Regulatory Constrained Portfolio Restructuring: The US Department Store Industry in the 1990s

Abstract

The US department store industry has undergone a recent round of strategic acquisition-based portfolio restructuring. This paper analyses one such acquisition, studying how its geography is restructured in the pre-merger stage to conform to the Federal Trade Commission's 'fix-it-first' policy and to improve the strategic fit of the transaction. The article then investigates evidence, and analyses the effects, of a new era of stricter FTC enforcement, where divestiture may no longer be sufficient in cases of horizontal market overlap. Fundamentally, the paper considers the nature of 'real' regulation in action, as rules partially dictate investment decisions.

Keywords: retail, regulation, antitrust, divestiture

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INTRODUCTION

There are numerous forms of corporate restructuring a firm may adopt in order to succeed in competitive markets. These have been well documented within the economic geography literature (e.g. Clark, 1993b; 1994; Clark *et al.*, 1992; McGrath-Champ, 1999). First, an organisation may pursue financial restructuring; changing the capital structure of the firm to increase shareholder value. High leverage restructurings (LBOs and leveraged recapitalisations) in particular, have met with varied levels of success across different industries and firms (Bowman *et al.*, 1999). Second, a firm may restructure organisationally, redesigning its operations to align with the firm's strategy (cf. Porter, 1980). Finally, and most obviously, a firm may restructure its portfolio of business units to sharpen its focus by disposing of units peripheral to its broader goals and core operations, eliminating under-performing units, or alternatively acquiring other operations and integrating either horizontally or vertically (see Bowman *et al.*, 1999; Bowman and Singh, 1993; Green, 1990). It is this latter form of restructuring which provides the focus of this paper.

Portfolio restructuring clearly does not operate within a regulatory vacuum. In the United States it takes place within the context of antitrust legislation and its enforcement (see Wrigley, 1992 for a review of antitrust regulation in the retail industry). This paper uses the example of the US department store industry in the 1990s to explore issues of portfolio restructuring operating in a regulatory constrained environment, considering in particular how difficulties with managing spatial strategic fit are negotiated through interaction with competitors in local markets⁵⁸. This geographical analysis of portfolio restructuring, interacting with governance and competition policy, provides an example of what Gordon Clark (1992a) has labelled 'real' regulation. In addition, it provides a perspective on the implementation of US antitrust legislation, and the implications of reinterpretations of antitrust regulation for future merger and acquisition activity within the US retail industry.

⁵⁸ This research is based in part on two extensive periods of US fieldwork during January and March/April 2000, consisting of over 30 interviews with leading industry executives at department store retailers including Bloomingdale's, Saks Incorporated, and Macy's, academics, and equity analysts at Goldman Sachs, Merrill Lynch and Schroders. This material was triangulated with industry reports, press releases and the retail press. Interview quotations are numbered to protect the anonymity of respondents where this was requested.

FORMS OF PORTFOLIO RESTRUCTURING

There are a number of situations where a firm may choose to adopt a strategy of portfolio restructuring. First, it may adopt an aggressive acquisition policy of *related businesses*, purchasing similar firms in order to increase market dominance and economies of scale. Bergh (1997) identifies three principal benefits of such a transaction. First, there may be the prospect of synergies, both operational and financial. Second, governance efficiencies may result where the acquired businesses may be more efficiently managed in the parent firm's governance system. As Hill et al. (1992) suggest, the acquirer may be 'able to achieve a more efficient allocation of capital resources between divisions, and police the efficiency of divisions more effectively than the stock market could were each division an independent firm' (p503). Third, managerialism benefits may result whereby the corporation achieves market power and increases in organisational size as a result of the acquisition.

Alternatively, the firm may adopt an acquisition policy of related businesses as a defensive strategy - possibly leveraging up to fend off potential acquirers (Laulajainen, 1990). In a market where there are few acquisition targets, the firm may be prepared to pay a premium for any remaining candidates (Wrigley, 1999b). This premium may be worth paying if the acquisition improves the firm's position in the market and prevents a competitor from pre-empting it.

Third, portfolio restructuring may entail disposing of units peripheral to its core business. Such divestiture might be to raise capital for other acquisitions or to rid itself of under-performing divisions, although they are likely to incur what Clark and Wrigley (1995; 1997) refer to as 'exit sunk costs'. This would have the effect of sharpening focus, but at the expense of increasing dependence on the core operation.

Finally, the firm may diversify its portfolio through the purchase of units *not related* to its core business. This is likely to act as coinsurance for the acquirer, enabling the balancing of revenue cyclicalities, substantially reducing risk (Bergh, 1997). Such a defensive manoeuvre may shift emphasis away from a faltering core operation, allowing entry to a growth industry, or alternatively, be a strategy to increase revenue to fund the core operation (Chung and Weston, 1982; Gort, 1966; Hughes *et al.*, 1980). However, unrelatedness often represents a barrier to realising operational and financial synergies, and as such, 'a high proportion of unrelated acquisitions are divested shortly after purchase' (Bergh, 1997, p726).

PORTFOLIO RESTRUCTURING AND THE US DEPARTMENT STORE INDUSTRY

All of these methods of portfolio restructuring have been characteristic of the US department store industry over the last few turbulent decades. During the 1960s and 1970s, with the impression that the future of the conventional department store looked bleak, department stores adopted strategies of portfolio diversification, acquiring businesses from other sectors, including discounters, supermarkets and speciality stores (Bluestone *et al.*, 1981; Laulajainen, 1987; 1988; Traub, 1994). The industry, in this respect, was characteristic of the so-called conglomerate merger wave of the period (Clark, 1992b; Fligstein, 1990; Schendel, 1993).

During the mid to late 1980s the department store industry underwent a period of portfolio restructuring principally driven by financial restructuring imperatives. This portfolio restructuring was principally motivated by opportunities for individuals and firms to acquire retailers with little equity through significant changes in the capital structure of the target. The US department store industry was one of the most notable casualties of the over-leveraging and debt-burdening characteristic of 'junk' bond financing. Firstly, between 1986 and 1988, Federated, and Allied, two of the largest department stores, were acquired by Canadian real estate virtuoso, Robert Campeau in a highly leveraged acquisition, underpinned by money from the coffers of Citibank and First Boston (see Hallsworth, 1991; Kaplin, 1990, 1994; Rothchild, 1991). Eventually, after substantial divestiture to pay down the debt, the corporation collapsed, and Federated/Allied filed for Chapter 11 bankruptcy protection in January 1990. The poor state of the sector was compounded by the failed leveraged buy-out of R. H. Macy for \$3.5 billion in 1986, which ended in Chapter 11 protection in 1992. Indeed, before the buyout, the business had \$1.48 billion in shareholder equity (\$1 of debt for every \$11 in equity), after the takeover, the ratio was \$3.15 billion in debt and \$290 million in equity (or \$10 in debt for each dollar of equity) (see Lehmann-Haupt, 1996; Serwer, 1996; Trachtenberg, 1996). This portfolio restructuring was driven more by the theory of financial restructuring where the pressure of high interest debt payments would force managers to focus on the core business, and not squander cash flows in presumably less rewarding diversification projects (see Bethel and Liebeskind, 1993, p10; Bowman and Singh, 1993; Jensen, 1986; 1989). However, the department store industry proved to have too cyclical a cash flow for successful leveraging, especially at the levels owed. Furthermore, the luxury-oriented nature of many of the more upscale department stores was in direct opposition to the pressure to aggressively cut operating margins. This experience can be contrasted with numerous successful leveraged buy-outs in the supermarket industry which were characterised by non-cyclical cash flow (cf. Denis, 1994; Wrigley, 1999a; 1999b).

