Non-price Effects of Mergers - Note by Italy

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More documents related to this discussion can be found at www.oecd.org/daf/competition/non-price-effects-of-mergers.htm.

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1. Executive summary

1. The experience of the Italian Competition Authority (the Authority or AGCM) in assessing non-price effects of mergers has so far been focused on more traditional aspects such as variety, quality and investment, while the practice in dealing with effects related to innovation or privacy is still limited and has occurred outside the merger review context.

2. Recent transactions in publishing sector affected by the digitalization process have brought to the Authority’s attention the importance of considering also competition dimensions other than price which can be industry specific - such as terms for payment and returns policy, but also the quality, variety and “visibility” of editorial production - and can affect players at different level of the value chain. Similarly, in assessing mergers between retail distributors other variables such as product range and mix, the “shopping experience” and ex-ante and ex-post services were considered to be key drivers for competition.

3. In publishing sector mergers, non-price elements have been generally considered at the stage of assessing the competitive effects of the transactions (unilateral and/or co-ordinated effects), while in evaluating mergers between retailers the analysis of other competitive variables was carried out at an earlier stage, when deciding whether the various distribution channels should be considered to be subject to the similar competition conditions and therefore under the same relevant market.

4. In the AGCM view, the precise balancing between price and non-price effects may be difficult to carry out in practice, particularly if they move in different directions or affect customers in different ways. Furthermore, in mergers with vertical dimension, foreclosure effects may play an important role in the balancing exercise although any quantification of such effects may prove hard to measure. However, in the Authority’s experience well-tailored merger remedies may help address negative non-price effects; being often of behavioural nature, the remedies imposed by the Authority in such cases have been limited in duration in order to account for the continuing evolution of the markets.

5. The Authority has not dealt yet with innovation markets and the use of personal data in the context of merger review although these non-price effects are likely to play an increasing role in future. In this regard, competition agencies entrusted with consumer protection powers like the Authority might be better placed in addressing the challenges of digital markets since the dual competences enable significant synergies and a better understanding of new competition concerns related to innovation and the use of personal data.

2. Introduction

6. This contribution provides an overview of the recent practice of the Italian Competition Authority (the Authority or the AGCM) in assessing non-price effects of mergers, whose focus was more on traditional aspects such as variety, quality and
investment, while the Authority’s experience with aspects related to innovation or privacy is still limited and has occurred outside the merger review context.

7. Recent transactions in the publishing sector affected by the digitalization process have brought to the Authority’s attention the importance of considering also competition dimensions other than price which can be industry specific - such as terms for payment and returns policy, but also the quality, variety and “visibility” of editorial production - and can affect players at different levels of the value chain. These non-price elements have been considered at the stage of assessing the competitive effects of the transactions (unilateral and/or co-ordinated effects).

8. Non-price effects such as product range and mix, the “shopping experience” and ex-ante and ex-post services were considered in mergers between retail distributors, but only at the stage of market definition, when deciding whether the various distribution channels should be considered to be subject to the similar competition conditions and therefore included in the same relevant market.

3. Non-price effects in the publishing sector

9. In Italy a consolidation process is currently underway in the publishing sector where a number of concentrations, recently assessed by the Authority, are restructuring the different segments of the value chain and reshuffling the roles of traditional players.

10. In reviewing a joint venture that would have merged the assets of two major publishing groups in the wholesale distribution of books\(^1\), the AGCM was concerned by potential negative effects on small and medium publishers since the two merging parties were the main businesses offering wholesale distribution services to non-integrated publishers and bookshops.

11. In particular, the Authority identified potential negative price effects in the form of margin squeeze, since the merged entity would have been able to extract higher discounts from small publishers for their distribution services. Moreover, concerns were expressed in relation to the potential deterioration of other terms and conditions of the wholesale distribution contracts, such as longer payment periods or increased penalties for surplus of returns, with the overall result of a tightening of the access to the distribution network. Other potential negative effects were found on the bookstore side, such as service disruption or interruption, or refusal to deal with bookstores not affiliated with the parent companies of the joint venture. According to the AGCM, such potential negative effects would have translated at retail level, in the form of a reduction of the quality and the variety of editorial products offered by independent publishers to readers or in a price increase of at least this portion of editorial production.

