Anticipated acquisition by Amazon.com Inc of the Book Depository International Limited

ME/5085/11

The OFT's decision on reference under section 33 given on 26 October 2011. Full text of decision published 14 December 2011.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. **Amazon.com Inc** (Amazon) is a US-based company which sells various items online. Among many other products, such items include books, DVDs, CDs, consumer electronics, toys and games, household items jewellery and clothing. It retails books in physical, e-book and audio book formats. Related to the retailing of books, Amazon also supplies its Kindle e-book reader. Further, Amazon offers third party sellers the opportunity to sell products on Amazon's website platform (known as Amazon Marketplace) and on AbeBooks.com.

2. In addition to the US, Amazon has websites the UK, Germany, France, Japan, Canada, Italy and China.

3. **The Book Depository International Limited** (The Book Depository) is registered in Cyprus although it has a number of UK subsidiary companies[1] and a UK website.[2] It is an online retailer of books (in physical, e-book and audio book formats) although it also sells a small number of other products such as DVDs, CDs and video and PC games.

[1] The Book Depository Limited, Dodo Press Limited and The Deposit Limited.
[2] www.Bookdepository.co.uk

4. For the last financial year (to the year ending 30 June 2010) The Book Depository's UK turnover was £[ ] million. More recent (unaudited) data from the parties show that The Book Depository's annual turnover in the UK is around £[ ] million of which around [ ] is earned through Amazon Marketplace and [ ] is from its own website.

TRANSACTION

5. On 30 June 2011 the parties agreed a Share Purchase Agreement whereby Amazon will acquire the entire issued share capital of The Book Depository for £[ ] (subject to adjustments).

6. The parties filed an informal notification with the Office of Fair Trading (OFT) on 4 July 2011 and the OFT's extended administrative deadline by which to announce a decision in this case is 24 October 2011.

JURISDICTION

7. As a result of this transaction Amazon and The Book Depository will cease to be distinct. The parties overlap in the online retailing of books in the UK where together they account for more than a 25 per cent share and so the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

MARKET DEFINITION

8. The parties principally overlap in the online retailing of books. The parties also overlap in the online retailing of DVDs, CDs, video and PC games, but they submitted that The Book Depository's sales in these products are small, the largest being £[ ] (for [ ]). Given this, the OFT's investigation has focused on the retailing of books.

Product scope

Online versus offline retailing

9. The parties stated that books are sold to end consumers through a variety of sales channels, including three distinct sales channels:

- physical 'bricks and mortar' retail outlets or stores (including both specialist and general retailers)
- online sales channels, and
- mail order book clubs.

10. The parties consider that these three sales channels overlap on the demand-side and form part of an overall book retailing product market. According to the parties, the main reason for the aggregation of these three distinct sales channels was that the purchasing behaviour of individual customers did not show any particular fixed pattern or preferences in buying books from any one of these channels. The parties submitted that, for example, a consumer may wish to take possession of a book immediately in which case they would prefer a physical store but in other instances they may wish to trade off a delay in receiving the book for a lower price online. This, the parties said, was consistent with previous decisions from competition agencies.[3]

11. The parties also submitted that the distinction between traditional bricks and mortar and online retailers has blurred over time, as an increasing proportion of the UK population has access to the Internet.

12. The OFT has in previous cases concluded that while online retailers constrain traditional bricks and mortar retailers on price and range, the constraint may not be strong on other competitive dimensions (for example, service).[4] However, this case involves an acquisition by one online retailer of another and therefore the previous decisions do directly address the direction of constraint of interest in this case (namely the constraint from physical retailers on online retailers). The Competition

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[3] For example, the Competition Commission, *HMV Group plc and Ottakar's plc: proposed acquisition of Ottakar's plc by HMV Group plc through Waterstone's Booksellers Limited*, 12 May 2006; and the European Commission M.4611 *Egmont / Bonnier*, 15 October 2007.
[4] *Anticipated acquisition by HMV Group plc through Waterstone's Limited of Ottakar's plc*, Case ME/1974/05, 21 December 2005, paragraphs 61–63.

