



UPP: Up and Away?

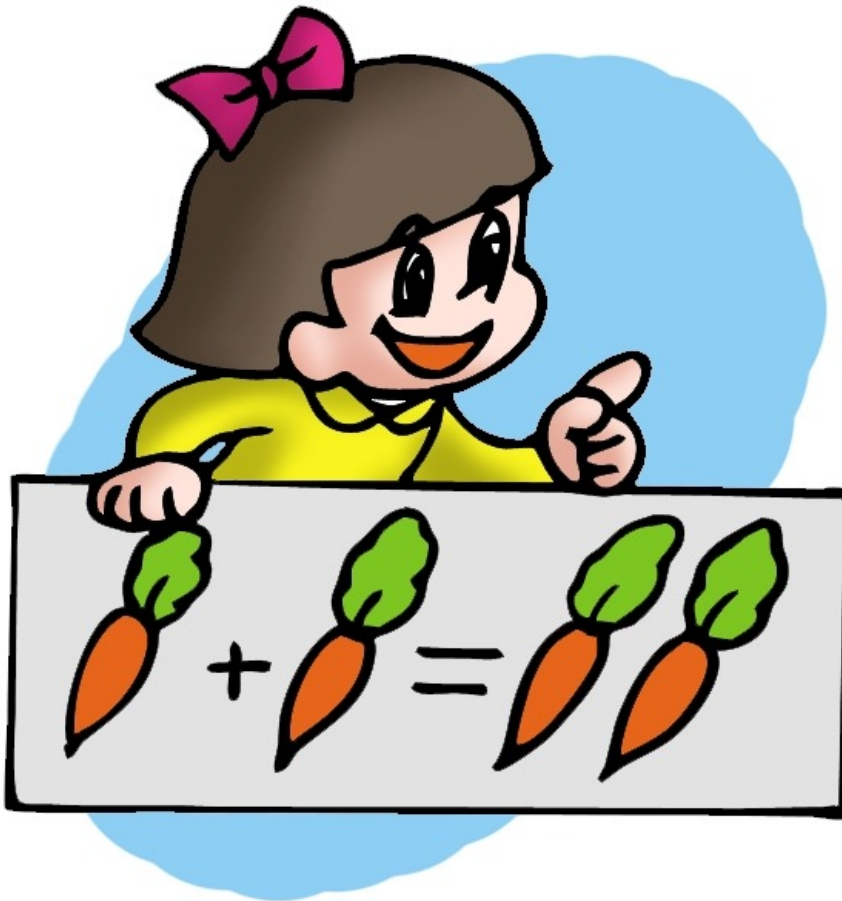
The rising prevalence of pricing pressure indicators

**Dr Amelia Fletcher
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and Chief Economist, OFT***

**CRA Brussels
8 December 2010**

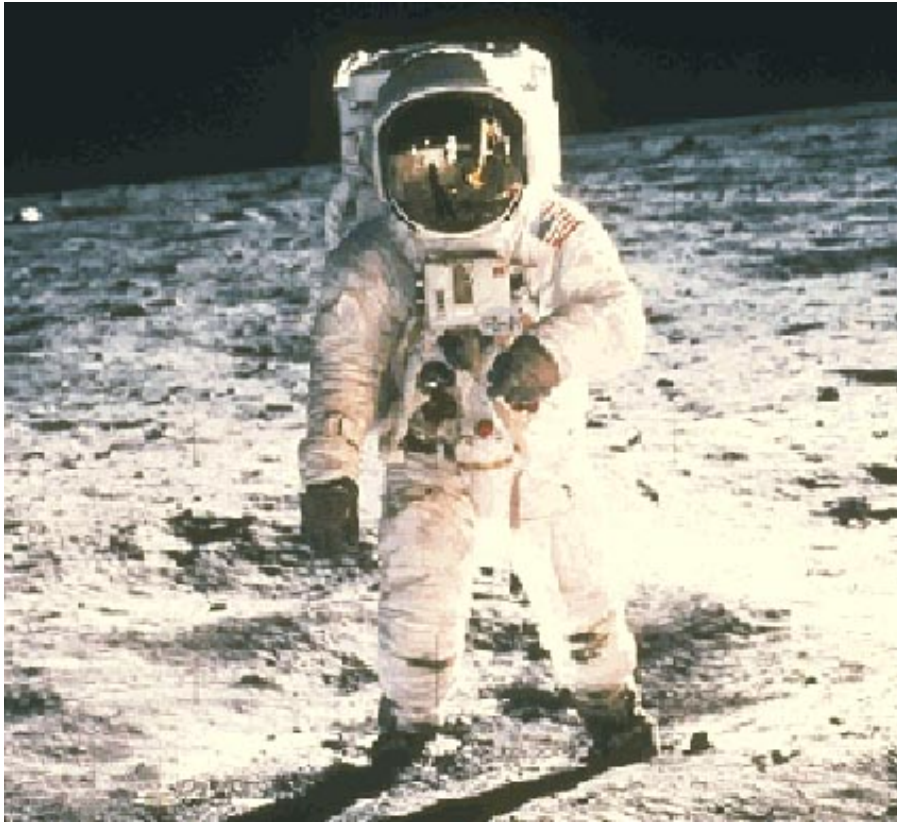
* This presentation is based on a paper co-authored with Chris Walters (OFT) and Alison Oldale (CC). The views are the authors alone, and not necessarily those of their respective institutions.

