92] In this matter it appears that while the sample sizes were consistent with the aim of approximating population proportions, these were not consistent with the aim of diversion ratio calculation – which required further stratification of the data. The extremely wide confidence intervals for the RDRs in the instant matter suggest that the sample size was too small.

[93] The Tribunal accepts that there is inevitably some uncertainty regarding the reliability of any survey results and that the significance thereof must be assessed on a case-by-case basis. What must however be stressed in the instant case is that that uncertainty is extreme, given the small sample size for the RDRs and the resulting extremely wide confidence intervals.

[94] Based on the above, we will consider the RDRs in the following sections of these Reasons by reference to the lower bounds of the confidence intervals (as opposed to the point estimates).

Survey design and execution and sense-checking against other facts

[95] It is common cause that the quality of quantitative survey data must be evaluated by way of a sense-check against other evidence, for example industry, economic and commercial facts. Survey data results must for example always be checked against the available information regarding the characteristics of the relevant market under consideration, which may include factors such as the elasticity of demand, if relevant. *Shapiro* emphasises that the results of quantitative analysis must be checked against the views of market participants, company documents and other (qualitative) information sources.[28] Both Noble and Baker accepted this principle as best practice.

[96] In the above context we will specifically consider the construction of and responses received to the Commission's survey questions 30 and 31, given their significance in the calculation of the RDRs.

[28] Shapiro (1996), 'Mergers with Differentiated Products', *Antitrust*, Spring issue.

Survey questions 30 and 31

[97] The first issue regarding question 30 (as quoted in paragraph 74 above) relates to the fashion in which Nielsen executed the survey. Testimony revealed that the long list of potential responses to this question was ‘read out’ to certain respondents, i.e. to the first 53 respondents in the survey, but not to the others. The Commission’s intention was that this exceptionally long list of potential responses, i.e. 25 individual firms in total, should not have been read out at all. Furthermore, Nielsen pooled the said 53 responses with the other responses without disclosing this fact to the Commission prior to the hearing.[29] Exclusion of these 53 observations from the dataset is likely to further influence the already wide confidence intervals of the RDRs. We will not deal with this issue in any detail, save to say that it raises questions regarding the integrity with which Nielsen conducted the survey pertaining to survey question 30 and subsequently reported thereon to the Commission.

[98] The second issue is that the hypothetical scenario portrayed in question 30, i.e. that the main supplier “*was no longer available*”, will not present itself in the post merger reality. Ultimately one does not seek to model the effects of either a Weirs or a Finro store closing, but instead want to measure the added incentive caused by the merger to raise price in the relevant market. However, the responses to survey question 30 do not provide any information regarding the behaviour of customers if one of the parties to the merger were to post merger increase prices by a small but significant amount (a particular finite price increase), or if current quality, range or service worsened post merger.

[99] The Commission’s survey question 30 in fact essentially equates to an infinite price increase. This means that it elicits responses not only from “marginal” consumers who would divert to an alternative supplier in the event of a small but significant price increase, but also from “infra-marginal” consumers who would not divert to an alternative supplier in the event of a small but significant price increase.

[100] Given that the sales to infra-marginal consumers would remain with the party who post merger hypothetically increases the price, it is clear that the responses of marginal consumers are what really matters in measuring the likely competitive effects of a merger. In this regard Noble concedes that “ ... *marginal diversion ratios are in fact the correct theoretical approach* ...” and “ ... *as you’ve heard from Dr Fletcher, she has concerns about the empirical robustness of the marginal diversion*

[29] This only came to light on 26 August 2006 during the hearing.

ratio values". The Commission's marginal diversion ratio calculations are discussed below.

[101] To overcome this practical dilemma, the Commission used the responses to survey question 31 to identify as best can the marginal customers. Customer survey question 31 reads as follows:

"*READ OUT*
What percentage price increase would cause you to use this alternative?
1 - 5%...
5 - 10%...
10 - 25%...
25 - 50%...
More than 50%.................................
I would not switch ....".

[102] By including only those customers who in the survey indicated that they would respond to a price increase of between 1% and 10% (and excluding all other data), the Commission calculated the RDRs based on marginal customers only.

[103] The available evidence indicates that the latter approach has the following effect on the Commission's predicted post merger price increases: the predicted price increases are significantly lower on the basis of RDRs constructed from the responses of marginal consumers only than corresponding estimates on the basis of RDRs constructed from both marginal and infra-marginal consumers. This suggests that there could be significant systematic bias if both marginal and infra-marginal responses are relied on, as opposed to relying only on the marginal responses.

[104] Furthermore, two problems are associated with this latter approach:

(i) The dataset used for the calculation of the RDRs become very small and unreliable:

Fletcher states in this regard that " ... *in splicing data from a sample that was not designed to accommodate subsets, you end up with very small subsets and the problem is that you then get estimates that are very unreliable*". Fletcher testified that even if you splice the data at a price increase of up to 10% (as opposed to up to 5%), the estimates would still not be robust, given the small sample.

In conclusion, the relevant data from responses to survey question 31, based on its lack of empirical robustness, cannot be used to calculate marginal consumer diversion – which as conceded by Noble is the appropriate measure to use in this context (see paragraph 100 above).

(ii) The manner in which survey question 31 was posed to respondents and the responses received thereto raise concerns in the context of the relevant market characteristics. This survey question when subjected to a sense-check against other facts appears to be nonsensical, as discussed in detail below.

[105] A sense-check of the magnitude of realistic post merger price increases in the relevant market under consideration reveal that price increases of above 25% - as considered plausible by the Commission in survey question 31 - are absurd in the context of the wholesale grocery market.

[106] As will be discussed in a latter section of these Reasons, the evidence shows that the large corporate retail places a ceiling on the achievable extent of price increases at wholesale level (see paragraphs 174 to 177 below). In this context Wright testified that the prices in large corporate retail outlets are approximately 10% to 12% higher than in the wholesale sector (compare this to the Commission's hypothetical 25% and higher price increases at wholesale level in survey question 31).

[107] Gomes was of the view that there are no meaningful differences, at a specific product level taking promotional prices into account, between prices in independent wholesalers and corporate retailers. This view was not supported by any evidence however and was disputed by Wright. If price differences were indeed non-existent as suggested by Gomes, then the independent wholesalers would simply not be able to maintain their position in the grocery supply chain. Be that as it may, hypothetical price increases of the magnitude suggested in the Commission's survey question 31 (i.e. exceeding 25%) are clearly far removed from any commercial reality in the relevant market.

[108] Furthermore, from a customer perspective, especially in the current economic climate and considering the nature of the products in question (i.e. grocery products), one would expect the customers of the grocery wholesalers to be price sensitive. The merging parties submitted some evidence in support of this, namely that certain

customers at wholesale level as a matter of course request prices from various wholesalers. Also, there is no evidence to suggest that customers incur any switching costs when altering their wholesale supplier, as confirmed by competitors such as Metcash.[30] Yet, 18% of respondents to the Commission's survey indicated that they would only switch to an alternative supplier in the event of a price increase of more than 25% (excluding 10% of respondents who indicated that they would not switch under any circumstances). It is also noted that a large number of these same respondents indicated in the survey that they are indeed price sensitive.

[109] In the above context it is not surprising that the merging parties produced information that indicated that the Commission's survey results regarding the sensitivity of customers to particular increases in relative prices are starkly at odds with the elasticities implied by the parties' own pre-merger margins.

Other survey anomalies: Springbok

[110] We will not deal extensively with the merging parties' allegations regarding further anomalies in the Commission's survey results, but will focus our attention on one of these identified anomalies given its relative importance from an effect perspective, namely the questionable responses of Springbok (a competitor of the merging parties and a member of the Shield buying group). Springbok is by far the largest customer included in the survey data; it accounts for approximately [0 - 20]% of all revenue in the survey sample and therefore significantly affects the RDRs.

[111] A number of Springbok's responses in the Commission's survey have been shown to be factually incorrect. It, for example, indicated that it does not purchase any supplies from buying groups, when it in fact purchases approximately R[...] million of product annually from Shield. The Springbok representative interviewed by Nielsen ought to have known this fact and, given that certain other answers were also factually incorrect, the Springbok data are highly suspect. Fletcher and Noble agreed with Baker that if there is good reason to doubt the integrity of a particular respondent's response, it should be excluded from the analysis. In this regard Fletcher states "... *the way to deal after that with your data with integrity is, if it is clear that the observation is incorrect, it should be excluded from the analysis*". Springbok was, however, not excluded from the Commission's data analysis.