Commission (CC) has stated in previous decision that price competition across all types of retailers on best-selling titles, meant that the competitor set included all types of retailers, both retailers with a physical presence and distance sellers such as online retailers and book clubs.[5] The European Commission (the Commission) has in previous cases concluded that further segmentation of the overall market for the sale of books to consumers was not necessary, since different sales channels formed part of the same market and included both the physical store retailers and the distance selling retailers.[6]

13. The OFT received a wide range of responses from third parties during the course of its investigation including from customers, competitors and book publishers. The majority of these third party responses were of the view that the sale of books online was not generally substitutable from that of traditional physical retailers from the demand side. Some made similar points to the merger parties in that it may depend on how soon the consumer wants the book but third parties generally noted that the price difference between online and offline meant that they would not expect to see a significant level of switching between the two sales channels in the event of a five per cent price rise of online books. Some third parties reasoned further that the online and offline retail channels were distinct product markets due to the difference in availability of titles (particularly those outside the best-selling titles), the convenience and the functionality of online shopping (for example, the prevalence of buyer reviews). Several third parties suggested that there was an asymmetric constraint between online and physical stores, with online constraining physical stores, but not the other way around.

14. One third party submitted a survey of UK book customers that it had undertaken. This survey found that:

- in the event of a 10 per cent price rise of the particular book that the customer last bought online, 84 per cent said that they would still have purchased a book online (80 per cent saying that they would have purchased the same book)[7]

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[5] HMV/Ottakar, paragraphs 4.6–4.7.
[6] Egmont / Bonnier, paragraphs 12–13.
[7] Out of 192 respondents.

- in the event of a 10 per cent price decrease in the offline channels for the particular book that consumers last bought online, 69 per cent said that they would still have purchased a book online[8] and

- in the event of a 10 per cent price rise of all books sold online, 77 per cent said that they would still have purchased a book online.[9]

15. Using the survey results, the OFT was able to compare some indicative critical loss thresholds using gross margin data from the OFT's investigation against what consumers said they would do in the event of a price rise. This calculation supported the proposition that online retailing of books is a separate product market to books retailed through other channels (based on a price increase of 10 per cent).[10]

16. The parties submitted that the third party's survey may have a number of shortcomings. The parties submitted that these shortcomings are that:

- the survey was conducted online and therefore may result in respondents' bias to online retailing

- respondents were given a list of possible options as answers to questions (for example, what they would do in the event that a book's price was increased online) and the ordering of these options could result in bias (the options given first or near-first are more likely to be chosen by the respondent) and

- given the survey was trying to establish whether online retailing was constrained by offline retailing, the questions were more general than would be the case if the survey tried to establish which retailers in particular constrained the merger parties. The general nature of the questions may give less reliable results than a more focussed survey.

17. Despite these criticisms, the OFT considers that the third party survey provides useful evidence of the extent to which offline retailing may constrain online retailing. The OFT does not accept Amazon's criticism that

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[8] Out of 227 respondents.
[9] Out of 192 respondents.
[10] OFT calculations indicate that at least 29–33 per cent of sales would need to switch to offline retailers. In its critical loss analysis the OFT used gross profit margins for Amazon of [ ] per cent and, separately, [ ] per cent.

because the survey was conducted online it introduces bias. Both merger parties retail solely online and therefore online customers should be the starting point for any analysis of market definition. Indeed, the third party itself submitted that:

- joint OFT and CC guidance says that the CC is increasingly using online methods where these fit well with the channels of purchase[11]
- in *Zipcar/Streetcar* the market research firm hired by the CC said: 'after giving consideration to various data collection methods it was decided to conduct an online survey of members. This was considered to be most appropriate since most car club members join online and make most of their bookings through online methods. Zipcar and Streetcar also regularly communicate with their members by email and email addresses were available for all members of the two car clubs'[12] and
- the OFT itself has used online only surveys when investigating online markets. For example, in *LOVEFiLM/Amazon* (online rental of DVDs).[13]

18. In terms of the parties' second criticism – that the listing of options could introduce bias – the OFT notes that the relevant questions had, at most, six possible answers including 'other' and 'don't know'. The third party submitted (and the OFT agrees) that it is unlikely that respondents would be confused by such a reasonably small number of options and therefore there is unlikely to be any substantial bias introduced from the ordering of the options.

