Radio Mergers Are Not Substantial: The impact of the Communications Act and the Enterprise Act on radio mergers

Report by Indepen

for the CRCA

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Indepen Consulting Ltd is a management consultancy providing advice and assistance to organisations addressing the challenges of regulation, competition and restructuring in telecommunications, media and utility sectors. Further information can be found at www.indepen.co.uk

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Summary

1. In 2003 the Communications Act and the Enterprise Act came into force. The former recognises the need for radio companies to consolidate and local radio ownership rules are to be liberalised, potentially paving the way for greater industry concentration. At the same time the Enterprise Act changes the rules under which mergers are to be approved. It is important that the Government's recognition of the need for a more consolidated radio industry does not come into conflict with the approach to radio mergers adopted by the competition authorities.

2. Commercial radio stations compete for audiences with BBC radio and sell the opportunity to reach these audiences to advertisers. They compete for advertising revenues with other media (e.g. press, TV, cinema and outdoor). Radio is a small advertising medium accounting for about 7% of all display advertising and 4% of advertising overall. Within this, the commercial radio industry is highly fragmented with 72 owners of 263 stations and many stations are not profitable. There are high fixed costs associated with operating a radio station and so consolidation of radio companies allows significant scale economies to be exploited. This provides the funding for investment in programme innovation, new station formats and digital radio. Commercial radio companies need to consolidate if they are to compete effectively with the BBC for audiences and with other media for advertising revenues, particularly press and TV which are larger and more concentrated.

3. Indepen was commissioned by the Commercial Radio Companies Association (CRCA) to examine the competitive nature of the industry, the way in which this issue has been addressed by the competition authorities and the impact of the implementation of the Enterprise Act, by the Office of Fair Trading (OFT) and the Competition Commission (CC). The main concern of this report is the approach taken to assess the competitive effects of local radio mergers by the competition authorities. The three main elements of a competition analysis are addressed, namely

   - the definition of the relevant market (Section 3)

   - whether the merger has resulted or is likely to result in a substantial lessening of competition (Section 4)

   - whether there are customer benefits that might offset any finding of a substantial lessening of competition (Section 5).

4. The changes introduced in the Communications Act and the Enterprise Act come at a time when the media and wider communications sector is undergoing rapid change, as a result of increasing internet penetration, the expansion of digital broadcasting and the roll-out of fixed and mobile broadband services. The market context for the study is described in Section 2.

5. The evidence contained in this report includes two surveys conducted in March 2003 in the Severn estuary region: a questionnaire survey of 56 respondents and a qualitative survey of 14 respondents. Both surveys involved buyers of radio advertising. In the time available to us we have not sought evidence for the purposes of this report from

respondents in other areas of the UK nor from buyers of advertising on other media. Further work in these areas may provide additional useful results.

Market Context

6. New media is expanding the choice of entertainment for consumers and the choice of advertising outlets for advertisers. So far, this appears to have had a negative impact on TV and the press but radio has maintained its audiences. Around 65% of the population listen to commercial radio each week and individuals on average listen for 15-16 hours a week.

7. Radio is increasingly listened to over new media platforms, such as the internet and digital TV. In those markets that are served by digital radio the number of radio services broadcast has roughly doubled. As the coverage of digital radio is extended over the next few years and the take-up of digital sets increases, competition for radio advertising revenues is likely to increase.

8. Radio revenues have grown rapidly at 12% p.a. (in real terms) over the last 10 years. Forecasts predict slower growth over the next 5 years.

9. Most of the growth in radio advertising revenues since 1992 (about 80%) has come from national rather than local advertisers, so that national advertising now comprises about 70% of the total.

10. Radio's share of advertising (at 7% of display advertising and about 4% of all advertising expenditure) is still small compared with that of TV, press and direct mail. Of the UK's top 100 advertisers, 40 attributed less than 2% of their total media spend to radio and 21 attributed more than 6.6%, with only 5 of those attributing more than 10%. In broad terms advertisers tend to use other media, disregarding or substituting for radio.

11. Commercial radio faces strong competition for audiences from the BBC which has increased its market share in recent years to over 50% of weekly listening. The BBC's funding through an hypothecated tax gives it a competitive advantage over commercial radio because of its security of funding and, all else being equal, audiences are likely to prefer to listen to radio without advertisements. The BBC's presence has a material impact on the degree of competition between commercial radio stations and the customer benefits from programme innovations by commercial radio companies (see paragraph 21 below).

Market Definition

12. The key issue in considering the relevant market in local radio merger inquiries is whether radio advertising is part of a wider advertising market including advertising on other local media such as local press, TV, cinema and outdoor. If radio is part of a wider market then mergers between companies owning radio stations in a given local market are less likely to give rise to competition concerns, because the companies will still face competition from other media.

13. The approach used by the CC (and the OFT) to define the relevant market involves the application of a test which assesses whether a hypothetical monopolist of a certain product or set of products, which might constitute a market, could profitably impose a

small but significant non-transitory increase in price (SNNIP). The SSNIP test is commonly applied assuming a 5-10% price increase, however, the CC has stated that it will normally hypothesise an increase of 5%, whilst assuming all other prices remain unchanged.

14. To implement the SNNIP test price elasticity estimates are required. In practice these estimates are often not available and so more indirect evidence is used such as information concerning the similarity or not of product characteristics, the extent of and obstacles to switching between products, correlations between the prices of potential substitutes and survey data reporting advertisers' views on the extent to which different products are substitutes or complements.

15. The CC has tended to adopt narrow market definitions such that radio, local newspapers, cinema advertising, roadside posters and classified directories have each been regarded as separate markets.

16. In the past the CC has suggested that lack of price transparency and difficulties in comparing the effectiveness of different media means that it is unlikely radio and other media are substitutes. This argument is not tenable as national advertisers (who account for 70% of all radio advertising sales) are well informed about prices, the relative effectiveness of different media and can readily substitute between media and between different geographic markets.

17. Our work has led to the following findings.

- Survey evidence suggests that a significant proportion of advertisers regard radio and other media, particularly local press, as substitutes and, consistent with this, that competition between media is used to drive down the price of local radio.

- The lack of correlation between the growth in local press and radio advertising and the apparent absence of demand for joint local radio and local press advertising suggest that local radio and local press are not complements.

- Evidence of switching between media by advertisers suggests radio substitutes for other media.

- Demarcations between media budgets are becoming increasingly blurred implying increased substitutability.

- Evidence on cross elasticities of demand from our own advertiser survey and US studies indicates that radio and newspapers are substitutes.

- Advertiser survey evidence suggests demand for radio airtime is elastic and radio is part of a wider media market. This conclusion is supported by evidence from studies of US radio and other media markets which indicates that on balance demand for radio advertising is elastic.

- In addition, evidence from the UK TV market indicates that demand for TV airtime is likely to be elastic and, given that TV is generally regarded as having fewer substitutes than other media, this suggests that demand for radio airtime is also elastic.

18. Taken together this evidence suggests that radio is part of a wider media market. Local radio and local press appear to be substitutes and for some advertisers other media such as other printed media, TV and direct mail are also relevant.

19. The evidence would seem to contradict the position taken by the CC that radio is a separate market from other media. One reason for this may be that the CC does not seek to derive elasticity evidence to support its position on market definition. Another may be that the CC only draws evidence from radio advertisers who by definition value radio highly and so are less likely to regard other media as a good substitute for radio.

Substantial Lessening of Competition

20. Under the Enterprise Act, the OFT and the CC will test mergers in terms of whether they have resulted or are likely to result in a substantial lessening of competition (SLC) as opposed to the traditional test of whether mergers were against the public interest. If a merger leads to an SLC then it will generally be prevented unless there are benefits to customers that outweigh the adverse effects to competition. The move from a public interest to an SLC test should help reduce uncertainty for businesses contemplating mergers. We discuss the implications of the introduction of the SLC test for mergers in the commercial radio sector and consider how sector specific regulation and price discrimination should impact on the SLC assessment. We make the following recommendations.

- Current guidelines, if followed, give insufficient weight to the concept of 'substantial' in the SLC test. At times the guidelines are written as if appropriate for a mere lessening of competition test rather than a substantial lessening of competition. We argue the 'substantial' concept is important and care is needed not to 'airbrush' this away in the implementation of the Enterprise Act.

- Concentration should be less of a concern in the context of commercial radio mergers due to sector specific regulation and the role of the BBC, as acknowledged in the Carlton/Granada merger enquiry, both of which have the effect of increasing industry concentration. In particular, the interpretation of Herfindahl-Hirshmann Index (HHI) concentration measures is unlikely to be useful in assessing mergers in the commercial radio sector as all markets are likely to fail the OFT's threshold (for the HHI) of 1800 as an indicator of a highly concentrated market.

- The way the CC has approached discrimination in media markets is unlikely to be appropriate under the Enterprise Act. A company's ability discriminate to meet market pressure, even if judged to be against the public interest, does not imply there will be an SLC following a merger. There is little in the history of Commission cases to suggest that if there is some potential for discrimination then it is likely to lead to an SLC. We note that in the recent Scottish Radio Holding/GWR and the Trinity Mirror cases the CC concerns over discriminatory pricing played a role in the final decision. Similar issues concerning discounting and a lack of price transparency arose in the Carlton/Granada, though curiously the CC concluded that it had not had been able to examine the market in sufficient depth to come to a conclusion on the issue.

- Discrimination can only be a potential barrier to a merger under the Enterprise Act if the probable outcome of the merger is that prices will rise for a material number of customers without falling for others and that the net effect in terms of competition is substantial. It is this test that should apply and not a test of the potential for discrimination.

- In cases where discrimination is thought to be an issue the share of supply should be taken into account when assessing whether there is an SLC. We suggest that if the share of supply test is borderline (i.e. the area relevant to the merger comprises 3-4% of the UK) then any lessening of competition arising from discrimination is unlikely to be substantial.

- Materiality is likely to be a common theme in radio mergers because many radio stations serve relatively small parts of the UK. This issue has not arisen in recent television mergers because parties have had significant shares of the national advertising market. However, it appears surprising that in the Carlton/Granada decision the Competition Commission permitted a significant reduction in competition in the London TV advertising market[1] by allowing competing Carlton and Granada services to merge, whilst blocking radio mergers in much smaller markets. It is important that the materiality issue receives particular consideration in the new Enterprise Act framework and that in doing so there is consistent treatment of television and radio mergers.

Customer Benefits

21. Radio company mergers may have effects on the quality and choice of radio services and on innovation in relation to those services. We find that mergers

- are likely to increase the diversity of radio formats thereby offering listeners greater choice and advertisers more attractive audiences

- lead to increases in the quality of radio services because cost savings from mergers enable the merged entity to invest in improving programme quality through the transfer of programming and management skills from more to less successful stations

- enable commercial stations to compete more effectively with the BBC by providing funding to support innovation in programming which is essential if the commercial sector is to attract audiences away from the BBC (given the BBC's funding advantage). Innovations in the commercial sector not only offer benefits to listeners of commercial stations but also create significant spill-over benefits arising from the diffusion of innovations into the BBC

- may create companies that can sustain the long term investment required to develop less mainstream services

- provide funding to support digital transmission and new digital radio services. This investment is required so that radio can compete effectively with other media as they convert to digital operation.

[1] The Competition Commission recognised that Carlton and Granada competed in the London market and that competition between Carlton and Granada acted as a constraint on their ability to increase the level of their customers' commitment for a given level of discount (paras 2.125-2.126, Carlton Communications plc and Granada plc, Competition Commission Cm 5952, October 2003).

1. Introduction

1.1 Scope of the Report

In 2003 the Communications Act and the Enterprise Act came into force[2]. The former contains significant changes in the rules that govern the ownership of the media. In particular, radio ownership rules are to be liberalised, potentially paving the way for greater industry concentration. Mergers between commercial radio stations may affect competition for advertising revenues in which case they may be reviewed by the competition authorities. The Enterprise Act changes the rules under which mergers are to be approved. It is important that the Government's recognition of the need for industry consolidation does not come in to conflict with the approach to radio mergers adopted by the competition authorities.

These legislative changes come at a time when the media and wider communications sector is undergoing rapid change, as a result of increasing internet penetration, the expansion of digital broadcasting and the roll-out of fixed and mobile broadband services. It is therefore timely to address the issue of competition between radio advertising and advertising on other media.

Indepen was commissioned by the Commercial Radio Companies Association (CRCA) to examine the competitive nature of the industry, the way in which this issue has been addressed by the competition authorities and the impact of the implementation of the Enterprise Act, by the Office of Fair Trading (OFT) and the Competition Commission (CC).

This report addresses

- substitutability between radio and other media and the implications for the definition of the relevant market in radio mergers
- the competitive effects of local radio mergers, in particular whether or not these are likely to result in a substantial lessening of competition
- the benefits to advertisers and listeners that may arise from consolidation in the local radio industry.

There are two ways in which commercial radio stations compete with each other and other media. They compete for audiences with each other and the BBC (and indirectly with other uses of people's time). In addition, commercial radio stations compete for advertising revenues with other media (e.g. press, TV, cinema and outdoor). Radio stations sell advertisers the opportunity to reach audiences of varying size and composition. While this report primarily addresses competition for advertising revenues, competition for audiences is also addressed where this impacts on competition in advertising markets.

The focus of our work is on local radio mergers rather than mergers between national radio stations. However, local radio stations earn revenues from local and national advertisers and so competition for both types of advertising is relevant.

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[2] The Communications Act received Royal Assent on 18 July 2003. Competition provisions of the Enterprise Act (2002) came into force on 20 June, 2003.

1.2 Legal Context

The Communications Act introduces significant liberalisation of media ownership regulation including liberalisation of controls on radio ownership. Controls that prevent ownership of more than one national commercial radio licence are removed and local ownership is liberalised to allow an operator to control up to 55% of the points in a market[3]. The latter rule – known as the 2+1 rule – would in theory allow local radio markets to be supplied by two commercial operators plus the BBC.

Mergers that meet the requirements of the Communications Act may still be scrutinised by the competition authorities. Mergers have been governed by the terms of the Fair Trading Act 1973, however, the merger provisions of the Enterprise Act 2002 took effect on 20 June 2003. The two most significant changes are first, that mergers will no longer be tested against whether they are in the public interest or not but whether they lead to a substantial lessening of competition, and second, merger decisions will be made by the OFT and the CC rather than the Secretary of State, save for newspaper and certain 'public interest' mergers. Under the Communications Act new public interest considerations relating to mergers involving broadcast and newspaper enterprises were added and these are implemented under the Enterprise Act. As a matter of policy the Secretary of State expects that intervention will be limited to those areas where media ownership rules have been removed under the Communications Act[4]. In the case of radio, intervention will normally be limited to mergers involving companies owning national radio stations.

Under the Enterprise Act a relevant merger situation arises if the turnover of the enterprise being acquired exceeds £70m (the turnover test) or the new joint enterprise will supply at least a quarter of those goods and services in the UK or a substantial part of the UK (the share of supply test). The OFT is required to consider mergers that meet either one of these tests and will then refer cases to the CC when necessary. Economists tend to group mergers into one of three types, horizontal, vertical and conglomerate, and both the OFT and CC use this categorisation to assess relevant mergers. The radio sector is almost exclusively concerned with horizontal mergers (mergers where parties operate in the same market) and we concentrate our analysis on these.

The OFT will undertake a series of steps before referring a case to the CC. First, it must decide whether there is a relevant merger situation. Here the turnover test is fairly straightforward but the market share test is less so. The OFT does not conduct a market analysis at this stage but deliberately takes a narrow view of the relevant market by focussing solely on the set of goods or services supplied by the merged parties. A full market definition analysis is only undertaken once it is decided that there is a relevant merger situation. Given this narrow market definition, the OFT then asks if it believes that the merger has resulted or is likely to result in a substantial lessening of competition (SLC). If it believes that the merger will have such an effect then the OFT must refer the merger to the CC unless the merger is of insufficient importance to justify reference or if there are 'obvious' benefits to customers that

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[3] If a person owns two or more overlapping licences (where the coverage area of one service reaches at least 50% of the population in the coverage area of the other), he is prevented from owning a third licence that overlaps with two or more licences (to form a cluster of 3 or more stations) if doing so will mean he owns more than 55% of the points in the coverage areas of any of those licences. See the draft statutory instrument Broadcasting, The Media Ownership (Local Radio) Order 2003.