Strategic Acquisition-Based Portfolio Restructuring

Since the late 1980s, there has been a movement away from holding a diversified conglomerate of separate retail businesses and a focus on acquisition based portfolio restructuring throughout the department store industry, concentrated on acquiring rival department store operators rather than retailers in other sectors (Table 1). This de-conglomeration trend has been characteristic of US industry more widely, as 'divestitures of segments of the firm now deemed peripheral to the company's core operations are motivated by...a systematic strategic analysis that there are weak (or no) synergies among broadly diversified activities' (Harrison, 1997, p40; see also Prahalad and Hamel, 1990). Michael Porter (1987) provides justification for this by suggesting that diversification is only effective when there is the opportunity to share resources and transfer skills across the portfolio of businesses (see also Chang and Singh, 1999). This is difficult across such diverse segments as department stores and supermarkets, and, to a less extent, discounters. Unlike the 1960s and 1970s, department store firms no longer attempted to construct a broad array of retailing operations across a conglomerate portfolio, but instead pursue strategic acquisitions⁵⁹. As the Director of the Federal Trade Commission (FTC) has acknowledged:

What is remarkable about this merger trend, in addition to its sheer volume, is also the nature of the acquisitions. In the 1980s, many mergers were prompted by financial market considerations. To a far greater extent, today's mergers appear to be motivated by *strategic considerations* (Baer, 1997, my emphasis).

Explaining the Acquisition-Based Restructuring of the 1990s

In the same way as the easy finance from high yield corporate bonds and private pension fund investment freed from its regulatory constraints (see Clark, 1993a; Wrigley, 1999b) paved the way for the great wave of financial re-engineering of US industries during the 1980s, so there are general, and industry specific, factors underpinning the mid-late 1990s merger wave in the department store sector. Fundamentally, there was negative net growth in the industry. Over three decades, conventional department stores lost market share to discount stores such as K-Mart and Wal-Mart (**Figure 1**), and speciality store such as Limited and Gap (Porter, 1999; Rachman and Fabes, 1992; Rousey and Morganosky, 1996). Therefore, although consolidation increased the individual market shares of retailers within the industry, this took place within a sector that has been declining in real terms. For example, whilst Federated Department Stores increased its share of *conventional department store sales* from 14.8% of industry sales in 1989 to 28.8% in 1999, its share of *GAF* (general merchandise, furniture and apparel sales) has declined from 2.1% to 1.8% (see **Table 2**). **Table 3**, for example, contrasts the slow growth of conventional department stores with the spiralling success of discount stores through the 1990s, as the latter ate their way into the traditional apparel heartland of the conventional department store. Squeezed between alternative retail formats, department stores were forced, in effect, to consider acquiring their competitors to maintain their market position (Dunne and Kahn, 1997). Within this hostile environment, many regionally based department store chains in the US were prepared to accept consolidation with sympathetic, larger operators to save themselves from insolvency.

The restructuring period of the mid-late 1980s principally involved the national operators who acquired, and integrated, the large multiregionally and regionally dominant chains with attractive locations and strong market shares in major metropolitan markets. By the early 1990s, however, there were few remaining large department store operators left to be acquired, although there remained a fragmented smaller *regional* industry of small chains, both publicly and privately owned across the country, previously too insignificant to attract larger players. Firms such as Alabama based Proffitt's began to exploit this niche, in turn creating a second wave of consolidation in the industry (see **Table 1**).

For this second wave of acquisition based restructuring to be successful, the department store firms had to leverage their increased market power in two fundamental ways. First, capital concentration allowed the leading department stores to realise considerable cost savings through economies of scale by demanding discounts through large scale purchasing (cf. Stern and Weitz, 1997). This is now a necessity in the conventional department store sector, as acknowledged by Michael Gould, Chairman of Bloomingdale's:

If you are a stand alone business today in the department store world then you are a \$1 billion business then – what do you mean – what do you stand for? Let's say you are a \$1 billion chain store in Pennsylvania – what's their power when they go into the marketplace...they go to Tommy Hilfiger or they go to Nautica – what's their power when they are up against \$16 billion Federated or \$14 billion May Company? Awful difficult! Better figure you are going to win on something unique, but I don't think they are big enough to win on service (Interview 16).

⁵⁹ The exception to this rule has been the Target Corporation (formally Dayton Hudson Corp.) which has successfully built up a thriving discount business alongside their three department store operations.

Second, the new portfolio of department store chains had to be organisationally restructured to eliminate duplication of core back office functions, centralising those operations the customer not see (Wood, 2001). These cost savings increase when operational expertise passes throughout the new firm in a process known as 'knowledge transfer' (see Merrill Lynch, 1999a). The difficulty of this reorganisation should not be underestimated - a recent study by KPMG found that 83% of mergers were unsuccessful in producing any business benefit as regards shareholder value (KPMG, 1999).

It is in this rapidly consolidating environment that the conventional department stores found themselves during the 1990s. Such portfolio restructuring did not occur however in an aspatial or unregulated environment. Instead, it had to operate within the boundaries set by the Federal Trade Commission, in addition to those set by the competitive restraints of the market. For Gordon Clark, 'real regulation' of this type must be understood as 'derived through the interplay between economics and political culture and then mediated through institutional practices' (Clark, 1992a, p 622). It is consequently necessary to understand these embedded regulatory conditions before analysing the strategic execution of merger activity in the sector and prescribing future solutions.

A BRIEF HISTORY OF US ANTITRUST REGULATION AND ITS IMPACT ON THE RETAIL INDUSTRY

US competition regulation has been a contested issue since the late 19th Century. There was an awareness of the virtues of economic competition in industry - it limited excessive concentration of power, dispersing benefits broadly along the contours of the market. It also provided a mechanism for the upward mobility for new market entrants to challenge the primacy of old competitors (Wood and Anderson, 1993, p1). However, it was also appreciated that:

Free from outside interference, competitors often collude or resort to unfair practices to restrict competition. They may erect barriers to market entry to preserve their position. They may also seek a large market share in order to suppress the operation of market pricing mechanisms. Thus, competition does not maintain itself. Government action often becomes necessary to preserve or restore economic competition (Wood and Anderson, 1993, p3)

Hence there was a need for the state to interfere with the working of the market mechanism to produce outcomes as near as possible to those demanded by neo-classical economics. The difficulty came in what form this action took, and how laws and statutes could be drafted to accommodate the smooth operation of the economy and ensure competitive industries.