19. Finally, the OFT does not accept that the generality of the survey questions about switching destinations (or sales channels) leads to bias. Indeed, if the survey had named as options particular well known retailers this may have biased results, perhaps in favour of offline retailers.

20. For these reasons the OFT does not accept the contention that the third party survey cannot be used a probative evidence in this case.

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[11] OFT and CC, *'Good practice in the design and presentation of consumer survey evidence in merger inquiries'*, OFT1230, March 2011, paragraph 3.44.
[12] *'Zipcar Streetcare Merger Inquiry: a survey of car club members'*, TNS-BMRB report, October 2010, section 1.3. See the CC's website for the report in *Zipcar/Streetcar*, merger inquiry completed 22 December 2010.
[13] *Anticipated acquisition of the online DVD rental subscription business of Amazon Inc by LOVEFiLM International Limited*, Case ME/3534/08, 15 April 2008, paragraphs 12–13.

21. The parties also submitted two surveys to the OFT. One was conducted by Book Marketing Limited (BML) as a part of BML's continuous monitoring of a panel of 15,000 consumers.[14] The other was especially commissioned by Amazon for the OFT's merger investigation and was conducted by ICM Research Limited (ICM).

22. BML data show that [ ] per cent of consumers who had purchased a book from Amazon also bought books offline.[15] Moreover, offline spend for these customers amounted to [ ] of their total book spend over the period. Similar results were recorded for The Book Depository customers; again around [ ] per cent of customers also bought books offline accounting for over [ ] per cent of their total book spend. The parties submitted that this evidence strongly indicates that there is no segmentation between books purchased online and offline.

23. However, the OFT notes that the BML survey does not ask a hypothetical monopolist type question that is typically used when determining market definition.[16] For this reason the OFT does not consider the BML survey to be especially probative for the purpose of market definition.

24. The second survey that the parties submitted to the OFT – the ICM survey – did ask hypothetical monopolist type questions.[17] This survey found that in the event of a 10 per cent price rise of all books sold by Amazon, over [ ] of respondents would still have made the purchase from Amazon. Some [ ] of respondents said that they would switch to another retailer, of which [ ] said that they would switch to an offline retailer (that is, [ ] per cent of respondents). Indicative critical loss analysis undertaken by the OFT using

[14] The parties submitted that the BML Consumer Data provides book purchasing information using data from a TNS panel of 15,000 people aged 12 to 79, demographically and regionally representative of the population of Great Britain. Every two weeks panel members are phoned to establish their purchasing of books (and related products). Key information about the purchase, the book itself and the price are collected.
[15] During the 52 weeks to 7 August 2011.
[16] That is, questions asking what customers would do in the event of a small but significant non-transitory price rise.
[17] The survey was a telephone survey undertaken between 22–27 September 2011 questioning 500 people within the UK who had purchased a book online in the last three months.

the available information indicates that around [ ] per cent of lost sales to physical stores is not sufficient to constrain online retailing.[18]

25. However, the information from the ICM survey is incomplete for the purpose of market definition in that it asked about a 10 per cent price rise in books sold by individual retailers, not by all online retailers. Moreover, the lost sales are reported as a percentage of respondents not as the proportion in value terms which is what is required for critical loss analysis. As such the critical loss analysis discussed above (paragraph 24) is not sufficiently probative to show that bricks and mortar retailers constrain online retailers from the demand-side.

26. In this case, the OFT has taken a cautious approach and examined the merger by reference to the retailing of books online. However, where the evidence warrants it the OFT has taken account of any competitive constraint imposed on the parties by those bricks and mortar retailers.

Physical books versus e-books

27. The parties told the OFT that a notable trend in the retail supply of books to end consumers has been the introduction of e-books, which are books downloaded from a website in digital format to be read on an e-book reader, a tablet (for example, iPad), a computer or a smart phone. They suggested that with the growth of Internet access and usage, e-books could be aimed at an ever-wider audience of readers. The parties submitted that (according to the UK Publisher's Association 2010 Yearbook) digital sales (that is, e-book and audio book sales) accounted for around five per cent of all UK book sales.[19] The parties submitted that they did not consider a separate product market for e-books to be appropriate.