[4] Intervention in Media Mergers, Department of Trade and Industry, December 2003.

outweigh the adverse effects to competition. Note, that the OFT asks what is the effect of the merger as it stands or as proposed. As such, if the OFT has decided to refer the case, it is always open to parties to offer undertakings that may change the merger in such a way that the OFT decides not to make a referral.

Upon receiving a referral, the CC repeats the exercise of defining the relevant market and then formally asks the same question as the OFT, i.e., whether the merger has resulted or is likely to result in an SLC. The CC interprets this as an assessment of whether the merger would increase market power. (Note the CC do not make an assessment whether the merger would lead to a 'substantial' increase in market power.) If the CC finds that the merger will lead to an SLC, then they consider potential remedies that may mitigate or prevent the SLC or adverse effects arising from the SLC. In doing so they need to consider the cost and proportionality of remedies and whether there are consumer benefits that offset the SLC.

1.3 Approach

Our approach to assessing the competition implications of local radio mergers has been to use the analytical framework likely to be used by the competition authorities. The Competition Commission's Merger Guidelines[5] provide guidance on the approach to be adopted. In addition we have reviewed the approach taken by the CC in relevant cases, particularly those involving radio and local press mergers.

Market definition and so the degree of substitutability and/or complementarity between different media is an empirical issue requiring information on the impact of price changes for a given media on demand for another. In addition, the definition of the relevant market for radio merger inquiries requires data on the responsiveness of demand to changes in the price of radio. The main challenge for this study has been the lack of suitable data with which to estimate these demand effects. We have therefore assessed substitution from more indirect evidence including information gathered in interviews with advertising agencies radio stations and advertiser representatives, secondary evidence from a variety of sources and evidence from an advertiser survey we undertook and surveys undertaken by the CC.

1.4 Report Structure

The report is structured as follows

- Section 2 discusses the market context for the study
- Section 3 discusses the issue of market definition
- Section 4 evaluates the competitive effects of local radio mergers and in particular whether they are likely to result in a substantial lessening of competition
- Section 5 assesses the customer benefits of local radio mergers.

The Appendix contains summaries of the Competition Commission's approach to market definition in recent media merger inquiries.

[5] Merger References: Competition Commission Guidelines, March 2003, CC2.

2. Market Context

2.1 Summary

In this section of the report we discuss recent developments in media markets overall and in commercial radio in particular. The key findings are the following.

- New media is expanding the choice of entertainment for consumers and the choice of advertising outlets for advertisers. So far this appears to have had a negative impact on TV and the press.

- By contrast, radio has maintained its audiences. Around 65% of the population listen to commercial radio each week and individuals on average listen to 15-16 hours per week. Radio is increasingly listened to over new media platforms, such as the internet and digital TV.

- Commercial radio faces strong competition for audiences from the BBC which has increased its share in recent years to just over 50% of weekly listening.

- Radio revenues have grown rapidly over the last 10 years – much faster than any other medium except the internet. Forecasts predict slower growth over the next 5 years.

- Radio's share of advertising (at about 7% of display advertising and about 4% of all advertising expenditure) is still small compared with that of TV, press and direct mail.

- Most of the growth in radio advertising revenues since 1992 (about 80%) has come from national rather than local advertising. Sponsorship and promotion revenues have also been growing rapidly over the last two years.

- Ownership of local press and TV has consolidated in recent years, however, ownership of radio still remains highly fragmented with 72 owners of 263 stations.

- In those markets that are served by digital radio the number of radio services broadcast has roughly doubled. As the coverage of digital radio is extended over the next few years, and the take-up of digital sets increases, competition for advertising revenues is likely to increase.

2.2 Media Market Developments

Digitisation and the internet have expanded the media choices available to consumers over the last five years.

- <u>Internet</u>: 46% of households now have internet access at home as compared with less than 10% in 1998[6]. 52% of adults have access to the internet[7] while 62% of adults have accessed the internet at some time.

[6] Internet Access, National Statistics, 17 December 2002.
[7] The Public's View 2002, Robert Towler, An ITC/BBC research publication.

- Broadband: 7% of households have broadband internet access as compared with almost none three years ago[8].

- Digital TV: 41% of households have digital TV and 47% have multi-channel TV as of December 2002, compared with 33% and 42% in mid-2001 respectively[9]. The audience share of multi-channel TV rose from 14% in 1998 to 22% in 2002.

- Digital Radio: Digital radio is available to over 75% of the population terrestrially and is also available via satellite and the internet.

- Radio using New Media: The number of people listening to radio over new media is growing rapidly with 14% of adults claiming to have listened to radio over the internet in the past year, 20% having listened via the TV and 3% via a mobile phone[10].

- Mobile Phones: Penetration of mobile phones has grown from around 11% at the start of 1997 to 83% in May 2003[11].

These developments are affecting advertising markets in a number of ways.

- New media (e.g. mobile phones, the internet, multi-channel TV) are used more heavily by younger age groups.

- The internet accounts for a small (1%) but rapidly growing share of advertising revenues. Internet advertising spend totalled about £200m in 2002 and has quadrupled since 1999.

- SMS advertising to mobile phones is now used to reach young consumers.

- Advertising revenues for multi-channel TV doubled between 1996 to 2001 and now account for over 20% of TV advertising revenues[12].

Competition between advertising media has arguably grown not only because of the expansion in the number of media but also because demarcations between budgets for above the line (e.g. press TV, radio, cinema and outdoor) and below the line advertising (e.g. direct mail, exhibitions, point of sale material and demonstrations) have been eroded. Advertising on different media is now generally regarded as coming from the same budget, meaning that there are more potential substitutes for radio advertising than has previously been the case.

Table 1 below shows the shares of different media since 1992. Direct mail, radio and the "other" category (i.e. outdoor, cinema and internet) have all experienced growth in share, whilst TV has been roughly static and press and other print media have been in decline. Despite ten years of rapid growth radio advertising still only accounts for a small share of total advertising spend.

As the number of media outlets has expanded, the number of owners within traditional media channels has declined. The increasing concentration of ownership in ITV is well known, with

[8] Oftel's Internet and Broadband Brief, March 2003.

[9] ITC Multichannel Quarterly, October-December 2002 and Quarter 3, 2002

[10] Radio listening data from RAJAR for second quarter 2003.

[11] Mobile Communications. May 2003.

[12] Developments in the UK TV market, ITC, September 2002

the recent merger of Carlton and Granada resulting in a single advertising sales house for ITV. The press market has also become increasingly concentrated with five main groups accounting for more than 70% of all circulation of local newspapers[13].

Table 1: Shares of Advertising Revenue by Medium

Year	Radio[2]	TV	Press[1] Display	Press[1] Classified	Direct Mail	Other
1992	1.9	28.0	33.5	19.7	12.5	4.4
1993	2.3	28.6	33.2	19.7	11.7	4.5
1994	2.6	28.5	32.1	20.0	12.2	4.7
1995	2.9	28.5	31.6	20.1	12.1	4.8
1996	3.0	27.9	30.2	20.3	13.7	4.9
1997	3.1	27.4	28.9	20.9	14.4	5.2
1998	3.4	27.8	28.5	21.3	13.5	5.5
1999	3.5	27.9	28.0	20.6	14.2	5.8
2000	4.1	27.0	27.3	20.9	14.0	6.7
2001	3.9	24.8	26.7	21.8	15.7	7.1
2002	3.9	25.6	25.4	21.1	16.6	7.4

Source: Advertising Statictics Yearbook 2003, World Advertising Research Centre (WARC)
[1] Excludes Production Costs
[2] Independent Radio Gross Revenue

In summary

- new media is expanding the choice of entertainment for consumers and the choice of outlets for advertisers
- radio is increasingly listened to over new media platforms, such as the Internet and digital TV
- TV and press are the main casualties of the increased advertiser choice
- ownership of local press and TV has consolidated in recent years, however, ownership of radio remains highly fragmented with 72 owners of 263 stations.

2.3 Radio Market Developments

Since the early 1990s commercial radio has experienced a period of sustained growth in terms of numbers of stations, audience and revenues.

2.3.1 Number of Stations

Since 1991 the number of stations has grown at an average rate of 13 per year increasing from 107 to 263 at the end of 2002 as the Radio Authority has licensed new local, regional and national stations. Licences were initially assigned to areas that did not have a local commercial radio station and, once these gaps were filled, the Authority sought to license services that would broaden choice covering regions or major metropolitan areas or would provide a localised smaller scale service. Three new national services were also licensed

[13] The Likely Impact of Proposed Commercial Radio and Related Ownership Rules in the 2002 Communications Bill on Plurality, Diversity and Economic Efficiency, Oliver and Ohlbaum Associates Ltd, September 2002.

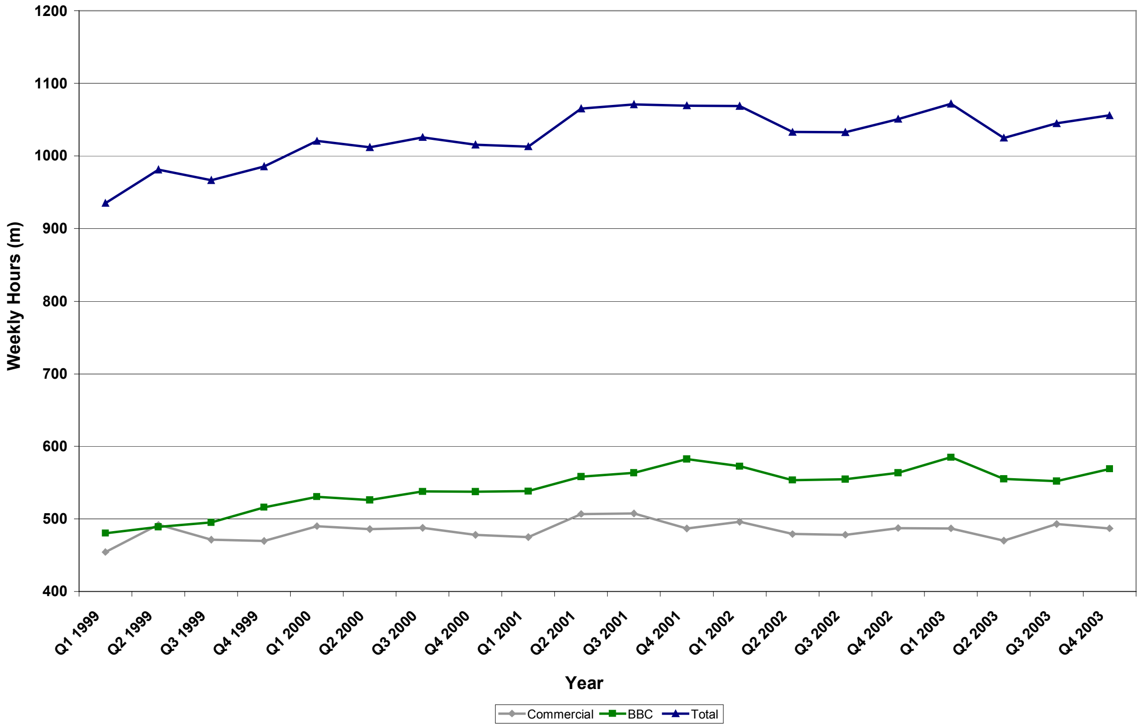
between 1992 and 1995. There are currently 263 commercial radio stations owned by 72 operators.

There is spectrum available for around a further 40 commercial FM radio licensees giving a total of about 300 stations. Licences are still being awarded in nine areas identified by the Radio Authority in 2002 and the Authority has recently identified 20 possible metropolitan licences and 10 other licences for which spectrum can or can very likely be found[14]. There is also spectrum available in the AM band however there is no current strategy for its release[15]. The licensing strategy for both the AM and FM bands will be decided by Ofcom once it is established at the end of 2003.

2.3.2 Reach and Listening Hours

Around 65% of the population listen to commercial radio each week and individuals on average listen for 15-16 hours per week. Commercial radio faces direct strong competition for audiences from the BBC and its share of listening has fallen slightly over the last four years (see Figure 1). More generally radio competes with other uses of people's time. Despite individuals spending increasing amounts of time on the internet and watching videos and DVDs, radio listening has increased slightly since 1999 and radio has maintained its share of time spent on media consumption[16].

Figure 1: Total Commercial, BBC and Total Radio Weekly Hours



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[14] See Radio Authority announces plans for next phase of local licensing 61/02, 21 May 2002; Radio Authority publishes statement about future FM availability, 33/03, 4 March 2003.

[15] See AM Waveband Strategy published by Radio Authority, 118/02, 1 October 2002.

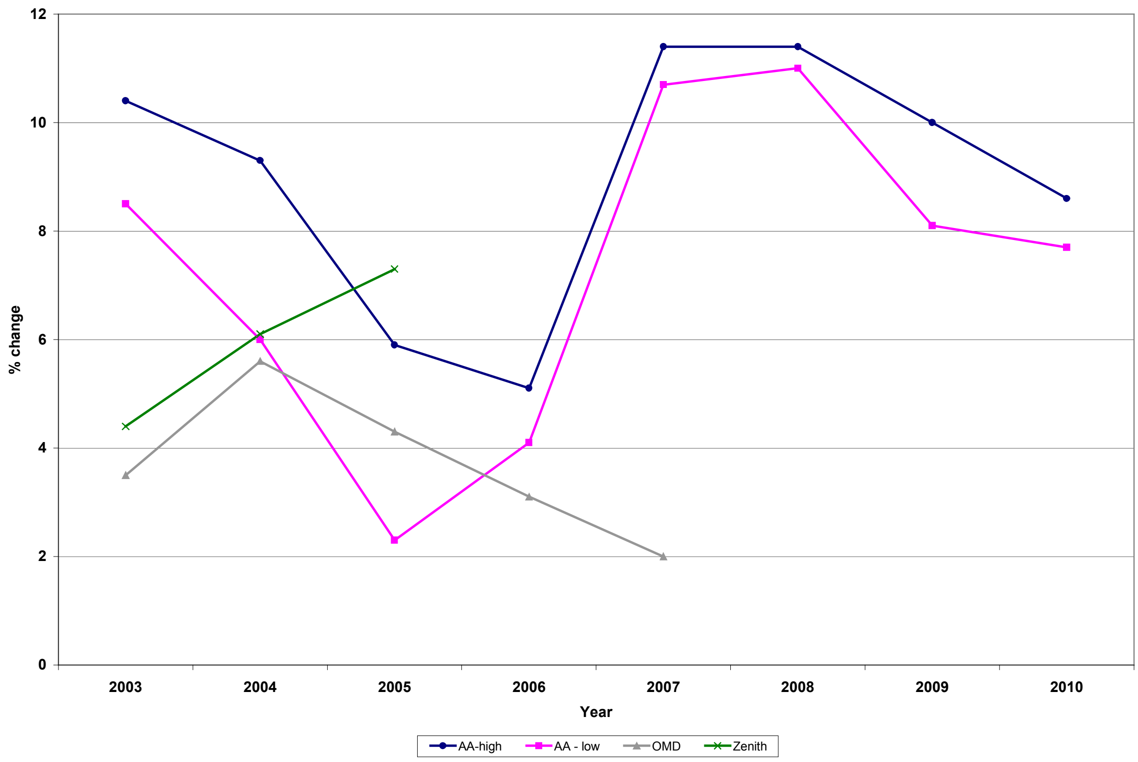
[16] See Radio Days 2 and 3, RAB.

