JD SPORTS / FOOTASYLUM MERGER INQUIRY REMITTAL

Supplementary SLC analysis

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Non-Confidential

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Section 1

Introduction and summary

1.1 In their Initial Submission[1] dated 30 April 2021, the Parties identified the three principal changes brought about by the COVID-19 pandemic (the substantially accelerated growth in digital, DTC, and progressive disintermediation) and described their impact on the Parties (Section E) and on the competitive assessment (Section F).

1.2 Following the discussion at the site visit, this paper develops the analysis in Section F of the initial submission to explain:

a. why the market developments identified in the Initial Submission and at the site visit mean that an SLC is unlikely; and

b. why the evidence in the Final Report[2] (or evidence of a similar type, if updated) does not suggest otherwise.

1.3 The remainder of this report is structured in two parts.

1.4 The first part sets out the basic framework of analysis which explains why an SLC is unlikely. Thus, we set out in light of the market developments:

a. an analysis of the counterfactual – *see Section 2;*

b. a framework for the SLC analysis – *see Section 3*.

1.5 The second part then explains why the CMA's prior analysis, grounded in evidence from before the pandemic, should not pose a bar to now finding that an SLC is unlikely (or should indeed reinforce a finding that an SLC is now unlikely) in light of market developments due to the pandemic. Thus, we consider the implications of the market developments for:

a. diversion ratio and GUPPI evidence – *see Section 4*;

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1 JD Sports Fashion Plc / Footasylum Limited Parties' Opening Submission on Remittal, 30 April 2021 ("the Initial Submission").

2 Completed merger on the acquisition of Footasylum plc by JD Sports Fashion plc - Final Report, 6 May 2020 ("the Final Report").

b. entry-exit impact analysis – *see Section 5*;

c. other evidence on closeness – *see Section 6;* and

d. supplier constraint – *see Section 7*.

Summary of conclusions

1.6 In separate submissions, the Parties have identified three key market developments, which are ongoing: a shift to digital sales; plans by the brands substantially to increase DTC; and progressive disintermediation of retail partners, through the application of segmentation policies (tiering), allocations, cancellations, timing of product access, shared inventory, data capture and ultimately termination.

1.7 The evidence base for the SLC analysis has therefore altered in material ways that were not foreseeable to market participants in early 2020. These have a critical bearing on various types of static evidence (e.g., GUPPI based on survey results) or retrospective evidence (e.g., entry/exit analysis of store openings/closings) previously at hand.

1.8 The market changes result in the tandem effect of the simultaneous **[✂]** (counterfactual) and the strengthening of third-party constraints (constraints on the Parties) on a prospective basis, as summarised below.

Counterfactual

1.9 The first substantial implication of these developments is that Footasylum will be a **[✂]** competitor of JD Sports prospectively than currently **[✂]**.

1.10 **[✂]**

1.11 **[✂]** (without those products, Footasylum would be **[✂]** to many other less preferred retailers which the CMA previously considered to be weaker constraints).

1.12 **[✂]** For instance, **[✂]**.[3]

1.13 While the brands, most importantly Nike, will be able to supply the CMA with further information on Footasylum's likely allocations over the next few years, presumably consistent with their own public commitments to DTC and wholesale channel restructuring, **[✂]**.

1.14 For the reasons above, the counterfactual depends on Footasylum's *market position* and not on its financial position. Footasylum will be **[✂]** because it lacks the key attributes to be a preferred partner of the brands and will thus receive **[✂]** to be a key constraint on JD Sports. In so far as Footasylum's financial position weakens due to **[✂]**, that could exacerbate its

[3] See Appendix A for further details.

weakness as a constraint. However, it is not necessary to conclude that Footasylum will likely be *financially* weak to conclude that it will likely impose less of a constraint based on **[✂]** and consequent competitive position.

1.15 Footasylum's **[✂]** position as a constraint on JD Sports would not be restored by alternative strategies since such strategies (such as cost-cutting, selling more of non-brand products, or diversifying) do not **[✂]** of key branded product that are the source of 'closeness' with JD Sports in the first place. Similarly, an alternative purchaser that is not *itself* preferred by the brands (in relation to the products that JD Sports and Footasylum **[✂]**) would be unlikely to assist Footasylum's position of **[✂]**.[4]

Constraints on the Parties

1.16 At the same time, other competitive constraints are substantially increasing in intensity, implying that the Parties will be increasingly constrained in the future.

1.17 Nike and adidas aim substantially to increase DTC by 2025.[5] In other words, the suppliers on whom the Parties depend for the majority of the products they sell (and who have full control over that supply) will become much stronger direct competitors. Moreover, they have a number of advantages in selling directly to consumers, including scope to offer their products exclusively (or on early release), to offer discounts using their integrated margin and to use data collected on their apps.

1.18 In the wholesale channel, a reducing number of preferred partners who benefit (for now) from continued access, and among those especially digital platforms (including marketplaces) – players such as **[✂]** – will be a growing competitive constraint on the Parties.

1.19 The above basic facts, which are well supported by evidence, do not, *prima facie*, give grounds for an SLC concern. On the contrary, they describe a situation in which surviving wholesale partners are highly constrained by horizontal competition from DTC (with permanent preferred access to product) and digital players, and also fundamentally by the need to offer competitive PQRS to win customers in order to remain relevant as partners to the brands for as long as possible, rather than being disintermediated. The contrary idea, that the market exhibits only

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4 Alternatively, if such players would expect to gain access to product absent merging with Footasylum then they would be a prospective constraint making the merger much less likely to be an SLC, since the previous SLC assumed an absence of such players. Other scenarios are considered further below.

5 As stated in the Initial Submission, Nike has a 50% target for digital penetration of sales (Initial Submission, paragraph 15(a)) and adidas has explicitly stated its target of 50% DTC by 2025 (Initial Submission, paragraph 7(b)). Nike's digital target is across owned and partnered sales. JD Sports understands that "*owned*" refers to Nike digital DTC (i.e., excludes Nike's brick-and-mortar DTC), and "*partnered*" refers to sales Nike makes through connected inventory software such as Anatwine (i.e., Nike makes the sale with the consumer via another retailer's website and fulfils the order directly). In any event, none of the points put forward in this submission depend on a precise 50% DTC target. As part of their publicly stated strategies, Nike and adidas are clearly planning to increase DTC substantially.

moderate competitive constraints, creating space for a retail partner of the brands profitably to worsen PQRS on a durable basis, does not seem likely.

Evidence from previous Phase 2

1.20 Nevertheless, the question arises of whether there is any specific evidence that could suggest that the merged entity would have an incentive to worsen PQRS after the merger. We review the sources of evidence relied on in the Final Report and conclude that such evidence, even if updated, would not suggest an SLC and, properly understood, further reinforces that an SLC is unlikely.

Diversion ratios and GUPPIs

1.21 The GUPPI framework is a useful tool for identifying the potential strength of static incentives for merging parties to worsen their offer following a merger. The GUPPI framework identifies this incentive based on one incentive mechanism: the idea that if merging party A worsens its offer it may recapture some lost sales at merging party B. Thus, in static markets where this is the only or main incentive, the GUPPI can be important evidence for competitive effects.

1.22 However, a GUPPI framework omits any other incentives that could affect the overall incentive to change PQRS following a merger. Thus, in more dynamic markets the GUPPI may be much less informative about competitive effects. This can work both ways: in some situations, the GUPPI may understate competitive effects (e.g., if the target firm might otherwise become a much stronger competitor over the next few years or more) and in other cases it can overstate competitive effects. Such under- or over-statement can be large compared to the measured GUPPI.

1.23 Of critical importance in the present merger, the market developments give rise to many other important incentives – incentivising the Parties to maintain or improve PQRS – that the GUPPI does not (and was never intended to) capture, and these should be taken into account.

1.24 Thus as stated by Shapiro (2010), the GUPPI "*cannot capture the full richness of competition in real-world industries";* by Valletti and Zenger (2021) "*Quantitative tools should therefore not be used mechanically, but … including an analysis of potential mitigating factors that may act as constraints on merger effects";* and by Carlton and Israel (2021) *"Another problem with UPP and merger simulation in general is its over-reliance on the assumption of static Bertrand competition …While Bertrand-Nash can be a useful modelling tool, one should not lose sight of its limited scope for measuring merger effects—both pro- and anti-competitive— given that it rules out dynamic effects".*[6]

1.25 As we explain in this paper, the GUPPI framework *omits entirely* a number of very important constraints that would operate not only to counteract an apparent incentive to worsen PQRS arising from recaptured diversion, but potentially to give stronger net incentives to improve

6 References in footnotes 53-55.

PQRS, in order to obtain the strategic benefit of competing more effectively and retaining access to product – or at least to maintain PQRS.

1.26 For example, the GUPPI for JD Sports takes *no account at all* of any of the following:

a. that lost sales recaptured by Footasylum would be at more risk of being disintermediated than when sold at JD Sports (therefore the supposed recapture benefit would be insecure and thus overstated);

b. that consumers diverting to Footasylum (as well as those remaining at JD Sports) would be more vulnerable to DTC competition because they would necessarily be less attracted to JD Sports and more easily induced to switch away by marketing (including targeted marketing) of the brands;

c. that by worsening PQRS, JD Sports would necessarily lose some consumers to the brands, adding impetus to their DTC efforts; and

d. that by worsening PQRS JD Sports would reduce its own likely longevity of securing branded supply and allocations on the same terms.

1.27 On the other hand, the GUPPI for Footasylum takes no account that worsening of PQRS could dramatically accelerate a reduction of product allocations **[✂]**. Indeed, the incentive suggested by the GUPPI is precisely opposite to JD Sports' strategic objective of securing product allocations for Footasylum – an objective which requires making Footasylum's offer better not worse. Aside from the potentially dramatic consequence of reduced allocations, the Footasylum GUPPI also omits a number of the other incentives described above and does not take into account the benefit to JD Sports of maintaining a different offer in the marketplace.

1.28 The above omissions mean that a material GUPPI, even a large one, is unlikely in the present case to reliably identify an incentive that would be acted on. A further issue is that **[✂]** – **[✂]** – means that the static GUPPI is likely to be overstated compared to its prospective level over the next few years. In simple terms, **[✂]**.

1.29 In short, any GUPPI analysis leaves out incentives – arising from the market developments identified by the Parties – which in the present case are more important than the incentives it captures and cannot reliably identify an SLC. On the contrary, consideration of the omitted incentives helps to identify why the Parties would have an incentive to maintain PQRS or even improve it. This in itself is not surprising given that the 'big picture' is one of **[✂]** – as explained above.

1.30 For the avoidance of doubt, the above does not mean that GUPPIs may not be a key source of evidence for an SLC in more static situations, i.e., in the absence of market dynamics of the type identified above, or that static GUPPIs may not understate concerns that arise from dynamic considerations (this can easily be the case for example if the target firm is expanding). However, the present case is neither of these.

Other evidence on ‘closeness’

1.31 We also explain that other elements of the ‘closeness’ analysis in the Final Report do not suggest an SLC in light of the market developments. In particular, the entry-exit analysis, ‘scoring’ results and similarity of offerings analysis *all* depend crucially on Footasylum’s access to products and none captures (at all or adequately) the prospective threat of DTC and digital platform competitors. In other words, it would be mistake to view the various sources of evidence as all corroborating an SLC story because they all measure closeness that stems from product allocations – which determine the relative market position of Footasylum, DTC and all other competitors – and when the allocation ‘thread’ is pulled it affects all sources of evidence.

1.32 In any event, we do not consider that the entry-exit finding presented in the Final Report had a proper basis since it depended critically on the choice of time period and, as we explain in the main body, the reasoning for that choice – shared for the first time in the Final Report – was circular. It thus did not justify the CMA’s choice not to rely on results covering the (then) prior three or four years which did not show particular closeness of Footasylum. Ignoring this, and even on its own terms, the results upon which the CMA relied depended on the inclusion of data from January 2016 or earlier that will be almost a *decade* old on a prospective time horizon of a few years from now. Even in a fairly static market, far less a highly dynamic one, such results would have limited prospective evidential value. They should have none when the market is highly dynamic and where, among other things, **[✂]**.

1.33 Thus, the market developments, which are ongoing, have pervasive implications for the relevance of the types of evidence in the Final Report. This suggests that those developments – digital, DTC and progressive disintermediation – need to be considered directly for their relevance to competitive constraints, and for reasons set out above we consider they suggest that an SLC is unlikely.

