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WHEN PLUNDER MEETS BLUNDER

The collapse of the Mega supermarket chain illustrates how greed and mismanagement characterize many or even most business disasters in Israel

THE STORY is all too familiar. Bad management and greed drive a once great company into bankruptcy, threatening the livelihood of 3,500 hardworking loyal employees.

The company is the supermarket chain Mega, with 126 stores across Israel, second only to the Shufersal chain, which operates 284 stores. After massive losses, it is now in receivership and up for sale, whole or in part. Some 1,000 workers have already been fired and the jobs of the remaining 2,500 are in jeopardy.

The cause? Plunder – company owners who bled the company's profits by pouring excessive dividends into their pockets, while piling up excessive debt, at a time when most wise managers were trying to reduce debt.

And blunder – a series of very bad decisions that could have and should have been avoided, while company directors kept quiet to avoid endangering their fat payoffs.

All this, meanwhile, was hidden behind a veil of secrecy since the companies involved were privately held and not bound to reveal data as are public companies. Even though Mega's Blue Square parent company is public, Blue Square does not have to break down the financial data of each of the separate businesses it owns.

A decade ago, the picture was very different. Billionaire lawyer Shraga Biran, now 83, Polish-born and a Holocaust survivor, made a fortune in the 1990s by helping kibbutzim and moshavim to get their land rezoned for housing. Despite his wealth, Biran is a self-styled socialist. His 2008 book titled "Opportunism" calls for redistribution of wealth.

BOARDS OF DIRECTORS ARE OFTEN NEGLIGENT AND COMPLIANT, AND AVOID CHALLENGING MANAGEMENT

He says: I'm not a radical. I don't suggest distributing assets in the hands of private individuals because, first of all, you will create a new corrupt bureaucracy. I'm against a revolutionary revolution. I am against the redistribution of distributed assets. What I am in favor of is the distribution of undistributed assets; some 70 percent of wealth that exists today is new wealth that didn't exist before 1980.

Together with his close relative David (Dudi) Weissman, Biran built a powerful business pyramid, along with the Kibbutz Purchasing Organization. At the top: Alon Holdings. In the layers beneath it – Alon Blue Square, Dor Alon (energy), Mega (supermarket chain) and Blue Square Real Estate, among others.

Weissman, the Blue Square CEO, built a conglomerate combining gas stations (Alon) and food (Mega). Weissman and Biran even attracted a powerful investor, Canadian Matthew Bronfman (who later sold his holdings, cleverly sensing looming trouble). Under Weissman, Mega grew to rival the venerable Shufersal chain which, ironically, is now owned by Bronfman and doing well.

And then – plunder and blunder, the key words that characterize many or even most business disasters in Israel.

First plunder. A rule of good management, and a key tenet of healthy capitalism, is that you grow your business mainly by plowing your profits back into the business while borrowing as little as possible, especially during times of deflation when debt is dangerous and burdensome. Intel Corp., for instance, an enormous, highly profitable global company with a strong presence in Israel, has only a dollar of debt for every five dollars in assets.

But Israeli tycoons consistently break this rule, bleeding their companies by paying themselves huge dividends while using their influence to borrow massively and irresponsibly from banks and pension funds. More often than not, this leads to disaster, as tycoon Nochi Dankner and his IDB pyramid proved.

Between 2006 and 2011, Blue Square paid out 1.5 billion shekels (today, worth about $375 million) in dividends to its owners. That money should have been plowed back into

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Employees of the Mega supermarket chain, concerned about the possible loss of their livelihood, demonstrate in Tel Aviv

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the business. Instead, the Alon businesses, especially Mega, borrowed heavily from banks and bondholders. Opportunism, indeed, but not the kind Biran lauded in his book.

Such borrowing is called "leverage," a fancy word for risk. If you invest your own money and things go wrong, well, you tighten your belt and try again. If you invest a lot of borrowed money and things go wrong – when you fail to pay your creditors, they ask the courts for protection, i.e. you go broke.