2.3.3 Revenues

Despite vigorous competition from the BBC for audiences, radio advertising revenues have grown at 12% p.a. in real terms since 1992, so that by 2002 they accounted for 6.6% of display advertising revenues. Forecasts of revenue growth produced by the Advertising Association and several advertising agencies (OMD and Zenith) show continued strong growth in revenues over the next 5-10 years but at lower rates than the average of 12% p.a. experienced between 1992 and 2002 (see Figure 2).

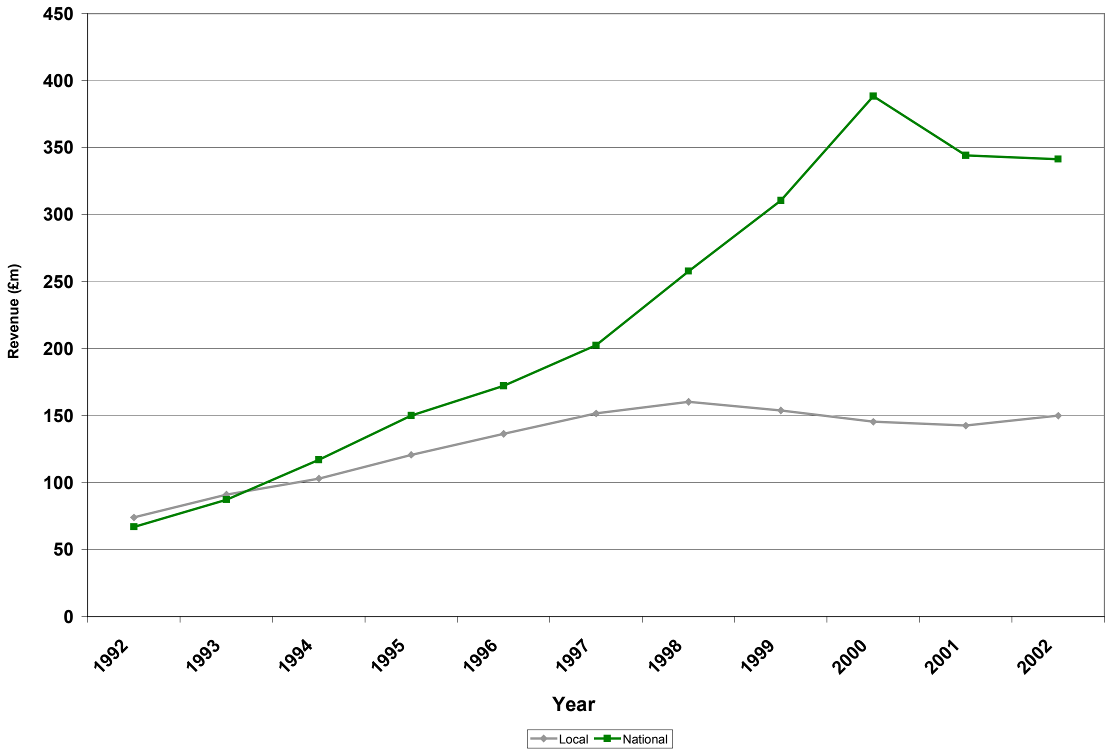
Recent growth in radio advertising has largely been the result of growth in national advertising[17] (see Figure 3) and, in the last 2-3 years, spending on sponsorship and promotions. National advertising now accounts for just under 70% of all radio advertising revenues, excluding sponsorship and promotions. In 2002, sponsorship and promotions accounted for 13% of commercial radio revenue.

Figure 2: Forecast Growth in Radio Advertising Revenues



[17] National advertising is advertising placed with a national buying agency.

Figure 3: Commercial Radio Revenue Split by Market



Many explanations are given for the success of commercial radio relative to other media including

- growth in the number of stations and listening
- the launch of national commercial radio and in particular the success of Classic FM
- the efforts of the Radio Advertising Bureau (RAB) and the industry in general in marketing radio and improving professionalism
- more reliable and timely audience data.

We estimated the relationship between radio advertising revenues and a number of possible drivers, including GDP, numbers of stations and audience. Using quarterly data from 1992 we found that GDP was the key driver with an estimated elasticity of about 3 meaning that a 1% change in GDP would result in a 3% change in commercial advertising revenues. Listening hours (with a one quarter lag) had a much weaker impact – a 1% change in listening hours implied a 0.4% change in advertising revenues.

2.4 Digital Radio

Commercial radio companies are investing hundreds of millions of pounds in digital radio over the initial 12 year licence period for these services. Digital radio services are being transmitted by commercial radio operators and the BBC to 80% and 65% of the population, respectively. Around 320 digital radio services are currently provided, of which 154 have digital radio coverage only and the remainder are simulcast services. The 154 stations with only digital radio coverage include a mixture of new stations and stations that are broadcast in areas not reached by their analogue transmissions (e.g. Xfm, a London station, is rebroadcast digitally outside London). Another way of looking at the supply of services is to abstract from coverage area and to focus on brands. There are currently 141 brands broadcast digitally – 37 provided by the BBC and 104 by commercial radio – and 28 of these brands are new.

By the middle of 2004 approximately 85% of the population will be covered by BBC and commercial digital radio services. The number of stations is growing rapidly with roughly a new multiplex (carrying about 10 stations) being licensed every month meaning that by the end of 2004 there will be around 400 digital radio stations.

At present relatively few people have digital receivers (see Table 2 below), although rapid growth is anticipated as units are installed in new cars, hi-fis and other electronic goods and as receiver prices continue to fall.

Table 2: Current and Forecast Sales of Digital Radios

	Sales estimates and forecasts (000s)
2002	125
2003	300-500
2004	1,000

Source: Digital Radio Development Bureau

Digital radio provides much greater listening choice and increased competition between commercial radio stations in local markets. Table 3 below shows the number of analogue stations and the number of non-simulcast digital stations broadcast as of March 2003 in selected local markets. The number of stations available to listeners has roughly doubled as a result of the advent of digital radio. As the coverage of digital radio is extended over the next few years, and the take-up of digital sets increases, competition for advertising revenues is likely to increase.

Table 3 Number of Radio Services by Market

	Commercial Radio						
	Analogue[1]			Non-Simulcast Digital[2]			Total
Market	Regional	National	Sub Total	Regional	National	Sub Total	
London	20	3	23	17	5	22	45
Leeds	6	3	9	3	5	8	17
Glasgow	5	3	8	4	5	9	17
Bristol	4	3	7	6	5	11	18
Cardiff & Newport	4	3	7	1	5	6	13
Peterborough	4	3	7	3	5	8	15
Norwich	3	3	6	5	5	10	16

[1] Source: The Radio Authority; The Radio Advertising Bureau
[2] Source: The Radio Authority; Radio-Now

3. Market Definition

3.1 Summary

The key issue in considering the relevant market in local radio merger inquiries is whether local radio advertising is part of a wider advertising market including advertising on other local media such as local press, TV, cinema and outdoor. If radio is part of a wider market then mergers between companies owning radio stations in a given local market are less likely to give rise to competition concerns, because the companies will still face competition from other media.

In this section we discuss the approach to market definition used by the competition authorities and review empirical evidence that can be used to answer the question of the relevant market. Ideally one needs evidence on demand elasticities to define the relevant market, however, we find that only partial or indirect elasticity evidence is available. Other more indirect quantitative and qualitative information is typically used in CC inquiries and we first review this evidence.[18] We recognise that the evidence reported is partial, however, more robust results will not be possible until advertising price data for radio, newspapers and possibly other media are developed for local markets.

In summary we find that

- radio advertising sales through agencies comprise 70% of all radio advertising revenues. Agencies' campaigns are required to be evidence based and they are highly accountable to their advertiser clients. Thus most advertising spend is subject to price and effectiveness comparisons

- survey evidence suggests that a significant proportion of advertisers regard radio and other media, particularly local press, as substitutes and, consistent with this, that competition between media is used to drive down the price of local radio

- a lack of correlation between the growth in local press and radio advertising and the apparent absence of demand for joint local radio and local press advertising all suggest that local radio and local press are not complements. On the contrary, evidence of switching between media by advertisers suggests radio substitutes for other media

- demarcations between media budgets are becoming increasingly blurred implying increased substitutability.

- evidence on cross elasticities of demand from our own survey and US studies indicates that radio and newspapers are substitutes

- advertiser survey evidence suggests demand for radio airtime is elastic and radio is part of a wider media market. This conclusion is supported by evidence from studies of US radio and other media markets which indicates that on balance demand for radio advertising is elastic.

[18] The Appendix gives a summary of the CC's approach to market definition in a number of recent media merger inquiries.

- evidence from the UK TV market suggest that demand for TV airtime is likely to be elastic and, given TV is generally regarded as having fewer substitutes than other media, this suggests that demand for radio airtime is also elastic.

Taken together the evidence suggests that radio is part of a wider media market. Local radio and local press appear to be substitutes and for some advertisers other media such as other printed media, TV and direct mail are also relevant. The evidence would seem to contradict the position taken by the CC that radio is a separate market from other media. One reason for this may be that the CC does not seek to derive elasticity evidence to support its position on market definition. Another may be that the CC only draws evidence from radio advertisers who will by definition value radio highly and so are less likely to regard other media as a good substitute for radio than other advertisers.

3.2 Approach to Market Definition

There are two dimensions to market definition – the product market and the geographic market – and the approach used by the CC is the same in both cases.[19] It involves the application of a test which assesses whether a hypothetical monopolist of a certain product or set of products, which might constitute a market, could profitably impose a small but significant non-transitory increase in price (SNNIP). The SSNIP test is commonly applied assuming a 5-10% price increase, however, the CC has stated that "it will normally hypothesise an increase of 5 %, whilst assuming all other prices remain unchanged"[20].

Price increases may be unprofitable because one or more of the following may occur:

- consumers stop purchasing the product and do not consume more of a substitute product
- consumers stop purchasing the product and switch to other substitute products
- other firms start supplying an effective substitute to the product in question e.g. firms supplying similar products in adjacent areas or other countries. (This is referred to as supply-side substitution.)

In the case of radio mergers, supply side substitution is not generally feasible because spectrum constraints and the licensing process mean that operators cannot readily start up new services, change their service formats or expand their coverage areas. We therefore focus on the demand-side effects.

To apply the SNNIP test the key parameter that is required is the price elasticity of demand for the good or service in question[21]. If the price elasticity is greater than one, then revenues will fall as a result of a price increase – this is the combined effect of consumers purchasing less of the product and switching to other products. For a price increase to be unprofitable it is necessary that the loss of revenues exceeds any associated reduction in costs. Data on the variability of costs is required to determine whether this is the case or not[22]. If elasticity

[19] Merger References: Competition Commission Guidelines, March 2003, CC2.

[20] Para 2.7, Merger References: Competition Commission Guidelines, March 2003, CC2.

[21] The price elasticity of demand for A = percentage change in quantity A resulting from a change in the price of A/percentage change in price of A.

[22] (p-c)/p < -1/elasticity of demand, where p= price; c=marginal cost so that (p-c)/p is the margin made on an incremental unit of output. See Kamerschen, *Testing for Anti-trust Definition Under the Federal Government Guidelines*, Journal of Legal Economics, Spring 1994.

estimates are not available then survey evidence and information on consumers' past behaviour in response to price changes can inform decisions concerning the relevant market.

The extent to which two goods or services are substitutes is clearly relevant to the issue of whether they are in the same market or not. A key element of the assessment of the relevant market in CC merger inquiries for local media has been an analysis of whether different local media are substitutes or complements. In economic terms two products A and B are substitutes if raising the price of A leads to an increase in the quantity of B demanded, whereas they are complements if the quantity of B demanded falls. These effects are measured by the cross price elasticity of demand for products A and B[23]. If estimates of cross price elasticities are not available then more indirect evidence must be used. Typically this includes information concerning the similarity or not of product characteristics, the extent of and obstacles to switching between products, correlations between the prices of potential substitutes and survey data reporting consumers' views on the extent to which different products are substitutes or complements.

In the case of advertising in local markets the CC, and before it the Monopolies and Mergers Commission (MMC) have tended to adopt narrow market definitions such that radio, local newspapers, cinema advertising roadside posters and classified directories have each been regarded as separate markets[24]. The issue of market definition for radio was examined in some detail in the recent GWR case and the CC's conclusions largely echo those reached in 1998 in its decision on the Capital Virgin merger. In particular the CC found[25]

the local radio market is distinct from other media. [The CC's] view is that:

(a) *local radio has distinct characteristics;*

(b) *it is more likely to be complementary rather than substitutable by other forms of advertising;*

(c) *in addition it is not easy for advertisers to compare the prices and assess the effectiveness of advertising using different media; and*

(d) *there also appear to be limited synergies in supply of different media."*

Evidence collected by the CC and submitted by others on the price sensitivity of radio advertising and the extent of churn between media was discussed at some length in the report but did not appear to influence the CC's conclusions on market definition[26].

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[23] The cross price elasticity of demand between A and B = percentage change in quantity of B resulting from a change in the price of A/percentage change in price of A.

[24] Para 2.36, *Scottish Radio Holdings plc and GWR Group plc and Galaxy Radio Wales and the West Limited*, Competition Commission, May 2000.

[25] Para 2.63, op. cit.

[26] Para 2.43 op cit

3.3 Is Radio a Complement or a Substitute for Other Media?

3.3.1 Introduction

Advertisers' media choices are determined by the extent to which different media meet their advertising objectives, such as raising brand awareness, direct response or sales and the size of their advertising budget. The key aspects of the media considered include the following.

- The physical characteristics of the media Visual and aural dimensions of media affect the impact they are likely to have and their ability to convey different types of information. For example, detailed product information is best delivered through press rather than radio advertisements, while TV, press and radio may all be used to present brand images.

- The ability of the media to reach target consumers. Geographic coverage and the size and composition of the audience are of particular importance.

- When and how the media is consumed. For example, radio may be better for conveying information about immediate events as compared with say the press because the timing of media consumption is known for radio and not the press.

- The price of the media. Rapid price inflation in TV, for example, is said to have led advertisers to switch to other media including radio.

The differences in media characteristics mean that several media are often used to support a single campaign. Advertising on radio, for example, is often used as a cost effective means of supporting messages delivered over TV[27]. It is in this sense that different media may be said to be complementary. It is important to note, however, that this does not necessarily mean that radio and TV are complements in an economic sense. For although different media have different characteristics in terms of the way they are consumed, their audiences and their price levels, they all provide advertisers with an opportunity to communicate to possible audiences. It is this common feature that suggests different media could be effective substitutes.

Differences in media characteristics and their effectiveness in achieving different objectives has led the CC to the conclusion that radio is more of a complement than a substitute for other media[28]. By contrast, the Radio Authority has disagreed.[29]

> *[The Radio Authority] finds it barely credible that previous competition decisions have assumed that there is no substitutability of advertising between local radio and local newspapers. That is entirely opposite to the evidence derived from experience of the radio medium at first hand, where local newspapers and local radio stations actively compete for the same advertising monies. In any competition adjudication affecting broadcasting, the definition of the relevant "market" should be based upon the practical operation of sales in that market.*

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[27] The RAB has found that the use of radio can boost messages delivered via TV campaigns RAB research shows that adding radio to TV has a 15% multiplier effect. The radio multiplier: radio and TV, RAB Guide Series no 15.

[28] Para 2.63, *Scottish Radio Holdings plc and GWR Group plc and Galaxy Radio Wales and the West Limited*, Competition Commission, May 2003; para 2.70, *Capital Radio plc and Virgin Radio Holdings Ltd*, January 1998.

[29] Para 26, *Radio Authority response on Consultation on Media Ownership Rules*, January 2002.