[30] Metcash's submission to the Commission dated 4 March 2009.

Economic modelling of likely post merger price effects

[112] The Commission used an economic model that acts as a framework to analyse the changes to the post merger profit-maximising incentives of the merging parties. The model compares one equilibrium where the firms compete with each other, with another where they are merged and act as a single profit-maximising entity. The model used is a differentiated-goods Bertrand model of competition, which assumes that the parties are differentiated from one another and that they compete by setting prices and other competitive parameters.

[113] The Commission employed two economic models, namely (i) the standard symmetrical model and (ii) the asymmetric model. Although both of these models use estimated diversion ratios (RDRs) and pre-merger gross margins as variables they are premised on very different assumptions:

(i) Standard symmetrical model

This model assumes that the RDRs and the pre-merger margins of the individual firms to the merger are the same. Clearly this model cannot be applied to this case since both the calculated RDRs and the margins of the merging parties differ significantly. This model will therefore not be discussed any further in these Reasons.

(ii) Asymmetric model

This model allows for differences in the RDRs and the gross margins of the individual parties to the merger. Both Nobel and Baker agreed on the score that this is the appropriate model to utilise in this case. Noble also submitted that this model is preferable as it "*relies on fewer assumptions and uses more data*".

[114] As a general principle, the larger the gross margin the lower the RDR necessary to raise anticompetitive concerns. As stated in paragraph 45 above, grocery wholesalers operate on a low cost structure model and margins are on average below 10%. Therefore, relatively high RDRs will be required to show anticompetitive price effects.

[115] The other crucial issue to this type of economic modelling is the assumed shape of the demand curve. Either linear or isoelastic demand specifications can be assumed:

(i) Linear demand

Linear demand implies that the elasticity of demand rises as prices increase.

(ii) Isoelastic demand

Isoelastic demand implies that the elasticity of demand remains constant as prices increase. In other words, consumers' willingness to reduce demand in response to price increases remains unchanged as prices rise.

It is accepted that price effects for the isoelastic variant will always be higher than that of the linear variant. The theory is that price rises are less profitable the greater the elasticity of demand since greater elasticities imply more volume loss for a given price rise. One should therefore be cautious of making this particular assumption and the importance of finding *a priori* support (in documents, in the testimony of witnesses or in survey data) for this form of demand is stressed across the relevant economic literature.[31]

[116] Thus, the demand system used to predict post merger price effects should conform to the available evidence. However, no qualitative or quantitative evidence was provided in this case in support of an isoelastic demand assumption. Therefore the Tribunal does not consider isoelastic demand relevant and it will not be discussed any further in these Reasons.

[117] The third assumption on which the Commission's model is based is that firms set prices both pre- and post merger in a way that is consistent with the Lerner index. This index represents the degree of market power held by a firm. The more market power a firm has, the lower its firm-specific elasticity of demand, and the greater its ability to raise prices above marginal cost. The assumption implies that firms set profit-maximising prices based on this degree of market power. In this model, gross margins are used to infer, using the Lerner index, the elasticity of demand faced by the firm. The Commission used gross margins of [...]% and [...]% for Weirs and Finro respectively (also see paragraph 46 above). These imply elasticities of [...] and [...] respectively.

[118] Baker severely criticised the Commission's use of the single-product Lerner condition, arguing that it fails to take into account the complex real world complementarities and substitutabilities between each of the firms' products. He expressed the view that this approach is likely to provide a poor representation of how the merging firms actually set their prices, given the diverse range of different

[31] See, for example, Shapiro (1996), 'Mergers with Differentiated Products', *Antitrust*, Spring issue.

products that the parties to the merger supply. Baker also criticised the use of pre-merger margins based on actual accounts data in this case since it is likely to understate the true firm level own-price elasticities faced by the parties, i.e. own-price elasticities would be more price elastic, according to Baker.

[119] The Commission's modelled post merger price effects are summarised in **Table 4** below. These predicted effects are based on the following:

- the lower limits of the RDR confidence intervals are relied on;
- the asymmetric model is used;
- linear demand is assumed; and
- (at this stage) any potential efficiency gains are excluded from the model.

Table 4 Commission's predicted post merger price increases based on the lower limits of the confidence intervals of the RDRs, excluding any efficiency assumptions

Price rise	Asymmetric model, assuming linear demand
Predicted price rise for Weirs	0.6%
Predicted price rise for Finro	2.0%

[120] Thus, the Commission's economic simulation predicts that the merging parties would not be able to raise prices by more than 2% post merger - this is without any regard to possible repositioning by existing rival firms or efficiency gains of the merged entity (see paragraphs 148 to 153 (repositioning) and 184 to 189 (efficiencies) below). As can be seen from **Table 4** above, the predicted price rise for Weirs is an insignificant 0.6% (without regard to potential efficiencies and supply-side responses from rival firms in the relevant market).

[121] It is noted that this likely price rise evidence is not directly related to the choice of market definition (i.e. whether defined more broadly or more narrowly). Furthermore, it is noteworthy that the merging parties submitted information that shows that if market shares are used to infer diversion ratios (instead of the RDRs derived from the Commission's customer survey), the model predicts post merger price decreases in one scenario (Finro to Makro), and insignificant increases (0.6%) in the remaining two scenarios (Weirs to Finro and Finro to Weirs). These results were not contested by the Commission.

[122] Regarding the price increase threshold for a likely substantial prevention or lessening of competition, Noble suggests that a 5% predicted price increase "*represents a useful threshold when assessing whether the lessening of competition predicted by the model is significant*". According to Noble's evidence on the basis of this suggested threshold, the Commission's model predicts that the merging parties will face an incentive to engage in an *insignificant* lessening of competition.

[123] However, Gomes submits under oath that a 5% price increase in the wholesale grocery sector would be excessive. He states: "*I do not believe that anybody in the Port Elizabeth market is going to be wanting to be pushing up their prices by 5%*" and "... *in our industry 1% is significant*".

[124] Gomes is not referring here to the relevant price increase threshold that would be indicative of a significant lessening of competition (SLC) in the relevant market from a competition perspective, but what post acquisition price increase in his view is realistically achievable based on his knowledge of and experience in this market. One can assume that he allows in this 1% figure for possible supply-side reactions from rivals. He, however, later also suggests that "*the fact that they [the merging parties] might be one or two percent better off is necessarily good for their trading ability, they can choose where they want to put that into aggressive pricing or put that into the bottom line of their business*". Efficiencies are discussed in paragraphs 184 to 189 below.

[125] Both Baker and Noble agreed that two further factors are critical in the assessment of the likely post merger price effects, namely:

(i) likely changes in prices or product offerings by rivals, including entry, expansion and repositioning. Note that this cannot be accounted for within the Commission's economic simulation - they are so-called "off model" adjustments; and

(ii) synergies that lower marginal costs and reduce the predicted price increases. Efficiencies on the other hand can be incorporated into the Commission's economic model, as Oxera has in fact done (see paragraph 189 below).

[126] Therefore, the Commission's simulated maximum post merger price increase of 2% may not occur in practice due to the above-mentioned factors that could defeat the predicted price increase. These supply-side factors as well as efficiencies are analysed below.

Supply-side considerations and efficiencies

Supply-side considerations

[127] In the next section we will discuss the following ‘off model’ adjustments: potential new entry (including barriers to entry); competitive repositioning by rival firms; direct supply by grocery manufacturers to retailers; the role of buying groups; the large retail as potential constraint on the wholesale; and lastly the anticipated and modelled efficiency adjustments.

Entry

[128] The Commission identified certain potential barriers that may impede or slow entry into the relevant market, namely:

(i) capital costs, including the costs of stock, fixtures, fittings, land and buildings; and

(ii) economies of scale, i.e. a sufficient scale to negotiate discounts with suppliers.

Capital costs, including suitable land and buildings

[129] Finro identifies suitable location as one of the main barriers to entry during discussions with the Commission. Internal Masscash documents also refer to the fact that “... *new sites are proving challenging”.* However, Masscash avers that this statement relates to retail sites in South Africa in general and not specifically to wholesale sites.