28. Some third parties told the OFT that the e-book segment had grown considerably over the past couple of years and that they expect e-book sales to continue to grow strongly over the coming years.

29. Several third parties contacted by the OFT during its enquiries suggested that e-books formed a separate market for several reasons, including the

[18] Assuming that the proportion of respondents switching is a good proxy for the proportion of book spend that would switch. In its critical loss analysis the OFT used the figures described in paragraph 15 and switching rates of [ ] and [ ] per cent (from the ICM survey).
[19] Audio books accounted for the bulk of these digital book sales.

difference in pricing methods. Third parties suggested that pricing of physical books was ultimately the decision of the retailer. Retailers receive a discount from publishers (or wholesalers in the case of smaller retailers or for some book titles) from the recommended retail price (RRP) of the title, which is in turn set by publishers. Since May 2010 some major UK publishers started to sell their e-books under the so-called 'agency model' whereby publishers set the final retail price and retailers receive a commission on each sale made.

30. A third party submission to the OFT said that differences in pricing, purchase methods (e-books are much easier to purchase), range (e-book backlist titles are more readily available) and the need for access to an e-reader (or computer) in the case of e-books, meant that the two book formats could plausibly be considered to form distinct candidate markets.

31. The OFT has not found it necessary to conclude on whether physical books and e-books are in the same market in this case. Without concluding on the exact delineation with respect to the retail supply of e-books, given The Book Depository's sales of e-books amount to less than [ ] per cent of its sales, the OFT has assessed the merger on the basis of physical books being separate from e-books and has not considered e-books further in this decision.[20]

Range of book titles

32. Several third parties told the OFT that the assessment of the transaction should take into account the effects of the merger on the retailing of deep-range books, since they considered the overlap between the parties in this segment to be particularly significant. One third party suggested that average sales of the top 500 books had been falling, as sales of 'long-tail' books had been increasing. Furthermore, this third party suggested that high street retailers sold mainly new books, best sellers and mainstream titles and are restricted by limited retail space on the range they could stock. Online retailers, on the other hand offered a vast range of books, including the 'long-tail' titles.

[20] By contrast, Amazon submitted that in the first half of 2011 its sales of e-books from its UK website amounted to over £[ ].

33. The parties submitted to the OFT that they did not consider it appropriate to segment the book selling market on the basis of a book's sales ranking. That is because although no two retailers stock exactly the same set of books, they will each typically offer both popular books and a selection of specialised books. Furthermore, the parties told the OFT that the [ ] book titles which accounted for around [ ] per cent of Amazon's sales in June 2011 were all available from a number of competing retailers.

34. The OFT,[21] CC[22] and the Commission[23] have in previous cases considered the existence of a distinct product market for the supply of deep-range titles, separate to the supply of best-selling titles (those in the top 5,000 ranked titles). In each case, the relevant authority considered that such a distinction was not appropriate since title rankings varied significantly during the course of a year, implying that titles could switch across these potential product segments (for example, Amazon submitted that around [ ] titles appeared in Amazon's top 5,000 list over the course of last year). Furthermore, the authorities noted that there were no retailers focussing solely on the supply of deep-range books, suggesting that this would not be a viable business model. However, the OFT notes that these decisions were taken in reference to retailing from physical stores where the issues of deep-range retailing may be different from online retailing.

35. In this case the OFT has not concluded on the market definition with respect to the range of book titles. However, in considering the competitive effects of this merger the OFT has examined the conditions of competition in the supply of long-tail books and best sellers separately.

Geographic scope

36. The parties submitted that the geographic market was at least national. They suggested that the parties operated in an international market with global scope. As an example of this, the parties highlighted the fact that The Book Depository, through only two websites, is active in over 100 countries and achieves around [ ] per cent of its sales outside of the UK.

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[21] HMV/Ottakar.
[22] HMV/Ottakar.
[23] Egmont/Bonnier.

37. Third parties contacted by the OFT were generally of the view that the relevant geographic market was the UK. These cited differences in language, pricing and cultural perspectives, which all meant that the offering to the final consumer was targeted at the national level. Several parties noted that the geographic market would not be narrower than national since online retailing does not vary pricing and marketing locally and distribution strategies tend to be set nationally.