12. Notwithstanding this, the AGCM also considered potential non-price effects moving in an opposite direction: quality improvement and cost reductions to the benefits of large publishers (at upstream level) and chains of bookstores (at downstream level) were indeed recognized although merging parties did not substantiate their efficiency claims in this case. In the AGCM view, the precise balancing between price and non-price effects may be difficult to carry out in practice, particularly if they move in different

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directions or affect customers in different ways. Furthermore, in merger with vertical dimension, foreclosure effects may play an important role in the balancing exercise although any quantification of such effects may be hard to measure.

13. In order to address the competition concerns identified by the AGCM, the merging parties submitted **behavioural remedies** in relation with the distribution contracts with the small and medium publishers. The Authority accepted the commitments to maintain the terms of contractual relationships with publishers (existing customers) unchanged and to ensure similar conditions to other small-sized publishers (potential customers). To account for the growing importance of online distribution channel and e-books, the Authority limited the duration of such remedies to two years, concluding that the operation would result in the foreclosure of small-sized operators only in the very near future.

14. In a merger between the two main Italian publishers\(^2\), vertically-integrated, the Authority found potential negative non-price effects at different levels of the value chain, vis-à-vis bookstores and rival publishers. In the market for the acquisition of copyright licenses of Italian and foreign fiction and non-fiction books, the AGCM considered that the merged entity would have lowered the bargaining power of authors or their agents by extracting lower royalties and payments (price effects) and **worsening other contractual conditions** (e.g., liability and withdrawal clauses). Furthermore, the Authority took into account indirect effects vis-à-vis rival publishers: as result of the concentration, the merged entity would have become the first choice of any author (due to its critical mass, promotional and network strengths, number and variety of brands, and privilege access to media) and rival publishers would no longer have the **incentives to scout new authors**, build long term relationships with them if they would later be attracted by to the merged entity which can provide higher visibility.

15. In the market for the publishing of fiction and non-fiction books, the AGCM found negative effects on both bookstores and rival publishers. With respect to bookstores (independent and chains not controlled by the merging parties), the elimination of one merging party (RCS Libri), which was well known in the market for its favourable policy versus independent bookstores (e.g., payment methods aimed at reducing the financial exposure and more relaxed returns policy) and chain bookstores (e.g., investments in promotional activities), would have led to deterioration of these terms and conditions. With regard to rival publishers, the Authority was concerned by the increased range of books offered by the merged entity which would have reduced the **visibility of rival editors in bookstores**, given the limited space of the latter. Risks of foreclosure, supported by evidence of past refusal to deal, were found also in relation to the publishing of e-book since the merged entity would have combined the largest e-book catalogue, a must have for any e-book distribution platform.

16. The transaction was eventually cleared with a set of remedies, including structural remedies (divestiture of some publishing businesses and brands) and behavioural remedies to fix the above negative non-price effects such as: the obligation to waive several clauses (option, preference and pre-emption clauses) in contracts with authors already signed or to be signed by the two merging publishers, to provide its e-book catalogue to platforms requesting it and to ensure the presence and visibility of books from third party publishing houses in merged entity’s sales network.

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17. Non-price effects such as a **contraction of specific investments** were considered in a merger between the two main operators of directory assistance services. In reviewing the transaction the Authority noted an upward trend in investments of one merging party (Libero) in the period 2012-2014 while an opposite trend was observed for other party (Seat) over the same period. Concerns about quality were also expressed by the Authority which noted the services offered by one party (Seat) were of higher quality because key inputs (e.g., call centre services, databases and software) were not outsourced but produced in-house. In the AGCM view, such difference in quality would have not persisted in the post-merger context if the new entity had standardized all the services towards the lower standard. The transaction was cleared subject to a structural measure to eliminate the horizontal overlap (i.e., the transfer of a number of directory assistance services).