Merger benefits

1.34 Finally, the market developments identified by the Parties appear to strengthen the merger benefits identified by JD Sports. As a (currently) preferred partner of the brands with a specific strategy to **[✂]**, JD Sports is **[✂]**, which is not the source of particular closeness between the Parties.

Notes on approach in this report

1.35 When we refer generically to *“the brands”* we mean Nike, adidas, Puma, North Face, Under Armour and other third-party brands.

1.36 Where we cross-refer to the conclusions of the Final Report we sometimes provide references only to those in respect of horizontal unilateral effects in footwear.[7] Where we do so, we consider that the point also applies to apparel.[8]

7 Final Report, paragraphs 8.457-8.479.

8 Final Report, paragraphs 9.287-9.309.

Section 2

Counterfactual

2.1 The counterfactual issue primarily concerns Footasylum's future access to key branded footwear and apparel products. Access to this product, which is controlled by the brands, *"shapes"*[9] the retail market and is therefore of crucial importance for the degree of competition between Footasylum and JD Sports – as well as the relative constraint compared to all other players in the market. For the reasons set out below, the most likely scenario is that Footasylum will be a **[✂]** competitor of JD Sports prospectively than currently, **[✂]**.

2.2 In what follows, we set out a proposed framework for counterfactual assessment, addressing:

a. current and prospective progressive disintermediation as it applies to Footasylum and its implications for closeness of competition between Footasylum and JD Sports;

b. the relevance of further evidence from the brands, **[✂]**;

c. that the counterfactual stems from Footasylum's market position rather than its financial position; and

d. the relevance of alternative strategies and alternative purchasers.

Progressive disintermediation and its implications for closeness of competition

2.3 The Parties have submitted evidence that **[✂]**:

a. The brands are engaged in a global process of progressive disintermediation, affecting footwear and apparel. For example, Nike has stated that it expects to substantially increase its DTC and digital penetration and envisions having fewer strategic wholesale

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9 This is recognised by the CMA in the Final Report, paragraph 8.96 (footwear): "*We therefore consider that suppliers play an important role in shaping retail competition in this market. In particular, we consider that Nike and adidas impose the most restrictions and have the greatest influence, given their importance for retailers in this market.*" See also Final Report paragraphs 19, 2.17, 9.67 (for apparel), 11.11 and 11.44.

partners.[10] Similarly, adidas aims to substantially increase DTC sales by 2025, as part of a shift from an "*analogue wholesale business model*" to a "*digital DTC business model*" with fewer wholesale partners.[11]

b. Footasylum has the characteristics of a player – including lack of scale and lack of global reach – that is likely to **[✂]** from that process rather than (in the short-term) **[✂]**.[12]

c. **[✂]**. Footasylum has provided evidence to the CMA about (i) **[✂]**;[13] (ii) **[✂]**;[14] and (iii) **[✂]**.[15]

d. Footasylum has explained that **[✂]**[16] (this seems obvious: were it possible, then the brands' highly public statements about restructuring the wholesale channel would amount to nothing).

2.4 **[✂]** which is key to the strength of the competitive constraint. As noted in the Final Report, access to key product is an *"important competitive parameter"*[17] and segmentation policies and reduced allocations (compared to other retailers) reduce the competitive constraint a

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10 See for example JD Sports' site visit presentation, slides 10 and 14. See also Nike's Q4 2020 management call transcript, and footnote 5.

11 See for example JD Sports' site visit presentation, slides 10, 15-17. See also footnote 5.

12 JD Sports' site visit presentation, slides 19 and 51-63, listing the following **[✂]** attributes of the brands' global strategic partners: **[✂]**.

13 Initial Submission, paragraph 16(b); Footasylum's response to Q22 of CMA's s109 dated 6 April 2021 ("Footasylum's response to Q22"), paragraphs 22.1 to 22.71; and Footasylum's site visit presentation, slides 19-30.

14 Footasylum's response to Q22, paragraphs 22.72 to 22.87; Footasylum's site visit presentation, slides 19-30.

15 Footasylum's site visit presentation, slides 8 and 28.

16 Footasylum's site visit presentation, slide 28.

17 Final Report, paragraph 2.18: *"Access to branded products, particularly the more sought after higher-tier or exclusive products (including 'top-of-the-range' limited range products) from suppliers such as Nike and adidas, is therefore an important competitive parameter. Multi-brand retailers generally seek greater access to these types of products, including 'exclusive' products, to help differentiate their offer and position their proposition as unique. This helps to attract and retain consumers, and to build the retailer's brand and reputation. The value placed on branded products by consumers and as a result, by multi-brand retailers, has meant that suppliers of these products have an influential position in the sector."*

retailer is capable of exerting.[18] Thus, **[✂]** as a competitive constraint within or from the relevant markets.

2.5 Appendix A presents data on consumer online searches on Footasylum's website and shows that search terms relating to **[✂]**.

Evidence from the brands

2.6 The **[✂]** and the public commitments of the brands to DTC and wholesale channel rationalisation mean that Footasylum will be a **[✂]** competitor prospectively due to **[✂]**.

2.7 We recognise that the brands may provide the CMA with further evidence about the scale and pace of **[✂]**. To be consistent with what is already known to Footasylum and publicly stated by the brands we expect such evidence would *at least* confirm the position described above. To the extent that it implies **[✂]** In any event, however, Footasylum will be **[✂]** in the counterfactual (and, as explained below, **[✂]** and thus a greater supplier constraint irrespective of the precise pace with which disintermediation actually takes place[19]).

2.8 In considering evidence from the brands, we would suggest that the following points should be considered:

a. Evidence from the brands in relation to their plans for Footasylum should reconcile to their actions to date, their plans for DTC growth, and their public statements about wholesale channel rationalisation. Together, these necessarily imply substantial wholesale channel rationalisation.

b. For the brands there may be a degree of uncertainty albeit one that is constrained by their targets for 2025. However, any such residual uncertainty would not detract from the need to establish what is most likely in particular as concerns Footasylum.

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18 Final Report paragraph 8.392: *"…we recognise that suppliers can restrict retailers' access to products through their segmentation policies and that these are strategic decisions, which suppliers are in principle able to change … Sports Direct will continue to be able to access only some of the products available to the Parties in the foreseeable future. While the volumes of the products that it can access may increase, we did not find it was likely it would get access to sufficient volumes of the most desirable lifestyle segment products to significantly change the strength of its constraint on the Parties, in the foreseeable future."* We make this general point to highlight the importance of access to sufficient volumes of the most desirable products, as found by the CMA in its Final Report. We address Fraser Group further at footnote 29 below.

19 See paragraph 2.24.

c. It would be helpful to understand any specific plans that the brands, **[✂]**, have for supplying Footasylum in so far as formulated, both in absolute terms and relative to other retailers. It would also be helpful to understand at **[✂]**.[20]

d. The brands can also address whether Footasylum's current position would have been worse without the ownership of JD Sports, such that the factual (**[✂]**) has seen Footasylum receive better allocations than it may have done as an independent company and has thus overstated its competitive position.[21]

e. The brands may prefer to reduce access incrementally and through a mixture of means (segmentation, allocation, cancellations, etc.) to: (i) capture consumer data from retailers through QR codes and shared inventory, and (ii) avoid various negative consequences of a more abrupt reduction in supply (e.g., blame for retail job losses).

f. That the brands have a **[✂]** and it will be necessary to look through this to understand actual implications for access in absolute and relative (compared to other retailers) terms.

Footasylum's financial position

2.9 The counterfactual analysis described above is not driven by its financial position. It is principally driven by Footasylum's *market position* – which is inextricably linked to its current and future relationship with the brands. In particular, Footasylum **[✂]** because it does not have the attributes required to be a preferred partner prospectively[22] and those attributes concern its market position (in terms of scale and global reach, etc.).

2.10 Thus, the issue is different from that assessed in the Final Report which considered how Footasylum's financial position would affect its access to branded products.[23] The genesis of the counterfactual issue was different in the Final Report, with important implications: in the Final Report's analysis, if Footasylum's financial health would be restored, then Footasylum's competitive position in the counterfactual scenario absent the merger would not be materially different to its competitive position in 2019 to early 2020 that formed the evidence base for the Final Report (as indeed the Final Report concluded).

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20 Footasylum's site visit presentation, slide 28.

21 Formally, (before considering alternative purchasers, addressed below) the counterfactual is an independent Footasylum, whereas Footasylum is currently owned (albeit subject to the IEO) by JD Sports, which might be affecting the way that the brands deal with Footasylum. **[✂]**

22 See footnote 12.

23 Final Report, paragraph 5.63-5.68.

2.11 While the counterfactual scenario described in paragraphs 2.3-2.5 above does not originate with Footasylum's financial position, **[✂]** due to its market position may deteriorate its financial position (and is likely to do so unless it can readily substitute into different but equally profitable product markets) and at some point may do so critically. Thus, financial issues are not a necessary condition for the weakening of Footasylum in the counterfactual, but they may exacerbate it.

2.12 In any case, Footasylum is not well-placed to project its own financial performance since that performance is highly dependent on the future allocation decisions of the brands, **[✂]**. As a backdrop to this, we understand that at Grant Thornton's instigation, **[✂]**.[24]

2.13 In the same way that the counterfactual does not depend on Footasylum's financial position, it also does not depend on it closing any or many stores (**[✂]**). Rather, it depends on the fact that, **[✂]**, Footasylum would be a **[✂]** competitor of JD Sports than currently because of the key products from its offering.

The relevance of alternative strategies and alternative purchasers

2.14 It follows from above that alternative strategies and alternative purchasers would only potentially be relevant to the counterfactual analysis if they **[✂]**. As a corollary, alternative strategies or purchasers that would help Footasylum (i) survive with **[✂]**, (ii) expand elements of its offer where it is not particularly close to JD Sports (relative to other retailers) and/or (iii) diversify into other product areas *would not restore the competitive constraint at issue* and would thus not materially change the counterfactual analysis.

Alternative strategy

2.15 We understand that Footasylum considers that its business is **[✂]** allocations of key products from the brands, **[✂]**. Footasylum has indicated that **[✂]**.[25] In any event, all the key brands are engaged in an acceleration of DTC, which is associated with disintermediation, limiting Footasylum's scope to **[✂]**.

2.16 As noted above, in so far as any alternative strategy would involve measures to survive with reduced access (e.g., cost cutting, in order to be profitable with reduced allocations) and/or repositioning to offer more of non-branded product or products outside the relevant market, that would at best make Footasylum a more distant competitor of JD Sports – and put it on a

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24 **[✂]** requires Footasylum to produce audited accounts for FY2021 by the end of May 2021 and has retained Grant Thornton as auditors.

25 Footasylum's site visit presentation, slide 30.

much more even footing with many other competitors of JD Sports – for the reason that securing branded product has been found key to closeness by the CMA.[26]

Alternative purchaser

2.17 The question is not whether Footasylum could have found, or could find, an alternative purchaser, that sees some value in Footasylum's business, but rather whether it was likely, or would be likely, to find one that **[✂]**, such that the counterfactual could be taken to be closer to the scenario **[✂]**.[27]

2.18 There appear broadly[28] to be two types of alternative purchaser: (i) those that are preferred partners of the brands (at least for the next few years) in the sense of being likely to secure the key products such as those that **[✂]** and (ii) those that are not preferred partners in the sense that they do not obtain the access to the key products enjoyed by JD Sports and, **[✂]**Footasylum. Somewhat different considerations arise for each.

2.19 In relation to preferred partners of the brands, the relevant issues would be:

a. whether it is likely they would in fact have purchased or purchase Footasylum;

b. whether they would be successful in obtaining key allocations for Footasylum; and

c. whether they would not themselves have competition issues prospectively in any scenario where JD Sports itself would.

2.20 In relation to non-preferred partners, it has to be assumed that they would not otherwise access the products themselves, since if they could, it seems unlikely there could be an SLC in relation to the merger in the first place as the Parties would be subject to a significant constraint from entry and expansion. Thus, it would be necessary that:

a. it is likely that such a purchaser would in fact have purchased or purchase Footasylum; and

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26 See paragraph 2.4.