Reconciling these opposing views is problematic because the evidence used to support these claims does not relate directly to the question of whether the cross price elasticities of demand are positive or negative. Rather inferences are drawn from indirect evidence including evidence of media characteristics, media purchasing decisions and advertisers' views on the extent to which different media are regarded as substitutes or complements. In the following sections we review this evidence. Evidence on cross elasticities of demand is discussed in Section 3.4.

3.3.2 Comparability of Different Media

The CC has suggested that the lack of price transparency and difficulty in comparing the effectiveness of different media means it is unlikely that radio and other media are substitutes. However, these arguments are becoming less tenable for the market as a whole as purchases by advertising agencies, who are well informed about media effectiveness and prices, account for an increasing share of radio revenues. Radio advertising sales through agencies now account for around 70% of all radio advertising sales (as compared with 48% ten years ago)[30]. Furthermore, media performance is increasingly measured and marketing managers are increasingly accountable for their spend, so that price and value for money increasingly drive media choices.

Given these developments it would be surprising if difficulties in making price and effectiveness comparisons between media meant that for radio advertising as a whole there was no possibility of substitution with other media. While there may be some advertisers who cannot make informed trade-offs between media, the question to be addressed is whether there is a sufficient proportion of advertisers who can make informed trade-offs between media to mean that, for the market as a whole, radio and other media could be substitutes.

Media Effectiveness

The relative effectiveness of different media in achieving advertisers' sales, branding and other objectives is measured increasingly. Research is undertaken by advertisers, advertising agencies for their clients and by other organisations such as the RAB, the Newspaper Society and the Institute of Practitioners of Advertising all of whom publish their findings.

For example, in 2000 research undertaken for the RAB found that, although TV was over 60% more effective than radio at raising brand awareness, the price differential between the two media is such that radio is four times as cost effective as TV at raising brand awareness[31]. In 2002, the Newspaper Society undertook a similar study assessing the effectiveness of local press versus other media and found that for the brands studied local press was more effective at raising awareness than radio and TV[32]. More recently work commissioned by the RAB analysing the effect of radio advertising on sales has shown that radio advertising increased sales by an average of 9% for a range of brands[33].

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[30] This is the fraction of sales that are classed as national. National sales are sales for advertising in more than one region and the vast majority of these sales are made through advertising agencies.

[31] The radio multiplier: radio and TV. RAB Guide series no 15, 2000.

[32] The Conversion Study, Millward Brown for the Newspaper Society, 2002.

[33] Radio: the sales multiplier, RAB 2003

We understand from our discussions with advertising agencies and advertiser representatives that research is increasingly used to inform advertising expenditure decisions as radio audience information has improved, in terms of its quality and timeliness, and as marketing directors become increasingly accountable for their expenditures.

Transparency of prices for radio airtime

Advertising airtime is sold by media owners either directly to advertisers or indirectly through advertising agencies. Advertising prices are typically set through negotiation though we understand there may be some use of rate cards in the press.

A proportion of airtime is sold, typically to advertising agencies, on long-term (e.g. annual) contracts in advance. These contracts may provide the purchaser with airtime at a single negotiated cost per thousand. The remaining airtime is sold closer to the time of transmission. Stations generally offer lower prices for advance purchases and for high volumes. We understand that prices also vary by time of year time of week and time of day reflecting differences in demand and audience size and composition at these times. For example, prices are higher at the end of the week than the start reflecting the pattern of retail sales. Prices are higher at times of peak audiences (such as the breakfast hour) because large audiences more efficiently deliver advertising impacts.

Although prices are not published, knowledge or awareness of prices is achieved in the market through repeated purchases and purchases from competing operators and competing media. As in any market, larger purchasers (i.e. advertisers) will inevitably be better informed than smaller advertisers. Larger advertisers are more likely to be represented by advertising agencies who offer advertisers specialist media knowledge including an understanding of the relative effectiveness of different media and of media prices. In addition, some larger advertisers commission auditors to audit the work of the advertising agencies. Audits include comparisons of prices paid with average prices paid by other advertisers and in this way advertisers become even better informed about the price of airtime. Audits are most common for TV advertising but audits of radio advertising are growing.

While smaller advertisers may not use advertising agencies and so may have more limited access to price information, anecdotal evidence from our interviews with media owners suggests that these advertisers are often very price sensitive (because of their limited budgets) and this is supported by our survey findings (see Section 3.3.4). Furthermore, we note that one cannot draw any conclusions about the degree of price sensitivity of advertisers from any evidence on ability to compare prices – they are as likely to be price sensitive as not.

Conclusion

In this section we find that

- different media have distinct characteristics does not mean they are complements in the economic sense.

- there is increasing price transparency in the local media market as a result of the significant increase in sales via media agencies. Agencies' campaigns are required to be evidence based and they are highly accountable to their advertiser clients. Thus most advertising spend is subject to price and effectiveness comparisons.

- research into the relative effectiveness of differing media is regularly conducted and published by advertisers and independent organisations. Advertisers are therefore able to make comparisons to inform their buying decisions.

- larger radio advertisers are likely to be well informed about radio advertising pricing through their advertising agencies. Smaller radio advertisers are likely to be sensitive to radio advertising pricing because of their limited budget.

3.3.3 Advertiser Surveys

Advertisers use a mix of media and are observed to switch spend between media. For example, only 65% of advertisers who used radio advertising in 2001 also used radio in 2002. This suggests that different media are substitutes although such evidence is by no means conclusive. Surveys may be used to ask advertisers directly whether they regard different media as complements or substitutes. The survey evidence reported below, which relates to the market around the Severn Estuary, suggests that a significant proportion of advertisers regard radio and other media, particularly local press, as substitutes and, consistent with this, that competition between media is used to drive down the price of local radio.

Survey coverage

Below we report the results from the CC survey in the GWR case and our own survey of radio advertisers in the Severn Estuary region conducted in March 2003[34]. In the time available to us we have not sought evidence for the purposes of this report from respondents in other areas of the UK nor from buyers of advertising on other media. Further work in these areas may provide additional useful results.

The surveys are biased in the sense that the respondents will be those advertisers who value radio most highly (which is why they are using it) and so are less likely to regard other media as substitutes than the total population of advertisers. We note in this regard that respondents to the CC survey spent about a third their advertising budgets on radio whereas radio advertising only accounts for 4% of all advertising expenditure. To be representative of the market as a whole surveys should sample advertisers using all media.

Complements or substitutes?

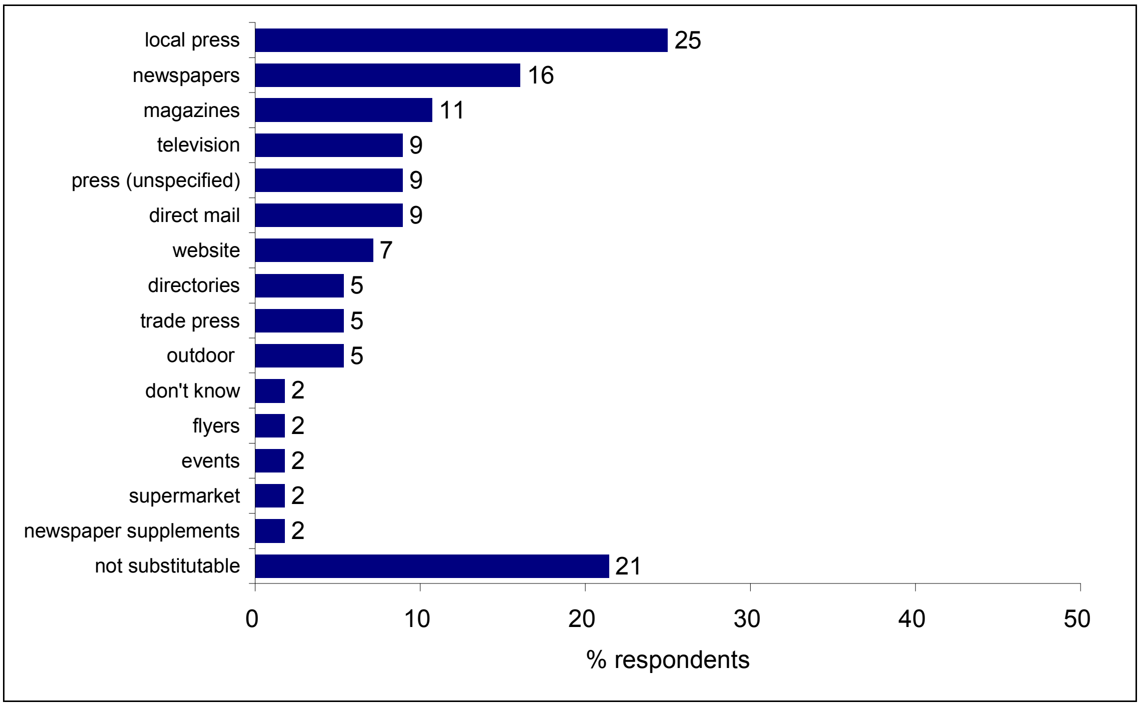
Respondents to our survey were asked what other media could be used to target the radio audience they were interested in. Forty four respondents (77%) thought that other media could be used to target the radio audience they were interested in, whereas twelve (21%) thought that other media could not be used. Figure 4 below shows that one quarter of the

[34] Two complementary surveys of advertisers in the Severn Estuary area were conducted by Accent Market Research between 5 and 18 March. First, a telephone survey of 56 radio advertisers using a set questionnaire was conducted. This was aimed at gathering information on the use of different advertising media, factors influencing choice of media and responses to changes in the price of radio advertising. Second, a qualitative survey of 14 radio advertisers was conducted through in depth face to face and telephone interviews. These interviews explored how advertisers make media choices and how they interpreted some of the questions asked in the set questionnaire. The sample mainly comprised advertisers undertaking local (86%) rather than national campaigns and the majority of respondents (82%) were businesses other than advertising agencies.

sample thought that local press could be used to target the radio audience they were interested in[35], 16% thought newspapers could be used and 11% magazines.

Of the forty six respondents to our survey who used media other than radio, twenty four (52%) thought radio was an optional element of their advertising package, nineteen (41%) considered local radio to be a core element, and three (7%) were unsure.

Figure 4: Media other than radio that can be used to target radio audiences



Base: All respondents (56). More than one answer may be given so sum of percentages may exceed 100%

In the recent GWR inquiry the CC found that:

- 60% of respondents said radio commercials complemented other media rather than as being used as individual alternative advertisements

- 29% of respondents thought local radio was generally substitutable by other media rather than providing a unique element of the advertising mix.

However about half the respondents gave inconsistent responses to these questions. Part of the problem may stem from the lack of precision in the terms substitute and complement. Ideally the questions asked of advertisers would be aimed at illuminating whether the

[35] A survey of regional newspaper advertisers in the Johnston Press/Trinity Mirror inquiry found that local radio was the most popular non-print medium. *Johnston Press plc and Trinity Mirror plc*, Competition Commission, May 2002, Cm 5495

economic test for complementarity/substitution is satisfied or not i.e. evidence relating to the cross elasticity of demand would be collected.

To ascertain whether advertisers simply responded to price changes or were more proactive in their use of competition between media we asked whether advertisers use competition between media to drive down prices on local radio. Twenty four (42%) respondents agreed that competition between local radio and other media is used to drive down prices on local radio, 19 (34%) disagreed, 5 (9%) neither agreed or disagreed and the remainder (14%) did not know.

Respondents to our survey were asked to rate the value for money of advertising on different media. Table 4 below shows the number of respondents giving each rating value, from very good to very poor, for local radio, television and local press. In order to increase the sample size, these figures are shown for all 70 respondents who took part in both the qualitative and the quantitative survey. The mean ratings (using a scale with 1 representing very good and 5 very poor) are similar across all media. This outcome is as would be expected in a competitive market in which radio, press and TV are substitutes.[36]

Table 4: Number of respondents rating value for money of different media

	Local radio	**Television**	**Local press**
1) Very good	3	3	4
2) Good	31	12	19
3) Neutral	22	9	23
4) Poor	8	7	13
5) Very poor	5	2	7
Don't know	1	37	4
Mean	**2.72**	**2.79**	**3.00**

Source: Indepen Survey. Base: 56 respondents to the set questionnaire and 14 depth interviewees. Don't knows are excluded from the calculations.

Conclusion

Our research shows that advertisers consider radio to be a substitutable advertising medium and, consistent with this, advertisers tend to rate different local media in similar terms when assessing value for money. We also found that advertisers are more likely to agree than disagree that competition between local media drives down the price of radio advertising. The CC's findings on advertisers' attitudes to substitutability were not only inconsistent with our findings, but also with other findings within the CC's research.

[36] Given the small number who gave a response for television one ought to be cautious in reading too much into the television comparison.

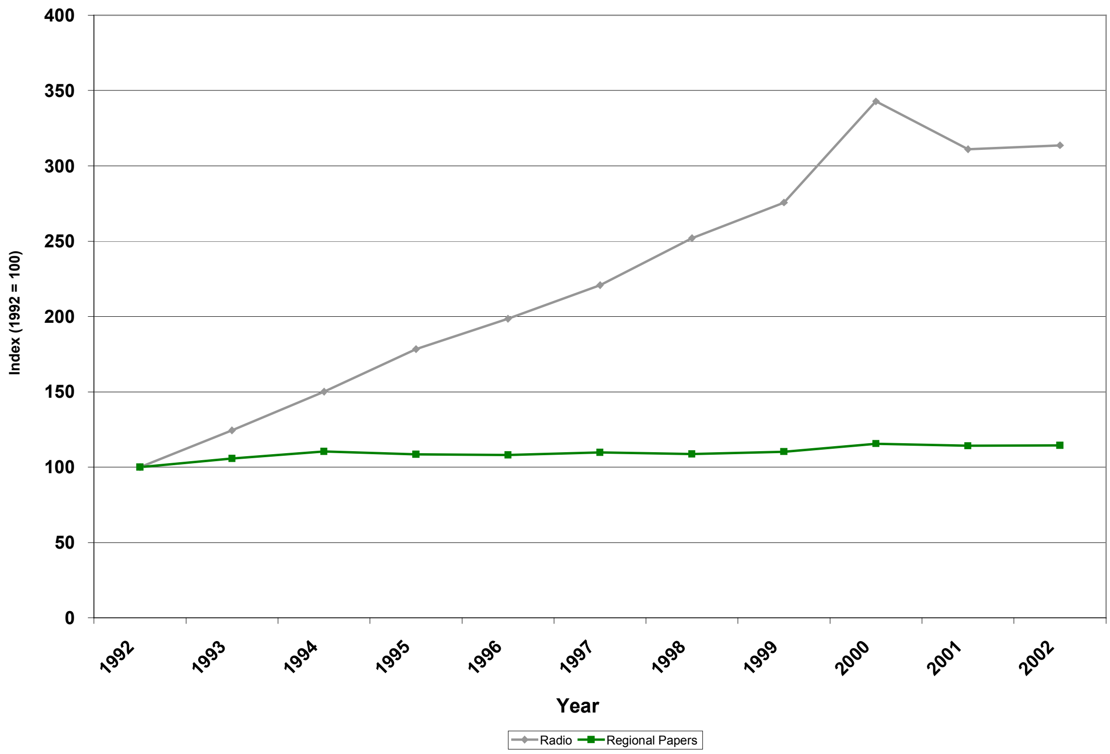
3.3.4 Market Evidence

If radio and say local newspapers were complements rather than substitutes then one would expect to see

- the rapid expansion in commercial radio and growth in radio advertising revenues to be matched by a similar expansion in the fortunes of local newspapers
- a negative correlation between changes in the price of local radio airtime and the price of local newspaper advertising, as an increase in the price of radio reduces demand for radio airtime and so reduces demand for newspaper space
- joint selling of radio airtime and newspaper advertising space in cases where there is joint ownership of the two media, as this would be an advantage to advertisers who would be seeking to buy both products.