Archimedes said he could move the world if he had a big enough lever. It is true, if you invest a shekel and borrow four more, you can do five times more with the money than when you borrow nothing. But if you borrow and blunder, the burden of those four shekels you owe can be fatal – the lever can snap back and knock you out. For Mega, that is what happened.

Under Weissman, and Biran above him, the Mega chain alone piled up 1.3 billion shekels ($360m.) in debt, about half of it owed to suppliers and half to banks. When the extent of Mega's woes became apparent early last year, Biran fired his nephew Weissman, in a bitter dispute, and Weissman sold all his shares.

Suppliers, who were not paid, stopped supplying food. Mega slid downhill. Biran was humiliated when, last year, Bank Hapoalim, its biggest creditor, insisted he appear in District Court in Lod to explain – not a pleasant experience for a highly respected senior citizen.

TO RUB salt into the wounds, Raviv Bruckmayer, who replaced Weissman as Mega CEO, drew a reported 2 million shekels (as a contractual salary, he claims) for a few months' work, and newly appointed Alon chairman Avigdor Kaplan, a former insurance executive, was paid a bonus of 560,000 shekels ($140,000), just one week before Mega collapsed.

Bruckmayer kept the plunder, saying he earned every penny and saved many jobs. Kaplan, mortified by the outcry of Mega workers, donated the money to a Histadrut labor federation charity.

But plunder alone usually will not sink a business. You also need blunder, and Mega management and directors made a long string of very bad, ultimately fatal, mistakes. Here are just a few.

Disruptive competition: Entrepreneur Rami Levy shook up the supermarket industry by building a chain of some 35 low-price discount stores (*see The Jerusalem Report, "Checkout champion," April 23, 2012*). Also, another 33-store discount chain sprang up called Victory.

Mega failed to meet the challenge. Mega's cost structure was high; the average age of its employees was 45, and their seniority meant their wages were higher than those paid by competitors. Mega revealed to the

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courts that its wage costs were 600 million shekels annually, or 11 percent of sales – 3 or 4 percent higher than its competitors Rami Levy, Victory and Shufersal. When profit margins are slim that cost differential is potentially fatal. Yet, instead of slashing costs, Mega spent a fortune on two big logistics centers.

When social protests in the summer of 2011 focused on the high cost of living, Israeli shoppers began to shun Mega, a high-price chain. Mega tried to launch a discount brand, spent a fortune on refitting stores and advertising, but it was a decade too late. Management missed the boat.

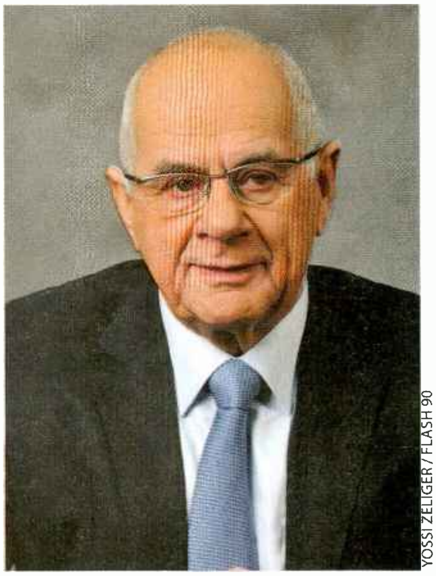
Anger your best customers: Weissman had acquired a chain of convenience stores called AM:PM that were open on Shabbat. This led the ultra-Orthodox to boycott all Mega stores, costing Mega many hundreds of millions in lost revenues. With large and growing families, the ultra-Orthodox are among the biggest and fastest-growing population of food shoppers in the country. Now that Mega is no longer in Weissman's hands the Haredim have lifted the ban. But it came too late.

Skullduggery: Weissman spun off a new company called Blue Square Real Estate, whose main assets were 86 stores rented by Mega, two-thirds of all Mega stores, and offered its shares to the public. Blue Square Real Estate cut a deal with Mega to lease the 86 stores for very high rents – in some cases, double the going market rates, claims the business daily TheMarker.