38. Besides these points discussed above, the OFT also notes that multinational online book retailers, including the parties, have dedicated national websites. Further, while The Book Depository offers an all in single price of a product and delivery on all orders through its websites (regardless of the where the order originates), the OFT notes that it [ ].

39. The OFT has therefore assessed the merger on a UK-wide basis.

Conclusion on the frame of reference

40. The OFT has assessed the merger on the basis of the retail of physical books online within the UK for best seller and 'long tail' titles (both separately and together). The OFT has, in addition, considered any competitive constraint from physical stores where the evidence warrants it.

HORIZONTAL ISSUES

41. The parties submitted that they account for around [50–60] per cent of books sold online (with an increment of around [0–five] per cent). [24]

42. However, the OFT notes that the revenue figures supplied by some third parties relating to their own online sales of books in the UK do not, in all instances, accord with those estimated by the parties.

43. Also in its own internal documents provided by the parties (dated August / September 2009) Amazon estimated that the parties combined had a share of around [ ] per cent in 2008 (which was [ ]). Third party responses to the OFT were broadly in agreement with the above market shares, suggesting

[24] The parties submitted that given the lack of authoritative date sources, there is likely to be a very high margin of error in this estimate of their share of supply.

that Amazon's market share of the online books market was likely to be 70–80 per cent.

44. Moreover, sales figures from 2010 (which comprise sales from the second half of 2009 and the first half of 2010) may not provide a representative indication of the strength of competition today. For example, the OFT notes that The Book Depository has been growing and its UK sales in 2010-11 amounted to around £[ ] million. But even allowing for The Book Depository's growth, it accounts for only [0–five] per cent of physical books sold online in the UK.

45. In addition, Amazon has estimated that the total value of online physical book sales in the UK amounts to around £[ ] million. However, a market research company has estimated it to be around £910 million[25] while several third parties told the OFT that online retailing accounts for about a third of all books sales, which would make the size of the market at least £1 billion.

46. The OFT notes that there is a certain degree of uncertainty in measuring the total size of the market. As such, it has taken a cautious approach in assessing shares of supply and considered it appropriate to take the parties' estimate of a combined share of [50–60] per cent to be a lower bound estimate. The OFT does not rule out the possibility that the merging parties combined share of supply of the online retailing of physical books in the UK is in excess of 70 per cent. However, irrespective of the measurement difficulties, the OFT accepts, based on revenue information supplied by the parties, that the increment offered by The Book Depository is expected to be small under any alternate total market size, ranging from [0–5] per cent.

47. During the course of its investigation the OFT received a number of third party representations which raised a number of concerns. These were that:

- book prices would increase as a result of the merger

- free delivery (to anywhere in the world) would no longer be offered by The Book Depository (thereby increasing the total price paid)

[25] Verdict, 'e-retail 2010'.

- there would be less choice in the range of books offered and

- the merger would eliminate a potentially strong competitor to Amazon.

48. The OFT investigated each of these concerns and the results of the OFT's investigation are below.

Price competition

49. Despite the small size of The Book Depository relative to Amazon, many individuals wrote in to the OFT saying that Amazon and The Book Depository are each other's closest price competitor.

50. As such, the OFT has examined the effect of the merger on price competition using pricing data from the parties and their internal documents.

51. Both parties price with reference to other online book retailers. In order to find the price offered by a competitor for a matching book, specialist software is used which identifies a precise match.

52. The Book Depository's pricing mechanism uses a number of decision algorithms in the software. These are:

    - [ ]

    - [ ] and

    - [ ] or

    - [ ].

53. Amazon's pricing algorithm is slightly different. [ ].[26] [ ]. Amazon does not include The Book Depository in its pricing algorithm for [ ] those titles [ ] ASINs.[27]

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[26] Internal documents from Amazon show that [ ].
[27] ASIN is Amazon Standard Identification Number, the identification unique to each book title.

54. The OFT's investigation focussed on how closely Amazon and The Book Depository competed given their respective pricing algorithms.