At the heart of the US antitrust legislation is the *Sherman Act* passed in 1890, as a reaction against the predominant cartelisation and centralisation of market power prevailing in the United States at the end of the 19th Century. The act consisted of two main sections. The first, prohibited all contracts, combinations, and conspiracies in restraint of trade, whilst the second, prohibited monopolisation and attempts to monopolise (see Audretsch, 1989). The inability of the *Sherman Act* to control merger activity, however, was evident in the great merger wave that occurred at the turn of the century (Audretsch, 1989). Indeed, the *Sherman Act* was not drafted expressly to deal with mergers. As Valentine (1996) suggests, the act was successful in eliminating trusts and holding companies as vehicles for cooperation among companies although 'the Supreme Court did not extend its reach to mergers unless it could be shown that their very purpose was to restrain trade. Not surprisingly, businesses and barons adapted their technique and the US saw its first great merger wave in the 1890s, after and perhaps because of the *Sherman Act*' (Valentine, 1996). The *Clayton Act* was consequently passed in 1914 to clarify and supplement the *Sherman Act*. It attempted to solve the difficulty inherent in the 19th Century legislation, which applied only to mergers when the merging firms were on the verge of attaining substantial monopoly power. The revised Section 7, the part of the *Clayton Act* relevant to mergers, thus read:

That no corporation engaged in commerce shall acquire, directly or indirectly, the whole or part of the stock or other share capital of another corporation engaged also in commerce where the effect of such an acquisition *may* be to substantially lessen competition between [the two firms] or to restrain such commerce in any section or community or tend to create a monopoly of any line of commerce (cited in Viscusi *et al.*, 1995, p197, my emphasis).

This represented a notable shift in emphasis, with Congress coming down on the side of interventionist policy. It did not require proof that an acquisition definitely would lessen competition substantially, but only a

reasonable probability that it would (Valentine, 1996). A second wave of mergers took place between 1916 and 1929. As Viscusi *et al.* (1995) suggest, because monopolistic mergers were effectively eliminated, there was a move towards the creation of oligopolies. This trend was truncated by the Great Depression of the 1930s, but was followed by a third merger wave after the Second World War (Viscusi *et al.*, 1995). There was yet again a legislative response to the consolidations. In 1950, the *Celler-Kefauver Act* was passed. This revision of Section 7 of the Clayton Act explicitly prohibited the acquisition of another firm's physical assets if the effect was to substantially lessen competition or tend to create a monopoly (Shugart, 1998). In the process it finally closed a loophole inherent in the *Clayton Act*, which prevented it from applying either expressly, or by judicial construction, to the acquisition of assets or to vertical or conglomerate mergers - hence the law could easily be circumvented through the acquisition of a firm's assets instead of its stock (see Audretsch, 1989; Luckansky and Gerber, 1993; Valentine, 1996). The *Celler Kaufaver* revision further armed the FTC to take action, as the 'emphasis on the concepts of "substantial lessening of competition" and "tendency to create monopoly" demonstrated Congressional concern at preventing mergers that might lead to monopoly power at some time in the future' (Audretsch, 1989, p41).

During this post-war period, a structure-conduct-performance (SCP) framework was adopted by the FTC when analysing the threat of anti-competitive conditions (Eisner and Meier, 1990; Kay, 1991; Williamson, 1987). This framework suggested that industrial structure had a direct impact on the conduct of constituent firms. As such, in concentrated industries, with barriers to entry, major firms possessed the capacity to form and maintain collusive arrangements through adoption of a range of pricing, output and promotional policies ensuring supracompetitive profits. Such a structural approach to policy accepted the causal link between structure, conduct and performance, with action based on the premise that if the state corrected market structure, market conduct and performance would look after themselves (George and Jacquemin, 1992). This prompted the FTC to make decisions based on simple statistical measurements, easing decision-making, where clear-cut rules were troublesome to establish. Levels of concentration in industries and sectors were therefore the means by which the FTC acted.

Because concentration was casually related to the existence and abuse of market power, an arithmetic representation of market structure (e.g. market concentration figures) could identify probable violations and define the limits of legality. Undoubtedly, the acceptance of the framework was also tied to populist implications. Through its focus on concentrated economic power, its assumption that this power prompted abusive forms of conduct, and its reaffirmation of open markets with multiple small actors, it provided technical justifications for...anti-big business goals (Eisner and Meier, 1990, p272).

Eisner and Meier suggest that the most striking display of Congress's adherence to the structure-conduct-performance framework came in the late 1960s, when national deconcentration programmes were considered. Such initiatives would have compelled major firms in concentrated industries to divest substantial parts of their holdings to achieve certain given concentration levels.

From National Concentration to Local Analysis of Horizontal Market Overlap

The more systematic analysis of merger activity due to the structure-conduct-performance interpretation of the *Celler-Kefauver Act* is clearly evident during the post-war period with considerable implications for the analysis of mergers in the retail industry. The landmark ruling on the Brown Shoe case of 1962 was particularly important. In this case, the Brown Shoe Company's acquisition of G.R. Kinney was declared unlawful as a result of competition being impaired in 270 cities or submarkets where both Brown and Kinney operated retail shoe outlets - despite the fact that merger would have created a shoe retailer with a mere 2% national market share (Shugart, 1998). This was due to a revised interpretation of market structure being adopted by the FTC. Crucially, instead of identifying national concentration levels, a new approach of identifying local market concentrations when investigating mergers was adopted. This method of analysis was then reinforced as a result of a ruling in 1966 on the proposed Von Grocery Company - Shopping Bag merger (Wrigley, 1992; 1997). In this instance, the Supreme Court refused the merger of two grocery chains holding a combined share of just 7.5% of the grocery market in Los Angeles (Valentine, 1996). The justification for this refusal was because;

mergers involving small combined market shares were prohibited by Section 7 when they involved the leading seller in a market experiencing a trend towards centralisation (Mueller and Patterson, 1986, p386; cited by Wrigley, 1992, p739).

It was clear that the FTC had changed its spatial scales of analysis⁶⁰. Indeed, Clinton-administration FTC Chairman, Robert Pitofsky cites the conclusions of the Brown Shoe case as continuing to set the precedent today:

...if two retailers, one operating primarily in the eastern half of the Nation, and the other operating in the West, competed in but two mid-Western cities, the fact that the latter outlets represented but a small share of each company's business would not immunize the merger in those markets in which competition might be adversely affected (cited by Pitofsky, 2000).

As a result of *Celler-Kefauver*, the 1960s saw the forestalling of a number of mergers in the department store industry. Often this took the form of a ban on horizontal mergers for 10-15 years following the horizontal acquisition of another department store chain. The effect was to push department stores to acquire retailers outside of their expert market segments through the purchase of discounters and speciality stores. Alternatively, if an FTC enforcement banned *any* acquisition, the focus shifted to organic expansion in greenfield localities and thus the establishment of branches (Laulajainen, 1987, see Table 4). As suggested more generally, an 'unintended consequence of the (*Celler-Kefauver*) act was to encourage firms to merge into...unrelated industries. Indeed, the law made it attractive to choose merger candidates that were quite distant' (Fligstein, 1990, p222).

During this period of regulatory tightening, dissenting voices originated from academics at the University of Chicago, who were advocates of a reduction in antitrust action. Especially during the 1970s, the 'Chicago School' was instrumental in making the case for a movement away from merger guidelines focused on market structure analysis toward a greater emphasis on the procompetitive effects of mergers (Eisner and Meier, 1990; Wrigley, 1992). The argument mounted was that the burden of proof should come from the regulator when arguing for market intervention (Fligstein, 1990; Wood and Anderson, 1993).