Where we were: A counting game!



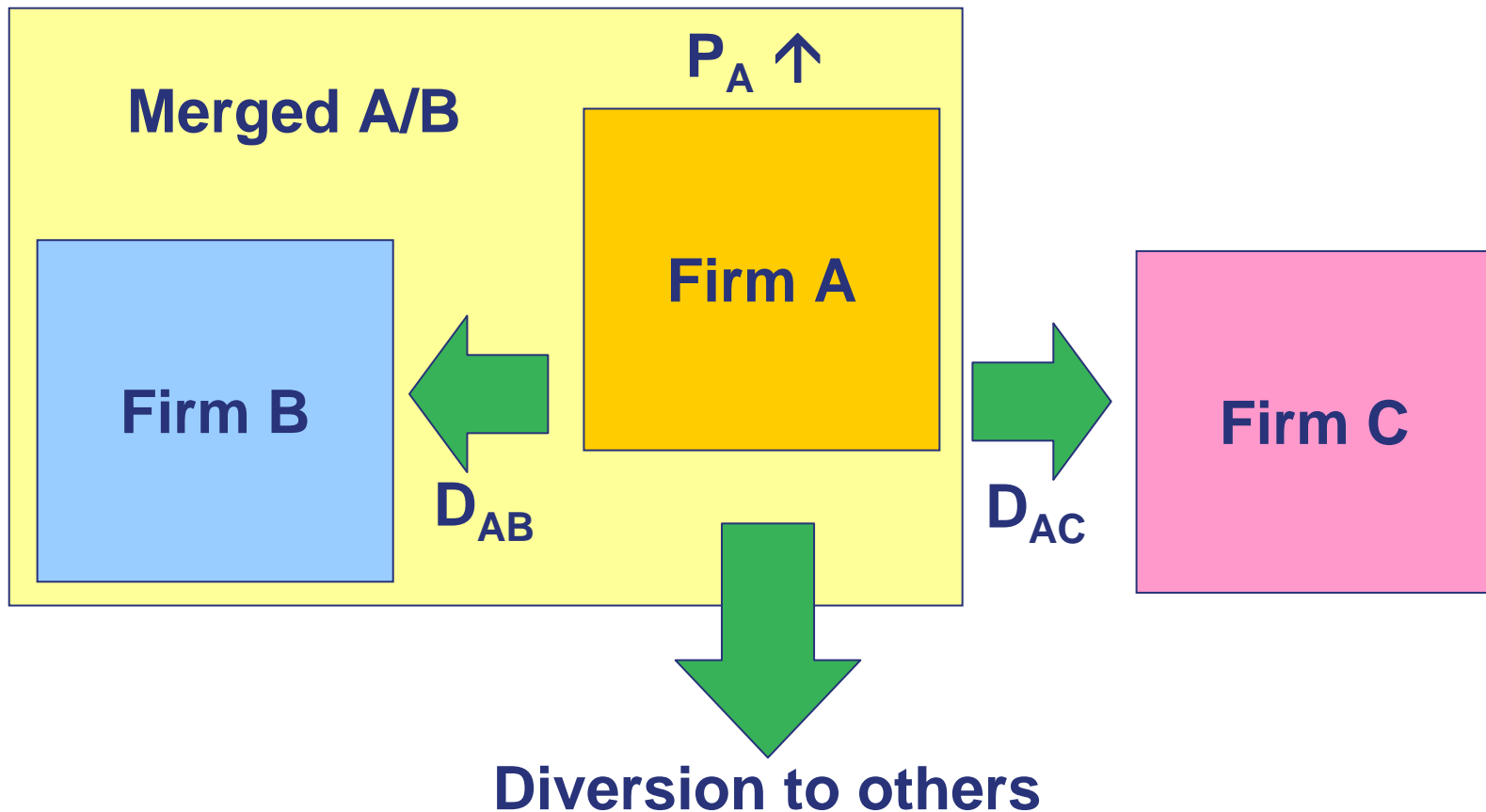
- **Market definition**
 - Carried out more rigorously...
 - ...or (often) less
- **Fascia counting**
 - 5 to 4 okay?
 - 3 to 2 bad?
- **Or market shares**