55. The parties provided the OFT with pricing data, between January and June 2011, for book titles ranked (by popularity of Amazon's sales) 1–10, 100–110, 500–510 and 5,000–5,010.[28] The results showed that The Book Depository was on average [ ] per cent more expensive than Amazon.[29] This evidence indicated that the parties were not close competitors in pricing terms. However, given the pricing algorithms of each, the OFT was conscious that those instances in which there was no direct competition between the parties for a particular book title may have distorted the results. The OFT's investigation found that there are a number of book title segments (by popularity) in which the parties do not overlap. Indeed, over the last financial year almost [ ] per cent of The Book Depository's revenues came from book titles beyond the top 40,000 selling titles, whereas [ ] of Amazon's book revenues came from within the top 40,000 selling titles.

56. Therefore, the OFT analysed those instances in which the parties price with direct reference to each other. The OFT performed these analyses with regard to the 'long tail' and the best seller book titles.

The 'long tail'

57. The Book Depository was added to Amazon's price matching system in [ ]. The following year Amazon decided to restrict The Book Depository's inclusion in the price matching system to [ ].[30] An Amazon internal document from 2010 explains this decision:

'[ ]'.[31]

58. Amazon told the OFT that it [ ].

[28] Prices for Amazon's free delivery service were used to make the comparison with The Book Depository like-for-like.
[29] Using Amazon Marketplace prices for which data were more readily available. However, The Book Depository's own website prices are never cheaper than its Amazon Marketplace prices.
[30] Amazon Standard Identification Number.
[31] [ ].

59. The removal of The Book Depository from Amazon's price-matching software was undertaken in stages, starting on [ ] and ending on [ ].[32] Analysis undertaken by Amazon at the time of the price removals shows that since removing The Book Depository from its price monitoring on titles outside of the best selling 40,000, prices increased for a significant proportion of book titles. The price increases are summarised in table 1.

Table 1: The effect on Amazon's prices of removing TBD (by proportion of book titles, per cent)

ASIN band	Proportion of Amazon prices higher	Proportion of Amazon prices same	Proportion of Amazon prices decreased
80,000–120,000	[ ]	[ ]	[ ]
120,000–160,000	[ ]	[ ]	[ ]
160,000–200,000	[ ]	[ ]	[ ]
200,000–250,000	[ ]	[ ]	[ ]
>250,000	[ ]	[ ]	[ ]

Source: The parties

60. The OFT has seen evidence in Amazon internal documents of the extent of price increases. By way of example, for the 80,000–120,000 ASIN band, around [ ] per cent of titles had a price increase of over [ ] per cent, as did [ ] per cent of titles in the 160,000–200,000 ASIN band and over [ ] per cent of titles in the 200,000–250,000 ASIN band.

61. Further, these internal documents also show that as a result of some price increases Amazon lost some sales, of around [ ] per cent in some ASIN bands.

62. However, Amazon provided evidence to the OFT showing that removing The Book Depository from Amazon's pricing algorithm for these ASIN bands was a profitable strategy for it. This is important since unilateral effects can occur in a horizontal merger if the merger allows the merged entity profitably to raise prices on its own and without needing to coordinate with its rivals given that the merger itself removes the competitive constraint which prevented such profitable price rises occurring before the merger.[33] A loss of such a competitive constraint could amount to a substantial lessening of competition. Conversely, however, if one or

[32] [ ].

both of the merger parties could profitably raise prices before the merger then this may indicate that a substantial competitive constraint did not exist before the merger. In other words, the OFT investigated whether the fall in prices when Amazon was using The Book Depository in its pricing algorithm for titles in the >40,000 ASIN bands, and subsequent rise in prices for a significant proportion of these titles once The Book Depository was removed from the pricing algorithm, was a result of how computer-generated pricing functioned rather than a competitive constraint generated between close rivals.

63. Amazon provided data showing that retail contribution profit for book titles [ ].[34]

64. In addition, the OFT tested whether the overall affect of pricing matching against The Book Depository for all titles in the >40,000 ASIN bands was consistent for ASIN bands 40,000–80,000, 80,000–120,000, 120,000–160,000, 160,000–200,000 and 200,000–250,000. In the immediate post removal of The Book Depository period ([ ]), Amazon internal documents showed that all the above ASIN bands experienced a rise in profitability ([ ]) except for the [ ] ASIN band. In this band only [ ] books (not titles) were affected and the price changes resulted in around [ ] per cent fewer books being sold and contribution profit falling by [ ] per cent.