27 Or earlier, if ownership by JD Sports has assisted Footasylum in obtaining allocations before this (see footnote 21).

28 We recognise that in practice at any moment in time the brands grant different levels of access to various retailers who they view as more or less preferred, or serving different purposes. Of importance for what follows, however, is whether Footasylum would prospectively still obtain the same access to the products that have in the past been a source of its 'closeness' to JD Sports, or not, and how its access would compare to others.

b. the purchase of Footasylum would be a *tipping event* helping the acquirer to secure allocations (for itself and Footasylum) to a material extent *that was not otherwise possible*. This seems inherently unlikely given that the brands are pursuing disintermediation strategies that involve *cutting back* (not adding to) their preferred partners, Footasylum is very small by reference to the scale of the players who are preferred partners and the scale of investment required to seek to remain or attain preferred partner status, so the likelihood of tipping is accordingly small.[29,30]

2.21 In other words, when key branded product is important for closeness of competition, and the brands are shaping the wholesale channel at an EMEA and global level to a smaller number of key partners (for now) through segmentation and allocation policies, the number of possibilities for where an alternative purchaser would not be a prospective competitor and would obtain materially better allocations for Footasylum appears at best limited – before considering whether such alternative owners would have interest in and fit with Footasylum.

2.22 The analysis of the alternative purchaser scenario is also made substantially more uncertain by timing considerations. In the counterfactual, anyone could have bid for Footasylum at any time. However, prior to Footasylum's **[✂]**, any bidder may have assumed that **[✂]**. Were such a bidder successful it would now likely **[✂]**.

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29 In the previous Phase 2, JD Sports submitted that Frasers Group's elevation strategy, involving a publicly stated investment of approximately £1 billion over five to ten years, which meant that it would obtain increased access to key products and become a greater competitive constraint (Compass Lexecon, 'The scale of Sports Direct/Frasers Group's elevation strategy compared to Footasylum', submitted 10 March 2020; Parties Response to the Provisional Findings, submitted 9 March 2020, chapter 2). Since then, the brands have decisively moved to make access to product harder as they simultaneously aim for substantially greater DTC sales and at the same time rationalise the wholesale channel. In any event, as regards Frasers Group, either (i) it is obtaining greater product access now and (a) should be recognised as a greater competitive constraint (absolutely and relative to Footasylum) making an SLC much less likely and (b) would have competition issues itself acquiring Footasylum; or (ii) it is not gaining greater access, in which case the acquisition of Footasylum would not make it likely that both it and Footasylum would start to obtain preferred access (i.e., both would suffer from the lack of access described in the Final Report, paragraph 8.392).

30 For completeness (noting that the CMA intends to apply the old Merger Assessment Guidelines), we acknowledge that under the revised Merger Assessment Guidelines likelihood should be assessed in terms of scenarios that give rise to similar competitive outcomes. Therefore, alternative strategy and alternative purchaser could be considered together in terms of their likelihood of improving allocations (CMA, Merger Assessment Guidelines, 18 March 2021, paragraph 3.9: "*The CMA will generally conclude on the counterfactual conditions of competition broadly – that is, prevailing or premerger conditions of competition, conditions of stronger competition or conditions of weaker competition. If two or more possible counterfactual scenarios lead to broadly the same conditions of competition the CMA may not find it necessary to select the particular scenario that leads to its counterfactual.*"). However, since the likelihood of Footasylum obtaining better allocations in any relevant scenario is low, such an approach would not change our conclusion.

Conclusion

2.23 The strategy of Nike and other brands of implementing progressive disintermediation implies that Footasylum, **[✂]**, will be a prospectively weaker (and weak) competitor in the relevant markets over the next few years. This conclusion is unrelated to the financial position of Footasylum but may be compounded by it.

2.24 Finally, we note that if reduced allocations are only factored into the counterfactual to a certain degree – e.g., because above a certain level they are considered to be possible but not likely – then the *further* loss of allocations above the counterfactual level would remain relevant in the SLC analysis as they operate as a *threat* for Footasylum. I.e., if Footasylum worsened PQRS, it could lead to **[✂]** loss of product access, thus acting as a material constraint. Therefore, to the extent that some future possible loss of product access is not all reflected in the counterfactual, it should be taken account as a relevant constraint in the SLC analysis (see Section 3 and Section 7 below). We turn to the SLC analysis next.

Section 3

Framework of SLC analysis

3.1 This section briefly introduces the SLC analysis:

a. we explain why the market developments of digital and DTC suggest that the Parties will be subject to substantial and increasing competitive constraints other than from each other and why progressive disintermediation means that Footasylum will be a weaker constraint on JD Sports – and, as a result, why an SLC appears *prima facie* unlikely; and

b. we introduce the structure of the rest of this report in which we explain why we do not consider that evidence presented in the Final Report, or evidence of a similar nature if updated, e.g., as regards diversion ratios, should lead to the conclusion that there is an SLC and why on the contrary consideration of the relevant incentives suggests no SLC.

Substantial and increasing competitive constraints

3.2 We take the SLC question to be whether the merger will reduce the competitive constraints operating on the Parties, such that their offer to consumers may be expected to worsen.[31]

Constraints on JD Sports

3.3 We consider the developments identified by the Parties (including their impact on Footasylum in the counterfactual) mean that a merger with Footasylum will not materially reduce the competitive constraints operating on JD Sports.

3.4 This is for at least the following key reasons:

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31 Competition Commission and OFT (now CMA), Merger Assessment Guidelines, September 2010, paragraph 4.1.3: "*Some mergers will lessen competition but not substantially so because sufficient post-merger competitive constraints will remain to ensure that rivalry continues to discipline the commercial behaviour of the merger firms. A merger gives rise to an SLC when it has a significant effect on rivalry over time, and therefore on the competitive pressure on firms to improve their offer to customers or become more efficient or innovative. A merger that gives rise to an SLC will be expected to lead to an adverse effect for customers. Evidence on likely adverse effects will therefore play a key role in assessing mergers.*"

a. As set out in the counterfactual analysis, progressive disintermediation means that Footasylum **[✂]**, a weaker constraint on JD Sports due to **[✂]**. However, irrespective of Footasylum's precise position, other constraints on JD Sports will increase substantially.

b. JD Sports will be subject to a strong and increasing competitive constraint from the brands. Nike and adidas each expect substantially to increase share of supply of their own products by 2025.[32] Whether the UK is somewhat ahead or behind the global average is secondary: the brands' strategies are to increase significantly their DTC sales around the world.

c. The brands have numerous key competitive advantages including access to their entire range and complete control over which and how much product they supply to independent retailers and when they release it.

d. JD Sports will face strong and increasing constraints from other retailers which, for now, enjoy access to product including the favoured digital partners of the brands and marketplaces, including **[✂]**.[33]

e. JD Sports will continue to be constrained by Foot Locker which is also increasing its apparel offer, reportedly showing triple digit growth in Q1 2021 relative to the same quarter the previous year (2020).[34]

f. Furthermore, although JD Sports is **[✂]**. JD Sports has strong incentives to provide a highly attractive consumer offer and to innovate because **[✂]** is critical to securing branded supply for longer.

3.5 In short, therefore, and taking the SLC question to be about constraints, the market developments mean that JD Sports will be highly constrained by DTC, by digital rivals and by the brands in their capacity as suppliers. JD Sports will be at best weakly constrained by Footasylum. There is every reason to think that the market developments mean that JD Sports'

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32 See footnote 5 above.

33 See the Parties' response to Question 2 of the CMA's RFI dated 6 April 2021, where the Parties provided examples of noteworthy entry or expansion since 1 March 2020.

34 Foot Locker Q1 2020 earnings call transcript, 21 May 2021: *"It was also a strong quarter for our apparel business, which was up triple digits compared to the first quarter of last year and up double digits versus the first quarter of 2019. Men's and kids led the way up triple digits, while women's increased strong double digits. The casualization of society remained the catalyst for our business, and we saw all major categories increase, with shorts driving the largest gain with momentum across many brands, including our own."* (https://www.fool.com/earnings/call-transcripts/2021/05/21/foot-locker-inc-fl-q1-2021-earnings-call-transcrip/) A Berenberg update report also mentions that Foot Locker's Q1 2021 growth in apparel and accessories in Europe were in the "*high 30's*" (Berenberg, 'Foot Locker Q1 Call Feedback and Readacross (sic) to JD Sports, Adidas, Puma', 24 May 2021).

incentive to make an attractive consumer offer will be materially unchanged as a result of the merger.

Constraints on Footasylum

3.6 The developments identified by the Parties (including their impact on Footasylum in the counterfactual) mean that merger with JD Sports will not materially reduce the competitive constraints operating on Footasylum.

a. The constraints operating on Footasylum principally come from the challenge of obtaining supply. Footasylum is **[✂]**. That has at least four implications.

b. First, the key constraint on Footasylum is from obtaining supply. Footasylum has strong incentives to maintain a good consumer offer to seek to preserve as much of its relevance to consumers as possible and therefore to the brands. Footasylum is **[✂]**, and degrading PQRS (relative to other players who are investing much more heavily) would only make this worse.

c. Secondly, DTC will be a strong constraint on Footasylum, in addition to the constraint from JD Sports and other preferred partners.

d. Thirdly, **[✂]**, it will **[✂]**, and accordingly Footasylum will be more constrained by such retailers. For example, Footasylum understands that **[✂]**.[35]

e. Fourthly, Footasylum's competitive significance in the market will be **[✂]**. As set out in Appendix B, Footasylum's share of the supply of key branded product could become **[✂]**.

3.7 In short therefore, Footasylum will have diminished prospective significance in the merger and will be fundamentally constrained by the brands and by a wider pool of less differentiated retailers.

No *prima facie* basis to expect SLC

3.8 In our view, there is no *prima facie* basis to expect an SLC and strong counter-indications as a result of the market developments. The Parties' key suppliers aim to substantially increase their DTC share by 2025 (and history suggests the brands have tended to exceed their stated targets in the past[36]); they have the ability and incentive to make that happen, and numerous competitive advantages they can confer on themselves; Footasylum **[✂]** and is manifestly not among the currently preferred partners who, aside from DTC, will be the key competitors in the relevant markets in the next few years.

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35 Footasylum's site visit presentation, slide 29.

36 We understand that JD Sports considers that **[✂]**.

Review of evidence in the Final Report

3.9 The issue remains of whether the *prima facie* view that the Parties are subject to material and increasing constraints could nevertheless be reversed by evidence, in particular in relation to the 'closeness' of the Parties or an inadequacy of the constraints described above.

3.10 In the remaining sections we explain why, in light of the identified market developments, we do not consider that the evidence in the Final Report (or evidence of a similar type, if updated) should suggest a different conclusion (and indeed reinforces the conclusion of no SLC).

3.11 In particular, we next address the implications of the market developments for diversion ratios and GUPPIs, then entry-exit impacts, then other sources of evidence on 'closeness'. Finally, we address the implications of the market developments for the supplier constraint. (We do not address internal documents as this has been addressed by the Parties in the Initial Submission and their RFI responses.)

Section 4

Diversion ratios and GUPPIs

4.1 In the Final Report, the CMA considered that the diversion ratios and GUPPIs (calculated from the CMA's own in-store and online surveys) implied a *"strong incentive"* for each Party to deteriorate PQRS following the merger.[37]

4.2 However, we consider that diversion ratios and GUPPIs derived from the CMA's surveys (including where updated) should carry significantly less evidential weight in the remittal in light of the market developments identified above.

4.3 This is essentially for two reasons (elaborated below):

a. First, the inputs to the GUPPI framework are likely to change substantially and potentially radically over the next few years as a result of the identified market developments. Since the merger assessment is forward-looking, any incentives based on existing evidence would need to be adjusted and/or otherwise given less evidential weight to account for prospective changes.

b. Secondly, and more fundamentally, the basic GUPPI framework fails to capture key features of how the market works, which are more important because of the market developments. Thus, it would also be necessary to consider whether even a prospective GUPPI above a certain level really suggests an SLC, or on the contrary whether incentives entirely omitted from the GUPPI framework mean that an SLC is unlikely (as we explain below is the case).

4.4 Thus, we consider the present case to be one where dynamic considerations materially reduce the likelihood of an SLC compared to a static GUPPI analysis, recognising that in other cases

37 Final Report, paragraph 8.469. Other key points made by the CMA concerning the diversion ratios and GUPPIs in the conclusions for footwear in the Final Report were that: (i) the CMA *"have not placed full evidential weight on the online survey results due to the low response rates"* (Final Report, paragraph 8.467); (ii) for each Party, the other Party was the most mentioned as the next preference, except for the online customers of JD Sports for which Nike accounted for most next preferences, followed by Footasylum and Foot Locker (Final Report, paragraph 8.468); and (iii) the implied GUPPIs were asymmetric (higher for Footasylum than JD Sports) (Final Report, paragraph 8.469).

a static GUPPI analysis may materially under-estimate the risk of an SLC (e.g., where a merging party is entering or expanding in the market).