[130] Contrary evidence is the fact that Orient in 2007 found suitable premises in Uitenhage. The parties also submitted estate agent details showing that a number of warehouses of a suitable size are currently available in the relevant geographic market. However, no specific evidence was provided regarding the suitability of these warehouses from a micro-location perspective.

[131] From testimony provided it can be deduced that the suitability of any particular location would largely depend on the business model of the wholesaler, including the relevant target market and pricing strategy. The evidence furthermore suggests that micro-location, for example the proximity of a wholesaler to a taxi rank, is not

paramount if hawker trade (by implication attracting relatively immobile customers) is not a priority. As stated in paragraph 22 above, the merging parties do not specifically target hawker trade and their warehouses are not located close to taxi ranks - in contrast to players such as Springbok and TradeValue who are in fact located in close proximity of a taxi rank.

[132] Furthermore, many wholesalers (including Weirs) offer a delivery service which implies that the location of its warehouse is less important; larger customers also have their own transport. However, convenient access to the warehouse could be an important requirement from a customer perspective. TradeValue, for example, states that a suitable location for a new store is essential since customers prefer buying from stores located close to a highway.[32] Gomes testified that TradeValue is slightly better located than its competitors in terms of proximity to a highway, but that there is no major difference between the locations of the merging parties' stores and that of their competitors. As stated in paragraph 131 above, pricing strategy also affects the choice of location since the more price aggressive the wholesaler, the further customers might be willing to travel to that location.

[133] According to TradeValue new entry would require a capital investment of R35 - R40 million (assumingly including the costs of owned land and buildings) and additional sunk costs (i.e. marketing costs) of R2 million. Gomes estimated the costs of entry at a scale comparable to Finro at approximately R83 million (including approximately R38 million for land and building ownership).

[134] However, land and buildings do not necessarily have to be owned and can be leased. Gomes conceded that lease arrangements can be entered into in respect of land and buildings but that "*your requirement ... from fixtures and fittings and stock*" remains.

[135] Information that surfaced during the hearing suggests that a warehouse type structure of at least 3 000 square metres[33] and stock of approximately R10 million[34] would be required to achieve credible entry with a turnover of approximately R100 million per year. This translates into a market share of approximately 5% in the

[32] Meeting of 29 January 2009 between the Commission and TradeValue.
[33] As comparison: the size of Finro's sales and warehouse areas is approximately [0 – 20 000] square metres.
[34] As comparison: Finro's stock as at 30 September 2008 is approximately R[...] million. However, the due diligence report on Finro suggests that it is [...].

relevant market.[35] Gomes testified that this would be a "*viable business*" in the relevant market. For comparative purposes: Gomes testified that the size of Orient's building (a new entrant in the relevant market) is an estimated 10 000 square metres (see paragraphs 140 to 142 below).

Economies of scale

[136] Gomes confirmed in his testimony that volume plays a key role in the wholesale grocery sector, which influences trading terms with suppliers, rebates and advertising. TradeValue in its submissions also underscores the importance of scale economy advantages.[36] This is furthermore reiterated by Massmart's rationale for the proposed transaction (see paragraph 7 above) and the merging parties' alleged efficiency claims (see paragraph 185 below).

[137] Barriers to entry at a scale and competitiveness level comparable to Finro are put into perspective by Wright's testimony. Wright when asked why Masscash does not simply open a Jumbo[37] store in Port Elizabeth responded as follows, drawing from Masscash's experience to open a new store in Durban:

> "...*the reality is it's not as simple as it seems, because Finro indeed is a very profitable business. If you opened a Jumbo store, you could well be in the situation that we're faced in Durban where we were actually trading at a loss for a number of years before ... it's currently broken even, but we traded for several years at a loss. So business is not as simple as it sounds, you don't just open up tomorrow and guarantee, and particularly in a market where Finro are already well established and extremely aggressive competitors,* ... ".

[138] Wright also testified that it would take three to four years for a new entrant in the relevant market to develop to the size of Finro.

[139] Gomes expressed a similar sentiment to Wright regarding the fact that sufficient time is required to become established as a competitor: " ... *with the opening of a brand-new store the most important thing for us would be to establish a market presence ... our profit and loss and cash flow projections for the next 6 months with*

[35] A total market size of R2 billion is assumed.
[36] Letter to the Commission dated 30 January 2009.
[37] Jumbo, elsewhere in the country, carries similar product lines to Finro.

that business would be at best to break even because as a new entrant we have to pay school fees in that town."

Actual and potential entry

[140] In contrast to the Commission's view, the merging parties alleged recent successful entry into the relevant market by players such as TradeValue and Orient. However, the evidence showed that TradeValue is not a recent entrant into the relevant market, and in fact has been active in that market for more than 10 years. Gomes states: "*Trade Value ... as it stands today in that business certainly is not a new entrant. Many, many decades of experience and at least 12 years of operating doesn't qualify him to be termed a recent entrant*."

[141] Orient, on the other hand, is indeed a recent entrant in the relevant market; it entered in 2007 and is located in Uitenhage. Gomes testified that Orient is affiliated with Shoprite Holding's MegaSave division (a buying group division of Shoprite) and that MegaSave facilitated its entry. Wright estimated Orient's current turnover at R135 million per annum, but the Commission obtained a turnover figure from Orient for 2008 which is significantly lower than that suggested by Wright. The Commission did not obtain Orient's actual turnover for the period January 2009 to September 2009.

[142] However, although Orient's actual turnover to date is disputed, the available evidence is clear on the fact that it will become a significant player in the relevant market in future. In regard to Orient Gomes testified that " ... *they are very aggressive in pricing*"; "*I don't think they have taken much market share from many people, but if they continue with their current aggressive marketing campaign, I certainly believe that within the short-term they will be a volume player in the industry, yes, in that particular area*, ..."; " ... *it certainly is going to become a player in that industry going forward*"; and "... *I see them as a future threat*".

[143] As was the case with Orient, buying groups generally speaking may facilitate new entry in the wholesale grocery market. Gomes summarised the role of buying groups as follows: "*our [UMS'] primary goal is to help independent retailers and help independent wholesalers compete effectively in the markets that they are serving*"; and "... *the values that buying groups do provide is the access to stock, it is the access to credit and it is the access to marketing and advertising*. ... *We do facilitate*

[the] opening of stores. That is what buying groups specialise in." He further testified that UMS assists new businesses with issues such as store layout, the building, refrigeration, till points and point of sale.

[144] Further testimony, however, revealed that buying groups with an existing membership in the Port Elizabeth geographical area are unlikely to facilitate the opening of a new store in the same area in direct competition with its current member(s). Wright testified that it would be "*pretty silly*" and "*pretty disloyal*" to open a new trading outlet in the same area where one of Shield's customers operate as that would result in the loss of those members as Shield customers. Gomes expressed the same sentiment: "*We [UMS] wouldn't sign on anybody who competes with TradeValue* ..." and "*If I [UMS] have a member in Queenstown that I'm trading with, there is very little chance that I would entertain another member trying to join my organisation*".

[145] The current membership of buying groups in the relevant market is summarised in **Table 6** below (see paragraph 163 below). MegaSave, UMS and Independent Buying Consortium ("IBC") are represented in the relevant market. However, Gomes pointed out that Independent Cash and Carries ("ICC") does not have a trading partner in Port Elizabeth and also testified that it "*is a really massive business representing very, very big players*". Wright testified that BEC and Elite are also not represented in the Port Elizabeth area. Therefore, there appears to be some scope for facilitated entry into the relevant market.

[146] Testimony furthermore revealed that entry into the relevant market by family owned, independent wholesalers such as Africa Cash and Carry (Gauteng), Kit Kat Group Cash and Carry (one store in Pretoria), Devland Cash and Carry (one store in Gauteng North), and Trade Port (one store in KwaZulu Natal) is highly unlikely - even in response to a post merger price incentive. This is due to their family orientated business model, which allegedly is also the cornerstone of their success. In this regard Gomes testified that "[m]*ost of them [family owned wholesalers] are managed by one family and the family formula has traditionally worked well for people like Kit Kat and Devland. So that particular formula you can't replicate totally in Port Elizabeth, ... a lot of independents in Southern Africa have become very successful because it is one family committed to driving that particular one business*." It is also noted that these wholesalers have all been in existence for many years and none of them have reacted to opportunities in and thus expanded into other geographic

areas. In this context Gomes states: "*All these businesses that we are talking about are between 15 and 25 years old and have been in the same premises for the last 15 to 25 years and their formula is because it is family owned, family driven* ...".