Lack of suitable data means we cannot test the second proposition. Evidence relating to the first proposition is given in Figure 5. This shows that while there was strong real growth in radio advertising revenues over the last ten years advertising on regional newspapers has shown almost no real growth. This is not what one would expect to observe if advertising on local radio and local newspapers were complements.

Figure 5: Radio and Regional Newspaper Advertising Revenues 1992 – 2002 (in real terms)



With regard to joint selling of advertising on local radio and in local newspapers, we received anecdotal evidence that this did not occur because there was no demand for it from advertisers. This is supported by the CC's finding in the GWR case that[37]

> *although there are cross-share-holdings between media there appears to be little cross selling as a result …..indeed GWR told us there were no such successful relationships in the world.*

In short we find no market-wide evidence to support the view that radio and local newspapers are complements. On the contrary, evidence of switching between media suggests that radio and other media are substitutes.

3.4 Demand Elasticity Evidence

3.4.1 Introduction

The responsiveness or elasticity of the demand for radio airtime to a change in the price of radio advertising is relevant to the issue of whether radio advertising can be said to be part of a wider media market. If the elasticity of demand for radio is greater than one (i.e. demand is elastic) then radio is unlikely to be a market separate from the markets for other media. In addition, a positive cross price elasticity of demand between radio advertising and, say, local newspaper or TV advertising indicates radio and the other media are substitutes. Values less than one indicate weak substitution while values greater than one indicate strong substitution.

Ideally these elasticities would be estimated using market data and a system of media demand equations. This requires data on media advertising expenditures, media prices and other determinants of advertising expenditures. Lack of published data on the price of radio airtime and the price of local newspaper advertising means that it is not possible to estimate radio and cross media price elasticities for the UK. We have therefore looked to other markets for indicative evidence, in particular the US radio market and the UK TV market. In addition, we report the results of asking advertisers in our survey how they would respond to changes in the price of radio airtime.

In summary, advertiser survey evidence suggests demand for radio airtime is elastic. Evidence from the UK TV market suggest that demand for TV airtime is likely to be elastic and, given TV is generally regarded as having fewer substitutes than other media, this suggests that demand for radio airtime is also elastic. Three of the four US studies reviewed indicate that the elasticity of demand for radio is one or more.

The evidence from our own survey and the US studies on cross elasticities of demand indicates that radio and newspapers are substitutes.

3.4.2 UK TV Elasticity of Demand

A number of studies have estimated the elasticity of demand for TV advertising in the UK. Early studies conducted with aggregate data were undertaken in the mid-1980s and found a

[37] Para 2.54 *Scottish Radio Holdings plc and GWR Group plc and Galaxy Radio Wales and the West Limited*, Competition Commission, May 2003

price elasticity of demand less than one[38]. Later work by Hendry (1987, 1988, 1992)[39] replicated the earlier studies and also used quarterly data to separately estimate supply and demand for commercial home minutes. Hendry found that demand for TV was elastic with a long run elasticity of 2.2-2.4. Cave and Swann (1989) replicated Hendry's work but found that changes to the equation specification had the effect of halving the elasticity estimate to around one.

The CC reports on the Carlton/Granada/United News Media and Carlton/Granada mergers cite more recent evidence on TV demand elasticities[40]. One study submitted to the CC confirmed Hendry's results while another obtained lower estimates though these were still greater than one.

On balance the econometric evidence suggests the elasticity of demand for TV is greater than one and possibly greater than two. In interviews with advertising industry representatives we were told repeatedly that advertisers were more captive to TV than radio. The main reason for this is that TV offers many advertisers the most effective and sometimes the only way of quickly reaching a mass audience. By contrast radio is perceived to be a more dispensable medium with numerous substitutes. This suggests that demand for radio is likely to be more elastic than that for TV and hence the elasticity of demand for radio would also be greater than one and possibly greater than two.

In summary, evidence from the UK TV market suggest that demand for TV airtime is likely to be elastic and, given TV is generally regarded as having fewer substitutes than other media, this suggests that demand for radio airtime is also elastic.

3.4.3 US Evidence

Rapid consolidation of the radio industry since 1996[41] has led the US Department of Justice (DoJ) to closely scrutinise radio mergers. The DoJ's view is that radio advertising constitutes a market existing independently of advertising markets for other local media[42]. By contrast the US radio industry has argued that radio advertising is part of a wider market for local advertising. Several recent studies have investigated the market definition issue by estimating demand for radio and other local advertising. The results of the studies are summarised in Table 5 below.

The estimated radio price elasticities of demand range from –0.25 to –7.7, though three of the four estimates have a value of –1 or more. The results for cross elasticities of demand indicate that radio and newspapers are substitutes, albeit weak substitutes in most studies. The picture for TV and radio is more mixed with evidence of these media being both complements and substitutes. The differences may in part be explained the use of different data sets in each study. In this regard we note that Silk, Klein and Berndt (who use data

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[38] Cave and Swann (1985) The Effects on Advertising Revenues of Allowing Advertising on BBC television, HMSO; NERA (1985) The Effects on ITV and Other Media of the Introduction of Advertising on the BBC in various Amounts, Report for the Committee on Financing the BBC, HMSO.

[39] Hendry (1987) A Reassessment of the Econometric Research on TV Advertising Revenue, NERA; Hendry (1988) An Econometric Analysis of TV Advertising Expenditure, NERA; Hendry (1992) An Econometric Analysis of TV Advertising Expenditure in the United Kingdom, *Journal of Policy Modelling*, 1992.

[40] See para 4.123, Carlton Communications and Granada Group and United News and Media, Competition Commission, July 2000, Cm 4781; para 5.141, Carlton Communications and Granada, October 2003, Cm 5952.

[41] The consolidation followed liberalisations allowed under the Telecommunications Act of 1996.

[42] See DoJ Analysis of Radio Mergers, Joel Klein, 1997. www.usdoj.gov/atr/public/speeches.

spanning a long time period) suggest that their results (i.e. inelastic demand and weak substitutability and complementarity) can be expected to change substantially in future as a result of competition from new media and rising demands by national advertisers for efficiency and accountability in media selection.

In summary, evidence from analysis of the US radio market (conducted from 1999-2001) suggests that radio and TV are substitutes, albeit it weak ones.

Table 5: Results from Recent US Media Demand Studies

Study	Radio elasticity	Cross elasticities	Sample
Ekelund, Ford and Jackson (1999)[43]	-2.1	TV: +0.3 Newspapers: +0.6	All advertisers, 1995, 110 local markets
Silk, Klein and Berndt (2001)[44]	-0.25	TV: -0.12 to +0.07 Newspapers: +0.01 to +0.19	National advertisers, annual data 1960-94
Bush (2002)[45]	-0.96	TV: – 0.22 Newspapers: +0.1	Local advertisers 2001, 45 local markets
Seldon, Jewell and O'Brien (2000)[46]	-7.7	TV: +4 Newspapers: +3.7	Beer firms, quarterly data 1983-1993

3.4.4 Survey Evidence

In order to provide data that would help answer the question of whether radio is part of a wider media market, respondents to our survey were asked what actions they would take and how much their expenditure on local radio and other media would change in response to 5% and 10% increases in the price of local radio. These responses allow price elasticities to be calculated.

When asking questions about advertisers' reactions to price changes it is important to be clear whether respondents are talking about changes in their radio spend or changes in the volume of radio advertisements. This issue arose in the Johnston Press/ Trinity Mirror case[47] where the CC asked a sample of advertisers about their response to a 10% increase in the rates for local weekly papers. A "do nothing" response was interpreted by the CC as meaning volumes would be unchanged and so expenditures would increase. However, Johnston argued that it meant expenditures would be constant and so volumes would be reduced. We

[43] Is Radio Advertising a Distinct Local Market? An Empirical Analysis?, R Ekelund, G Ford j Jackson Review of Industrial Organisation 14, 1999

[44] Intermedia Substitutability and Market Demand by National Advertisers, A Silk, L Klein E Berndt National Bureau of Economic Research Working Paper 8624, December 2001.

[45] On the Substitutability of Local Newspaper, radio and Television Advertising in Local Business Sales, A Bush, Federal Communications Commission Research Paper 10 2002.

[46] Media Substitution and economies of scale in advertising, International Journal of industrial Organisation, 18 (8), 2000

[47] Johnston Press plc and Trinity Mirror plc, Competition Commission, May 2002, Cm 5495

sought to avoid this confusion by checking whether respondents were referring to revenues or quantities when responding to price change questions.

There are two potentially offsetting biases in the demand elasticities we report. It might be argued that respondents are likely to over state their response to a hypothetical increase in the price of airtime, as a short run reaction that would be reversed over time or in order to discourage companies from raising their prices. Against this, the sample choice (of radio advertisers and not all advertisers) tends to bias the analysis towards finding lower demand elasticities since those advertisers not in the current sample are more likely to be those most sensitive to radio prices.

Actions in response to an increase in the price of local radio

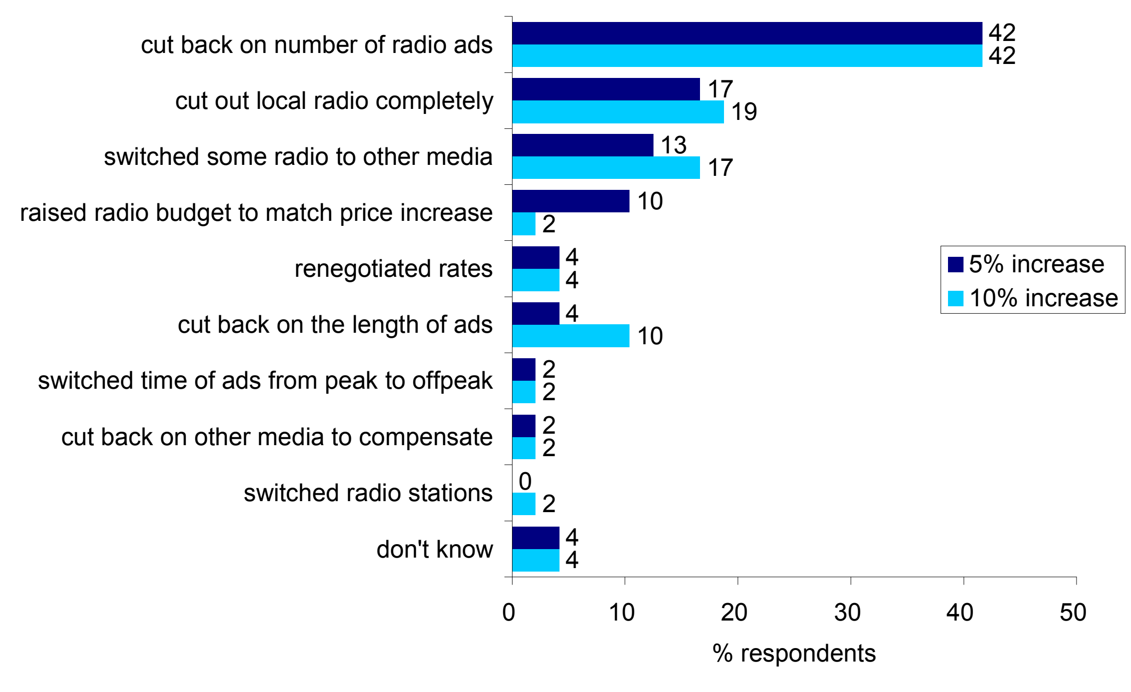
Respondents to our survey were asked to consider their actions if the costs of radio advertising in the Severn Estuary region had been 5% higher and the costs of all other media had remained the same whilst all other aspects of both radio and other media had remained the same. They were also asked to consider their actions with a 10% increase in price.

Figure 6 shows the proportions of respondents who would have undertaken different actions if radio prices had been 5% or 10% higher. Of the 48 respondents[48], 42% would not have altered their budgets but would have reduced the number of radio advertisements they purchased as part of their campaigns in response to a 5% increase. Seventeen per cent of respondents would have cut out radio completely and 13% would have switched some radio spend to other media. Five of the 48 respondents (10%) would have increased the amount they spent on radio in order to match the price increases in the case of a 5% price rise. However, only 4% of the sample would do so if local radio advertising prices had increased by 10%.

Similar results were obtained by the CC's survey in which 68% of respondents said that they would change their advertising pattern in response to a 5% price increase and 64% of respondents who had experienced a price increase in the last two years said they changed their pattern of advertising. The changes included switching to other media or localities, cutting back on the quantity of radio airtime purchased and cutting out radio advertising completely. It is unclear however from the wording of the relevant questions in the CC's questionnaire (questions 32 and 33) what proportion of the 32% that would or had not changed their pattern of advertising would absorb the increase in price and so spend more. Nevertheless, our results and those obtained by the CC suggest that radio advertisers are sensitive to increases in the price of radio airtime.

[48] Eight respondents were unable to answer these questions.

Figure 6: Actions taken for 5% and 10% cost increases in radio advertisements



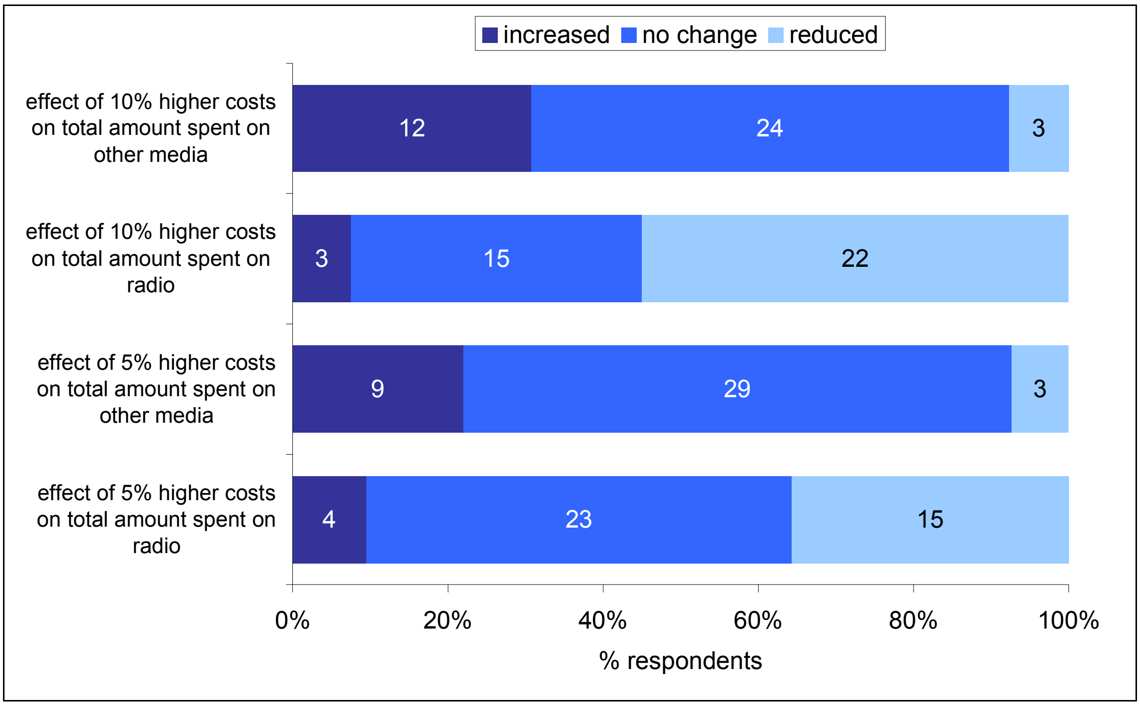
Base: those able to give an answer (48). More than one answer may be given so sum of percentages may exceed 100%

Change in expenditures in response to an increase in the price of local radio

Respondents to our survey were asked by what percentage their radio and other media budgets would have changed if the price of local radio advertising had been higher by 5% and 10% and the cost of all other local media remained the same and all other aspects of radio and other media remained the same.

Figure 7 below shows the number of respondents who would have increased, reduced or not altered their advertising budgets on radio and other media as a result of higher advertising costs on radio. Respondents were a little more likely to reduce their radio budgets and spend more on other media and were less likely to spend more on radio and less on other media in response to a 10% as compared to a 5% price increase.