Weakening of Enforcement and 1980s Financial Re-Engineering

Chicago School views were used during the early years of the Reagan administration to support deregulation and monetarist policies of economic development (Oesterle, 1997; Wrigley, 1992). This period was subsequently characterised by a relaxation in antitrust enforcement which reverted to a goal of preventing mergers that may enhance or create market power or facilitate its exercise - away from a decision based exclusively on concentration per se (Keyes, 1995; Valentine, 1996). These regulatory conditions coincided with the rise of new financial instruments and markets, specifically the high-yield bond market, to partly provide the environment for the fourth merger wave in the 1980s, where the total value of transactions increased from \$50 billion in 1983 to over \$200 billion in 1988 (Viscusi et al., 1995, p198, see also Taggart, 1988). This decade was accordingly characterised by financial restructuring, during a period Clark refers to as the 'arbitrage economy' (Clark, 1989a, see also Baker and Smith, 1998; Bartlett, 2000; Hallsworth, 1991; Oesterdale, 1997).

The 'Fix-it First' Regulatory Environment of the 1990s

By the late 1980s, in response to mounting public and Congressional criticism of the FTC's relaxed stance to retail mergers, there were signs of a retightening of antitrust enforcement (Wrigley, 1997). In particular, the State of California challenged the food retail industry merger of American Stores and Lucky Stores, Inc. in 1988 (Chevalier, 1995; Wrigley, 1997). The challenge was successfully carried to the Supreme Court in 1991, and American Stores was forced to divest its entire 145 store Alpha Beta chain in California (Cotterill, 1999b, p4; Wrigley, 1997). This was indicative of a new era of antitrust conditions for retail horizontal acquisitions during the 1990s, whereby the onus was on the acquirer to produce an acceptable strategic fit of acquisition to pre-empt any FTC action.

The FTC, throughout the 1990s, essentially adopted a 'fix-it-first' approach, not necessarily opposing mergers in which the acquiring firm committed in advance (under the spirit of the *Celler-Kefauver Act*) to divest itself of horizontal market overlaps that might be deemed anti-competitive at the local level (Wrigley, 1999b, p304).

⁶⁰ See Cotterill (1999b, p2; 1999c, p3) for recent comments on the importance of investigating local market effects.

This approach was practical because the 1976 *Hart Scott Rodeno Act* compelled all proposed mergers of considerable size to be submitted to the FTC for consideration, allowing all mergers to be subject to the same level of investigation (Baer, 1996).

The retail regulatory environment of the 1990s was, therefore, characterised by a two-component policy. The first component of this was the FTC's 'fix it first' policy – whereby the retailers had to divest horizontal market overlaps deemed to be anticompetitive at the local level in order to gain FTC approval of the merger. This involved, as George Strachan of Goldman Sachs observed, the acquirer making 'some strategic decisions regarding what the likely outcome of the FTC will be'. In its turn 'the acquirer probably makes an educated guess as to what the FTC is likely to demand and they try to accommodate the most obvious overlaps before the FTC orders them to do so. It is probably built into their plan before the FTC has even announced it' (Interview 8).

This anticipation of future enforcement through the 'fix-it-first' approach is echoed by Daniel Barry, equity analyst at Merrill Lynch:

You think about the FTC and what they might do – you get the lawyers opinion – but you don't talk to the FTC. After it's done you go to the FTC. The FTC has a certain number of days with which they have to issue an opinion so if they want to stop it or attempt to stop it then they have that many days to do it. At that point they start negotiating and you may end up selling stores (Interview 6).

Second, the merger had to be approved by the State Attorney General in the individual State in which it was occurring, even if clearance was granted by the FTC. Indeed the American – Lucky Stores divestiture was insisted on at the level of the Attorney General, as were the divestitures in Massachusetts and Connecticut in 1995/6 in the case of the mergers of Stop & Shop and Purity Supreme and between Royal Ahold and Stop & Shop, even though the FTC had provisionally agreed the transactions⁶¹ (Wrigley, 1997). As Professor David Rachman of Baruch College, New York suggested:

Basically there is another level that nobody talks about, that even if the FTC approves mergers, here are these State Attorney Generals get involved with these things and sometimes they get nasty. They fight. I happen to be involved in one. Some clerk in the main office of the Attorney General he said "they shouldn't let them do that" and they put forward some stipulation and before you know it there is an uproar going on even though the FTC has approved the merger (Interview 21).

This two-component policy was the regulatory framework that the US department store had to negotiate during the 1990s (see Figure 2). The following case study serves to evoke the internalisation of the 'fix-it-first' approach demanded by the FTC, which department store retailers had to realise in their portfolio restructuring strategies. In addition, it underlines how proposed acquisitions had to be negotiated and adjusted with, and between, other retailers in the surrounding area to result in an acceptable strategic fit. The extent to which divestitures and store swaps were pre-emptive of those insisted on by the FTC and the individual State Attorney Generals, and how much they were due to creating an improved strategic fit, is unclear and will be discussed in the following sections.

REGULATORY CONSTRAINED PORTFOLIO RESTRUCTURING IN ACTION - THE DILLARD'S – MERCANTILE STORES ACQUISITION

On May 18th 1998, Dillard's announced an agreement to acquire Mercantile Stores for \$2.9 billion in cash. Under this agreement, Dillard's, the 3rd largest conventional department store, with sales of over \$6.5 billion in fiscal 1997, proposed to take, in one bite, the 7th largest chain, which had 1997 sales of over \$3 billion across its 106 department and home fashion stores under 13 different names in 17 states.

Examining the Logic of the Deal

⁶¹ This influence was most recently seen in September 1999, when the whole of the US retail industry waited to hear whether the Attorney General of California would ban all supercentre and warehouse club stores over 100,000 square feet (see Merrill Lynch, 1999b; 1999c for assessments). Although this was eventually vetoed, it showed the power of individual states in regulating their economic landscape hand-in-hand with the FTC.

The proposed deal was completely contrary to Dillard's previous strategy of paying bargain-basement prices for extremely small regional chains which did not attract the larger industry consolidators of Federated and May (see D. Smith, 1998 and Rosenberg, 1988). In addition, there were considerable challenges and question marks concerning the strategic fit between Dillard's and Mercantile. Dillard's had for 15 years adopted a policy of every day value pricing and did not promote merchandise excessively. This was the opposite to the highly promotional Mercantile Stores. In essence, the two department stores were at opposite ends of the value-luxury spectrum. As Linda Kristiansen, Retail Analyst for Schroder's Capital Management commented:

I can't think of two more opposite companies than Mercantile and Dillard's in terms of their markdown philosophy so I think that this was a real problem for Dillard's. It was set up from the beginning to be a real disaster (Interview 14).