Conclusion

[147] In conclusion, barriers to *de novo* entry on balance appear to be high; it will take significant time and expense. However, small scale entry possibly aided by a buying group does not appear entirely unlikely, although this would not provide effective competition to the merged entity in the short or medium term, as testified by Right. Potential entry would thus, viewed in isolation from other evidence, not alleviate potential unilateral anticompetitive concerns arising from the proposed deal.

Competitive repositioning by rival firms

[148] The other supply-side response that must be considered in the context of this merger is the ability of existing players in the relevant market to reposition their offerings to take advantage of the opportunities presented by a hypothetical post merger price increase. In theory, precisely such a scenario of higher prices may incentivise a rival firm to reposition itself, and this threat could deter the merged entity's price increase in the first place.

[149] Repositioning in this relevant market can take two forms: (i) expansion into grocery product categories in which a particular firm was not previously present, and (ii) up-weighting of presence in a grocery product category in which a particular firm is already active.

[150] The likelihood of repositioning would depend *inter alia* on the sunk costs associated with repositioning, as well as the length of time that any such supply response would take. The higher the sunk costs associated herewith and the longer it takes, the less likely they are to deter or defeat a hypothetical post merger price increase by the merged entity.

[151] The available evidence indicates that repositioning by incumbent firms in the relevant market by expanding their product categories is an actual pre-merger phenomenon. Qualitative evidence was provided of incumbent players who were specialising in a particular product range and who have successfully expanded their product ranges into other lines. Notably, Springbok has undisputedly expanded from

being a wholesaler of fresh and frozen meat and chicken into a broader range of commodities, in particular maize and flour; and Keens Cash and Carry, traditionally only a tobacco supplier (i.e. a commodity product supplier), has branched out into a broader food and confectionary offering. As is clear from **Table 2** above, Springbok has a significant market share in the relevant market of more than 10% (see paragraph 53 above).

[152] TradeValue is another example of successful expansion in the relevant market. Its initial entry was facilitated by the Shield buying group and its expansion was aided by UMS. Gomes testified that TradeValue (and Orient for that matter) "*in the last year and a half really made tremendous strides*". Furthermore, notwithstanding Finro's strength in cosmetics, TradeValue has managed to introduce cosmetics as part of its product offering in 2008. TradeValue submits regarding this expansion into cosmetics that "*it has taken us around [...] months to become profitable*".[38] According to Gomes, TradeValue has also identified opportunities in confectionary and chicken, which it had traditionally neglected. Gomes furthermore testified that buying groups assist independent wholesalers and retailers with assessing whether or not it would be viable to expand into new product ranges, for example the addition of a butchery or bakery to the business.

[153] As stated above, economic theory predicts that any post merger price increase may incentivise a rival to reposition its offering so that it is more closely aligned to the product offering of the merged entity and in that way attract volume away from it. This could ultimately affect the ability of the merged entity to sustain a likely price increase, i.e. it could make the price rise unprofitable. There is no substantive evidence in the instant matter that suggests that the barriers to existing rivals' reactions (such as the expansion of product ranges) in the context of a price incentive are prohibitive. To the contrary, the available qualitative evidence indicates that rival firms have managed to successfully reposition their product offerings pre-merger and the proposed deal is unlikely to alter that.

Direct supply by manufacturers to retailers

[154] As can be seen from the typical grocery supply chain illustrated in **Diagram 1** above, certain producers of grocery products bypass the wholesale channel and supply products directly to independent retailers. Examples of such suppliers are

[38] Correspondence with the Commission dated 13 August 2009.

Coca Cola, British American Tobacco (BATSA), ABI, Sasko, Tiger Brands, Simba, Willards and Alpha-Pharma. This is the analogue of the backward integration possibility considered under an assessment of buyer power.

[155] This direct supply is significant: Masscash estimates that direct supply by grocery manufacturers into the relevant market amounts to approximately R600 million per annum (however, this figure includes some sales to formal retail chains). TradeValue puts the importance of a number of major suppliers further in context: "*although there are a huge number of suppliers in SA, only about 10% of them provide approximately 80% of the wholesale stores' stock requirements*".[39]

[156] CBW board meeting minutes [40] confirm this trend of direct supply and reveal that "*big banner members are [...] the big buying organizations. ... businesses like Kit Kat are able to get the same deal as ICC, etc and are given credit by suppliers (Suppliers diversifying risk)".* In the same vein the Masscash board minutes[41] confirm that the "*[...] direct distribution model appears to be having an impact on our [...] category*".

[157] Gomes testified that membership of a buying group does not preclude a member from buying directly from manufacturers. He submits that there are many suppliers whose ranges and market strategy lend itself to not supplying through buying groups and dealing directly with a trader. This way they extract costs from the system and achieve the lowest possible selling prices, according to Gomes.

[158] Furthermore, the Commission's customer survey evidence shows that respondents (retailers) use the direct supply channel to a significant extent, albeit more for selected product categories (as detailed in paragraph 160 below):

- 64% of the respondents indicated that they make use of the direct supply channel;
- 55% indicated that they "*one or more times per week*" buy groceries for their shop directly from a manufacturer;
- 27% indicated that they spend more than 25% of their total annual demand directly with manufacturers; and

[39] Meeting of 29 January 2009 between the Commission and TradeValue.
[40] Meeting of 29 January 2007.
[41] Meeting of 28 July 2008.

- 7% of respondents indicated that they spend more than 50% of their total annual demand directly with manufacturers.

[159] From a customer size perspective, the available qualitative information suggests that, because of efficiency and thus cost considerations, direct supply is normally limited to larger quantities delivered to larger buyers, i.e. direct supply is not a real option for the small (informal) retailer. However, contrary to this qualitative evidence, the Commission's survey evidence indicates that a significant number of smaller retailers do actually make use of the direct supply channel, although to a lesser extent than 'medium', 'large' or 'very large' customers: 52% of the 'small' category of respondents make use of this channel, compared to 76% of the 'medium', 77% of the 'large' and 63% of the 'very large' category. In this context Gomes confirmed that a limited number of manufacturers, for example Simba and Coca-Cola, have very good distribution systems and "*wouldn't be concerned about delivering 30 deliveries at 20 cases each to little superettes*".

[160] It is important to reflect on the product categories that retailers mostly source directly from manufacturers. The Commission's survey results regarding the product lines that retailers mostly buy directly from manufacturers are summarised in **Table 5** below.

Table 5 Product categories bought directly from manufacturers

Product category	% of 257 respondents[42]
Non-alcoholic beverages, such as Coke	90
Perishable food products, such as dairy products	52
Tobacco	38
Confectionary, such as chocolates and sweets	21
Commodity food products such as dried produce, frozen chicken, maize, malt, oil, rice, sugar, wheat	21
Non-edible groceries, such as cleaning materials	12
Toiletries	14
Edible groceries, such as canned food	11

[161] As is evident from **Table 5** above, direct supply is clearly more prevalent in some product categories than in others, although it does extend to all the major product categories.

[162] Based on the above qualitative and quantitative evidence, it is reasonable to expect that the merging parties would post merger be cognisant of the seemingly real threat of direct supply when setting prices regarding the competing lines being supplied directly by manufacturers.

Buying groups as link between suppliers and independent wholesalers/retailers

[163] As already indicated above, voluntary buying groups, such as Shield, UMS, IBC and MegaSave, are active in the area of grocery procurement from suppliers on behalf of their members. The membership of firms in the relevant market of buying groups is summarised in **Table 6** below:

[42] 257 out of 399 respondents (64%) indicated that they make use of the direct supply channel.

Table 6 Buying group membership in the relevant market

Firm	Affiliated buying group
Finro	Shield
TradeValue	UMS
Springbok Wholesalers	Shield
Afrisave	IBC
Desais (Uitenhage)	Shield
Orient	MegaSave (Shoprite)

[164] Gomes confirmed that these buying groups serve both independent retailers and independent wholesalers. TradeValue[43] also confirmed the presence and function of buying groups in the grocery supply chain: "*[t]he independent wholesalers have formed buying groups which enable them to gain some countervailing power in order to negotiate better trading terms with suppliers*." The formation of new buying groups is also expressly articulated in Masscash's strategic documents[44], which state the following regarding Shield: "*the voluntary buying group model [...] proliferation of new entrants eg. UMS + ICC resulting in [...]* ....". It, however, also appears from Masscash's strategic documents that switching of wholesalers/retailers between buying groups may be difficult in practice. The Masscash board minutes[45] suggest that Shield members would be required to use "*the [...] system with deal management integration, which would add significant buying management functionality to the member whilst [...]*".