Figure 7: Effects of increases in radio prices on respondents' total expenditure



Base: Those prepared to give an answer for 10% radio (40), 10% other (39), 5% radio (42) 5% other (41)

We calculated the price elasticity of demand for local radio from reported expenditures on radio over the previous 12 months and responses to questions about how much respondents' radio advertising would change following a 5% and 10% price increase in the price of local radio.

Calculating the amount each respondent would have increased or decreased their expenditure on radio following a 5% increase in local radio prices gives an overall decrease of around 8%, implying a price elasticity of demand of about 2.5[49]. For a 10% increase in the price of radio advertising, the total amount respondents would have spent on radio fell by around 16%, implying a demand elasticity for local radio of around 2.4. These results indicate that radio airtime demand is elastic in response to 5% and 10% price increases.

In addition, we found that respondents with higher expenditures were less sensitive to price increases than those with smaller advertising expenditures – the elasticities were about –1.5 and –3.0 respectively. This confirmed anecdotal reports from radio owners that small advertisers were more likely to switch to other media if the cost of a radio campaign seemed high relative to the cost of alternative media, in particular local press.

Cross elasticities of demand can also be inferred from responses to questions about the impact of price changes on spending on other media. In response to a 5% increase in local radio prices respondents said they would increase their advertising spend on other media (in aggregate) by 1.5%. In response to a 10% price increase, respondents would have increased the amount spent on other media by 10%. This indicates that radio and other media are substitutes not complements.

[49] The price elasticity of demand = percentage change in quantity demanded/percentage change in price.

In summary, our survey responses show that radio airtime demand is elastic, with a demand elasticity of around 2.5, and that cross elasticities of demand are positive indicating that radio and other media are substitutes, not complements. In addition, we found that small advertisers are more sensitive to price increases than advertisers with higher expenditures.

3.5 This Study's Evidence and its Application

The elasticity estimates reported above can be used to assess whether a 5% price increase would be profitable for a hypothetical monopolist, and so whether radio advertising is a separate market from other media, we need to assess the impact of the price increase on profitability. Taking the calculated elasticity of 2.5, a 5% price increase results in a 12.5% decrease in quantities demanded and an 8% reduction in revenues. Clearly if costs did not vary then the price increase would be unprofitable. In practice costs will vary with a change in quantities and revenues.

A change in the volume of advertising and so revenues is likely to mean that payments to copyright societies (about 10% of revenues) would decline as would sales commissions, suggesting between 80 and 90% of costs are fixed[50]. If we assume that this margin applies to all stations and prices were increased by 5% then a decrease in sales of more than 5.5-6%[51] would be sufficient to make the price increase unprofitable. Taking the calculated elasticity of 2.5, a 5% price increase results in a 12.5% decrease in sales implying that the price increase would be unprofitable. This indicates that radio advertising is not a separate market from advertising on other media. It is important to note that this result holds even if lower gross margins of say 50% are assumed.

[50] In this regard we note that GWR reported to the CC that 80-90% of its costs were fixed (para 2.42 of the GWR report).

[51] This is the critical loss in sales at which profits are unchanged. A larger loss will be unprofitable and a smaller one profitable. The critical loss equals percentage change in price/(percentage change in price+ gross margin).

4. Substantial Lessening of Competition

4.1 Summary

Under the Enterprise Act the OFT and the CC will test mergers in terms of whether they have resulted or are likely to result in a substantial lessening of competition (SLC) as opposed to the traditional test of whether they were against the public interest. If a merger leads to an SLC then it will generally be prevented unless there are benefits to customers that outweigh the adverse effects to competition. The move from a public interest to a substantial lessening of competition test should help reduce uncertainty for businesses contemplating mergers. In this section we discuss the implications of the introduction of the SLC test for mergers in the commercial radio sector and consider how sector specific regulation and price discrimination should impact on the SLC assessment.

We make four main recommendations that are likely to be particularly important for the treatment of mergers involving commercial radio services under the Enterprise Act.

First we address how the OFT and CC suggest they will interpret the concept of substantial in the SLC test and argue that if they follow their current guidelines it appears that they will give insufficient weight to this matter. Indeed, at times the guidelines are written as if appropriate for a lessening of competition rather than a substantial lessening of competition test. We argue the 'substantial' concept is important and great care is needed not to 'airbrush' this away in the implementation of the Enterprise Act.

Second we note that sector specific regulation increases station costs while the presence of the BBC reduces potential commercial audiences. Given economies of scale these factors have the effect of increasing concentration in the industry. Hence concentration should be less of a concern in the context of commercial radio mergers relative to general mergers. In particular the interpretation of HHI concentration measures is unlikely to be useful for assessing mergers in the commercial radio sector.

The issue of discrimination is then addressed. The traditional way the CC has approached discrimination in media markets is unlikely to be appropriate under the Enterprise Act. A company's ability to discriminate to meet market pressure does not imply there will be an SLC following a merger. Discrimination can only be a potential barrier to a merger under the Enterprise Act if the probable outcome of the merger is that prices will rise for a material number of customers without falling for others and that the net effect in terms of competition is substantial. It is this test that should apply and not that of the potential for discrimination.

We also consider materiality and in particular the role of the share of supply test. We suggest that in cases where discrimination is thought to be an issue, then one should take into account the share of supply when assessing SLC. We suggest that if the share of supply is borderline (i.e. 3-4% of the UK population), then any lessening of competition arising from discrimination is unlikely to be substantial.

Materiality is likely to be a common theme in radio mergers, because many radio stations serve relatively small parts of the UK. This issue has not arisen in recent television mergers because parties have had significant shares of the national advertising market. However, it appears surprising that in the Carlton/Granada decision the Competition Commission permitted a significant reduction in competition in the London TV advertising market[52] by allowing competing Carlton and Granada services to merge, whilst blocking radio mergers in much smaller markets. It is important that the materiality issue receives particular consideration in the new Enterprise Act framework and that in doing so there is consistent treatment of television and radio mergers.

4.2 Background

The idea of a substantial lessening of competition test is not new. It was incorporated in the 1914 Clayton Act in the US, which prohibited takeovers where the effect of the takeover may be to substantially lessen competition. However, despite the wording of the Clayton Act, the SLC wording has not been the central theme in US merger inquiries. Current US Department of Justice and Federal Trade Commission Horizontal Merger Guidelines use the term 'creating or enhancing market power'. This sounds much closer to the European Commission position as it currently stands, which does not address SLC but instead blocks mergers that are likely to create or strengthen a dominant position. The existing EC policy prevents mergers if they pass a double hurdle of creating or strengthening a dominant position as a result of which effective competition would be significantly impeded. However, recent proposals to modernisation EC merger legislation[53] considered the idea of replacing this with an SLC test. This approach has not been adopted, rather new merger legislation will prohibit mergers that 'significantly impede effective competition … in particular as a result of the creation or strengthening of a dominant position'[54]. Whether this test will be different from an SLC test is unclear but the focus on 'significant impediment' emphasises that we should not be concerned with trivial changes in competition (see below).

The 1973 Fair Trading Act used a public interest test, although in practice public interest was generally interpreted as being about competition (the so called Tebbit guidelines). This gave an informal and inconsistent focus on competition and a potential benefit of introducing SLC is that it can give a clearer policy, particularly as there is also a commitment to increase transparency. The hope is that this will lead to greater consistency in decision-making. To achieve this it is essential that the OFT and CC set the appropriate standard for a SLC and are consistent in its application. Failure to do so will be particularly costly and damaging to the radio industry since the potential benefits of the new liberalisation of media ownership could be chilled by any inappropriate application of the SLC test in the industry. Here we address some areas of concern for the commercial radio sector.

4.3 The Interpretation of 'Substantial Lessening' of Competition

In practice, one might well expect many horizontal mergers, even possibly the majority, to fall between two extremes, i.e., neither substantially damaging competition nor positively enhancing it. That is, there may be some impact on competition but there may be other benefits. The 'public interest test' was supposed to balance off these two effects and this is one of the reasons why 'substantial' is in the SLC test.

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[52] The Competition Commission recognised that Carlton and Granada competed in the London market and that competition between Carlton and Granada acted as a constraint on their ability to increase the level of their customers' commitment for a given level of discount paras 2.125-2.126, Carlton Communications plc and Granada plc, Competition Commission Cm 5952, October 2003.

[53] Green Paper on Review of Council Regulation EEC No 4064/89, COM(2001) 745/6, December 2001.

[54] The new merger regulation will come into force on May 1st 2004 (see DN: MEMO /04/9 and IP/04/70).

The problem with the public interest test was the lack of clear view about what else besides competition should be taken into account and competition and any other factors should be balanced. The result was that most cases had slightly ill defined competition effects, no matter how small, with a sometimes unpredictable emphasis on public benefit. Adding precision to the competition element is helpful to avoid this uncertainty. This brings benefits to the business economy since repositioning in the market can then be planned in a more certain world. However, there is a danger that the gain in precision comes at the expense of blocking mergers where there is an insubstantial effect. The wording 'substantial' resolves the concern and should not be ignored.

The current Enterprise Act guidelines indicate how the OFT and the CC will interpret the test of a 'substantial lessening' of competition. There are signs in the guidelines and in consultation documents that the 'substantial' concept could be whittled away.

The OFT has indicated that it sees 'the standard of proof is the same as that against which Fair Trading Act reference advices were prepared', but it has also implied that there will be an SLC if 'the competitive process would no longer deliver the same level of customer benefits as it would without the merger'.[55] Similarly, the CC interprets SLC as being an assessment of whether the merger would lead to an increase in market power rather than a substantial increase in market power. Similar issues arise with the discussion of horizontal mergers. When discussing market power the Commission Guidelines say

> *'this is not to suggest that a horizontal merger will always give rise to an SLC. For example, in some circumstances, a merger may enhance competition, particularly if it strengthens firms whose challenge to market leaders would be weak in the absence of a the merger.'*[56]

This appears to be closer to a definition of 'lessening of competition' rather than SLC.

This is not just a trivial wording issue. It is important to recognise that the perfect solution is never feasible and we are choosing between a series of second best rules. The public interest test had failings because of its lack of clarity and precision and absence of well-defined focus on competition. The new approach has the aim of avoiding this but at the cost of a focus only on cases that have substantial effects. It is inevitable that this will allow some mergers that have negative effects on competition with no possible public benefit. This is the particular failing with the new approach but it is the best we can achieve with the new framework. 'Substantial' in the SLC must mean exactly that or the benefits of the new proposals will be undone.

Issues of interpretation also arise with the concept 'expected to result in'. In particular, the focus should be on preventing a merger only if it is the merger itself that leads to an SLC not if the SLC results from the pre-merger market situation. The CC's guidelines seem to suggest otherwise. For example, when considering the circumstances in which to apply the competitive price or the current price as the basis for a SSNIP test the Guidelines provide an example[57]. The Guidelines suggest using the competitive price if two firms are already exercising some market power and point out that

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[55] Enterprise Bill Consultation on Mergers October 2002.

[56] Merger References: Competition Commission Guidelines,

[57] para 2.10, Merger Guidelines op.cit.

"otherwise a merger which might increase market power may appear benign simply because the firms concerned had already been able to exercise a degree of market power".

This suggests that the merger policy is being used to prevent mergers in situations where the merger itself does not change competitive conditions and outcomes but where the CC regards the current position as unattractive. If the firms are already exercising market power then this should be addressed under the 1998 Competition Act. Market power should only influence merger decisions where the power results from the merger itself.

4.4 The Impact of Sector Specific Regulation

Although the Communications Act liberalises ownership controls it maintains regulation of programme content on commercial radio and this may affect the implementation of the Enterprise Act in the sector. The commercial radio sector will remain more tightly regulated than the BBC with explicit programme requirements written into licences as compared with self-regulation of BBC radio through the commitments given in the BBC's Statements of Programme Policy.

Commercial stations are limited in their ability to move format relative to the position of the BBC and this puts them at a disadvantage relative to the BBC since the BBC's greater flexibility allows it to respond to market changes more easily. Furthermore, the BBC is funded without recourse to advertising slots (and of course is prevented from doing so), which gives it an additional competitive advantage. As a result the BBC is able to capture a high market share, now over 50% (see Figure 1, Section 2). This makes the sector very competitive in terms of the battle for audience. This point has also been recognised by the Competition Commission in respect of the television market. In the recent Carlton/Granada inquiry the Commission noted that

ITV's [audience] share will also depend on its success in programming, particularly relative to the BBC[58] and

The proposed merger would render ITV better able to compete with the BBC, BSkyB and others….[59]

In short the BBC can play an important role in terms of market competition and customer benefits, which we discuss in the next section.

More significantly, regulation and associated presence of the BBC affects the equilibrium number of firms in the market and skews the size distribution. Content regulation raises the costs of providing radio services and the presence of the BBC reduces audiences and so commercial revenues.

Given that there are strong economies of scale in the industry it follows that there are fewer players than would be the case without the BBC and the sector specific regulation. This suggests that the conventional stance adopted by the OFT and CC to market structure and the competitive effects of a merger should be modified when dealing with commercial radio.

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[58] para 5.8, Carlton Communications plc and Granada plc, Competition Commission Cm 5952, October 2003.

[59] para 2.134, op cit.

The favoured measure of concentration is the Herfindahl-Hirshmann Index (HHI). The OFT states that they consider a market with a HHI in excess of 1800 as highly concentrated and, in these circumstances, a merger that increases the HHI by more than 50 points may give rise to concern. The CC point out that they will have regard to these threshold levels but only as one factor. The cost structure of the industry combined with the sector specific regulation suggests that these criteria will not be informative in the commercial radio sector. To illustrate this the HHI for the most competitive radio market, namely London, is 3017.

In summary, the conventional approach to assessing market concentration is unlikely to be helpful when assessing commercial radio markets. The presence of the BBC and strong content regulation in the commercial sector influence the competitiveness of the market. We suggest therefore that there is no value in using HHI figures as guidance in radio company mergers.

4.5 Price Discrimination

In several recent CC cases the role of potential discrimination has played a role in the final decision. For example, in the recent Scottish Radio Holding/GWR and the Trinity Mirror cases the CC explicitly raised concerns over discriminatory pricing. In the Carlton/Granada case the issue was raised but the CC concluded that it had not had been able to examine the market in sufficient depth to come to a conclusion on the issue.

4.5.1 Defining and identifying price discrimination

Price discrimination is often loosely defined as selling the same product at different prices. However, although the notion is well defined in theory textbooks, it is notoriously difficult to tie down in the real world since it is frequently hard to know what constitutes the same product, similar costs and even dissimilar prices. For example, train services typically charge different rates at different times of the day and it is not obvious whether this should be classed as price discrimination since the prices are available to all and differences are a reflection of differences in demand throughout the day. Indeed, in an effort to sidestep some of these problems EC and UK competition law tends not to refer to price discrimination at all but to the application of dissimilar conditions to equivalent transactions.

Price discrimination is more sensitive to market definition than almost any other concept in competition law. It is easiest to formalise when products have a natural units of measurement and it is no surprise that some of the most well known cases where authorities have decided to intervene have been found in markets such as bananas, gas and contraceptive sheaths. In contrast, even in the apparently well-defined railway example the definition of product remains problematic. A standard fare between Bristol and London appears radically different from a first class fare if the product is defined as a seat to London. But if the product is defined as the purchase of square centimetres to London then the discrimination disappears since there are far fewer first class seats per carriage.