A third major concern was the high price Dillard's proposed to pay (see **Table 5**). In essence the acquisition was highly defensive – Dillard's was proposing to acquire Mercantile to avoid its competitors gaining leading market shares in markets in which Dillard's was also present. As an industry source commented:

So basically Dillard deliberately overpaid for Mercantile and I think they did it as a defensive move because they (were) trying to keep Saks and Federated from taking...(these)... spots. So even though they overpaid and they never get a good return on the investment, it might have been better for the shareholder in the long run, from a defensive standpoint, to have taken it over and go through all the problems they are going through than to let a competitor take those spots (Interview 6).

Dillard's – Mercantile and 'Fix-it-First'

This case study displays how retailers learned in the 1990s to operate within the remit of the FTC 'fix-it-first' policy, thus avoiding any adverse regulatory enforcement by the FTC. Second, it shows how the geography of portfolio restructuring can be reworked, whilst still in the merger negotiation stage, through divestitures and store swaps with competitors. In particular, two events demonstrate the willingness of Dillard's to take action ex-ante of regulatory enforcement (see **Figure 3**).

a) The Belk exchange

On July 19, 1998, Belk, the largest privately owned US department store, with coverage principally in the South Eastern United States, agreed to exchange with Dillard's seven Mercantile Stores located in Florida and South Carolina, for nine Belk stores – eight located in Virginia and one in Tennessee (Dillard Press Release, July 14, 1998). This action made up half of the Dillard strategy to pre-empt any FTC antitrust action. The transaction also produced a strategic fit appropriate for Belk as it gave them a strong first time presence in the Jacksonville, Florida market and enabled them to enter the Columbia, South Carolina market with three stores.

For Dillard's, the transaction represented an agreement that would avoid duplication of stores in certain geographical areas improving the strategic fit for the corporation. It represented Dillard's first entry into the Chattanooga, Tennessee and Wilmington and Hickory, North Carolina markets and increased its presence in the Richmond and Tidewater markets. The Dillard CEO, Bill Dillard, hailed this as a win-win exchange: "It's rare that we can make the deal that so clearly benefits both parties. When we add the Belk stores to our existing stores, we will be able for the first time to offer our Virginia customers a full assortment of Dillard's merchandise in competitively sized stores. Chattanooga is a long sought-after addition to our already strong Tennessee stores, and Hickory and Wilmington will enable us to continue our aggressive growth strategy in North Carolina. On the other side of the coin, Jacksonville and Columbia fit naturally into Belk's geographical strategy, and we welcome them into these markets".

A major factor that made the store swap so successful was the similar average square footage between Belk and Dillard's and the same upper middle class target customer, indicative of an up-market conventional department store. The strategy ensured that there would be minimal competition loss in specific spaces in the light of the transaction, appeasing the FTC, and producing a much-improved strategic fit for both retailers.

b) Pre-emptive divestitures to Proffitt's and May Company

In August 1998, Dillard's followed the coup of the Belk store swaps with the announcement that it was divesting some of the acquired Mercantile locations to Proffitt's Inc. and May Company, again to pre-empt any FTC regulatory enforcement and improve the geography of the acquisition. Under this agreement, Proffitt's acquired 15 former Mercantile stores in several markets including Nashville, Tennessee and Orlando, Florida, whilst May Company, on the other hand, agreed to acquire 11 former Mercantile locations in markets which included Kansas City, Missouri and Colorado Springs, Colorado. Critically, the stores sold were located primarily in markets in which Dillard had a strong presence *prior* to the Mercantile acquisition, especially around Kansas City, Nashville and Orlando. Such action prevented Dillard, therefore, from enjoying a localised

monopoly in conventional department store retailing in the specific locales but equally ensured no cannibalisation of sales.

The Federal Trade Commission and Defining the Department Store Industry

Although Dillard's acquisition of Mercantile was of itself strategically questionable, the execution of the consolidation, provides an extremely interesting case study of a firm tailoring an acquisition to conform to the FTC's 'fix-it-first' policy secondly, producing an improved strategic fit beyond that evident in the pre-merger geography. The extent to which the store swaps and divestitures were pre-empting antitrust action or to what degree they were initiated to improve the deals' overall strategic fit is not immediately obvious. It is dependent on the perceptions of the firm regarding how the FTC might choose to interpret the boundaries of the conventional department store industry.

As Shugart (1998) recently noted, narrowly drawn market boundaries, which only include a few retailers, increase the probability that a proposed merger between any two sellers in that market will be challenged. Conversely, if the market definition is more broadly defined, the greater number of competitors dilutes the impact of any merger on their reported market shares. There are two perspectives the FTC could have adopted in this case. First, it could have viewed the conventional department store sector as an industry of itself. Such an interpretation would have suggested a highly concentrated market, and the need for antitrust action. **Table 2** for example suggests that, in 1999 Dillard's possessed nearly 16% of the total industry. However, as previously noted, the conventional department store sector had faced vigorous competition during the 1980s and 1990s and seen substantial sales decline in the face of discount and speciality stores, driving consolidation in the sector. This suggests that a broader definition of the market for conventional department stores is more appropriate given a situation where, as Terry Lundgren, President of Federated Department Stores, acknowledged '(c)ompetition used to be defined more directly as department store versus department store. Today it is department store versus everyone' (Interview 23). That broader conception of the market comes in the form of the GAF (General merchandise, furniture and apparel sales) statistic of what, in 1999, Dillard's accounted for only 1.1% (**Table 2**).

There is considerable evidence to suggest that FTC prudently adopted the GAF approach rather than the conventional department store definition of the market in its consideration of mergers in the industry in the 1990s. Perhaps the best evidence of this comes from two acquisitions undertaken by a post-bankruptcy Federated. In 1994, Federated acquired Macy's, giving it a significant increase in the number of stores in New York, the south-east, and a major breakthrough on the west coast. The Macy acquisition was quickly followed by the purchase of the troubled Broadway Stores, also a west coast, Californian operator in 1995. As a result, and as evident from **Figure 4**, there was considerable market overlap in California, yet the reaction of the FTC was muted. As Vice President of Federated Department Stores, Carol Sanger noted in terms of FTC – required divestitures:

With the Macy's there was none. None that was FTCIn California it was a different story because we were there with Macy's, and then with Broadway, the question was for the FTC, who was our competition? And there were some in the FTC who wanted to say that only department stores - we only competed against department stores. Well that's ludicrous, we compete against anybody who sells anything. And by the broader definition of competitor, Wal*Mart's our competitor, K-Mart's our competitor, Penney's and Sears are our competitors so our definition of who our competitors are was key in that whole decision and ultimately the decision was that all retail is the marketplace that you have to look at. You can't say that we only compete against May Company, we compete against Sears, Penney's and Limited and Gap and we compete against speciality stores and shoe stores....We had to divest ourselves of four I think! (Interview 3)

In this light, it is clear that the Dillard's - Mercantile pre-merger adjustments during the Summer of 1998 were driven as much by strategic market fit considerations as they were by the 'fix-it-first' policy of the FTC, given the likely use of the GAF figure by the FTC to interpret industry boundaries. It was this dual motivation of 'fix-it-first' and strategic market fit that drove pre-merger divestitures and store swaps.

Throughout the 1990s the 'fix it first' approach has represented the understood policy of the FTC in which retailers have understood their responsibilities and acted accordingly. Recent developments from two proposed consolidations however signal a harsher reading by the FTC of merger policy and a divergence away from this status quo. This has vast implications for the outcomes of portfolio restructuring in the conventional department store sector in particular and the US retail industry more generally.