[165] The rationale for buying groups is that it allows independent wholesalers and retailers to aggregate their demand in order to secure better terms than they would be able to achieve each acting individually. Physical distribution to the buying group member is undertaken by the supplier. Buying groups, however, also provide their members with other value added services in addition to grocery procurement, as testified by Gomes, and already elaborated on in paragraph 143 above. Gomes highlighted the fact that the role of buying groups has significantly changed from 20 years ago when they were mostly concerned with prices, products and rebates, to more advanced value-added services, for example labour management, advertising and marketing, cost analysis and business development. Gomes further testified that the vast majority of buying groups pay fixed rebates to their members, although some of the rebate payouts are subject to the achievement of a particular target. The buying groups generally take a margin of 1% to 3% for their services.

[43] Meeting of 29 January 2009 between TradeValue and the Commission.
[44] Source: Masscash Strategy Document dated May 2008.
[45] Meeting of 30 July 2007.

[166] Gomes and Noble testified that buying groups typically have minimum thresholds, such as annual turnover, that members must meet in order to make use of their services. UMS, for example, focuses on larger customers with annual purchases of R[...] million and above. However, testimony indicated that other buying groups like Shield and BEC are more willing to trade with smaller retailers. Shield, for example, has numerous customers with purchases of less than R500 000 per annum.

[167] The Commission's customer survey evidence confirms that retailers to some extent use buying groups. The survey shows the following results:

- approximately 19% (of 399) respondents indicated that they use a buying group "*one or more than once a month*" (14% use this channel "*once or more than once a week*"; and 5% use it "*once or more than one a month but not every week*");
- 15% of respondents buy more than 10% of their total annual demand through a buying group; and
- 78% of respondents, however, never make use of a buying group.

[168] From a customer size perspective Gomes testified that from a buying group level small customers are expensive to maintain and that the selection criteria of a new member start at the turnover of that new member, and extend to the quality, credibility and risk profile of the member. Gomes also stated that from a UMS perspective the larger customers specifically are catered for. He further pointed out that buying group membership is still largely governed (and thus restricted) by the rules of the manufacturer regarding supply logistics: as indicated above the manufacturer still physically delivers the products to the member.

[169] The Commission's survey evidence, however, shows that only 12% of the 'very large' category of respondents make use of buying groups, compared to 19% of the 'small' category, 27% of the 'medium' category and 28% of the 'large' category. In regard to these results Baker states: "*buying groups do appear to be a significant source of groceries for what I concede is a small number of customers, mainly in the medium and large categories*."

[170] In summary, the quantitative survey evidence shows that buying groups are an option to some 19% of the interviewed retailers who use buying groups "*once or*

more than once per month". It furthermore suggests that it is a more meaningful source of supply for the 'medium' and 'large' customers. The low percentage of 'very large' customers that use buying groups (according to the Commission's survey results) contradicts the qualitative evidence that many buying groups specifically target larger wholesale and retail outlets. If the relative size of the customer is a key factor for making use of a buying group, and that certainly is Gomes' contention, then logic dictates that there is no reason why 'very large' customers would make less use of buying groups than 'medium' and 'large' customers (as per the survey evidence). Thus, a higher proportion of revenues are likely at stake than that suggested by the survey evidence.

Large retail as potential constraint

[171] There is general consensus regarding a growing penetration of the large corporate retail grocery chains in South Africa. As stated in paragraph 6 above, these chains have created their own distribution centre (warehousing) systems, and the efficiencies and scale thereof impact the margins and ultimately the prices charged by them.

[172] Although these large supermarket chains have also started targeting the lower LSM consumers, it appears from internal Masscash documents that they have enjoyed limited success in this regard. Masscash states: [w]*hilst the major retail chains are targeting the lower LSM sector they have not been able to develop a successful small store (R10 – 40m pa) format. Usave, Score, Friendly, Ok formats are not successful and the sector continues to be dominated by the Independents and informal traders who typically have a lower cost base and an ownership mindset*".[46]

[173] In the context of this acquisition two issues must be considered regarding the role of the large corporate retail and its potential impact on the pricing conduct of the wholesale: (i) direct demand-side substitution, and (ii) indirect demand-side substitution.

Direct demand-side substitution

[174] Direct-demand side substitution would occur if the independent smaller retailers could purchase products directly from the large retail stores such as Pick 'n Pay,

[46] Source: Masscash Strategy Document dated May 2008.

Shoprite and Spar, specifically when price promotions are offered on certain product lines.

[175] The merging parties submit that "*to a limited extent, smaller, independent traders will occasionally source supply from large retailers during particular promotions*". However, Gomes contradicted this notion. He testified that retailers typically ban traders from their stores or limit the amount of goods that the traders are allowed to purchase. Following Gomes' testimony, Wright then conceded that in regard to independent retailers buying so-called "loss leaders" such as Coke from the formal retail, the formal retailers "... *would limit quantities or they would make it difficult*". Wright also testified that "... *there are not many medium and large size independent retailers shopping at retail formats. They just aren't geared up to do it*".

[176] Wright furthermore testified that a "save" differential between the prices of the wholesale and the large formal retail is between 10% - 12%. He stated: "*Wholesale pricing must be cheaper than retail by virtue of the fact that their model is a 20% gross profit mark up and ours [the wholesale] is 10%.*" Wright estimated that the major retail chains on average charge a 10% premium above the corresponding Weirs price (also see paragraph 106 above).

[177] In conclusion, the available evidence suggests that the purchase of goods by independent retailers from the large formal retail chains, i.e. direct demand-side substitution, is not a viable alternative for the merging parties' customers. On balance it appears that the large retail chains at best place a ceiling (i.e. maximum limit) on potential price increases by the wholesale since the large retail is approximately 10% - 12% higher priced.

Indirect demand-side substitution

[178] In this acquisition context indirect demand-side substitution refers to the potential constraint placed on the focal product market by the downstream consumers, i.e. end-consumers. From an end-consumer perspective, the small informal and large formal retail theoretically could be viable alternatives, depending on a number of factors, *inter alia* the income of the individual consumer, the proximity of the informal and formal retailers (i.e. the convenience of the various locations from a customer perspective) and the mobility of the consumer, for example the mode of transport used. Depending on these factors, hypothetically speaking, if the merging parties were to increase prices post merger, and these prices are in full or in part passed on

to end-consumers, the latter consumers may direct their demand away from the retailer supplied by the merging parties to alternative distribution channels (such as the large formal retail chains).

[179] The available information submitted by the merging parties shows that the large retail chains have expanded extensively in the relevant market, such that there is currently a high density of major retail grocery chains (for example Pick 'n Pay, Shoprite and Spar) in the Port Elizabeth region. They submitted a map indicating the locations of approximately 54 corporate retail outlets in the Port Elizabeth area, covering effectively all the high density and shopping areas.

[180] The ultimate effect of any indirect demand-side substitution on prices would *inter alia* depend on three factors:

(i) the extent to which the smaller independent retailers would absorb any price increases by the wholesale (which will be largely influenced by the magnitude of the price increase in the first place, bearing in mind that the margins under which the independent retailers operate is relatively low[47]);

(ii) the effect that any pass-through of price increases at wholesale level would have on the prices of the independent retailers, bearing in mind that wholesale prices constitute a very significant portion of the final selling price of the retailers; and

(iii) the effect that higher retail prices would have on the sales of the independent retailers to end-consumers (this would *inter alia* depend on the ability of consumers to switch their purchases to other retailers not supplied by the merged entity).

[181] Although it could be argued that the merged entity's own demand is determined by downstream (i.e. end-consumer) demand, one should be mindful of the fact that Massmart is already active in the grocery retail market through its hybrid Makro store, and therefore to some extent in competition with its customers for the business of end-consumers. Massmart may also expand further into the Port Elizabeth retail market in future. The merged entity may thus post merger not be entirely concerned with the downstream demand for its customer's products.

[47] Masscash estimates its customers' gross margins to be in the region of 25%.