The degree of accuracy in product definition that is necessary to give cutting power to the notion of discrimination goes far beyond what is provided in standard definitions of the market. Customers will have different perceptions of what they are buying and this is clearly relevant. One cannot resolve this problem by defining discrimination as a relationship between price and cost. Where there is uncertainty as to the appropriate measure of the product then this problem is likely to arise in the definition of cost. For example, in the railway example the cost price relationship will itself depend on whether common or fixed costs are attributed according to number of seats or square centimetres. The general point is that even in this simple example it is impossible to set prices that are non-discriminatory in the textbook sense. Therefore, when addressing whether discrimination is worthy of concern one of the central issues should be recognition of the precision of the product definition. The more heterogeneous the nature of the product the more one would expect to see variability in pricing and the harder it is to be sure one is seeing discrimination.

This is a particular issue in the context of radio advertising. The individual product is typically measured in impacts (essentially listeners in thousands) conditional on length of advertisement. Volumes are almost impossible to measure any way other than by revenues. The product also differs according to time the advertisement is broadcast and the size and the composition of the station audience. This heterogeneity raises a problem in identifying real price discrimination in the radio market.

4.5.2 Reasons for price discrimination

Price discrimination can arise in a market whenever price deviates from the marginal cost of supply. There are two main reasons why this can happen. One is that the firm has some monopoly power and this is why it can be a concern. The other is if there are fixed and/or common costs. In the latter case the marginal cost, i.e., the cost incurred in dealing with an additional advertisement, is below the average cost and average prices must cover the latter for the company to breakeven. In these situations the cost of provision may depend on volumes; therefore one would expect to see price differences according to quantity and pre-committed volumes. If there are fixed costs and companies in the market are not making abnormal profits, then one would expect to see an array of prices that reflect volume, demand differences, etc., since without such a policy a company will be unlikely to survive in the market[60]. Therefore, there is no reason to suppose that the presence of discrimination in a market is a matter of concern or a sign of abuse of dominance.

The market for radio advertising exhibits significant fixed costs. For example, it is estimated in the GWR/Vibe case that the contribution to GWR's gross margin is 80 to 90% of local advertising revenues. Therefore, one would expect to see a high degree of discrimination in prices for radio advertising assuming the product could be measured. Price discrimination *per se* in radio does not imply a market abuse.

4.5.3 Evidence from Competition Commission inquiries

The CC raised concerns about the possibility of discrimination in the GWR/Vibe case:

> *The prevalence of individually negotiated prices and a general lack of transparency in price setting (particularly to local advertisers) is also likely to give GWR the means to selectively charge lower prices …. To those with the greatest buyer power*'.

In the Trinity Mirror case the CC noted that:

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[60] In the presence of fixed costs the prices that create the maximum social welfare (usually referred to as Ramsey prices) almost always display price differentiation.

‘ it is clear that rates vary considerably, and not only by volume of spend. Advertising sales departments know their customers and are well placed to take account of changing circumstances in negotiating rates’.

And in the Carlton/Granada case[61] the CC concluded that

The proposed merger would have an adverse effect on future competition for the sale of advertising airtime and so might be expected to operate against the public interest…In terms of advertising sales this might manifest itself in a number of ways, including in particular the parties’ ability, post merger, to … enhance the degree of price discrimination.

The presence of discrimination in the market is not itself a problem either in terms of creating an SLC, or in terms of an increase in discrimination. Under the old rules discrimination could be used as a reason to prevent a merger if it was deemed to be against the public interest. Under the Enterprise Act with the SLC test there is a problem only if the merger creates a situation where prices rise for some customers without falls for others and the net effect in terms of competition is substantial. As the CC point out:

‘When doing so it will not be sufficient for the Commission to believe that an SLC is possible; for the Commission to reach an adverse finding either the merger must have resulted in an SLC or the Commission must expect such a result. The Commission will usually have such an expectation if it considers that it is more likely than not that the SLC will result.’[62]

It is far from clear in either the GWR/Vibe or the Trinity Mirror cases that it has been shown that discrimination is likely to result in price adjustments that will have a substantial effect.

Whenever discrimination is an issue then if there is a problem it is likely to affect only a small group. For example, in the Vibe/GWR case the CC were worried about vulnerable users and in particular those local advertisers that felt unable to compare costs and benefits of different advertising media (the OFT also raised this as one of their prime concerns). The CC’s own analysis identified this group as being a minority of local advertisers. They found 80% of local advertisers had tried to do this comparison and half found it difficult. That is, less than half of local advertisers (defined as those not using a national agency) had difficulty in comparing the costs and benefits of different advertising media. Having difficulty does not necessarily prevent sensible choices so it can be assumed that the group that had real difficulties and hence were potentially vulnerable was less than the 40% that found it difficult. If the group were say a half of these then we end up with only 20% of local advertisers being affected. At some point one has to accept that these small groups do not constitute substantial effects. It is far from clear in either the GWR/Vibe or the Trinity Mirror cases that it has been shown that discrimination is likely to result in price adjustments that will have a substantial effect. We return to this issue in section 4.6.

In trying to determine how likely it is that discrimination will be a problem in markets where it is possible to discriminate we can look at past CC cases to assess the scale of the problem. However, if we address cases in the period from 1970 to 2003 there is limited evidence.

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[61] Para 2.132, Carlton Communications plc and Granada plc, Competition Commission Cm 5952, October 2003.

[62] Merger References: Competition Commission Guidelines March 2003 (Para 1.19).

There have been several cases where the CC has seen significant discounting and discrimination that has been the natural result of market competition and where it has not been harmful to the public interest[63]. For example, Starch, Glucose and Modified Starches (1971), Ceramic Software (1978), Wires and Cables (1979), Steel Wire Fencing (1987), and Plasterboard (1990) are good examples. Even in the well-known case of Postal Franking Machines (1986), where the CC observed discounts of over 50% to large purchasers arising from buyer power, the Commission did not insist that the size of available discounts be revealed to customers. In the Carlton/Granada case the CC noted the less than transparent nature of the deals stuck between the companies and advertisers and the fact that some media buyers and advertisers get better deals than others. However, the CC concluded that because it had not been able to examine the market in depth that it was unsure that any of this indicated the existence of systematic price discrimination and, if it did, whether it worked against the public interest[64].

Generally, the CC's interest in discrimination has been to do with predatory pricing and damage to competitors, and it is in this specific context that it has been more concerned with the cases that have come before them. However, even here, there are few cases where the CC has intervened to stop discrimination. British Gas (1988) and Chlordiazepoxide and Diazepam (1973) are the only two cases where the CC has specifically prevented any discrimination that could not be justified on cost grounds. These were extreme cases; in the latter products were supplied to some customers free of charge. There is little in the history of Commission cases to suggest that if there is some the potential for discrimination then it is likely to lead to an SLC.

4.5.4 Conclusion

The nature of advertising on commercial radio, i.e., high fixed costs and a heterogeneous product, suggests that one would expect to see heterogeneous prices in a competitive market. There is some evidence of the potential to discriminate but this appears to be driven by market conditions and volume discounting. This itself is not a sign that a SLC will arise from a merger; indeed discrimination driven by market pressures may be a sign of the competition. In addition, the past history of CC cases does not suggest that the ability to discriminate translates into damage to the public interest.

In summary, the case for the view that the ability to price discriminate is likely to cause a SLC in radio advertising markets is far from proven. This was not fundamental under the Fair Trading Act since discrimination could be used as a reason to prevent a merger if it was deemed to be against the public interest. This is no longer the case since there must be a genuine expectation of SLC.

A company's ability, and indeed need, to discriminate to meet market pressure, even if judged to be against the public interest, does not imply there will be an SLC following a merger. Discrimination can only be a potential barrier to a merger under the Enterprise Act if the probable outcome of the merger is that prices will rise for a material number of customers without falling for others and that the net effect in terms of competition is substantial.

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[64] The CC recommended that the OFT or the Independent Television Commission should examine the issues in more depth. See paras 2.181-2.183, Carlton/Granada op.cit

4.6 Materiality

The materiality of a merger was dealt with under the Fair Trading Act in terms of a turnover test and a share of supply test and this has been carried over into the Enterprise Act. A merger can only be investigated if it passes these tests. The share of supply test requires the merged entity to supply or acquire 25% of those goods and services in the UK as a whole or in a substantial part of it. The OFT has flexibility in defining the relevant goods and services and in deciding on a substantial part.

The identical wording in the Fair Trading Act and the Enterprise Act suggests that case law under the Fair Trading Act is likely to carry over to the Enterprise Act. The House of Lords ruled that for an area to be defined as substantial it must be of such a size, character and importance as to make it worth consideration for the purposes of merger control. The test case involved South Yorkshire Transport Limited who claimed that the area of South Yorkshire and parts of Derbyshire and Nottingham (covering 3.2% of the population of the UK) could not be considered a substantial part of the UK. Both the Divisional Court and the Appeal Court agreed but the case failed in the House of Lords. Given the differing views of the courts one may think of a share of supply of around 3% to 4% as being marginal.

Once the merger has passed the share of supply test these figures do not reappear in the SLC test. This seems odd. For example, that one merger affects 3.5% of the population while another affects 100% could be relevant to an assessment of whether a lessening of competition is likely to be substantial or not. In the case of local radio mergers we note that probably only twelve markets are likely to pass the share of supply test[65].

While not wishing to open the details of the case, the recent Vibe/GWR case, is useful to consider in this regard. The area defined as the Severn Estuary accounts for 3.7% of the population and 2.2% of the area of the UK. This is close to the margin of being a substantial part of the UK. Radio advertising accounts for 4% of all advertising so unless the Severn Estuary is abnormal this percentage is likely to be a good approximation for that area. The OFT were concerned about local advertisers who account for approximately 39% of all radio advertising in this area. So the market of concern is 1.56% of all advertising in an area that has 3.7% of the population.

The CC was concerned about discrimination in this case. Hence the group affected by a change in competitive conditions will be a subset of the group under investigation. Using the figures given above, the area affected is close to marginal with regard to passing the share of supply test (3.7% of UK population), where local radio advertising is 1.56% of all advertising in this small area of the UK and where the vulnerable users of concern may be around 20% of the local radio advertisers. Given this, it seems reasonable that one might look at the evidence and be inclined to think the effect on competition is not substantial.

The problem arises because whenever there is a focus on discrimination it is almost inevitable that the final concern will be with a very small group. Under the current law the only way the fact that a share of supply is marginal (if the test has been formally passed) can be used as informative evidence is in the interpretation of substantial. This is not normally done, but we suggest that it makes sense, when assessing whether competitive effects are

[65] Namely, the cities of Birmingham, Glasgow, London, Liverpool, Manchester, Newcastle and regions defined by the Radio Authority as the East Midlands, the East of England, the North East, the Severn Estuary, the Solent and Yorkshire.

substantial or not, to revisit the share of supply particularly if those affected by any possible lessening of competition are in a minority.

This ‘materiality’ issue is likely to be a common theme in radio mergers, because there are many small local radio stations. The issue has not arisen in recent television mergers because the parties have had significant shares of the national TV advertising market. Since the materiality issue impacts so differentially on radio versus TV it is important that it receives particular consideration in the new Enterprise Act framework. Failure to do so could exacerbate the potential for apparent asymmetric treatment of television and radio mergers.

5. Customer Benefits

5.1 Summary

Although the public interest test has been replaced by the criterion of a substantial lessening of competition under the Enterprise Act 2002, the Act still allows the CC to take account of any relevant customer benefits that arise from a merger when deciding whether, and if so what, remedial action should be taken[66]. Relevant customer benefits are limited to benefits in the form of: lower prices, higher quality or greater choice of goods or services in any market in the UK and greater innovation in relation to those goods and services.

Relevant customers include customers of the parties to the merger, customers of such customers and any other customers in a chain of customers beginning with customers of parties to the merger. In the case of radio mergers, customers clearly include advertisers and could also be argued to include listeners as the consumers of radio stations' output.

In addition, the Secretary of State may intervene in radio mergers on public interest grounds, where the relevant public interest considerations are those set out in Section 58 (2C) of the Enterprise Act[67]. These are concerned with plurality of ownership, availability of a wide range of high quality programming and the broadcasters' commitment to standards objectives[68].

Radio company mergers may have effects on the quality and choice of radio services and on innovation in relation to those services. Below we examine arguments and evidence in relation to each of these effects. We find that mergers

- are likely to increase the diversity of radio formats thereby offering listeners greater choice and advertisers more attractive audiences
- lead to increases in the quality of radio services because cost savings from mergers enable the merged entity to invest in improving service quality and through the transfer of programming and management skills from more to less successful stations
- enable commercial stations to compete more effectively with the BBC by providing funding to support innovation in programming which is essential if the commercial sector is to attract audiences away from the BBC (given the BBC's funding advantage). Innovations in the commercial sector not only offer benefits to listeners of commercial stations but also create significant spill-over benefits arising from the diffusion of innovations into the BBC
- may create companies that can sustain the long term investment required to develop less mainstream services

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[66] Under the Enterprise Act references may also be made to the CC by the Secretary of State if public interest considerations arise. At present the public interest considerations are limited to national security, including public security, and so are not relevant to radio mergers. The public interest considerations may be changed by the Secretary of State by statutory order.

[67] The Communications Act 2003 amended the Enterprise Act 2002 by adding public interest considerations relating to mergers involving media and newspaper enterprises.

[68] As set out in Section 319 of the Communications Act 2003.

- provide funding to support investment in digital transmission and new digital radio services. This investment is required so that radio can compete effectively with other media as they convert to digital operation.

5.2 Choice of Services

The Radio Authority licensed, and now Ofcom licenses, stations with the objective of increasing choice and diversity, although this is constrained by the marginal economics of many niche formats. O&O[69] find in over two thirds of the 35 radio markets they examined the number of formats was less than the number of stations. UK audiences cluster around two main formats – adult contemporary and contemporary hits radio – and so viable new stations tend to focus on these formats.

Radio station mergers may affect listener and advertiser choice of services through their impact on the profitability of more marginal formats. The impact of mergers on format diversity i.e. the choice of services has been analysed theoretically and empirically in the US. At a theoretical level outcomes are ambiguous. For simplicity suppose a market can support two stations, A and B, of a given format and that the stations become jointly owned. If the owner moves station B to a different format then the audience and so total revenues of the firm are likely to increase, as B is not competing head on with A for audience. However, by moving B to a different format entry possibilities are opened up for competitors – either new entry or more likely (given spectrum constraints) other existing stations will change their format. The firm must then trade-off the potential losses from entry/change in competitors' formats against the benefits from reduced cannabilisation when deciding the format of station B.

Berry and Waldfogel (1999)[70] investigate this issue empirically using US data. They find that the increased concentration in radio markets that followed the deregulation of radio ownership controls under the 1996 Telecommunications Act is associated with greater diversity in radio station formats.

The same results can be expected to apply in the UK, namely that mergers will result in increased diversity and choice for listeners. For although, unlike the situation in the US, formats are written into licences[71] they may be changed if the effect is to increase the range of independent radio services in the locality. If listeners are offered a greater diversity of formats then they will be able to find stations that more closely match their preferences and this is clearly results in an improvement in consumer welfare. Advertisers potentially benefit from being able to reach larger and possibly more differentiated audiences.

[69] The Likely Impact of Proposed Commercial Radio and Related Ownership Rules in the 2002 Communications Bill on Plurality, Diversity and Economic Efficiency, Oliver and Ohlbaum Associates Ltd, September 2002.

[70] Mergers, Station Entry and Programming Variety in Radio Broadcasting, S Berry and J Waldfogel, NBER Working Paper 7080, April 1999.

[71] When seeking a radio licence licensees must "bid" a particular programme format and the winning bidders' format will be written into the licence for the station. Any changes to the proposed programme format, once a licence has been awarded and issued, may only be agreed by the Authority on the basis set out in section 106 of the 1990 Act, namely: that the change does not narrow the range of Independent Radio services in the locality; or that it does not substantially alter the service's character.

5.3 Quality of Service

Assessing the quality of broadcasting services is problematic because there is no objective measure of quality and opinions differ as to what constitutes an improvement in quality. For the purposes of this discussion we assume that quality of service improves when a station's audience increases – either reach or listening – on the grounds that audiences will only increase if listeners think the station is in some sense better than it was.