And now: A giant leap forward!



- **IPR/UPP/GUPPI**
- **All have pros and cons**
- **But provide a better proxy of merger effects than before**
- **Much easier than merger simulation!**

The basic idea



UK Experience of the IPR



- **First used CC (2005) second phase inquiry into Somerfield/Morrison**
- **Instigated two-step process:**
 - Define local catchment areas, and count fascias within these to identify potential problem area
 - Within these, calculate IPRs
- **Since then, IPR methodology refined and applied by OFT, at first phase, in ten mergers**
 - including recent use of asymmetric IPRs (Asda/Netto, 2010)

Implementing the IPR methodology



Implementing the IPR methodology



1. Diversion ratios

- **Can be derived in various ways:**
 - Surveys
 - Econometric analysis of demand
 - Win/loss data
 - Event studies
- **OFT most commonly uses the survey question:**
 - What would you do if this product (or retailer) was unavailable?

Implementing the IPR methodology

- **Costs treated as variable over time period and output increments that reflect competition**
- **Tricky issues for multi-product firms, where merger only relates to one product (but not insurmountable)**



**2. Gross
profit
margins**

Implementing the IPR methodology

IPR formulae

$md/(2(1-d))$
for linear demand

$md/(1-m-d)$
for isoelastic demand

3. Assumed Demand function

- **md (=GUPPI) is very general**
 - Differences relate to degree of pass-through
- **In practice:**
 - Isoelastic treated as ‘upper bound’ IPR
 - Linear treated as ‘lower bound’ IPR
- **OFT typically employs the former**
 - as appropriate for ‘cautious’ first phase
- **But can ‘pass-through’ be assessed directly?**