Diversion ratios are likely to change substantially over the next few years

4.5 In the Final Report, the CMA noted that the GUPPI was static, describing it as "*an estimate, <u>based on current market conditions</u>, of the incentive that the merged entity faces to worsen PQRS post-merger*"[38] (emphasis added).

4.6 The CMA was able to rely on this static analysis in the Final Report because it found, at that time, that any future market developments would not be substantial enough to change the assessment.

4.7 Both the CMA's in-store and online surveys were conducted in October 2019.[39] The CMA is conducting a new online survey, but not a new in-store survey, in the remittal phase.[40] Assuming that the CMA were to update the GUPPI estimates, they would reflect dated in-store diversions and (now) current online diversions.[41]

4.8 However, the market developments identified mean that the diversion ratios may be expected to change substantially over the next few years (i.e., to 2024-2025) as explained below. Therefore, the approach of the Final Report of relying on current conditions would no longer be appropriate.

Diversion ratios will be fundamentally impacted by the market developments

4.9 Diversion ratios reflect consumer preferences. In particular, they reflect diversion *from* consumers' first preferences (what they choose to buy) *to* their second preferences (their next best alternative). The market dynamics are also fundamentally related to consumer preferences since they reflect changes into those preferences (e.g., greater preference for DTC or digital) and also changing options available to consumers over which to exercise those preferences (e.g., due to reduced allocation or timed launch of products). Therefore, it is

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38 Final Report, Appendix F, paragraph 3.

39 Final Report, paragraphs 6.27 and 6.28.

40 We provided separate comments on the CMA's draft questionnaire for the new online survey on 22 April 2021, which we do not repeat here.

41 Albeit the latter potentially affected by opening bubble effects.

inescapable that very substantial market developments in the next few years could materially change diversion ratios.[42]

DTC

4.10 Nike and adidas products account for around **[✂]** of the Parties' footwear sales[43] and Nike and adidas have announced plans to significantly grow DTC (for example, adidas has stated that it aims to increase the proportion of its global sales that are DTC to 50% by 2025, up from 33% in the year to December 2019 and 41% in year to December 2020).[44]

4.11 The increase in the extent to which suppliers sell directly to consumers (which has already occurred during the pandemic, and which is expected to increase even more in the next few years) implies a significant change in consumer preferences, for DTC as their first preference, and presumably also their second preference, and so on.

4.12 This will have implications for the diversion ratio from JD Sports to Footasylum. Overall, consumers must have increasing preferences for DTC and this is likely to lead to a substantial increase in second preferences as consumers shift towards DTC. Nike was already the main rival of JD Sports online measured by second preferences in 2019. As a corollary, all else equal, fewer of JD Sports' customers will have Footasylum as their second preference prospectively over the next few years.

4.13 The reverse direction, i.e., diversion from Footasylum to JD Sports (albeit starting from a higher level), will also be affected by the shift in consumer preferences for purchasing directly from suppliers for the same reasons.

4.14 However, an even more significant effect on the diversion ratio from Footasylum to JD Sports will come from the effects of progressive disintermediation, which we turn to next.

Progressive disintermediation

4.15 Footasylum is subject to progressive disintermediation by the brands. This is **[✂]**.[45]

4.16 The implication of this dynamic for diversion ratios is likely to be significant.

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42 Exactly how market developments change diversion ratios is hard fully to predict since future diversion ratios depend on changes in first and second preferences and the diversion ratios will most likely change during periods of transition.

43 Initial Submission, paragraph 2.

44 Initial Submission, paragraph 7. See also footnote 5.

45 For example, paragraph 48 of the Initial Submission states that **[✂]**. Paragraphs 52-58 discuss **[✂]**. Footasylum's site visit presentation, **[✂]**; that there would potentially be a **[✂]**; and that it therefore had **[✂]** and **[✂]**

4.17 First, in relation to diversion from JD Sports to Footasylum, **[✂]** now and prospectively than in 2019 and thus would capture less diversion of JD Sports' customers who want those products. **[✂]**[46] However, even these known developments are still to take effect on Footasylum, and will be intensified by other prospective plans of the brands that are not known to Footasylum (and which will be reinforced by further DTC growth), and thus will only be reflected in consumer preferences with a further lag.

4.18 Secondly, in the reverse direction, i.e., diversion from Footasylum to JD Sports, while JD Sports is expected to be relatively less affected by reduced allocations, the products purchased by Footasylum customers will be different as **[✂]**, thus the diversion pattern of its customers can naturally be expected to be different as their first preferences are necessarily altered due to the change in Footasylum's offering.

Digital

4.19 The acceleration of digital is causing rivals of the Parties to make major digital investments aimed at winning consumers, including Nike who spent over $1bn on data and analytics in 2019 and adidas who plans to invest more than €1bn to support the digital transformation of the company over the next 4 years. Other rivals such as **[✂]** each forecast to spend a minimum of £100m on upgrading their digital capabilities.[47] **[✂]**[48]

4.20 Changes in the competitive landscape due to increased digital commerce have implications for diversion from JD Sports to Footasylum for at least two reasons.

4.21 First, as a result of their investments and repositioning in the digital channel, some of those players are likely to increase the proportion of second preferences they account for prospectively over the next few years. For example, JD Sports has shown that marketplaces have a very high growth rate.[49]

4.22 Secondly, in the Final Report the GUPPI reflected a weighted average of the (implicit) GUPPIs for online and in-store sales. Increased digital sales means that the online GUPPI should have greater weight (all else equal).

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46 Initial Submission, paragraphs 52-58. See also footnote 45 which describes that Footasylum learned from **[✂]**.

47 Initial Submission, paragraphs 67, 75, 81-82.

48 **[✂]** Initial Submission, paragraph 100.

49 JD Sports presentation for the site visit, slide 45.

4.23 In addition, switching of JD Sports' customers to digital players may change the mix of the second preferences among those who do not switch but this is uncertain.[50]

4.24 In the reverse direction, i.e., the diversion from Footasylum to JD Sports, although starting from a higher level, there would be similar effects on the diversion ratios and their interpretation prospectively due to the increasing trend for consumers to shop online as set out above for JD Sports.

Margins

4.25 Gross margins are another input into the GUPPI framework. Any one of the developments above could be expected in economic terms to either (i) reduce Footasylum's gross margin over the next few years or (ii) increase the marginal 'extraction' of the gross margins in the form of fixed cost investments required by the brands for ongoing supply such that the effective gross margin is lower.[51] In either case, this would be a further factor to take account of in considering prospective GUPPIs (the former as relevant to the GUPPI and the latter as relevant to interpreting the GUPPI).

Conclusion

4.26 It is clear from the above that the anticipated market developments over the next few years are likely to have substantial implications for estimated diversion between the Parties and their competitors, in both directions, i.e., because they will affect consumer preferences in relation to the origin and/or the destination of diversion. For this reason, GUPPIs need to be adjusted on a prospective basis and/or considered very differently in a dynamic market.

Inferences about incentives are fundamentally affected by the market developments

4.27 Secondly, and more fundamentally than 'merely' considering prospective input values, the basic GUPPI framework fails to capture key features of how the market works – made more important by the market developments – which are relevant for interpreting the results. Thus, it would also be necessary to consider whether even a prospective GUPPI above a certain level really suggests an SLC, or on the contrary whether incentives entirely omitted from the GUPPI framework mean that an SLC is unlikely (as we explain below is the case).[52]

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50 See footnote 42.

51 In the standard GUPPI framework, upward pricing pressure arises because diversion combined with gross margins implies a rate of margin (profit) recapture. However, if suppliers extract any higher margin in the form of requirements to elevate stores as a condition for maintaining supply (or even obtaining the supply in the first place) at the receiving firm then this would be a factor outside the GUPPI framework which diminishes the incentive compared to the standard case. As Footasylum has explained, **[✂]**.

52 At the very least the omitted incentives mean that there can be no presumption that an SLC is likely based on the GUPPI, even if such a presumption is valid in a static case (i.e., one without developments such as those identified).

4.28 In what follows, we make some preliminary comments before then considering how the interpretation of GUPPIs is affected by the market developments identified.

Preliminary points on inferences about incentives

4.29 The GUPPI framework is a valuable tool because it has theoretical foundations in well-specified models of competition, it provides rich insights and it is capable of adaptation (e.g., to address bidding markets, vertical mergers, quality improvements, efficiencies, and more). Moreover, the basic mechanism in the GUPPI framework (the notion of recapture leading to upward pricing pressure) is highly intuitive.

4.30 Nevertheless, we offer the following propositions:

a. While the basic GUPPI framework captures an important incentive effect it is always necessary to consider whether market dynamics are more complex and other factors affect incentives.

b. If more complex factors (not in the GUPPI framework) are identified, then in principle the GUPPI framework could be adapted to include them (as noted above, various adaptations have been proposed to deal with particular circumstances) <u>or</u> the GUPPI results should be interpreted more cautiously or differently (e.g., taking into account that some omitted incentives would work in the opposite direction).

c. Where omitted factors are not explicitly included, there should be a sliding scale where, as the omitted factors appear more significant, the reliance on the GUPPI must accordingly be increasingly cautious.

d. There is no reason why, as a general rule, the GUPPI-identified incentive should be considered to be first-order and omitted factors second-order. It can, in principle, be the other way around, and what the model omits may be more important than what it includes.

4.31 Thus, while the GUPPI framework may provide reliable indications about competitive effects in more static markets, in more dynamic markets the GUPPI may be much less informative about competitive effects. This can work both ways: in some situations, the GUPPI may understate competitive effects (e.g., if the target firm might otherwise become a much stronger competitor over the next few years or more), and in other cases it can overstate competitive effects. Such under- or over-statement can be large compared to the measured GUPPI.

4.32 The GUPPI model's authors have suggested that the GUPPI can omit important factors – see, for example, Shapiro (2010): "*The value of diverted sales is an excellent simple measure for <u>diagnostic or scoring</u> unilateral price effects, but it **cannot** capture the full richness of competition in real-world industries. Indeed, as stressed above, all of the quantitative methods discussed here **must** be used in conjunction with the broader set of qualitative evidence that* *the Agencies assemble during a merger investigation*" (underlined emphasis in original, bold emphasis added).[53]

4.33 In an article that otherwise quite strongly advocates the use of GUPPIs, Valletti and Zenger (2021) nonetheless note: "…*it should be recalled that diversion-based tools are designed to illuminate one specific aspect of competition: the change in* ***static pricing incentives****…Quantitative tools should therefore not be used mechanically, but in the context of a coherent theory of harm that combines quantitative with qualitative evidence, including an analysis of* ***potential mitigating factors that may act as constraints on merger effects****."* (emphasis added).[54]

4.34 Similar views on the static foundations of the GUPPI are expressed by Carlton and Israel (2021): *"Another problem with UPP and merger simulation in general is its* ***over-reliance on the assumption of static Bertrand competition****, in which firms set prices in a one-shot game, with the equilibrium determined by the standard Nash equilibrium concept that says that no firm can unilaterally increase its profits—holding the prices of all other firms fixed…While Bertrand-Nash can be a useful modelling tool, one should not lose sight of its* ***limited scope for measuring merger effects****—both pro- and anti-competitive— given that it* ***rules out dynamic effects*** *via repeated or multi-stage games, more complicated strategy spaces than one-shot uniform pricing, changes in the set of players in the game over time, and so on"* (emphasis added).[55]

Interpreting GUPPIs in the present case in light of the market developments

4.35 We now turn to the issue of interpreting GUPPIs in the present case in light of the market developments. As noted above, this concerns interpreting GUPPIs even *after* taking account of prospective changes in diversion ratios over the next few years.

4.36 As we explain below, the GUPPI framework *omits entirely* a number of very important constraints that would operate not only to counteract an apparent incentive to worsen PQRS arising from recaptured diversion, but potentially to give stronger net incentives to improve PQRS, in order to obtain the strategic benefit of competing more effectively and retaining access to product – or at least to maintain PQRS.

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53 Carl Shapiro, "The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years", 77 Antitrust LJ 49 (2010), p. 77.

54 Valletti, T., Zenger, H., "Mergers with Differentiated Products: Where Do We Stand?", Review of Industrial Organization, 58, 179–212 (2021), page 195.