4. **Non-price effects in retail trade sector**

18. In reviewing two retail mergers, the assessment of non-price variables played a central role in defining the boundaries of competition, i.e., the relevant antitrust markets. One key question that competition authorities are often called to answer in retail mergers is whether the various distribution channels are sufficiently interchangeable so that they are subject to similar competition conditions.

19. In a concentration affecting a wide range of baby products (e.g., clothes, nursery, toys) distributed through several channels, the AGCM ascertained that the specialized channel called “baby store format” was a distinct market compared to other channels, in particular large scale distribution channel (e.g., hypermarkets), due to its characteristics in terms of product mix & range and ex-ante and ex-post sales services. At the competitive effects stage, the Authority found that the merged entity would have reached a 50% of market share or more in several local markets, with the implication of potential anticompetitive effects on price or non-price variables.

20. In evaluating the concentration between the two major distributors of cosmetics and luxury perfumes, the AGCM found that selective distribution channel was a separate relevant market from other channels (like pharmacies, supermarkets, single-brand stores) due to differences in a number of variables: prices, reputation of brands, quality and packaging, shopping experience, sales services and several other requirements for the selective distribution standard (e.g., product range, minimum retail outlet area, qualified sales assistants, quality and furniture of the outlet space). In addition, it was observed that such variables were not held constant but were adjusted to the local market conditions: as a result of the merger. In geographic areas where merging parties would have reached

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5 To support this conclusion, the Authority analyzed the various channels in terms of product range and mix (e.g., min and max # of SKUs and min and max of # of brands), types of ex-ante and ex-post sales services, price movements, consumer behavior and trends as from two consumer surveys submitted by the merging parties.

over 45% of market share\(^7\), the Authority imposed the divestiture of a number of outlets to address its concerns about the effects of the merger on price and non-price conditions.

21. Similarly, in a recent merger between two pet shop operators\(^8\), the specialized retail channel comprising traditional pet stores (independent outlets and chains) was considered a separate relevant market due to the importance of non-price aspects such as after sales services, product range and mix (e.g., the provision of pet care services) which were not offered by other channels (e.g., grocery retailers). This finding was also based on a consumer survey commissioned by the AGCM. In assessing the effects, the forward-looking analysis of the Authority pointed out to the dynamism of this sector in rapid expansion, noting the plans of the large-scale distribution operators to open specialized stores so to compete with the existing operators also on the above mentioned non-price variables.

5. Final remarks

22. Recent merger experience has brought to the Authority’s attention the importance of assessing traditional non-price effects, such as quality, variety, or range. In the AGCM view, the precise balancing between price and non-price effects may be difficult to carry out in practice, particularly if they move in different directions or affect customers in different ways. Furthermore, in mergers with vertical dimension, foreclosure effects may play an important role in the balancing exercise although any quantification of such effects may prove hard to measure. However, in the Authority’s experience well-tailored merger remedies may help address negative non-price effects; being often of behavioural nature, the remedies imposed by the Authority in such cases have been limited in duration in order to account for the continuing evolution of the markets.

23. The Authority has not dealt yet with innovation markets and the use of personal data in the context of merger review, although these non-price effects are likely to play an increasing role in future. In relation to the use of personal data, in 2017 the Authority launched a market study on big data, still on-going, to gain a deeper understanding of the data-driven economy and innovation\(^9\). On the consumer protection side, the Authority has recently opened an investigation against Facebook for misleading information for collection and use of data\(^10\).

\(^7\) Geographic markets were defined on the basis of isochrones (20 mins driving time) around merging parties’ stores.

\(^8\) Merger case n. C12139 - Noah 2/Mondial Pet Distribution, April 2018.
