The great GUPPI debate: 
*Topical issues*

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Four topical issues

- The 2-step process in retail mergers
- Choice of price pressure indicator
- Use of thresholds
- Role of efficiencies
The 2-step process in retail mergers

Step 1: Filter out unproblematic areas
- Identify catchment areas
  - Typically using customer location data
  - But other techniques too
- Ideally re-centring on:
  - Acquirer store
  - Target store
  - Population centres
- Identify potentially problematic overlap areas (eg ‘4 to 3’ or less)

Step 2: Price pressure analysis
- Surveys (outside both parties’ stores) to find area-specific diversion ratios
  - Typically using question: ‘what would you do if this retailer were not available?’
- Collect store-specific gross margins for both parties stores
- Use diversion ratios & margins to derive price pressure indicator

Key benefit: Reduces time and cost involved in survey and margin analysis, while minimising risk of missing problematic overlaps

Choice of price pressure indicator

GUPPI formula

Symmetric IPR formulae

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

Key points to note:
- Numerator of IPR formula = GUPPI
- Difference relates to denominator = degree of pass-through
- Effectively GUPPI = IPR if 100% pass-through

Pros and cons:
- GUPPI is very simple and measures the key element of interest (the value of diverted sales internalised by the merger). More easily applied in mergers between multi-product firms
- IPR is intuitive and ‘gives body’ to the GUPPI concept, albeit at the cost of requiring information/assumptions on demand/pass-through
Choice of indicator in Asda/Netto (2010)

- IPR SLC criteria: IPR > 5%
- Competitive relationship: Symmetric, Asymmetric
- Curvature of the demand curve: Isoelastic, Lincor
- Input variables: Relative costs, Relative prices, Margins
- Input choices: Equal, Netto 5% cheaper, Asda 5% cheaper, Or more?

Use of thresholds

- ‘Thresholds’ can be useful for identifying mergers that are more likely/less likely to give rise to an SLC
- Does not indicate tolerance for price rises, but rather allows for:
  - Credit for unmeasured efficiencies
  - Measurement errors
  - ‘Illustrative’ nature of model
- No ‘rebuttable presumption’
  - Albeit we get close to this, for pragmatic reasons, in major retail cases
  - Best employed as useful indicator alongside other evidence
- OFT has typically adopted a 5% ‘threshold’ (unweighted) for IPR but worth noting that...
Role of efficiencies

- Marginal cost efficiencies feed easily into IPR/GUPPI
- In Asda-Netto, parties put forward detailed efficiency arguments in respect of:
  - Lower input prices due to improved buyer power
  - Store repositioning
- OFT accepted former (to limited extent that evidence met compelling standard required), but not latter
- Key question: what is appropriate threshold when efficiencies are incorporated?
  - OFT did not have to address this issue due to limited extent of savings. We would welcome views!
NB Much of this and more…

- …is discussed further in the OFT/CC retail merger commentary
- This is not guidance, but answers 3 questions, based on experience in past mergers:
  - How do you use catchment areas, both to identify which of our stores overlap and to eliminate unproblematic areas from further analysis?
  - What if we compete nationally - all our stores offer the same products at the same prices with the same service quality?
  - How do you use simple quantitative techniques to assess how mergers might affect retail prices?
- And it is out imminently!

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