[182] Furthermore, for many of the end-customers that traditionally purchase from the informal retail, the formal retail does not provide a real alternative due to factors such as the convenience of location, extended hours of trade that the small informal retailers provide and the limited mobility of many end-consumers, specifically in the more rural areas.

[183] In conclusion, there is no compelling evidence that the formal retail would pose a constraint on the merged entity's post merger wholesale pricing strategy, apart from the fact that it does place an ultimate ceiling (i.e. maximum limit) on potential price increases by the wholesale since the formal retail is approximately 10% -12% higher priced (according to Wright's testimony).

Efficiencies

[184] Merger-specific efficiencies (in particular reductions in post merger marginal costs) could in theory potentially offset or at least reduce post merger price increases. Reductions in incremental costs can offset the incentive to raise prices, since the merged entity will have an incentive to set a lower price, the lower its incremental costs. Two issues are crucial to this analysis: (i) whether or not the savings are merger-specific; and (ii) if the savings are likely to be passed on to customers; as a general rule only savings that lower the merged entity's incremental (i.e. marginal) costs are likely to be passed on to customers (also see paragraph 187 below).

[185] Masscash submits that immediate efficiency benefits could be realised from the proposed deal by extending the typically higher rebates secured by Masscash to Finro's purchase volumes. Competitors of the merging parties such as Metcash and TradeValue concur with this expected benefit. Metcash is of the view that post merger Masscash's "*purchasing power from suppliers may increase and they will be in [a] better position to negotiate prices*".[48] TradeValue submits that post merger "*Finro would gain the advantage of bulk pricing and more favourable rebate schemes available to it through Masscash*".[49] Gomes also expects cost savings from the proposed deal: he states "... *the costs of good would be lower. Would they realise a higher rebate margin? Yes, they would*". Thus, the presence of post merger purchase cost benefits cited by merging parties appears to be a realistic expectation.

[48] Metcash's submission to the Commission dated 04 March 2009.
[49] TradeValue's submission to the Commission dated 30 January 2009.

[186] As a quantification of these efficiencies the merging parties submit that "*[a]t best, the merged entity is hopeful that Finro's [...]% gross profit may be improved to [...]% if all efficiencies are realised*". This implies that the parties expect savings of 1% to 2% of sales. Wright confirmed this in his testimony: "*We believe that there will be some synergies, but our estimate is that that is going to be between 1% and 1.5%.*"

[187] These purchase costs savings equate to reductions in the merged entity's marginal costs and are merger-specific. Noble submits that since the merging parties' expected saving is expressed as being an improvement in gross profit, it is reasonable to interpret this as being a marginal cost saving. It is generally accepted that marginal costs savings are more likely than fixed costs savings[50] to be passed on to customers in the form of lower prices.

[188] However, based on concessions made by the merging parties one can in this case accept that not all efficiencies will be passed on to customers in the form of lower prices. The merging parties submit that "*[a] significant proportion of that [efficiencies] is likely to be ploughed back into the business (improving systems, advertising and refurbishment)*".

[189] The Commission (Oxera) incorporated efficiencies into its economic modelling by subtracting an estimate of the resulting cost saving, expressed in proportionate terms, from its estimated price increase. This is calculated for only the standard symmetrical model (which, as concluded above, is not applicable in this case) and regrettably not for the asymmetrical model since the calculations in the latter case are significantly more complex. The Commission, however, submits that "*the results will not produce a significantly different result as the optimisation incentives are the same within both model frameworks*". These results indicate that a 1% efficiency assumption reduces the predicted price increases by 0.5% for both Weirs and Finro (assuming linear demand). This means that the Commission's predicted price rise for Weirs reduces to a totally insignificant 0.1% and for Finro this is 1.5%, without considering the necessary 'off model' corrections for rival responses (also see paragraphs 120 and 125 above).

Conclusion on unilateral competition analysis

[50] Economic theory predicts that reductions in fixed costs, i.e. cost that do not depend on the volume of the output, will not be translated directly and immediately into reductions in price.

[190] Finro is undoubtedly an effective competitor to Weirs and Makro in the Port Elizabeth grocery wholesale market. This factor and the fact that the market is highly concentrated post merger must be assessed in the context of the other qualitative and quantitative evidence, considering *inter alia* the fact that the relevant market in question is characterised by substantial differentiation. Post merger there remain several significant competitors in the relevant market, including three large wholesalers effectively competing with the merged entity each with market shares exceeding 10%, namely Metcash, Trade Value and Springbok, as well as four smaller competitors. It is also important to note that at least one of these competitors, namely TradeValue, has very significantly increased its market share in the past two years and has also successfully repositioned itself in terms of its product offering. Furthermore, there is undisputed evidence that Orient will become a significant player in the relevant market in the near future.

[191] It is accepted that market shares and concentration levels do not effectively proxy for the likely extent of sales diversion between parties to a merger in differentiated product markets, i.e. they are not a reliable indicator of unilateral market power in differentiated-goods markets. Acknowledging this, the Commission embarked on a customer survey to determine RDRs and used these ratios together with the gross margins of the parties' wholesale outlets to through economic simulation predict the likely post merger price effects of the proposed deal. This simulation, based on the asymmetric model and assuming linear demand, shows a weak ability of the merged entity to increase prices, even when efficiency assumptions are initially ignored. For Weirs the Commission's anticipated price increase is an insignificant 0.6% and for Finro it is a modest 2%. If post merger efficiencies of 1% are assumed and incorporated in the simulation, the predicted price increases are reduced by approximately 0.5%: the Commission's predicted price rise for Weirs reduces to a totally insignificant 0.1% and for Finro it is 1.5% (without considering essential 'off model' corrections for rival responses).

[192] As stated above, the Commission's economic simulation does not allow for 'off model' external supply-side factors, i.e. various potential reactions from incumbent firms in response to a price incentive, for example competitive repositioning by expansion of product ranges or enhancing of presence in a specific product category. Even the Commission's own economics expert, Noble, had to concede that there is mixed evidence on these supply-side factors, which could potentially mitigate a hypothetical substantial lessening of competition.

[193] First and foremost it is stressed that the identified potential mitigating factors must in this case be viewed in the context of weak indications of the merged firms' post merger incentive to increase prices. Second, two further points must be stressed in this case in regard to the potential impact of any mitigating factors and their assessment in relation to a hypothetical substantial lessening of competition, i.e. these factors:

(i) need not be viable alternatives for *all* customers or viable strategies for *all* competitors of the merging parties to effectively constrain the incentive to increase price; and

(ii) need not individually or in isolation constrain the post merger ability of the merging parties to increase prices, rather their aggregate impact must be considered.

[194] The available qualitative and quantitative evidence confirms that a number of constraints are relevant that could collectively mitigate the merged entity's muted post merger ability (as per the Commission's economic simulation) to raise prices. These are:

(i) the ability of incumbent firms to expand and/or reposition their competitive offering in response to a price incentive, for example rival firms may reposition or expand their product ranges. There is clear and undisputed evidence that this is an actual pre-merger phenomenon in the relevant market. Notably, Springbok, Keens Cash and Carry and TradeValue have all expanded their product offerings. There is no evidence that suggests that the proposed acquisition would alter this ability of rivals to reposition themselves;

(ii) the undisputed evidence of the expected future growth of Orient that is cited to become a significant player in the relevant market in the near future (according to the testimony of Gomes);

(iii) the significant direct supply of certain product lines by grocery manufacturers to grocery retailers, as confirmed *inter alia* by the Commission's customer survey evidence; and

(iv) retailers' procurement of supplies through buying groups which is a distinct alternative for the larger retailers, as per the qualitative evidence.

[195] In the final analysis it is concluded that, based on the Commission's simulated weak ability of the merged entity to unilaterally increase prices post merger, as well as the considerable collective threat of a number of mitigating factors there is no basis to conclude that consumers would as a result of this acquisition be worst off, either from a pricing or service delivery perspective. Based on the available evidence it is thus concluded that the proposed acquisition is unlikely to result in a substantial prevention or lessening of competition in the relevant market, either from a horizontal or vertical perspective.

[196] Although the Commission only analysed the merger in terms of its unilateral effects in respect of possible post merger price increases this is not the only theory of harm that required consideration. Largely as a result of internal board minutes that we received through subsequent requests, the possibility that Massmart might use the acquisition of Finro to further a strategy of predation against rivals needs to be considered. Hypothetically speaking, the merged entity could raise barriers to entry in the relevant market if it had a known predatory reputation or if the merger would allow it to gain or enhance such a predatory reputation.