55 Carlton, D.W., Israel, M.A., "Effects of the 2010 Horizontal Merger Guidelines on Merger Review: Based on Ten Years of Practical Experience", Review of Industrial Organization, 58, 213–234 (2021), page 225. The paper also states: *"In this sense, rather than "unilateral" and "coordinated" effects, we would emphasize whether merger analysis focuses on short-run price effects and marginal cost efficiencies that may be well captured in static Bertrand models, or, instead, focuses on the nature of strategic interaction, innovation and new products, and entry and repositioning, which require dynamic models with richer strategy spaces."*

GUPPI for JD Sports

4.37 The numerical GUPPI for JD Sports, even after taking account of prospective diversion ratios, fails to capture a number of factors that would be highly relevant for determining PQRS at JD Sports given the market developments described above.

4.38 First, worsening PQRS as implied by a GUPPI would be contrary to JD Sports' strategy of making itself as relevant to the brands for as long as possible. The essential strategic context is that JD Sports (like other retailers) is competing with brands for the same consumer. Acting on the GUPPI incentive necessarily makes JD Sports' offer to its own consumers worse, for the benefit of some recapture at Footasylum. This reduces JD Sports' bargaining power with the brands and increases its risk of losing allocations (which the brands can transfer to other preferred retailers or – now more importantly – their own DTC), a factor which is entirely omitted from the GUPPI framework. This seems *prima facie* likely to be a first order effect whereas the GUPPI incentive is at best second order.

4.39 Secondly, since a necessary consequence of JD Sports acting on the GUPPI incentive is that even its own customers who do not switch away will necessarily have lower consumer surplus from their purchases (since PQRS is worse), all JD Sports' remaining customers (i.e., all those not switching to Footasylum) would gain lower utility from shopping at JD Sports.[56] All of these customers would then be more vulnerable to dynamic competition from other sources as they have weaker preferences for the merged entity's offer than pre-merger. This is significant because (especially) the brands have a number of means to capture these customers, for example through discounts on the next purchase.[57]

4.40 Thirdly, suppose JD Sports went ahead and worsened its offer leading it to lose some customers, some of which would go to Footasylum. The value of these customers to JD Sports at Footasylum would be less than at JD Sports since Footasylum is at much more risk of losing allocations than JD Sports. Therefore, the discounted value of the customer to the merged

56 Illustratively, suppose that JD Sports sells trainers for £100 and a consumer values them at £120. The consumer's surplus from buying the trainers is then £20 (this must be positive, otherwise they would not purchase in the first place). Acting on the incentive implied by the GUPPI framework necessarily involves JD Sports making its consumer offer worse, for example raising price or lowering quality, and in either case reducing the surplus (say to £18). Given the lower surplus, those consumers are more vulnerable to being competed for by the brands which can use their integrated margin to offer greater discounts and can use data to offer more targeted offers. This dynamic is facilitated by the use by suppliers of QR codes in store (Initial Submission, paragraph 66). Thus, acting on the GUPPI incentive would make all of JD Sports' customers more vulnerable to DTC.

57 The vulnerability of losing customers to the brands also influences JD Sports' conduct pre-merger. However, the GUPPI framework is based on a static model of competition. The totality of the evidence suggests that JD Sports' strategy is driven to a substantial extent by a dynamic approach to competition such that its investments and attempts to win consumers are driven by the threat of disintermediation or the brands' DTC channel to a greater extent than the static diversion ratio to DTC suggests. **[✂]**.

entity is immediately cut by this move. Thus, illustratively, a static GUPPI around 5% would have incentive effects far below 5% once this is taken into account because the value of recapture is lower. As a corollary, a proponent of the GUPPI as evidence of JD Sports' incentives would need to explain why it would be rational for JD Sports *not* to account for the disintermediation risk of diverted sales as the unmodified GUPPI implies.[58]

4.41 Fourthly, a necessary consequence of JD Sports acting on the GUPPI incentive is that any customers who switch to Footasylum will necessarily have less consumer surplus than they did before the degradation of PQRS at JD Sports (since Footasylum is only their second preference which means it is less preferred). Similar to all JD Sports' remaining customers (see paragraph 4.39), all of these customers are also more vulnerable to dynamic competition from other sources as they have weaker preferences for the merged entity's offer than pre-merger. Thus, worsening the offer would be counter-productive for competing against DTC for this further reason.

4.42 Fifthly, acting on the GUPPI incentive necessarily increases sales made by rivals (whether DTC or other retailers) since Footasylum does not capture 100% of diversion. In so far as this diversion is to other key retailers, it could strengthen their short-term importance to the brands and help them secure allocations.

4.43 Sixthly, the relative diversion ratio from JD Sports to Footasylum compared to the brands is likely to overstate the competitive significance of Footasylum. This is because if JD Sports loses a customer to Footasylum, it may have a better prospect of getting the customer back than if it loses the customer to the brands, given the latter operate ecosystems and have numerous retention tools not available to retailers (facilitated by integrated margin, data and apps, full range offering and timing advantages with release dates). Thus, the present value of a loss to Footasylum is numerically smaller than to the brands for any given level of diversion.

4.44 All of the above factors reflect real commercial and economically coherent incentives that are entirely omitted from the GUPPI framework and are likely to be more important than the one static incentive the GUPPI framework does identify. In other words, they are reasons why it would not make economic or commercial sense to worsen PQRS, and, on the contrary, why JD Sports would have a strong incentive to keep improving PQRS after the merger.

GUPPI for Footasylum

4.45 It is also the case that the numerical GUPPI for Footasylum, even updated for (or otherwise taking into account) prospective diversion ratios, fails to capture a number of factors that would be highly relevant to the incentive for setting PQRS given the market developments described above.

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58 Note that it cannot be assumed that the customer who diverted from JD Sports to Footasylum would revert back to JD Sports in the event that Footasylum lost allocations, since by assumption such a customer has already been 'turned off' JD Sports by the worse PQRS offer.

4.46 The most acute issue on the Footasylum side is securing supply of product. That constraint is **[✂]**. Were JD Sports to worsen the offer of Footasylum it would presumably carry a significant risk of **[✂]**. Yet the costs to JD Sports of the reduction in allocations are entirely omitted from the GUPPI framework.

4.47 In this context, the GUPPI is uninformative because it measures marginal incentives and does not address step changes that would be implied by a significant loss of allocations. Rather, it is necessary to consider whether, on balance, JD Sports would prefer to operate Footasylum trying to retain the brands' allocations or not.[59]

4.48 In that regard, JD Sports has outlined to the CMA why it is in its interests to make Footasylum a success and attempt to secure branded product allocations. Yet to do so, JD Sports would need to maintain or in practice – **[✂]** – *improve*, the PQRS offer at Footasylum, not worsen it.

4.49 Simply put, even a high GUPPI with supplier reaction could be consistent with a lack of incentive to worsen PQRS. That is because the supplier reaction can largely destroy the incentive which the GUPPI purports to identify. Since progressive disintermediation has intensified since the Final Report (and is anticipated to intensify further in the foreseeable future), it would be inappropriate (even if it was reliable in other respects) to give the GUPPIs the same interpretation as in the Final Report. On the contrary, a much greater risk of disintermediation should fundamentally change the interpretation of the GUPPI.

4.50 In addition, on the Footasylum side, the second, fourth, fifth and sixth factors identified for JD Sports above are also likely to be important. For example, any hypothetical worsening of PQRS by Footasylum would make all remaining Footasylum customers, and all customers switching to JD Sports, more vulnerable to DTC offers and therefore a very questionable strategy in a dynamic market.

4.51 Furthermore, the GUPPI framework does not take into account the loss of diversification value to JD Sports of maintaining a different fascia on the market that may be better placed for future trends. Worsening PQRS at Footasylum would reduce this value.

Conclusion

4.52 For the reasons set out above, even if the GUPPI framework takes account of prospective diversion ratios over the next few years the interpretation of any given numerical GUPPIs is fundamentally affected by the market developments identified above.

59 This is akin in some respects to the comparison of vGUPPI and vertical arithmetic as methodologies to assess vertical foreclosure. The former captures marginal incentives and is thus used to assess partial foreclosure, the latter captures profitability of total foreclosure. In the present case, the error would be to fail to capture that a worsening of the offer at Footasylum could well result in it being totally foreclosed by Nike and/or adidas.

Materiality

4.53 The market developments, and progressive disintermediation in particular, also have implications for the materiality of the competitive constraint on JD Sports from Footasylum and the extent to which any loss of competition from Footasylum is substantial. In other words, any GUPPI result for Footasylum needs to be interpreted in conjunction with its materiality at the level of the market over the next few years. As explained in Section 6 and Appendix B, Footasylum may have much lower materiality prospectively than now (connected with the counterfactual).

Conclusion

4.54 For the reasons set above, we consider that the relevance and interpretation of diversion and GUPPI evidence (including from an updated online survey) is fundamentally affected by the market developments identified above and that even updated static GUPPI evidence would not suggest an SLC in this case because of what it omits and moreover those omitted factors explain why an SLC is unlikely.

Section 5

Entry-exit impacts[60]

5.1 During its previous Phase 2 assessment, the CMA conducted an analysis of the impact of competitor store entry and exit on nearby JD Sports' store revenues.[61]

5.2 As a preliminary point, the entry-exit evidence had narrow relevance for the assessment of closeness for three reasons: (i) it only measured impacts and constraints on *JD Sports* and thus was only relevant as evidence for the SLC finding in relation to JD Sports (and not Footasylum); (ii) it only applied to the constraint of *stores on stores* (and thus neither to the constraint from or on online); and (iii) the results concerned *revenue impacts* only, as the CMA dropped earlier versions that had also addressed parameters of competition (discounts, refurbishments and product range).

5.3 Importantly, as explained further below, the results evolved during the Phase 2 investigation (for a timeline see Appendix C). The results the CMA relied on in the Final Report to conclude that Footasylum is a close competitor to JD Sports depended entirely on the inclusion of data for September 2014 to January 2016; they were not found for more recent periods. The CMA's reasoning for relying only on results including this period and rejecting the relevance of any more recent period was first given in the Final Report and we have therefore not had the opportunity to comment on this until now.

5.4 In what follows, we set out three key points on the relevance of the CMA's historic entry-exit analysis, and the value of this evidence, for its remittal assessment.

5.5 First, we do not consider that the Final Report justified relying only on data that included the period September 2014 to January 2016, essentially because it did not weigh the benefits of using a more recent period. As a consequence the CMA gave no evidential weight to an analysis conducted over a shorter but more recent period of data which showed that

60 Enrique Andreu and Roberto Venturini are additional author of this chapter.

61 Final Report, paragraphs 8.233 and 9.170.

Footasylum's impact was reduced in magnitude compared to the full sample period and no longer robust in terms of statistical significance.[62]

5.6 Secondly, even if (*quod non*) the CMA were correct to focus on the full time period alone, its conclusions in respect of the constraint from Footasylum still critically *rely* on the inclusion of data for September 2014-January 2016, since it did not obtain the same results for any more recent period (whether four or three years). If the CMA were to use these historic results from the Final Report for a forward-looking analysis out to 2024-2025 (for which Nike and adidas are setting their targets), it would be critically relying on store entry and exit events that occurred around a full *decade* prior.

5.7 Finally, even if (again: *quod non*) the results for the entire period could be taken to reliably describe the position towards the end of that period (i.e., early 2020), which the Final Report did not claim, given the nature of the market dynamics previously described those results are still at least four to five years removed from the time horizon of the next few years (i.e., 2024-2025). During that period, it stands to reason that any impact of Footasylum on JD Sports would be substantially modified by the accelerated growth in digital, DTC, and progressive disintermediation.

The entry-exit analysis in the Final Report unjustifiably discarded the more recent time period when assessing the impact of Footasylum store entry on JD Sports

5.8 In the Final Report, the CMA made the following conclusion concerning the entry-exit impact evidence: *"Footasylum is the only retailer that has a negative impact on JD Sports in terms of both retailer and store entry, which holds when looking at a number of different reasonable variations of the analysis"*.[63]

5.9 Critically, the results the CMA relied on for this conclusion were *only* obtained using data covering the entire period (September 2014-February 2020) and were <u>not</u> obtained for *any* more recent subset of that period that was modelled (as explained in Appendix C, the CMA's findings were not sustained looking at the then most recent four- or three-year period covered by the data).

