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**

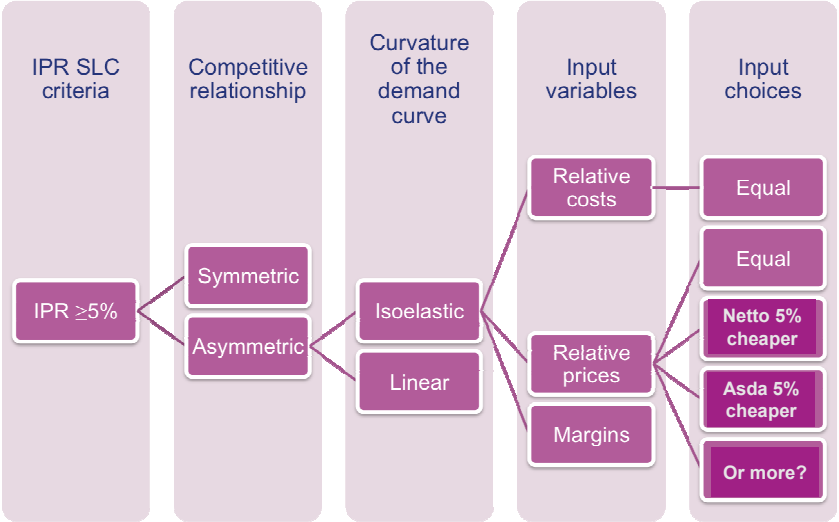
- **Key benefit: Reduces time and cost involved in survey and margin analysis, while minimising risk of missing problematic overlaps**

Choice of price pressure indicator

GUPPI formula	Symmetric IPR formulae	
margin x diversion ratio	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)



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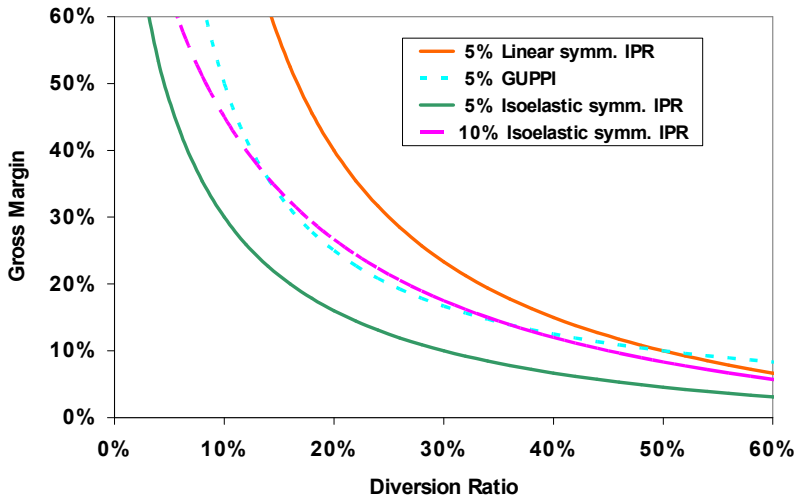
Use of thresholds

- **'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…**

…interactions of indicators and thresholds



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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 <u>not</u> 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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