[197] According to Masscash's strategic documents its vision is to "*selectively [...] the wholesale and distribution sector of the Southern Africa food, liquor, personal care, Gen[eral] Merch[endise] and cellular markets serving LSM 2-6 consumers, predominantly through warehouse formats, thereby: being the preferred supplier to our Customer, [...] each regional market in which we trade*. ...".[51] Although Massmart's quoted mere strive for dominance cannot be faulted from a competition law perspective, when it is read in context with certain other statements contained in the board minutes the ambition to achieve dominance acquires a much more sinister hue.

[198] The then chief executive of Weirs and now chairman of the board suggested in relation to the food market that it "[e]*xamine the necessity of establishing a "fighting fund" to take out competitors*". He was mapping out "*the way forward for the CBW core business*".[52] He also stated in relation to a Massmart rival firm that "*we have to force them into a position where they make no money. We cannot allow our competitors to flourish. Our margins may have to drop to fend off competitors*".[53]

[51] Masscash Strategy Document dated May 2008.
[52] Minutes of the CBW Board of Director's meeting of 11 August 2004.
[53] Minutes of Massmart Executive Committee meeting of 11 June 2007.

[199] The above quotes clearly go far beyond "bullish" commercial talk of fierce rivalry and healthy competition practices. Baker in his testimony conceded that these quotes are indicative of predatory intent. Wright, however, denied that a predation strategy had ever been implemented against rivals or that a 'fighting fund' had been constituted. The economists both considered the issue and whilst conceding that predation was a legitimate issue for consideration, argued that a predation strategy needed to be public in order to deter rivals. Without evidence that Masscash had a reputation of engaging in predatory strategies in the past it was unlikely to deter new entry. It is also not clear whether the merger affords Masscash any more opportunity to engage in predation than it could pre-merger through Weirs and Makro which it already controls in the Port Elizabeth area. There is no evidence that Masscash has engaged in predatory tactics in this area prior to the merger. On this basis there is no evidence to suggest, despite these unfortunate pronouncements in its minutes that Masscash is likely to engage in a predatory strategy post merger, as a result of the merger.

Public interest considerations

[200] The effect of the proposed acquisition on employment and small businesses (SMMEs) will be discussed below.

Employment

[201] The parties confirmed that there will be no retrenchments of employees as a result of the proposed transaction. According to the '*Memorandum of Understanding'* entered into between the parties, all employees (save for certain existing shareholders in Finro and family members who wish to retire) will be taken over and section 197 of the Labour Relations Act, 1995 is applicable to such transfer of employment. The parties further submit that it is the Massmart group's intention to continue to operate Finro as an independent business for the foreseeable future. Therefore, there will be no negative effect on employment as a result of this deal.

Small businesses

[202] The Commission, despite its finding that the proposed transaction is likely to substantially prevent or lessen competition in the relevant market, concludes that the said deal would have no adverse impact on small businesses (a very large number

of the customers of the merging parties, specifically of Finro, can be classified as such). The Commission also does not respond to the concerns raised by UMS as quoted in paragraph 14 above. UMS is specifically concerned about the effects of certain developments in the sector on the viability of small independent grocery traders. It states that the large retailers "*took hold of the opportunities now available to access the markets normally generally operated by the previously disadvantaged communities. Sadly many smaller house shops, spazas, mobile shops, garage shops disappeared from the areas*".

[203] In line with the spirit and specific public interest provisions of the Act the potential effects on small businesses, in this case small retail businesses such as spaza shops, small superettes and the like, deserve a larger focus in the Commission's analysis of potential public interest effects. The Act is unequivocal that "*the ability of small businesses, or firms controlled or owned by historically disadvantaged persons, to become competitive*" must be considered in merger analysis.

[204] In the above context, it is necessary to reflect on a number of developments that have changed the grocery sector landscape in recent years and that potentially directly and indirectly affect the small businesses in this sector. Traditionally, end-consumers in the lower-end of the retail market have shopped at smaller independent retail enterprises, the format being that of a typical "spaza" or other relatively informal traders. More recently, however, the purchasing habits of these consumers have changed due to increased urbanisation and a broadening of the middle class.

[205] Furthermore, Masscash's strategic documents[54] identify the expansion of the large formal retail chains as one of the key challenges to the wholesale sector: it states that there are "*[...] growth opportunities as a result of the mature state of the wholesale industry aggravated by aggressive expansion of the major retail chains into lower LSM (2-5) markets*". Minutes of the CBW board meetings mirror this "*... it is common cause that the wholesale food sector is under immense pressure (our traditional customers are being eroded by the expansion of the major retailers into these areas)"*[55] and " ... *our customers are indeed suffering from the formal chains / suppliers penetrating their catchment areas."*[56]

[54] Source: Masscash Strategy Document dated May 2008.
[55] Meeting of 01 February 2006.
[56] Meeting of 03 August 2006.

[206] Corporate retailers, such as Shoprite with the Usave concept[57], have identified the lower segment of the grocery market as a potential growth area. However, as stated in paragraph 172 above, Massmart questions the general success of these undertakings. Regarding the Port Elizabeth market Wright testified that 18 new corporate retail outlets have opened in the last five years targeting the lower LSM categories.

[207] As stated in paragraph 12 above, the Commission in this case argued that the transaction would likely result in a substantial lessening of competition, but in stark contrast thereto foresaw no negative post merger effect on the customers of the merged entity. Unfortunately the Commission did not in its customer survey make provision for qualitative questions to the small business owners regarding the likely effect of the proposed deal on them. The only customer on record with a view regarding the effects of the proposed transaction expects a pro-competitive outcome based on the fact that it expects Masscash to post acquisition be more willing to provide deals to traders than Finro pre-merger (see paragraph 13 above).

[208] In the context of the developments sketched above, it is evident that for independent retailers to remain in the market and compete effectively with the large formal retail, they need access to suitable product ranges at competitive prices. Thus, their ability to remain competitive depends in part on the cost-effectiveness and distribution efficiencies of the wholesalers who supply them. As stated in paragraph 187 above, it is generally accepted that marginal costs savings such as that identified by the merged entity are more likely than fixed costs savings to be passed on to customers in the form of lower prices (although in the instant case the evidence is clear that the merged entity will not pass on all identified benefits). Be that as it may, there is no evidence to suggest that this transaction would have a significant negatively impact on small businesses in the area.

[209] Regarding UMS' plea for legislation aimed at the protection of the family owned businesses in the grocery sector, the Tribunal is not in a position to comment in the context of this acquisition on the broader policy issue of the desirability of such legislation.

Conclusion

[57] Source: www.shopriteholdings.co.za.

[210] Based on the available qualitative and quantitative evidence, there is no sound basis to conclude that the proposed acquisition is likely to substantially prevent or lessen competition. Likewise; there is no evidence of public interest concerns arising from the proposed deal.

Discovery

[211] Although the proposed acquisition is cleared based on a lack of economic or other evidence of a substantial prevention or lessening of competition, the Tribunal notes its displeasure and dismay at the lack of full and timely disclosure of relevant documents by Massmart.

[212] In this case the Tribunal both prior to and during the hearing had to make periodic requests to Massmart for additional documentation. For example, strategic Massmart documents revealed that the Massmart Executive Committee (Management Board) is responsible for various approvals including the "*divisional strategies and new stores"* and the Tribunal had to request these minutes from the merging parties. Furthermore, when questioning Wright on the issue of a (lack of) motivation for this deal to the relevant board (which Wright later testified is the Masscash board), the Tribunal became aware of the fact that it was not in possession of a complete minute trail. More specifically, the Commission identified a Masscash board meeting minute of 03 November 2008 that was not discovered and which made specific reference to the Finro transaction and the fact that "*concerns exist regarding Competition Board approval".* Subsequently the merging parties during the hearing submitted additional Masscash board minutes referring to Finro which were not submitted to the Commission at the time of the merger filing, as well as certain so-called Execucom[58] minutes which also refer to the Finro transaction.

[213] It was further discovered at the hearing that the proposed merger arose not in 2007 as presented by the merging parties, but that this merger was contemplated as far back as 2004.[59] According to Wright's subsequent testimony Finro rejected this offer in 2004. The relevant 2004 minutes however also note the reservations of one of the directors regarding the possible purchase of Finro. Given this said reservation it is even more surprising that no minuted motivation exists at Masscash board level for this deal. The Tribunal also notes that the Masscash board meeting minutes have become extremely terse and perfunctory in its reference to merger transactions.