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62 The CMA's results for Footasylum in the three-year period do not meet the CMA's own standard of robustness detailed in the Final Report. In respect of Footasylum's reduced magnitude of impact in the three-year results, this can be easily seen from Tables 8 to 15 of the Final Report Appendix C. The only exceptions are two specifications for apparel using the store-entry model at the monthly level with 10-minute drivetime (Table 13), where the magnitude of Footasylum's impact is essentially unchanged but is in any case not statistically significant even using the full period of data.

63 Based on the conclusions for footwear set out in the Final Report, paragraph 8.277. The conclusion for Footasylum's impact on apparel revenue was "*slightly less strong than that for footwear revenue, since only retailer entry is associated with a statistically significant decrease in apparel revenue for JD Sports*" (Final Report, paragraph 9.197).

5.10 The CMA selected the full time period for its assessment of the competitive constraint from Footasylum stores on JD Sports for the following reason:

> *Our preferred approach is to use all years of data ie September 2014 to February 2020. This is primarily because if an effect were to cease to be statistically significant when the time period under consideration is made shorter it would not be possible to determine whether this was due to a change in the nature of the competitive constraint or due to the loss in statistical power. As with the full data, given the potential for upward bias and the loss of statistical precision, if a retailer is not observed to exert a statistically significant and negative impact on JD Sport's revenue using the most recent data this should be treated as an absence of evidence rather than evidence that the retailer does not have an effect. Nonetheless, if a result were to be statistically significant in specifications using more recent data this would be of relevance to our assessment.* [64]

5.11 We make the following detailed comments:

a. The choice of the time-period for analysis involves a *trade-off* when the effects that need to be estimated may have changed over the period covered by the sample. On the one hand, using the entire period includes more data and may allow for better identification of effects (if any) in the sample utilised. On the other hand, using a subset of more recent data will allow the analysis to focus on the impact of more recent entry/exit episodes, which are more likely to be relevant for a forward-looking SLC assessment.

b. Therefore, as the CMA acknowledges,[65] provided that the more recent data contain a *sufficient* number of data points to perform a robust econometric estimation, there is at least a potential basis to prefer or give some evidential weight to this subsample.

c. However, the CMA did not attempt in any way to assess the sufficiency of the shorter time period to identify robust effects.[66,67] Only by doing do could the CMA have considered the

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64 Final Report, Appendix C, paragraph 58.

65 Final Report, Appendix C, paragraph 53.

66 Crucially, this assessment should be performed by considering factual evidence about the frequency and distribution over time of entry/exit episodes, as well as the estimated coefficients, for all the retailers included in the analysis, and not just the merging parties.

67 The Final Report also justifies focusing on the full period in part due to the potential for upward bias (Final Report, Appendix C, paragraph 58). In other words, a negative and statistically significant result for Footasylum in the more recent period may be hidden by the presence of upward bias, such that we cannot take the lack of a result to mean that Footasylum does not have an effect. The CMA's concern about potential upward bias is, again, entirely hypothetical and unsubstantiated. The CMA, through its

trade-off. There was substantial evidence available to do this and Compass Lexecon had made comments, which were not addressed, that the shorter period was in fact sufficient.[68]

5.12 Instead, the CMA simply states that the lack of effects in the most recent period must necessarily be attributed to lack of precision or the potential for an upward bias, which is the (implicit) reason why the CMA decides that the full period should be considered as the preferred specification; and why the lack of a negative and statistically significant impact in the more recent period cannot therefore be taken as evidence that the retailer does not have an effect on JD Sports during that period.

5.13 This reasoning is circular and does not allow for a different interpretation of the results. Moreover, it fails to explain instances of *increase in statistical significance in the shorter period* compared to the full period.

5.14 In fact the impacts of certain competitors like **[✄]**, which are not statistically significant in footwear specifications estimated using the entire sample, become larger in magnitude and/or statistically significant when focusing on the more recent three-year period.[69] This is contrary to the finding for Footasylum (where the impacts *lose* statistical significant and magnitude in the three-year period), and shows that it is indeed possible to identify a relevant effect in the three year sample.

5.15 The CMA's reasoning for giving full weight to the full period *and* essentially no weight to the more recent period (if there is no effect) was unjustifiably bound to lead the CMA *always* to prefer the longer period result having found an effect there. In other words, on the CMA's own logic, having found an impact in the entire time period there were *no possible results* for the

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own reasoning (Final Report, Appendix C, paragraph 67) and analysis (see for instance Final Report, Appendix C Table 9, specifications 2 and 4 which show that the use of more granular fixed effects to control for any bias can lead to both an increase (as seen for Nike) or a decrease (Foot Locker) of the estimated coefficients) acknowledges that the bias can very well go in the opposite direction. In any event, it remains the case that the CMA's preference for the entire period was self-fulfilling and did not give *any* weight to the possibility that the lack of a Footasylum result in the more recent period could in fact reflect that Footasylum is no longer a material competitive constraint on JD Sports.

68 Compass Lexecon, 'Comments on the CMA's revised entry-exit econometric analysis', submitted 17 April 2020", footnote 1. In addition, the lack of statistical significance in one specification does not prevent the CMA from comparing the *magnitude* of the estimated coefficients across specifications for different time periods: doing so reveals that the estimated impact of entry episodes for Footasylum is systematically reduced for the last three years across all specifications – a key result to understand the change over time of the competitive constraint exerted by Footasylum on JD Sports.

69 Final report, Appendix C, Table 10 (footwear, retailer entry, 20-minute drivetime).

more recent periods that could have contradicted this finding. As such, the CMA's approach to its choice of time period was *self-fulfilling*.[70]

5.16 In summary, the CMA did not establish any basis upon which to prefer results finding impacts from Footasylum on JD Sports over the full time period, since its reasoning was bound to prefer the entire period results. The CMA's conclusion that Footasylum is a closer competitor to JD Sports than other retailers is therefore unsubstantiated.

The CMA's conclusions in the Final Report are based on events that will be a decade old for a prospective competitive analysis out to 2024-2025

5.17 Even if (*quod non)* the CMA were justified in using data for the full period (September 2014-February 2020) at the time of the Final Report, it is difficult to see how that reasoning can still apply today for a current and/or prospective assessment.

5.18 For the reasons explained above, the CMA's identification of a robust negative impact from Footasylum critically *relied* on the inclusion of data for the period September 2014-January 2016, since it did not obtain the same results for any more recent period (whether four or three years). The gap between the years upon which the CMA is reliant for its conclusions (2014-2015) and the time horizon of the remittal (2024-2025, for which Nike and adidas are setting their targets) is therefore around a full *decade*.[71]

5.19 Furthermore, as a consequence of this approach, the CMA's conclusions in the Final Report were already inaccurate.[72] The evidence did not show that Footasylum *"is"* (rather than *"was"*) a constraint. The evidence merely showed that on average over the prior five years and six months (viewed from February 2020) Footasylum *had been* a player that exerted a revenue impact on JD Sports. This problem is even more acute when using the evidence to evaluate competition over the next few years.

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70 To be clear, the CMA attempts to justify its reasoning for preferring the full time period results in the Final Report (Appendix C), but ultimately fails to do so. Paragraphs 55-58 (essentially repeated at paragraphs 98 and 116) contains the core of the CMA's reasoning, but involves no actual weighing of the benefits of recency against less statistical precision. Paragraphs 24 and 26 merely show that there are fewer number of events for Footasylum in the shorter period (which is close to being a truism), and does not address whether there are *enough* such events (in relative terms) to perform a robust analysis.

71 Indeed, structural changes in the competitive landscape have already occurred in the two years since the Final Report, which might render the CMA's entry-exit analysis less relevant e.g., the market exit of DW Sports (bought by Frasers Group and the brand dissolved).

72 Final Report, paragraph 24: *"Our analysis of the impact of store openings and closures also indicates that Footasylum is a competitive constraint on JD Sports".*

Market developments mean that *any* store entry-exit analysis conducted at the time would already be less relevant for a current or prospective assessment

5.20 Finally, even if (again: *quod non)* the results for the entire period could be taken to reliably describe the position towards the end of that period (i.e., early 2020) and not merely on average for the whole period, which the Final Report did not claim, given the nature of the market dynamics previously described, the results would still not capture any market developments between then and a time horizon of a few years from now.

5.21 During that period, any impact of Footasylum on JD Sports would be substantially modified in light of the market developments set out in the Initial Submission. In particular:

a. **DTC:** accelerated DTC growth could mean that JD Sports' stores will experience greater constraints from Nike and adidas stores (or other brands) relative to Footasylum stores.[73]

b. **Progressive disintermediation:** as explained above, the estimated impact of Footasylum stores on JD Sports' stores relies on the allocations Footasylum was receiving between September 2014-January 2016. It fails to capture recent changes in allocations or any prospective ones, such as **[✂]**.[74]

c. **Growth in digital:** the CMA's entry-exit analysis only captures store opening and closure impacts on other stores. It does not capture impacts exerted by online rivals on JD Sports' stores or any impact at all on JD Sports online. Thus, the analysis necessarily becomes less relevant when competitive constraints are increasingly digital in nature. Specifically, as evidenced in the Initial Submission: (i) a greater proportion of sales are expected to take place online,[75] (ii) traditionally store-based retailers such as Next and Frasers Group have been investing to improve their online channels and distribution networks,[76] and (iii) online-only or platform competitors such as ASOS and Zalando have also been expanding significantly.[77]

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73 As noted in the Initial Submission, as part of their DTC growth, Nike and adidas are also expanding / relying on their own physical store footprints. See Initial Submission, paragraph 25 (Nike) and 30 (adidas).

74 Initial Submission, paragraphs 52-58*.* See also footnote 45 above.

75 For instance, Nike's global digital penetration (share of sales of Nike products made online) has been growing, and in June 2020 Nike raised its digital target to 50% from 30% set in 2017 (Initial Submission, paragraph 68). See also Initial Submission paragraphs 76 and 80 *et seq.*

76 Initial Submission, paragraphs 81 *et seq.*

77 Initial Submission, paragraphs 82 *et seq.*

Conclusion

5.22 For the reasons above, we consider that the CMA was wrong to prefer the longer, but more dated period when carrying out the entry-exit assessment. Had it used the more recent data in order to obtain a better insight into then prevailing conditions of competition, the conclusions would have been different. In any case the entry-exit analysis presented in the Final Report, even on its own terms, is not relevant for assessing the prospect of an SLC over the next few years in light of the market developments identified in the Initial Submission.

Section 6

Other ‘closeness’ evidence

6.1 In this section we more briefly address the relevance of the market developments for the remaining sources of evidence concerning closeness. First, we address market shares, which the Final Report considered were not informative about closeness.[78] Secondly, we address two sources of evidence that the Final Report considered did provide evidence for closeness: (i) ‘scoring’ evidence; and (ii) similarity of offerings (product overlaps).[79]

Market shares

6.2 The Final Report’s conclusions on market shares were that *“they only give a basic indication of the Parties’ presence in terms of the market structure and do not fully capture the closeness of competition”* and were subject to measurement issues.[80]

6.3 We would make the following points:

a. We agree that market shares do not fully capture the closeness of competition. However, Footasylum’s share of each brand’s relevant product (**[✂]**) is a key determinant of its closeness of competition with rivals. Therefore, we consider that Footasylum’s prospective share of *brand* supply (in relation to relevant products and/or within relevant distribution tiers) would be informative. In any event, this may simply be viewed as part of the fact-gathering in the counterfactual analysis.

b. Secondly, the market developments could potentially have a very large impact on Footasylum’s share of branded supply and thus on closeness of competition. A combination of growth of DTC (thus shrinking wholesale) plus **[✂]** could imply very small brand shares over the next few years if not already.

78 Final Report, paragraph 8.462.

79 Final Report, paragraphs 8.463-8.464 (footwear) and 9.294 (apparel). As noted above (paragraph 3.11), we do not comment on internal documents.

80 Final Report, paragraph 8.462.

c. Thirdly, while shares are less informative of closeness than diversion ratios for markets that are static, prospective shares of branded supply may be a much better indicator of future closeness than current diversion ratios.

d. Fourthly, we would expect the brands to be able to estimate Footasylum's likely share of supply of their products, including by type of product that has been sold in the relevant markets and/or by distribution tiers.