Implementing the IPR methodology

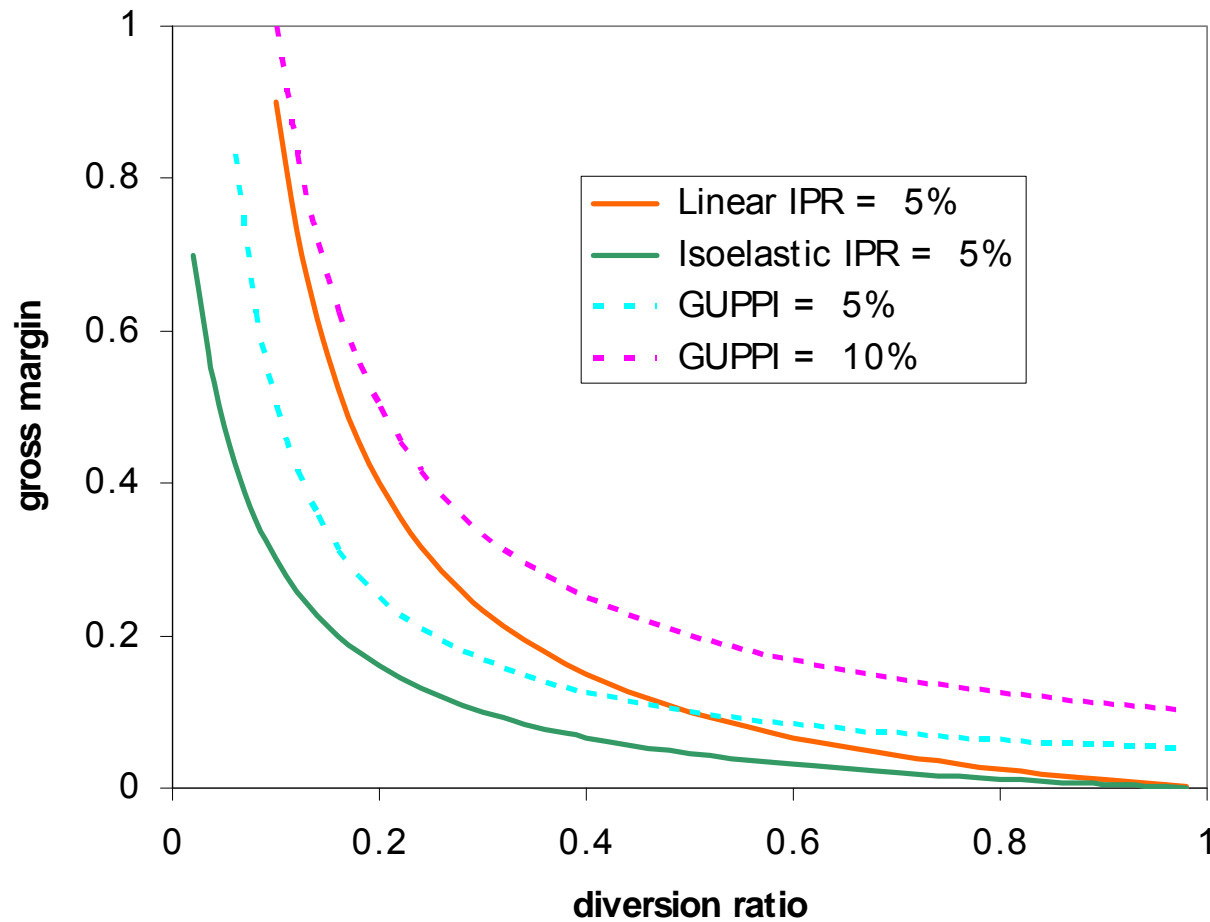
- **OFT has applied 5% threshold for IPR**
- **No tolerance for price rises, but arguably allows for:**
 - Unmeasured efficiencies
 - Measurement errors
 - ‘Illustrative’ nature of model
- **More research would be useful!**

Although the CC rationale was simpler:

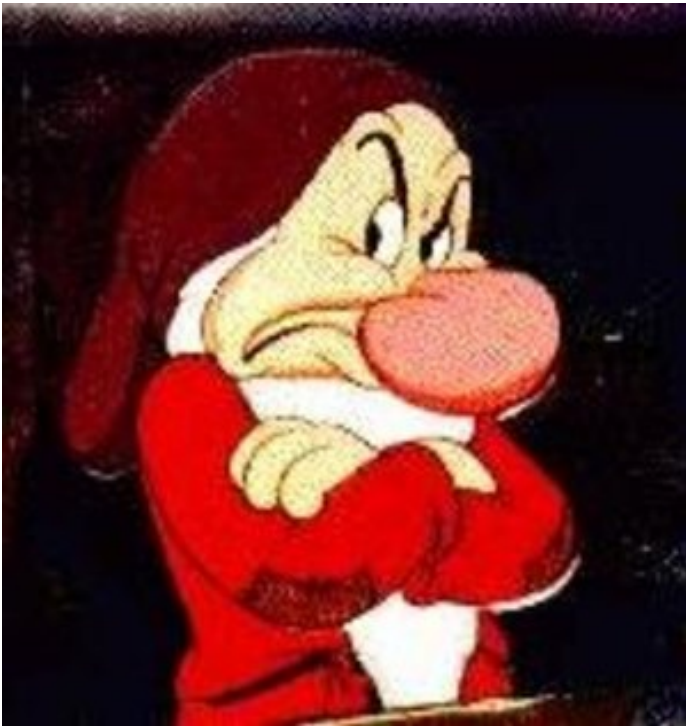
“The CC defines a 5 per cent price rise to be ‘small but significant’ when defining markets and this therefore seemed a useful benchmark for this purpose”

4. Intervention threshold

Interaction of indicators and thresholds



Not everyone likes this!



- **Concerns include:**

- Too much work/cost involved
- Too many implicit assumptions being made
- Over-simplistic: no allowance for competitor reaction, product repositioning, or buyer power
- Big measurement errors

- **Some truth to these concerns - caveats are needed!**
- **But let's not let the 'best' be the enemy of the 'good'**



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