[58] This is the executive committee of Masscash which meets on a monthly basis.
[59] Minutes of the CBW Board of Director's meeting of 12 May 2004; the said issue minuted under 'matters arising'.

[214] If merging parties desire the expeditious adjudication by the Tribunal of merger cases, they must ensure opportune and apt disclosure of all relevant information.

Onus of proof

[215] It has not been necessary in this case to deal with the argument by counsel for the Commission that the merging parties bear the onus of establishing that a merger does not give rise to a substantial prevention or lessening of competition. Novel and interesting as this argument was, we have largely decided this case on the facts accepted by the Commission's own witnesses. This case is therefore not one where it is necessary to decide whether to depart from the practice as set out in the large merger between the Tongaat-Hulett Group and Transvaal Suiker Beperk[60] where we held the following in respect of section 12A of the Act:

> "... *it is for the Commission to establish a lessening of competition; it is for the parties to establish that the efficiencies sacrificed by an anti-competitive merger are countervailed by efficiency gains."*

Guidance

[216] Since this is the first contested matter before the Tribunal that involves extensive economic modelling and customer survey and statistical data analysis (specifically diversion ratio analysis), the Tribunal deems it necessary (as guidance to future cases involving survey, statistics and economic simulation evidence) to make a number of comments regarding:

(i) the use of quantitative economic evidence in merger analysis in general;

(ii) customer survey design, execution and data analysis; and

(iii) the need for supplementary qualitative information in support of quantitative evidence.

[217] As a general comment, the Tribunal is highly supportive of the (increased) use of economic analysis in merger cases, supported by expert economic evidence. Furthermore, well conducted customer surveys can provide very valuable insights into the dynamics of a particular relevant market, for example the degree of competition between rival firms in differentiated-goods markets. This case lays a very good foundation for the consideration of survey evidence, statistical analysis and the

[60] Case no. 83/LM/Jul00, paragraph 100.

use of economic modelling tools to predict likely post merger unilateral price effects as indicator of any incentive to engage in a substantial prevention or lessening of competition.

Survey and statistical evidence

[218] Customer surveys are unquestionably useful additions to the evidence base in merger cases; they can provide very meaningful insight into *inter alia* market characteristics and dynamics, as well as customer behaviour and preferences, provided that they are well designed, both in terms of their construction and subsequent implementation.

[219] Questions in surveys that lead respondents to particular sets of answers or that are likely to give rise to biases in the responses of respondents must however be avoided. For example, in this case the Commission's survey question 30 (the central question for the determination of diversion ratios) contained an exceptionally long list of potential responses, i.e. 25 firm names in total, and these names had best not been read out to respondents to prevent any potential biased responses. The integrity with which Nielsen conducted the survey pertaining to survey question 30 and subsequently reported thereon to the Commission raises questions.

[220] To provide empirically robust measurements surveys should furthermore be designed with its intended purpose(s) as key objective. It was abundantly evident in the instant case that the customer survey was not designed and constructed with a specific preconceived hypothesis, i.e. with the measurement of conceptually relevant CDRs in mind, less still RDRs. The statistical experts employed by the Commission were not aware that this was the intended use of the survey data. Thus, the sample of respondents contained in the Commission's survey evidence was not designed to test the key economic issues in this matter, namely the calculation of RDRs and more specifically marginal customer behaviour (i.e. marginal diversion ratio values).

[221] Surveys should also be custom designed having regard for the specific relevant market(s) under consideration. The validity of survey results as inputs to empirical economic analysis is undermined when it does not reflect the underlying commercial or industry realities. To test the reliability of data, an industry or economic sense-check (in essence a reality or plausibility check against other evidence) is required to ensure consistency between qualitative information, on the one hand, and quantitative survey data, on the other hand. If the survey data conflict with factual evidence, then the survey evidence must either be discarded or valid reasons for

such differences must be provided to safeguard the integrity of the survey data. Questions that are based on implausible hypothetical situations and that are abstract from any commercial reality in a relevant market, for example hypothetical price increases of above 25% in the wholesale grocery market (as contained in the Commission's survey question 31), must be prevented.

[222] The Tribunal accepts that there is inevitably some uncertainty regarding the reliability of any survey results; however, although all surveys are to an extent subject to uncertainties of measurement and interpretation, this does not detract from their useful contribution to evidence. Statistical data and analysis are case-specific and therefore the statistical or empirical robustness of sample data must always be assessed on a case-by-case basis. It is stressed that in this case the Commission's customer survey results are not rejected in their totality, rather it was found that certain definite statistical data were insufficiently robust, i.e. the point estimates of the RDRs were found to be unreliable given the data stratification that occurred and the resulting small sample size for the marginal diversion ratio values, as well as the extreme confidence intervals of the RDRs. However, robust conditions may be present in other (future) cases under which one could more readily rely on the point estimates.

Economic modelling

[223] Economic modelling is one step in a multi-evaluation process. Such quantitative economic analysis supplements and does not obviate, substitute or moderate the need for contextualised qualitative analysis, focused on a particular theory of harm, in this case potential unilateral anticompetitive effects and adverse public interest effects on small businesses.

[224] In the context of supplementary evidence, it is surprising that in the instant matter only one customer response (Daku Spar) was obtained outside of the Commission's quantitative survey. Large scale, quantitative surveys contracted to third parties (Nielsen in this case) tend to be rigid in the sense that they do not allow for the motivation by a respondent of a particular answer or for follow-up questions in the case of ambiguous responses. The staff of market and media companies like Nielsen is not trained in antitrust and therefore cannot conduct in-depth interviews relating to competition issues. In-store, face-to-face, in-depth interviews, including some open-ended questioning, would have presented possibilities of exploring the breadth of

customers' perspectives, particularly from a public interest (small business) perspective. Furthermore, the Commission did not obtain detailed responses from grocery manufacturers regarding their perspectives on the proposed deal's potential competitive effects, despite the fact that direct supply by manufacturers is an integral and significant part of the grocery supply chain. The same lack of representation applies to buying groups, other than USM, which have an important role in the supply chain given its wide range of value added services to existing independent wholesalers and retailers and potential new entrants in the relevant market under consideration.

[225] Merger simulation models of the type relied on in this matter are static given their exclusive focus on customers' demand-side responses, i.e. only two variables are used, namely RDRs and gross margins. These simulation models do not consider 'off model' exogenous supply-side reactions possibly triggered by price incentives, such as potential post merger rival responses. Factors such as repositioning and expansion by existing rivals are undisputedly an integral part of the overall analysis of the likely anticompetitive effects of the merger, specifically in cases such as that under consideration where repositioning is an actual and significant (pre-merger) component of the competitive reality. Failure to consider these 'off model' factors would invariably overstate the likely post merger anticompetitive effects.

[226] In the instant case factual details were lacking regarding actual expansion by former niche players in the relevant market. It is surprising that the Commission did not obtain more factual details from the former niche players such as Springbok and Keens who have expanded their product offerings. Information regarding for example investments made in expansions, the time required to successfully expand and other barriers, if any, encountered by these firms, as well as future expansion plans, if any, would have been informative.

[227] In situations where third parties such as actual and potential competitors are unwilling to co-operate with the Commission and provide the needed quantitative and/or qualitative information, the Commission should not hesitate to utilise the extensive powers given to it by the legislature to force such person(s) to submit information (subject of course to appropriate and substantiated confidentiality claims by the parties submitting the information). Situations should be avoided were witnesses start speculating about factual information that can, as part of the Commission's investigation process, be obtained directly from the party who owns

that information, for example turnover information - in this case the “disputed” turnover figures of Orient.

[228] Lastly, economic modelling should not mechanically follow a formulaic approach without an assessment of the relevance of underlying assumptions, for example linear versus isoelastic demand assumptions in economic simulation. No evidence was provided in the instant matter in support of the presence of isoelastic demand conditions and therefore the Commission’s economic simulation based on this assumption had to be disregarded by the Tribunal.

30 November 2009

A Wessels **Date**

Tribunal Member

N Manoim and M Mokuena concurring

Tribunal Researcher : J Ngobeni

For the merging parties : Adv J Wilson instructed by Cliffe Dekker

For the Commission : Adv V Ngalwana SC