RECENT DEVELOPMENTS IN ANTITRUST INTERPRETATION: A NEW PARADIGM OF FTC ENFORCEMENT?

Recent developments in US retail industry regulation have cast doubt over the continuing implementation of the 'fix-it-first' approach in dealing with horizontal market overlaps. It is widely believed that precedents have been set by the FTC's response in recent cases; the first dealing with the definition of markets, and the second, with divestiture as a policy for ensuring local competitiveness.

Defining Markets: The Staples – Office Depot Precedent

The first case relates to the proposed merger in 1997 between the first and second largest US office superstore chains; Staples and Office Depot. Staples offered to divest itself of its horizontal market overlaps, yet the case was taken to court and effectively killed off when, in June 1997, the federal district court in Washington, DC granted the FTC's request for a preliminary injunction blocking the merger (Baker, 1997).

The rationale for the refusal, according to the FTC, was that they had evidence that Staples raised prices and was thus uncompetitive in areas where it was the only office superstore in town. Such assumptions relied on complex econometric calculations of past experience (see Baker 1997; 1999). The case however, had far broader connotations for the rest of the retail industry and represented an important change in practice by the antitrust authorities. Office superstores, in this instance, were essentially being regarded by the FTC as a separate retail category independent of all other forms of retail (Warren-Boulton and Dalkir, 1997, see also Dalkir and Warren-Boulton, 1998; Werden, 2000). However, as Shugart (1998) notes, had the market included sales of office products at independent, mail order and discount retailers, then the Staples and Office Depot's combined market share would have represented a mere 5%.

The case was indicative of a much stricter interpretation of industry boundaries by the FTC. Instead of the market being defined by all sales of the product, it is defined on the basis of the retail format. This is the exact opposite to what has traditionally occurred with the 'fix-it-first' policy in the department store industry throughout the 1990s.

Ineffective Divestiture: The Ahold – Pathmark Precedent

The second case relates to the FTC's harsh stance in late 1999 on the proposed merger between Royal Ahold, the 4th largest food retailer in the US and leading operator in the Boston and Washington DC corridor, and Pathmark (a subsidiary of Supermarkets General Holding Corporation), the market leader in the metropolitan areas of New York and New Jersey (Wrigley, 2001). Ahold had previously made a large number of successful acquisitions in the US and divested enough stores under the 'fix it first' approach to appease the FTC (see Wrigley, 1998; 1999a; 1999b). However, as Cotterill (1999a) suggests, such divestitures had often been ineffectual in terms of maintaining local market competitiveness. In an analysis of the performance of divested stores from Ahold's previous acquisition of Stop & Shop in 1996, Cotterill suggests that 'the stores divested have suffered major sales declines, but that the stores retained by the Royal Ahold have made major gains' (Cotterill, 1999a, p9, see also Cotterill *et al.*, 1999). In effect, it seems that retailers such as Ahold had been able to 'cherry pick' stores for divestiture, thereby divesting the least desirable store in each location (Cotterill, 1999a, p9). In addition, Cotterill suggests that merging firms should not be allowed to divest to weak competitors from whom they can rapidly recapture market share. In short he suggests that the 'fix-it-first' approach in the food retail industry has produced divestiture orders that have not protected consumers from increased concentration and the exercise of market power (Cotterill, 1999a, p9). The FTC accepted such evidence, and effectively blocked the Pathmark acquisition. Ahold consequently walked away from the deal, citing a significant change in policy by the FTC. Indeed, as Wrigley (2001) suggests, by mid 2000 there was mounting evidence of the tougher enforcement, as first the FTC decided to seek an injunction against the acquisition of 74 Winn-Dixie grocery stores in Texas by leading US grocery retailer, Kroger, citing its likely effect on prices and consumer welfare (see also Guidera, 2000) and, second, as it forced the 6th largest US food retailer, Delhaize America, to divest or close the entire southeast division of its Hannaford Brothers acquisition to gain regulatory approval (Wall Street Journal, 2000; Wrigley, 2001).

Interpreting the Evidence

There are two issues raised by these recent cases of FTC enforcement that have implications for future portfolio restructuring in the retail industry. First there is evidence that the method of defining markets and industry segments is becoming more restrictive. Second there is evidence of a significant shift in the 'fix-it-first' approach - no longer being enough to divest horizontal market overlaps to pre-empt FTC enforcement. Instead it is suggested by Cotterill (1999d) that divestiture is not a permanent prophylactic for market power. The FTC apparently agrees with this and has now shifted the bar towards tougher enforcement. 'It now seems to require more than a static divestiture that provides "numerical" parity to a competitive norm at the divestiture date. The momentum of the acquirer that will continue and may well increase after a merger is now factored in and this momentum factor requires a more substantial divestiture or outright challenge' (Cotterill, 1999d). Numerous statements coming from the FTC have supported this opinion.

On the subject of defining markets, literature from the FTC indicates the adoption of a more active and malleable view of market boundaries. As FTC Director William Baer suggests, the emphasis has moved from market *definition*, toward analysing market *interaction*:

But the fact that we take a hard look at the actual competitive interactions within a market, rather than considering our job done as soon as the market is defined, should not be a basis for criticism but a reflection of the fact that we are doing our job. When we find unique relationships among products made by the merging firms, as evidenced by how the firms behave in the marketplace and by quantitative analysis of past pricing behavior, we have a merger that poses problems. And the issue of the precise market definition becomes and should become secondary (Baer, 1997).

This active definition and subsequent reaction is reinforced by comments by FTC Chairman, Robert Pitofsky (2000), who suggests that consideration will be given to whether the merger is part of a greater merger wave, rather than viewing the case in isolation.

On the subject of divestitures, it is clear there are considerable developments. Pitofsky (2000) recently suggested that considerable problems are likely to remain even if *all* horizontal market overlaps are eliminated. Indeed, the issue of the *quality* of the divestitures has been central to recent FTC concerns. Baer (1996; 1997) suggests that in future there will be moves to speed the divestiture process if it is necessary. Secondly, Baer (1996) advocates the increased use of what he describes as the enforcement of *crown jewel divestitures*, where the Commission prescribe the divestiture of specified holdings. He acknowledges that in numerous cases, divestitures have been ineffectual, as acquirers have 'been able to frustrate the viability of a divestiture....by not transferring all the necessary technology or know-how' (Baer, 1996). As Pitofsky (2000) has suggested 'the bottom line is the divestiture must be effective and consumer welfare should not be asked to bear an unreasonably high risk that accomplished an uncertain and questionable undertaking'. Frequently, this has not been the case with the 'fix-it-first' approach as 'history has now shown that the antitrust authorities overwhelming preference for a 'fix-it-first' conciliatory approach to mergers in an industry has produced a series of ineffectual divestitures that have rationalized the positions of leading chains, often enabling them to expand market share in the post merger period, thereby resulting in increased rather than lower concentration' (Cotterill, 1999a, p2).