For a supermarket chain battling low-cost competitors, high rents are a big problem. Indirectly, this transaction also falls under plunder.

Loss of focus: Weissman made an inexplicable series of bad acquisitions. He bought 51 percent of an organic food chain, Eden Teva Market, but left control with its founder and saw it pile up losses. He bought a toy store chain, a household textiles chain and a free daily newspaper, Israel Post, co-owned by Jerusalem Post publisher Eli Azur. When you acquire companies, you look for synergies – ways the businesses strengthen and complement each other. I see few such synergies in Weissman's decisions.

Where was the board of directors? Management itself cannot sink a company. It also takes a negligent board of directors. The role of the board is to track carefully key management decisions, guide them, focus them, challenge them and, in general,



YOSSI ZELIGER / FLASH 90

Shraga Biran built a powerful business pyramid – then plunder and blunder crippled the Mega supermarket chain

carefully scrutinize how management spends money.

I believe that Israeli boards often are negligent. Board members are often appointed because they are compliant and pliable and avoid challenging management. This appears to be the case with Alon, Blue Square and Mega. I strongly advise start-up entrepreneurs to assemble boards with directors who will put their feet to the fire regularly. Some do. But Mega management's feet were put to the fire only when it was far too late to save the company.

What angers me most about blunder and plunder is that the perpetrators responsible for the disaster bail out with pockets full of cash, while the workers are dumped onto the street with very little or nothing. Many of the Mega suppliers who will lose money are farmers, who can ill afford the loss.

How will this play out? Several companies are bidding to buy the Mega chain, whole or in part, including Rami Levy and Victory. An unnamed Antitrust Authority official told The Marker that it would probably bar Rami Levy from buying Mega, and possibly Shufersal as well, on grounds of excessive monopoly power. Levy says this policy is misguided and that he would bring lower prices to many neighborhoods, not higher ones.

The trustees the court appointed to liquidate Mega's assets and repay some of its debts believe Mega is worth more when sold in pieces – e.g. its Mega in the City chain, upscale urban stores that are profitable – than if sold as a whole. But for those 2,500 remaining Mega workers, it is far better to sell Mega as a whole, as a going concern, so many could probably keep their jobs. By the way, the lawyers managing the court-supervised Mega liquidation will also pocket many millions.

Meanwhile, in a lightning deal, Biran and the Kibbutzim sold Alon Blue Square to a real estate developer, Gindi Holdings, for just 115 million shekels ($29m.), conditioned on Gindi paying off 1.2 billion shekels of Blue Square debt. Otherwise, Blue Square may have had to pay off bondholders of its downgraded bonds at once and lacked the money to do so. Gindi covets Blue Square's Tel Aviv Wholesale Market, a massive development project ultimately worth a fortune. Blue Square bondholders are challenging the sale, fearing they will get an unwanted "haircut" (reduction in their bonds' value).

For me, the Mega fiasco is very personal. I shop for groceries every Friday morning. For years I shopped at Mega. The stores were clean, the workers were polite, and I loved seeing weekly the amazing array of food that we Israelis take for granted. In a world where so many are hungry, the Land of Milk and Honey offers quality food, fruits, vegetables and dairy products that I think no other country can rival, even if they are a bit expensive.

Slowly, painfully, I watched my Mega store go downhill. The manager was nowhere to be seen. There was malaise among the workers. Service deteriorated. Prices were high.

Why could I see this, when the CEO, senior managers and board could not? Were they sitting in their glass-walled corner offices, isolated and insulated from customers who could have told them what was going on? Do overpaid managers avoid the coal face, where the coal is mined, and instead line their pockets with big bonuses even when the company they manage is drowning in red ink?

I switched to Shufersal, sadly and reluctantly, unable to witness Mega's painful dying gasp. ■

The writer is senior research fellow at the S. Neaman Institute, Technion and blogs at www.timnovate.wordpress.com