'Scoring' evidence

6.4 The Final Report presented evidence of 'scoring' of closeness by third parties as evidence of closeness between the Parties[81] – albeit Foot Locker always scored higher (for each Party and for footwear and apparel); Nike and adidas generally[82] score higher, although with fewer mentions; and a number of competitors were ranked as fairly close including Amazon, ASOS and Office.[83]

6.5 We would make the following points:

a. First, given the nature of how we understand the questions to have been posed (in particular, asking third parties directly to provide a ranking of *the Parties' closeness to each other*, and rankings for other retailers but where the identities of these retailers were unprompted[84]), and in particular in the context of a very public and contested merger as the basis for posing the questions, the responses seem extremely prone to framing bias.[85]

b. Secondly, the trends of digital, DTC and progressive disintermediation will have substantial impacts on closeness over the next few years for the same reasons that they will affect prospective diversion ratios.

c. Thirdly, scored closeness does not imply a material incentive for either Party to worsen PQRS for the very same reasons that this is not implied by GUPPI.

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81 Final Report, paragraph 8.464 (footwear) and 9.294 (apparel).

82 Except for apparel for Footasylum.

83 Final Report, Table 8.4 (footwear) and Table 9.4 (apparel).

84 Final Report, notes to Table 8.4.

85 Framing bias refers to the potential bias introduced in surveys due to cognitive biases that lead people to decide among options depending on how those options are presented or 'framed'. As noted in the CMA's guidance on '*Good practice in the design and presentation of customer survey evidence in merger cases*' (May 2018), paragraph 2.37: "*Importantly, though, framing effects normally should be avoided so there must be no mention of a merger inquiry: the survey's purpose should be described as seeking customer views more generally*."

Similarity of offerings

6.6 We consider that the market developments would have substantial implications for the value and interpretation of this evidence, for the following reasons:

a. **DTC:** Nike and adidas can or do have 100% product overlap with third-party retailers of their products, so to the extent that product overlap matters and consumers are choosing between retailers, they will always have (or could be given by suppliers) the choice to purchase directly from suppliers. Another important factor is that we understand that the brands are increasingly offering their members early access to their products via DTC before making them available through the wholesale channel.[86] Thus, there is an increasingly important dynamic dimension to product overlaps that is not captured by static similarity of offerings analysis.

b. **Progressive disintermediation:** further changes in allocations (e.g., due to **[✂]** reductions and/or changes in the brands' tiering/segmentation structures) can, on a forward-looking basis, be expected to substantially change the product overlap between JD Sports and Footasylum and their competitors. Notably, **[✂]**[87]**[✂]**, which is another factor that would need to be reflected in the analysis.[88]

c. **Growth in digital:** equally, growth in digital can be expected to have substantially changed the nature of product overlaps between retailers since the previous analysis, and the overlaps between the Parties' and other retailers' offerings prospectively.

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86 Initial Submission, paragraphs 63 and 65, and footnote 147.

87 Initial Submission, paragraph 56.

88 See footnotes 17 and 18.

Section 7

Supplier constraints

7.1 The issue of supplier constraints arises because each of the two merging Parties is highly dependent on branded supply **[✄]**.

7.2 Supplier constraints are not a source of SLC evidence but could provide evidence in mitigation of what may otherwise be an SLC. Therefore, supplier constraints need to be considered as integral to any SLC analysis although they may not be necessary for the absence of an SLC given horizontal constraints.[89]

7.3 The three major changes set out in the Initial Submission are likely to increase the supplier constraint.

7.4 First, DTC and rationalisation of wholesale partners gives the brands more options for substituting away from any one wholesale partner, thus places each wholesale partner at more risk. This shift in bargaining power towards the brands increases the supplier constraint thus exacerbating the control and influence identified in the Final Report.[90]

7.5 Secondly, each of the four[91] reasons why the CMA previously found that the supplier constraint was insufficient[92] is likely made less significant by the identified developments:

a. **Loss of benchmarking**:

i. The Final Report considered that the merger could lead to a reduction in the ability for the brands to benchmark JD Sports and Footasylum.[93]

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89 The Final Report appeared to consider that supplier constraints were insufficient to moderate an SLC before assessing the SLC.

90 Final Report, paragraph 8.458 (footwear): suppliers, particularly Nike and adidas, *"control and influence some aspects of retail competition"* and could use allocations *"as a mechanism to exert influence"*.

91 We combine monitoring and detection below.

92 Final Report, paragraph 8.461 (footwear).

93 Final Report, paragraphs 8.459 and 8.460(b) (footwear).

ii. A concern about loss of benchmarking would require both (i) that the brands would be benchmarking JD Sports and Footasylum against each other prospectively and (ii) that there would be a material loss from being unable to do so, including given other benchmarking options.[94]

iii. The market developments are likely to mean that the loss of any benchmarking ability is less important in light of the following factors:

– The brands' ongoing actions to reduce the number retailers of their products and volumes sold through the wholesale channel and thus potential comparators for the importance of benchmarking. By significantly reducing the number of wholesalers, the brands are demonstrating that they can carry out any benchmarking they wish to undertake using fewer wholesalers and/or the value they attribute to benchmarking is smaller than the value they derive from disintermediation.

– The increased capacity of suppliers to benchmark the Parties against their own DTC sales and/or to digital competitors (given growth in sales in these channels and more ready scope to benchmark between digital sellers).

– The loss of comparability between JD Sports and Footasylum due to progressive disintermediation and **[✂]**, and the fact that each Party would have more obvious comparators (being those in the same segment of the hierarchy).

– The increased scope to compare internationally as domestic accounts are cut and the brands select their main partners above country level.

iv. For the reasons set out above, it is hard to see how, even if this concern were correct at the Final Report, that it would not need to be fundamentally reassessed for its factual relevance over the next few years.

b. **Monitoring and detection**:

i. The Final Report considered that suppliers do not monitor all aspects of retailers' offerings[95] and there are limits to suppliers' ability to detect a deterioration of retailers' offerings.[96]

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94 We note that the Final Report contained very limited evidence of the former and no evidence of the latter. We contrast cases where benchmarking has been rigorously analysed, for example *Pennon Group / Bournemouth Water*, November 2015, paras 6.121-6.166.

95 Final Report, paragraph 8.460 (footwear).

96 Final Report, paragraph 8.460 (footwear).

ii. The market developments are also likely to have affected monitoring and detection in that (i) the brands have more ability to monitor digital sales; (ii) having fewer wholesale partners will make it easier to monitor those that remain; and (iii) progressive disintermediation makes wholesale partners more concerned to offer PQRS to secure supply, thus more constrained even if detection is imperfect (see paragraph 7.4).

c. **Incentives:**

i. Finally, the Final Report found that suppliers have no incentive to discipline retailers where any deterioration in a retailer's offering does not harm, or benefits, suppliers.[97]

ii. As a preliminary point, the supplier constraint does not require suppliers' incentives to be aligned with the interests with consumers (let alone fully aligned).[98] If suppliers would already prefer some outcome that is averse to consumer interests they would have the ability and incentive to bring it about pre-merger and then restore it post-merger.

iii. The market developments therefore suggest that this concern is less applicable because those developments mean that the brands have even more control to shape the wholesale channel and therefore more ability to restore that channel following a merger to the structure they desire.

7.6 In summary, we consider that the market developments likely mean that the CMA's previous conclusion that the suppliers, **[✂]**, *"control and influence some aspects of retail competition"* and could use allocations *"as a mechanism to exert influence"* should be materially strengthened and at the same time integrated in the analysis of the Parties' incentives to set PQRS post-merger. Nevertheless, it may not be necessary to rely on supplier constraints to any degree to conclude an SLC is unlikely.

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97 Final Report, paragraph 8.460 (footwear).

98 The Final Report (paragraph 8.68) gives an example of suppliers not having an incentive to react to a reduction in discounting because doing so might undermine their efforts to establish their products as 'status' products. However, that is not a sensible example of misalignment of suppliers' and consumers' interests: suppliers' efforts to establish and maintain their products as status products precisely reflects consumer preferences for status goods. In any event, **[✂]**.

Appendix A

Top-ranking search terms

A.1 This appendix adds to the evidence already submitted by Footasylum on the importance of the products affected by **[✂]** to consumers and thus the competitiveness of its offering by presenting some evidence on online search data from Footasylum's website.[99]

A.2 Footasylum has provided us with data on the top 1,000 search terms by number of unique searches on its desktop and mobile sites for the period 1 January 2021 – 15 May 2021.[100]

A.3 **Error! Reference source not found.** below lists the top 20 search terms over this period. As shown in the table, search terms relating to **[✂]** Alternative terms relating to these footwear franchises (e.g., **[✂]**) and terms relating to **[✂]** also appeared in the top 20 search terms over the period.[101]

A.4 It is also evident from the data that search terms including specific references to **[✂]** accounted for all but one of the top 20 search terms on Footasylum's website over the period – the only one of the top 20 search terms that did not include reference to a **[✂]** was the generic reference to "**[✂]**" sandals (ranked 19th).

99 See, for example, Initial Submission, paragraphs. 35(b) and 58; Footasylum's response to Q22 of CMA's s109 dated 6 April 2021; and Footasylum's site visit presentation, slides 16-26.

100 A unique search is defined in the data as the number of times people searched a given term on Footasylum's website, excluding duplicate searches within a single visit/session. These figures only include manually-entered search terms and do not include searches executed via drop-down links or suggested product results presented to users when clicking the search bar or as text is entered.

101 We recognise that the observations we make above relate to the relevant affected franchises/products in general **[✂]**.

[✂]

	[✂]	[✂]	[✂]
	[✂]	[✂]	[✂]
	[✂]	[✂]	[✂]
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Source: Footasylum extract from Google Analytics 360

Appendix B

Brand-level shares illustration

B.1 Below we set out an illustrative example of how growth in DTC and progressive disintermediation, in combination, could have an effect on the Footasylum increment of this merger.[102] In this hypothetical example, we do not take into account the impact of the shift to digital on shares, save to note that (as explained above) it is likely to amplify the first two effects.

B.2 As a starting point, we use the CMA's market shares presented in the Final Report to estimate retail shares of supply for Nike and adidas footwear and apparel in 2018.[103] Specifically:

a. We take the CMA's shares of supply for sports-inspired casual footwear (combined across in-store and online) in calendar year 2018 (and separately for apparel).

b. Given we know JD Sports' actual sales revenues, we can convert each retailer's share into revenue terms.

c. We use the Parties' own data, and the Parties' assumptions for other retailers', to split those revenues attributable to (i) Nike, (ii) adidas, and (iii) non-Nike/adidas.

d. From there, we can estimate shares of supply for Nike/adidas footwear and apparel.

B.3 Table 1 below presents the resulting share estimates for the retail supply of Nike and adidas footwear and apparel across store and online sales in 2018.

102 For the avoidance of doubt, this is a purely illustrative example. As explained above, we think the CMA can obtain estimates of future shares more directly by simply asking Nike and adidas for the relevant information.

103 The methodology and full set of assumptions and results are presented in 'Retail market shares for Nike-adidas vs non-Nike-adidas', submitted 9 March 2020 as Annex 2.3 of the Parties' response to Provisional Findings.

Table 1: Shares of supply of retail sales of Nike and adidas footwear and apparel, in-store and online sales, CY2018

	Footwear		Apparel	
Retailer	**Nike**	**adidas**	**Nike**	**adidas**
JD Sports	[✂]	[✂]	[✂]	[✂]
Footasylum	[✂]	[✂]	[✂]	[✂]
Combined	[✂]	[✂]	[✂]	[✂]
Nike	[✂]	[✂]	[✂]	[✂]
adidas	[✂]	[✂]	[✂]	[✂]
ASOS	[✂]	[✂]	[✂]	[✂]
Foot Locker	[✂]	[✂]	[✂]	[✂]
Next			[✂]	[✂]
Primark	[✂]	[✂]	[✂]	[✂]
Office	[✂]	[✂]		
Schuh	[✂]	[✂]		
Shop Direct	[✂]	[✂]	[✂]	[✂]
Sports Direct	[✂]	[✂]	[✂]	[✂]
Other	[✂]	[✂]	[✂]	[✂]
Total	**100%**	**100%**	**100%**	**100%**

Notes: *The CMA calculated market shares using two different methodologies. For simplicity, the above figures represent the mid-point between estimates using each of those methodologies.*
Source: *Compass Lexecon analysis of Final Report market shares. See Compass Lexecon estimates submitted to the CMA in Annex 2.3 of the Parties' response to Provisional Findings (submitted 9 March 2020).*

B.4 Adopting the above shares as a starting point for 2018, we make two illustrative assumptions:

a. Nike and adidas will scale their DTC share up to 50% by 2025; and

b. Nike and adidas, will distribute their products within their wholesale channels such that key third-party retailers (JD Sports and Foot Locker)[104] will maintain their brand share to 2025. In other words, while all third-party retailers will experience reduced brand shares due to DTC growth, JD Sports and Foot Locker as key strategic accounts for the brands will not suffer overall because the effect will be cancelled out by prioritised access to product *within* the wholesale channel.