It is uncertain as to whether the stricter enforcement and narrowing of market definition by the FTC will be carried through into rulings on portfolio restructuring in the department store industry. It is suggested that food retailing represents more of a political arena for state intervention, and that department store retailing operates in much more of a backwater. Indeed, an Ernst & Young analyst suggested, '(t)hey (the FTC) are not as sensitive as they are in apparel as they are in food. Food is a very sensitive thing, much more sensitive than apparel is....I don't know, they blow hot and cold. It just depends on the political – it is all very political of course' (Interview 18). There is certainly a convincing argument that the FTC is likely to retain the working definition of the competitive market for the conventional department store industry in terms of GAF as

This industry needs all the help it can get frankly. They are not dominating anything and certainly not in a position to name prices (Interview 8).

As one prominent department store CEO suggests, even high market concentrations in the conventional department store industry do not represent dominant market power beyond the tolerance of the FTC:

I think what the FTC has historically done is smart and appropriate and that is they have looked at retail as a broader issue than just department stores. Our competitor for our business is not just another department store. Department stores in the aggregate...in a typical market, department stores may in the aggregate have 25% of the general merchandise, apparel & furniture – the GAF figure, so clearly 75% of the competition is not department stores. It is other forms of retail. So the FTC appropriately has looked at these from that perspective and concluded that even after the merger of the two companies that the share market they have is not counter to the beliefs of the FTC (Interview 12).

IMPLICATIONS FOR FUTURE DEPARTMENT STORE CONSOLIDATION

Until the end of the 1990s, under the prevailing ethos of the FTC's 'fix-it-first' approach, US retailers accepted that they would have to divest a given number of stores in order to conclude mergers and acquisitions. Essentially, this represented to them, what Clark and Wrigley (1995) would regard as a sunk cost to barrier to entry in a given market area⁶². The recent hardening of the FTC stance may surpass a threshold of tolerance for these sunk costs and lead to a possible decline in horizontal mergers in the retail industry. Certainly for Royal

⁶² A sunk cost is regarded as those costs to the firm which are irrevocably committed to a particular use, and therefore not recoverable in the case of exit (Clark and Wrigley, 1995, p 205).

Ahold the threshold was exceeded and they walked away. However, within the department store industry the number of potential acquisitions has declined, as few regional chains are left. Consequently, as in the case of food retailing, the small number of acquisition candidates for department store acquirers 'effectively places a premium on chains that can offer to strategic buyers limited risk of extensive FTC-required divestment of stores. But conversely, because of the pre-existing geographies of major firms seeking to grow by acquisition and the regulatory risks of market overlap, such targets have, in practice, a strictly limited number of potential partners' (Wrigley, 1999b, p304). These potential partners are, by virtue of the considerable acquisition activity, clearly large entities. Consequently any merger will inevitably involve considerable market overlap. This would undoubtedly lead to a situation whereby any acquisition would undoubtedly trigger FTC action, with possible refusal through litigation. The only solution for such a situation would be for the leading department stores to adopt a strategy of joint acquisitions, effectively sharing the target in their unpenetrated markets where antitrust enforcement would not apply. This could possibly lead to another era of portfolio restructuring where the large department stores firms are once again broken up and shared out. Conversely, the tightened regulatory environment could serve to stabilise the industry, as emphasis turns of organisational restructuring of the existing store portfolios.

However, what must now be factored into the picture is the arrival of the Bush Administration in early 2001 and the expectation of looser antitrust scrutiny under a Republican appointed FTC Chairman. As the *New York Times* commented, 'most policy makers and corporate chiefs expect a loosening of antitrust policy. Economic advisers to President-elect George W. Bush have been critical of the Clinton administration for being too aggressive, particularly in its pursuit of monopolists' (Labaton, 2001, p 3). Clearly, the direction of antitrust policy remains a controversial and contested area of US economic and political concern.

CONCLUSION

This paper has illustrated, through the example of the US department store industry, the role of the regulatory state in portfolio restructuring. As Laulajainen suggested, over a decade ago, '(i)t is not just the willingness of the target to get acquired or the aggressor's capacity to place a hostile bid. It is as much a question of the FTC's attitude to the deal, which, in turn, is dependent on the political climate in general' (Laulajainen, 1987, p170). It is evident that the investment decisions by firms do not occur in a regulatory vacuum and instead regulation does, to an extent, dictate investment decisions (cf. Christopherson, 1993; 1999). The difficulty comes in interpreting state rules and, more broadly, theorising what role the state should have. What is clearly the issue, however, is the extent to which the state (at all levels) ought to have the size, roles, and functions that it currently has, given competing normative claims regarding the proper role of the state in relation to the market (Clark, 1992a, p615).

In addition, it is clear that market consequences cannot be read off investment rules. As Clark (1990) suggests, it is only in specific market contexts that the meaning of rules is determined and defined. Whilst the rules themselves may not change, the consideration and theorising of them may. Indeed, 'interpretations of rules and procedures are always vulnerable to changing circumstances and competing arguments about the significance of changing circumstances for the integrity of the rules; how those circumstances are accommodated within the institutional context is an issue of considerable dispute' (Clark, 1992a, p620). As such, 'rules of adjudication are often unstable and fragmented. Reality as the unidimensional empirical facts of legal positivism is an implausible reference point for determining the plausibility of competing interpretations, and interpretations are political acts – contested over as representations of political interests' (Clark, 1989b, p217). There must not be confusion over the substantive *content* of regulation and the *result* of the legal-regulatory process (see Clark, 1992b, p721). Indeed, '(a)lthough the process of corporate restructuring in retailing is clearly contingent upon the legislation which governs competition in the industry, corporate restructuring and its spatial expression, in turn, transform that regulatory environment' (Wrigley, 1992, p748). This leads one to a less rigid dichotomy between regulation as economic imperative and regulation as social practice - as Marden (1992) suggests, very much a false dichotomy as laws and regulations are continually re-interpreted and reviewed as conditions and political ideologies mutate over time (cf. Marsden and Wrigley, 1995; 1996; Marsden *et al.*, 1998; 2000; Wrigley, 1993). It is in this environment the retailer is challenged to undertake portfolio restructuring.

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Table 1 Department Store Acquisitions of the 1990s.

Date	Acquirer	Acquired (Geographical Area)	Cost (If known)	No of Stores (If known)
1990	May	Thalhimer's, (Richmond, Va.), Sibley's, (Rochester, N.Y.)	N/D	26
1990	Dayton Hudson	Marshall Field (Midwest)	\$1.4 billion	N/D
Oct 1992-July 1993	Proffitt's	Hess (Southeast)	\$24 million	18
March 1994	Proffitt's	McRae's (Southeast)	£212 million	28
1994	Bon-Ton	Hess	N/D	20
1994	May	10 stores from Hess (Northeast)	N/D	10
May 1994	Federated	Joseph Horne Co.	\$116 million	10
Dec 1994	Federated	R. H. Macy	\$4.1 billion	123
April 1994	Proffitt's	Parks-Belk	Less than \$20 million	3
July 1995	May and J. C. Penney	Woodward and Woodward & Lothrop stores	Total Cost \$460 million	21
Aug 1995	Federated	Broadway	\$1.6 billion	82
April 1996	May	13 Strawbridge & Clothier stores (Philadelphia).	\$479.5 million	13
Feb 1996	Proffitt's	Younker's (Midwest)	\$258 million	51
October 1996	Proffitt's	Parisian (Southwest and Midwest)	\$452 million	38
Nov 1996	Belk	Leggett Stores	\$92 million	31
February 1997	Proffitt's	Herberger's (Midwest and Great Plains)	\$154.9 million	40
January 1998	Proffitt's	Carson Pirie Scott (Midwest)	\$956 million	55
March 1998	Proffitt's	Broady's (North Carolina)	N/D	6
May 1998	Dillard	Mercantile	\$2.9 billion	103
August 1998	Gottschalks	The Harris Company (California)	\$36.1 million	9
Sept 1998	Proffitt's	Saks Holdings (National)	\$2.1 billion	96
October 1999	May	ZMCI (Utah, Idaho)	\$52 million	14

Sources: various company reports and 10K's submitted to the Securities and Exchange Commission.