Mergers may lead to an improvement in quality of service in two ways

- mergers offer the opportunity for cost savings arising from a reduction in overheads and other costs usually as a result of co-location of activities. These cost savings can then be used to invest in improving the quality of the services offered

- acquisition of a small and sometimes failing station by a larger well-funded enterprise can result in the small station being more efficiently run with the transfer of skills that enable it to deliver a service that is more attractive to listeners.

Two examples of mergers that illustrate these benefits are shown in the following boxes.

Case 1: Xfm (London) was acquired by Capital on 1st May 1998.

Format of station taken over and target audience – pre and post merger - did not change

Other stations owned in the same/overlapping market were 95.8 Capital FM and Capital Gold and their formats are contemporary hits and classic hits respectively

Xfm launched in Sept 97, less than one year prior to the acquisition. Its audience at the time of acquisition (Q1:98) was a 0.6% share and 2.2% reach. The audience measures have since grown to 1.7% and 5% respectively by December 2002

Xfm was failing when Capital bought it. Capital has invested to improve the station's output.

Xfm won award for Music Week's station of the year in 2003.

Case 2: Choice 102.2 (Birmingham) was taken over by Chrysalis in 1998 and renamed Galaxy 102.2

The station played Urban Contemporary music. The broad format was unchanged as a result of the merger though there was reduction in levels of specialist output which enabled the audience appeal of the station to be broadened.

The other station owned by Chrysalis in the West Midlands plays adult contemporary music.

The audience reach and share of the station were 9% and 2.6% respectively just after acquisition (Q2: 99) and had risen to 12% and 3.7% by December 2002.

Cost savings of the order of £500k were made through joint operation of the two stations. In the first year after the merger the company spent over £650k on programming, marketing and re-branding the station. Previously nothing had been spent on marketing.

5.4 Innovation

There are three relevant forms of innovation: two are innovations in service and the third is technical.

5.4.1 Service Innovations

As emphasised in Section 4, the presence of the BBC makes for considerable competition for audience share. In particular, commercial radio has to fight strongly to overcome the BBC's advantage of being financed by a hypothecated tax and not advertisements. Since, all else being equal audiences prefer to listen to stations with fewer advertisements, commercial stations must offer better and wherever possible more innovative products than the BBC. Frequently, these can be copied easily by the BBC, which is able to bring the successful innovations to a larger audience thereby giving large public benefits relative to the scale of the innovating commercial sector.

Two obvious examples of innovations that were copied by the BBC are football phone-ins (originally pioneered by Radio Clyde) and commercial Asian networks. For example, in the case of the Asian networks the first commercial station started in 1989 in London and was followed by new Asian services in Bradford, Birmingham, Leicester and Manchester. In the mid-1990s the BBC started its own Asian services. Copying and disseminating new ideas to much larger audiences is beneficial for the public. Only strong private companies are well placed to innovate in this highly competitive market place, since innovations are costly both in terms of immediate finance, employee time commitment and also risking market share.

Consolidation may also create companies able to support long-term investment in less mainstream services. Such services tend to be less profitable, at least initially, because it takes time to persuade advertisers of their value and in some cases services can be more costly to produce (particularly if they have a lot of speech rather than music content).

5.4.2 Technical Innovations

The main technical innovation in the radio industry is the advent of digital radio. Investment in digital radio is required so that radio is not left behind other media which are already digital (e.g. the internet) or which are in the process of switching to digital operation (e.g. TV on all platforms and the press via the internet). Digital radio will greatly expand the number of services available (see Table 3, Section 2) and give advertisers a greater choice of advertising outlets.

Digital radio currently has very few listeners despite considerable investment in services and their transmission and so is loss making. This is expected to continue to be the case for some time. The ability of companies to fund this investment in digital radio depends on their analogue services being profitable. Mergers assist in this respect by giving scope to exploit scale and scope economies and the opportunity to grow audiences and so revenues. Furthermore, small or unprofitable radio stations are less likely to provide digital radio services because they cannot afford the transmission costs or the costs of developing new services. Mergers with larger companies can therefore provide the funding required for the provision of digital services.

Appendix: Market Definition in Merger Cases

This Appendix reports the CC's views on the relevant market given in recent merger cases in each of the TV, radio and local newspaper sectors. The newspaper and TV inquiries are examined because local radio might be regarded as a substitute for these media.

1. Carlton Communications/Granada 2003

The case concerned the proposed merger of Carlton Communications and Granada to create a company that would control 90% of ITV advertising and about half of all television advertising revenues.

In addressing the issue of market definition the CC started from the position taken in its report on the Carlton, Granada and United News and Media merger in 2000 which is discussed below. It was noted that the 2000 inquiry concluded that the television advertising market was separate from markets for other advertising media. The parties to the merger and third parties agreed with this position and so the CC concluded that the relevant market is no wider than television advertising.

The CC then went on to consider whether ITV advertising was a distinct market segment (as was concluded in the 2000 inquiry). The CC observed that ITV's market advantages, in terms of its audience coverage and frequency, had diminished since 1999 so that other channels were now closer substitutes for ITV. The CC concluded that any market power the parties might have in selling airtime could be assessed within the television market as whole.

The CC also considered whether advertising on pay-TV was a separate market segment from advertising on Channels 3, 4 and 5. It concluded that convergence between free to air and pay TV services had blurred the distinction between pay TV and terrestrial channels to the extent that they could now be seen as differentiated products in the same market.

2. GWR/Vibe 2003

This case concerned the acquisition of Vibe Radio (formerly known as Galaxy) by GWR. Vibe held an FM licence serving the Severn Estuary licence area which includes Bristol, Bath, Taunton, Yeovil and parts of south Wales. GWR had a controlling interest in several stations in the area and sold airtime on one other station. GWR accounted for about 40% of the local radio advertising revenue and Vibe accounted for 14%. GWR's market shares were much higher in the Bristol and Bath area (85% post-merger and 73% pre-merger).

The CC considered the issue of market definition in some depth, examining the main sources of evidence which may suggest local radio advertising is part of a wider advertising market. The CC undertook a survey of advertisers in the Severn Estuary region to provide information on advertisers' use of different media, the degree to which they are substitutes and complements and their price sensitivity.

The CC concluded that radio advertising was a distinct market from other advertising markets. It was recognised there may be some price sensitivity caused by the availability of other media, but this was judged insufficient to justify a definition of a market wider than that of radio advertising. It was found that for a significant number of advertisers radio advertising is complementary to other media.

Arguments and evidence the CC found unconvincing were as follows:

- Local radio sales teams target users of other media. This was rejected on the grounds that users of other media may be attracted to radio for non-price reasons.

- Churn between local stations and other media as evidence of substitution. The CC noted that this may be because advertisers were ceasing to advertise or were experimenting with a new or different medium.

- Survey respondents' responses to questions concerning hypothetical price increases. The CC considered that responses to these questions may have been biased and to support this cited survey respondents' responses to questions about actual price increases.

- GWR may not be able to target price increases on particular groups of advertisers. The CC's survey indicated some advertisers were more reluctant to switch than others.

The CC considered that their survey evidence and industry discussions indicated there were a significant number of advertisers for whom the particular characteristics of radio were not easily substituted by other media. These characteristics included

- The ability to provide a strong supporting or complementary role to other media
- Its lower production cost, and cost effectiveness, especially against TV advertising
- The intimacy of its appeal to listeners
- The frequency of the advertisements broadcast
- The impact of radio advertising as a background medium
- The ability to target particular listener groups (e.g. youth audiences)
- The ability to target particular local areas with national advertising
- Its immediacy and speed to the market.

The CC also considered whether there were separate sub-markets or segments within local radio advertising. They concluded that it was not appropriate to regard separate stations as serving different markets, but that Bristol and Bath and Taunton and Yeovil were separate markets.

3. Johnston Press/Trinity Mirror, 2002

This case involved the transfer to Johnston of eight free weekly newspapers currently published by Trinity Mirror in and around Derby, Northampton and Peterborough.

The CC assessed the case based on the impact on

- Competition between and within media for readers and advertisers

- The accurate presentation of news and free expression of opinion

- Efficiency and employment

The CC found that the transfers of four of the eight titles would operate against the public interest but that there were no objections to the transfer of the other four titles.

In respect of the competition issues the CC found that

- Other media do not provide good substitutes for the editorial content of local newspapers because they are less local, less accessible or less convenient.

- The closest substitutes for local newspapers are advertising-only publications and, to a lesser extent, other forms of printed media.

- Radio was not a good substitute for free papers. It was seen as helping advertisers build brand awareness and advertise events and promotions. The CC referred to the conclusions of the proposed Capital-Virgin merger and commented (para 5.155) that radio might often be used to support a TV or press campaign which indicated that it was more of a complement than a substitute.

The CC expected that a significant number of advertisers (particularly providers of leisure and consumer services recruitment agencies and local government) would experience price rises in four of the eight publications. This was thought likely because prices were not transparent in the sense that advertisers generally paid negotiated rates and these rates varied considerably between advertisers in a given category and there was not a close relationship between price and rates. In addition, the CC noted that advertisers other than estate agents and motor dealers do not form a cohesive group of firms that may compare rates perhaps negotiate rates or that can be easily targeted by a new entrant.

When faced with a 10% price increase 30% of respondents to a survey said that they would do nothing and a further 7% said they would switch to another local paper - an option that would not be useful post merger. The survey focussed on large advertisers and the CC thought that small advertisers would be less likely to resist a price increase or switch to other media.

4. News Communications and Media – Newsquest/Johnston Press/Trinity Mirror, 2000

This inquiry involved the transfer of newspaper titles and assets owned by News Communications and Media to Newsquest, Johnston Press and Trinity Mirror. The CC concluded that none of the proposed transfers may be expected to operate against the public interest.

When assessing advertising competition from other media the CC referred to the findings in the Capital Virgin and Johnston/Home Counties cases. The CC reported findings from the former case that TV radio and local/regional newspapers are each separate markets because of the limitations on substitutability between them. The choice of media was said to be dictated largely by creative considerations and the overall strategy of the advertising campaign for a particular product or service (para 4.37). The CC did not think recent changes in the TV and radio markets had changed this situation.

5. Regional Independent Media and Gannett UK/Johnston press/Guardian Media Group, 2000

This inquiry involved the transfer of newspapers and related assets of Regional Independent Media to Gannett, Johnston Press and Guardian Media Group. The MMC concluded that none of the proposed transfers may be expected to operate against the public interest.

The issue of competition for advertising revenues between media was reviewed. It was found that

- Daily and weekly papers were complements rather than substitutes
- The Internet provides potential competition in future but there was no evidence it had resulted in a significant erosion of newspapers revenues
- Advertising-only publications, niche local publications, directories and direct mail are the main competition for the sorts of advertising carried in local newspapers.

In respect of competition from radio advertising the CC repeated the findings of the Capital-Virgin report in which it was found radio, TV and local/newspaper advertising were separate markets. TV and press were regarded as good at developing brands because of their visual nature and radio was effective for certain products and as a support to TV and press campaigns.

6. Carlton/Granada/United News and Media, 2000

The CC assessed the possible impact of the proposed mergers on the public interest. It focused on

- the impact on the advertising market of a reduction in the number of the ITV sales houses – from three to two
- the impact on the market for programme production.

The CC found that the mergers would act against the public interest, primarily because the mergers would lead to the creation of one large and one smaller sales house and not because of the reduction in the number of ITV sales houses from three to two.

The CC argued that the imbalance in the size of the sales houses would be lead to higher advertising prices. The imbalance was argued to be self-reinforcing, as advertisers paid higher prices to the larger sales house and had less revenue to spend on the smaller one (assuming fixed budgets in the short term at least). This would result in even higher prices being charged by the larger sales house to the detriment of advertisers.

The CC thought that the proposed mergers may offer benefits in terms of cost savings (£40m) that would be invested in programme production and strengthening ONdigital. The CC rejected the possibility that ITV would be able to compete more effectively with new media and in international markets, on the grounds that two “unbalanced” companies would not have common objectives.

The CC therefore proposed remedies that resulted in two sales houses of a similar size, in terms of their share of advertising and ownership of the four leading licences. The CC believed the two sales houses would compete strongly for marginal business. The CC thought there was existing competition between sales houses and this would continue. It rejected arguments that low levels of switching indicated there was little competition and argued that competition for the contestable element of ITV revenues – estimated by Granada at £100m – affected prices for all ITV sales.

The CC defined the relevant market and assessed existing competition in the market. It concluded that

- TV advertising is a separate market from other media advertising. Evidence cited included[72]:
  - Conclusions of previous inquiries
  - Results of a survey of advertisers and media buyers who said that TV was a separate market
  - The distinctive characteristics of TV cited by advertisers and media buyers
  - Billetts analysis for ITV showing increase in price on TV had no impact on demand for press or other media.
- ITV advertising is a separate market segment in economic terms but this segmentation will diminish over time. There is already potential for ITV companies to exercise market power in selling airtime. Evidence cited included:
  - Advertisers requiring mass audiences for national campaigns must use ITV
  - Share deals, particularly those that extended to all ITV spend, give the opportunity for raising the price of ITV airtime.

There is also mention of pay TV advertising (and viewing) being a separate market from free to air advertising (and viewing) [73], however, this distinction is not used to draw conclusions about the proposed mergers.

7. Capital – Virgin, 1998

This case involved the proposed merger of Capital Radio, which had a controlling interest in two London stations and 10 stations outside London, and Virgin Holdings which had one national station and a London station. The merger was prohibited unless Capital either divested Capital Gold or only acquired Virgin AM.

The key issues addressed by the MMC concerned the impact of the merger on radio advertising markets. The MMC found that

- Radio advertising was a distinct market from other media on the grounds that

[72] Although evidence on the elasticity of demand for TV advertising was presented to the CC (para 4.123) it did not appear to be used to inform decisions about the relevant market.
[73] Paras 4.94 and 2.48.

- It has particular characteristics as an advertising medium

- Qualitative differences between radio advertising and other display media are reflected in very different pricing arrangements which make price comparisons difficult

- Most large advertisers are likely to be relatively insensitive to movements in radio advertising prices because radio advertising comprises a small part of most major advertising campaigns.

- The London radio advertising market was a separate market from national radio advertising.

- Capital's share of the London market post merger would diminish competition and may result in prices higher than they would be in the absence of the merger.

- Capital would be able to use its dominance in the London market to raise prices in the national advertising market.

The MMC did not believe that the market should be segmented by category of listener.

The MMC was concerned that the merger would have a detrimental effect on Capital and Virgin's competitors and this could ultimately lead to less diversity as some radio stations found they could not satisfy their promises of performance and the requirements of the market place.

Potential benefits of the merger noted by the MMC were

- Potential to improve the attractiveness of Virgin's stations to audiences

- Creation of a stronger company better able to fund investment in DAB

- Modest cost savings.

The points made by the MMC in coming to its conclusions on market definition included:

- Creative considerations and strategy of campaign dictate choice of media rather than price

- Radio often complements other media rather than acting as a substitute

- Prices differ enormously from other media and price depends on more than just size and nature of audience which means price comparisons between media cannot be made easily

- Lack of price transparency reduces advertisers ability to respond consistently to price changes

- Radio has a small share of total advertising expenditure and it was argued that this meant that advertisers would be relatively insensitive to increases in the price of radio airtime.

The parties submitted the following evidence in support of their case that radio was part of a wider advertising market

- Changes in shares of radio and other advertising particularly in multi-media campaigns which it was argued to show that radio and other media are substitutes

- Correlations between prices for radio, newspapers and cinema which it was argued showed that radio prices were positively correlated with those of other competing media.

The first point was rejected by the MMC on grounds that changes could be due to non-price factors. The MMC examined the work on price correlations in some detail and found that the results were not robust to analysis of price changes rather than price levels.