104 As noted in the Initial Submission (paragraph 51), JD Sports and Foot Locker are recognised as key strategic accounts for the brands. Other key strategic retailers in Europe are likely to include Snipes (Deichmann in the UK) and Zalando. However, these retailers are either not factored into the CMA's market shares or not separately identified, so we limit our identification of key strategic partners in this illustrative example to JD Sports and Foot Locker only.

B.5 As a consequence of these two assumptions, less important retailers like Footasylum will suffer disproportionately. Not only would it lose share to the brands' DTC channels, but even within the wholesale channel, Footasylum's share would be reduced in favour of JD Sports and Foot Locker. These effects work in combination to reduce Footasylum's share of Nike and adidas product.

B.6 While these assumptions are only illustrative, they are not unreasonable in light of the forecasts and targets the brands are publicly setting themselves for the future.[105]

B.7 In our view, it is easy to see how these (or broadly similar) assumptions in combination could serve to reduce Footasylum's brand share from the CMA's previous (and now dated) estimates. As shown in Table 2 below, Footasylum's share of Nike footwear would decrease from **[✂]** in 2018 to **[✂]** by 2025, from **[✂]** to **[✂]** for Nike apparel, **[✂]** to **[✂]** for adidas footwear, and from **[✂]** to **[✂]** for adidas apparel.

Table 2: Shares of supply of retail sales of Nike and adidas footwear and apparel for Footasylum, in-store and online sales, 2025

	Footwear		Apparel	
Retailer	**Nike**	**adidas**	**Nike**	**adidas**
Footasylum	[✂]	[✂]	[✂]	[✂]

Source: Compass Lexecon analysis of Final Report market shares, estimating out to 2025.

B.8 To explain how these shares are calculated, we can take Nike footwear as an example:

a. As shown in Table 1, we estimate that in 2018: Footasylum's share of Nike footwear was around **[✂]**, Nike DTC was **[✂]**, and key third-party retailers accounted for at least **[✂]** (taking the sum of JD Sports' and Foot Locker's share).[106] This means less important third-party retailers collectively accounted for **[✂]** of Nike footwear sales (100% - **[✂]** DTC – **[✂]** key retailers).

b. In 2025, if Nike DTC is expected to reach 50%, that leaves the remaining 50% for the wholesale channel. Within that 50% for wholesale, if Nike allocates product such that JD Sports and Foot Locker (as key third-party retailers) maintain their brand share, then the remaining less important retailers will collectively account for **[✂]** of Nike footwear sales (100% - 50% DTC - **[✂]** key retailers).

B.9 Assuming Footasylum's share among less important retailers remains the same in 2025 as in 2018 (**[✂]** Footasylum share / **[✂]** less important retailers = **[✂]**), then its share of Nike

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105 For instance, adidas' "*Own the Game*" strategy announced on 10 March 2021 revealed its aim to increase considerably the proportion of global sales that are DTC to 50% by 2025 (Initial Submission, paragraph 7(b)). See also footnote 5.

106 Figures quoted in text derived from tables may not add up due to rounding.

footwear in 2025 will be **[✂]** (**[✂]** * 5% brand share available to less important retailers). This is significantly less than its **[✂]** share in 2018.

Appendix C

Entry-exit analysis up to and including the Final Report

Provisional Findings

C.1 The CMA's entry-exit analysis in Provisional Findings was based on the period **September 2014-September 2019**.

C.2 For present purposes, the CMA's provisional conclusions do not matter.

Updated data set

C.3 Following Provisional Findings, the CMA requested JD Sports to update the data set for the period **August 2017-February 2020** (thus partially overlapping with the prior period, but also extending it by five months).

First Compass Lexecon submission after Provisional Findings

C.4 On 25 March 2020, Compass Lexecon submitted a paper conducting further entry/exit analysis using the updated data set.[107]

C.5 In our analysis, we examined (i) the entire period combining the new and updated data (**September 2014-February 2020**) and also (ii) the period of the updated data set only and thus the (then) most recent 2.5 years (**August 2017-February 2020**).[108]

C.6 For present purposes, our results do not matter save to note that the results for the most recent 2.5 years did not support the CMA's conclusions in the Final Report.[109]

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107 Compass Lexecon, "The CMA's entry-exit analysis: Further analysis using extended data set", 25 March 2020.

108 Compass Lexecon, "The CMA's entry-exit analysis: Further analysis using extended data set", 25 March 2020, paragraph 3.5.

109 Compass Lexecon, "The CMA's entry-exit analysis: Further analysis using extended data set", 25 March 2020, paragraph 3.7.

The CMA's revised analysis

C.7 On 9 April 2020, the CMA sent its own revised econometric analysis using the extended data.

C.8 This analysis covered three time periods: (i) the entire period (as above); (ii) the (then) most recent approximately four-year period (**February 2016-February 2020**); and (iii) the (then) most recent approximately three-year period (**February 2017-February 2020)**.[110]

C.9 However, the CMA did not provide any commentary accompanying the results, including in relation to preferences concerning the different time periods, so it was unclear how the CMA intended to interpret these results.

Second Compass Lexecon submission after Provisional Findings

C.10 On 17 April 2020, we submitted a response to the CMA's revised results.[111] For that response, we adopted the CMA's calculations.[112]

C.11 We explained in our response why we considered it was appropriate, in so far as relying on this analysis at all, to prefer the more recent results.[113] We therefore commented on the CMA's results for the most recent three-year period.[114] We explained that our findings would have been substantially the same if looking at the more recent four-year period.[115]

C.12 We repeat in full our summary of the CMA's most recent three-year results.

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110 For completeness, we note that the analysis also included sensitivities restricting the competitor set to a limited number of "close competitors" (which was eventually not presented in the Final Report), and it ignored the inclusion of postcode-time fixed effects which was suggested in the first Compass Lexecon submission after Provisional Findings.

111 Compass Lexecon, "Comments on the CMA's revised entry-exit econometric analysis", 17 April 2020.

112 Compass Lexecon, "Comments on the CMA's revised entry-exit econometric analysis", 17 April 2020, paragraph 1.5.

113 Compass Lexecon, "Comments on the CMA's revised entry-exit econometric analysis", 17 April 2020, paragraph 1.6.

114 Compass Lexecon, "Comments on the CMA's revised entry-exit econometric analysis", 17 April 2020, paragraphs 1.8-1.10.

115 Compass Lexecon, "Comments on the CMA's revised entry-exit econometric analysis", 17 April 2020, paragraphs 3.6-3.8.

Footwear

C.13 The CMA's analysis for the three-year period February 2017-February 2020 shows:[116]

a. **There is no robust finding of an effect from Footasylum**, since it is only negative and statistically significant in 2/32 regressions.

b. There is much more evidence of a robust effect for other competitors.

   i. **Sports Direct/USC** and/or **USC** has a negative and statistically significant impact in 8/32 regressions,[117]

   ii. **Schuh** has a negative and statistically significant impact in 24/32 regressions,

   iii. **Nike** also has a negative and statistically significant impact in 23/32 regressions,

   iv. **Office** has a negative and statistically significant impact in 19/32 regressions,

   v. **Foot Locker** has a negative and statistically significant impact in 8/32 regressions,

   vi. In addition, various other retailers have a relevant negative impact: Offspring in 6/16 regressions, River Island in 5/16 and Skechers in 2/16.

c. **The magnitude of the (non-robust) finding for Footasylum is similar to or smaller than for many other competitors**. For example, USC, Office, Schuh Nike and Offspring all show larger average impacts than Footasylum at 10 minutes; and Schuh, Nike, Offspring and River Island all show larger impacts than Footasylum at 20 minutes.

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116 Compass Lexecon, "Comments on the CMA's revised entry-exit econometric analysis", 17 April 2020, paragraphs 1.8.

117 Sports Direct/USC is included in 32 regressions and USC is also included in 16 of these regressions.

Table 3: Summary of CMA analysis for the period February 2017-February 2020, footwear

Competitor	Proportion of regressions where negative and statistically significant	Average magnitude where negative and statistically significant[118]	
		20 mins drive-time	10 mins drive-time
Footasylum	2/32	[✂]	[✂]
SD/USC	2/32 SD/USC		[✂]
USC	8/16 USC	[✂]	[✂]
Schuh	24/32	[✂]	[✂]
Nike	23/32	[✂]	[✂]
Office	19/32	[✂]	[✂]
Foot Locker	8/32	[✂]	[✂]
Offspring	6/16	[✂]	[✂]
River Island	5/16	[✂]	[✂]
Skechers	2/16	[✂]	[✂]

Notes: *(a) Results only shown for competitors with at least one regression showing a negative and statistically significant effect (at 5% significance).*
(b) Results are summarised over a number of specifications and sensitivities looking at:
(i) Monthly vs quarterly data
(ii) Time fixed effects vs region-time fixed effects
(iii) 20 min vs 10 min drive-time catchments
(iv) Store entry vs retailer entry model
(v) All vs close competitors
(c) We note the proportion of regressions with statistically significant results for non-"close" competitors could be even higher if each retailer were individually included in the "close" competitor regressions.
Source: *CMA revised entry-exit analysis, received 9 April 2020*

Apparel

C.14 There are sparser statistically significant results in general for apparel. As previously noted, this is most likely because the apparel market is even more fragmented than footwear.[119]

C.15 Nevertheless, similar conclusions apply as for footwear:[120]

a. **There is no robust finding of an effect from Footasylum**. The CMA analysis does not find a negative and statistically significant effect in any of the 16 regressions for store entry,

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118 The average magnitude is computed *inter alia* across impacts from the store and retailer entry models. The general conclusion that a number of other competitors have larger impacts than Footasylum holds regardless of whether we look at store and retailer entry models separately or combined.

119 Compass Lexecon submission, 'The CMA's entry-exit analysis', submitted 26 March 2020, para. 6.5(c).

120 Compass Lexecon, "Comments on the CMA's revised entry-exit econometric analysis", 17 April 2020, paragraphs 1.10.

or for any of the 8 regressions for retailer entry at 20 minutes, and only for the 8 regressions for retailer entry at 10 minutes. Applying the same criterion for assessing robustness as the CMA applied for footwear in Provisional Findings, this means there is no robust finding of an impact from Footasylum.[121] The fact that there are almost as many statistically significant results for Office as for Footasylum is a further indication that the CMA's regression results are not robust given that Office does not sell apparel.

b. **There is substantially more evidence of a robust effect from Nike**. There are negative and statistically significant effects for Nike in 26/32 regressions.

c. **The magnitude of the (non-robust) finding for Footasylum is much smaller than for Nike**. Across all regression specifications where Footasylum displays a negative and statistically significant impact, the corresponding impact for Nike is also statistically significant and much greater in magnitude.

Table 4: Summary of CMA analysis for the period February 2017-February 2020, apparel

Competitor	Proportion of regressions where negative and statistically significant	Average magnitude where negative and statistically significant	
		20 mins drive-time	10 mins drive-time
Footasylum	8/32		[✂]
SD/USC USC	3/32 SD/USC 0/16 USC		[✂]
Nike	26/32	[✂]	[✂]
Office	5/32	[✂]	[✂]
DW Sports	1/16	[✂]	[✂]

Notes: *See notes to Table 3.*
Source: *CMA revised entry-exit analysis, received 9 April 2020*

The CMA's Final Report

C.16 In the Final Report, the CMA presented a subset of the time periods it examined previously: it included the entire period (**September 2014-February 2020**) and also the (then) most recent three-year period (**February 2017-February 2020**), but omitted the (then) most recent four-year period. For those time periods that were provided, the CMA's results were the same as those provided on 9 April 2020.

C.17 However, and critically for its conclusions, the CMA expressed a preference for the entire period results and solely relied on those results for reaching its conclusions.[122] Therefore all conclusions that it reached based on this evidence to find Footasylum a closer competitor to JD Sports than other retailers are unsubstantiated.

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121 Provisional Findings, paragraph 8.168.

122 Final Report, Appendix C, paragraph 58.