Strategic acquisition-based portfolio restructuring has set the pace for the 1990s department store industry. This has seen large stores acquire regional chains leaving very few available for purchase in the 21st century.

Figure 1 A Comparison of the Performance of Conventional and Discount Department Stores, 1987-1999

Source: data from US Department of Commerce (2000)

The conventional department store industry has gradually lost sales relative to the discount department stores (e.g. Target). This environment of minimal net growth has provided an inducement to consolidate.

Table 2 Major Department Store Retailers' Share of GAF Throughout the 1990s

	1989	1994	1995	1996	1997	1998	1999
Personal consumption exp. GAF sales (billions)	\$3,596.7	\$4,716.4	\$4,969.0	\$5,237.5	\$5,524.4	\$5,848.6	\$6,257.3
Department Store Sales (billions)	454.3	592.6	625.0	655.2	685.5	729.2	783.5
	51.2	51.1	51.0	51.7	53.1	53.7	55.1
Federated Department Stores	\$7.6	\$13.9	\$15	\$15.2	\$15.7	\$15.4	\$15.9
% of industry sales	14.8%	27.3%	29.5%	29.4%	29.5%	28.6%	28.8%
% of GAF sales	2.1	1.6	1.7	1.8	1.8	1.8	1.8
May Department Stores	\$9.5	\$9.8	\$10.6	\$11.7	\$12.4	\$13.1	\$13.9
% of industry sales	18.5%	19.1%	20.8%	22.5%	23.3%	24.4%	25.2%
% of GAF sales	2.1	1.6	1.7	1.8	1.8	1.8	1.8
Dillard Department Stores	\$3.0	\$5.5	\$5.9	\$6.2	\$6.6	\$7.8	\$8.7
% of industry sales	6.0%	10.8%	11.6%	12.0%	12.5%	14.5%	15.8%
% of GAF sales	0.7	0.9	0.9	1.0	1.0	1.1	1.1
Saks, Inc.	\$0.1	\$0.6	\$1.3	\$1.9	\$3.5	\$6.0	\$6.4
% of industry sales	0.2%	1.2%	2.6%	3.7%	6.7%	11.1%	11.7%
% of GAF sales	0.0	0.1	0.2	0.3	0.5	0.8	0.8
FD/MA/DDS/SKS department stores	\$20.2	\$29.9	\$32.9	\$35.0	\$38.2	\$42.2	\$44.8
% of industry sales	39.4%	58.4%	64.5%	67.7%	71.9%	78.7%	81.4%
% of GAF sales	4.4	5.0	5.3	5.3	5.6	5.8	5.7
Other department store operators	\$31.0	\$21.3	\$18.1	\$16.7	\$14.9	\$11.4	\$10.3
% of industry sales	60.6%	41.6%	35.5%	32.3%	28.1%	21.3%	18.6%
% of GAF sales	6.8	3.6	2.9	2.6	2.2	1.6	1.3

NB: GAF – *General merchandise, furniture and apparel sales*

Source: adapted from Goldman Sachs estimates, April 2000

Table 3 Department Store Retailers v Discount Store Retailers' Share of GAF in the 1990s

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Total Retail Sales \$ <i>billions</i> (a)	\$1,844	\$1,855	\$1,951	\$2,082	\$2,248	\$2,359	\$2,502	\$2,610	\$2,729	\$2,972
GAF Sales \$ <i>billions</i> (a)	471.6	485.4	519.2	553.0	594.2	624.4	655.0	683.2	724.8	778.7
Department Store Sales \$ <i>billions</i> (a)	51.2	50.6	51.3	50.7	51.6	51.4	52.5	53.9	54.9	56.6
% of GAF Sales	10.6%	10.4%	9.9%	9.2%	8.7%	8.2%	8.0%	7.9%	7.6%	7.3%
Discount Store Sales	N/D	N/D	N/D	122.0	146.1	161.9	171.9	187.4	205.0	N/D
% of GAF Sales	N/D	N/D	N/D	22.1%	24.6%	26.0%	26.2%	27.4%	28.3%	N/D

NB: GAF – *General merchandise, furniture and apparel sales*

Sources: adapted from Goldman Sachs (1996; 1999) unless otherwise stated.

(a) data from US Dept. of Commerce (2000).

Table 4 Diversification of Major Department Store Chains in the 1960s and 1970s

Corporation	FTC ban	Major entry into	
		<i>Discount retailing</i>	<i>Speciality retailing</i>
Allied	1965-1975	1961-1978	1979-early 1990s
Associated	1975 (divestment)	1972-1976	1916-
Macy's	None	1987- early 1990s	None
Federated	1965-1970	1968-early 1990s	1982-early 1990s
May's	1965-1975	1970-early 1990s	1979-early 1990s
Dayton Hudson	None	1962-present	1966-present
CHH	1966-1974	None	1969-acquired 1987

Source: adapted, with modifications from Laulajainen, 1987, p235. Additional data from R. H. Macy, 1994 and various company reports.

Figure 2 A Decision Flow For a Retail Horizontal Acquisition Under the FTC 'fix-it-first' Policy

Table 5 Dillard's, Inc.'s Acquisition in Context

Acquirer	Acquired	Date	Enterprise Value to LTM Revenue (a)	Enterprise Value to LTM EBITDA (b)
Proffitt's	McRae's	Mar-94	0.8x	6.0x
Federated	Macy	Jul-94	0.7x	17.8x
May & JC Penney	Woodward	Jul-95	0.9x	30.9x
Federated	Broadway	Aug-95	0.8x	20.6x
Proffitt's	Younkers	Feb-96	0.5x	6.5x
May	Strawbridge	Apr-96	0.5x	9.4x
Proffitt's	Parisian	Oct-96	0.7x	9.2x
Proffitt's	Herberger's	Feb-97	0.6x	8.6x
Proffitt's	Carson	Jan-98	0.8x	9.2x
Dillard	Mercantile	May-98	1.0x	10.3x
Industry Average			0.73x	12.85

(a) LTM – Last Twelve Months

(b) EBITDA – Earnings Before Interest, Tax Deductions and Depreciation

Source: adapted from Merrill Lynch (1998) and Paine Webber (1999)

Figure 3 The Geography of the Dillard – Mercantile Stores Acquisition

Figure 4 The R. H. Macy and Broadway Stores Acquisitions By Federated Department Stores