65. A longer period of analysis (to [ ]) shows that higher levels of profitability were maintained for the >40,000 ASIN titles. Amazon undertook regression analysis which showed that even controlling for underlying growth in sales and seasonality, it experienced an overall increase in profits for these book titles.

66. Furthermore, the parties submitted that of those who did switch away from Amazon the majority switched to book sellers other than The Book Depository (whether on Amazon Marketplace, other websites or to bricks and mortar retailers). They submitted that they established this by estimated sales volumes lost by Amazon as a result of the price increases and analysing the uplift in sales from those competitors about whom they

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[33] OFT and CC, *'Merger Assessment Guidelines'*, September 2010, OFT1254, paragraphs 4.1.5 and 5.4.1.
[34] Contribution profit is a measure of profitability based on direct and variable costs but exclude fixed costs.

could get information (that is, The Book Depository and other Amazon Marketplace sellers).

67. Contemporaneous Amazon internal documents estimated that, by volume, Amazon lost around [ ] per cent of sales in the 40,001–80,000 ASIN range, [ ] per cent in the 80,001–120,000 ASIN range and [ ] per cent in the 120,001–160,000 ASIN range.

68. Analysis undertaken by Amazon for the purpose of the OFT's merger investigation found that for the >40,000 ASIN range overall, Amazon estimated that it lost around [ ] per cent of sales (or a little over [ ] books per month). In order to determine this figure, the parties stated that in the two weeks following the price increase The Book Depository sold almost [ ] books with the titles on which Amazon had increased prices. The parties submitted that with normal sales and growth figures one would have expected The Book Depository to have sold around [ ] books of these titles had Amazon not changed its prices. Therefore, the parties estimated that The Book Depository sold around [ ] more books as a direct result of Amazon increasing its prices (equating to around an additional [ ] books per month, or around [ ] per cent of Amazon's estimated lost sales).

69. Evidence submitted by the parties indicates that there was little, if any, growth in The Book Depository's sales on its own website relative to those titles on which Amazon did not alter the price (which can be viewed as the baseline growth of The Book Depository). This evidence indicates that The Book Depository website was not picking up substantial diversions away from Amazon in reaction to price increases. The Book Depository's sales on Amazon Marketplace, however, showed considerable growth.[35] This adds further evidence that it is Amazon Marketplace sellers who provide the strongest competition against Amazon itself.

70. Moreover, the parties submitted that at the time immediately following Amazon's price increases, The Book Depository accounted for around [ ] per cent of sales on Amazon Marketplace for those titles comprising the >40,000 ASIN range, suggesting that online competition in the retailing of these book titles would be sufficiently strong post merger.[36]

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[35] The Book Depository sells the bulk of its books on Amazon Marketplace (paragraph 4).
[36] As of September 2011 The Book Depository's share of sales of these titles on Amazon Marketplace had fallen below [ ] per cent.

71. Analysis of the overall >40,000 ASIN band titles on Amazon Marketplace and Amazon submitted by the parties showed that The Book Depository was the cheapest or equal cheapest seller for these titles on [ ] per cent of instances.[37] On these titles it was cheapest by [ ] in [ ] per cent of the time. Further, the parties submitted that when The Book Depository was the cheapest option, the next cheapest seller was a third party in almost [ ] per cent of instances. Amazon itself was the next cheapest together with a third party in over [ ] per cent of instances.

72. The OFT is satisfied on the basis of the evidence presented to it that the effect that both merger parties had on each other's pricing behaviour for book titles in the >40,000 ASIN range has been more a result of algorithmic price setting rather than of market-based competitive constraints. As such, and since Amazon had taken the unilateral decision to remove The Book Depository from its pricing algorithm before the merger, the OFT does not consider that there is a realistic prospect that the merger, in itself, will lead to a substantial lessening of competition for titles in the 'long tail'.

Best selling titles

73. As mentioned above, internal Amazon documents state that Amazon monitors other online competitors ([ ]). In addition, Amazon undertakes some limited price monitoring of some physical store retailers. It submitted that since 2009 [ ]. Amazon [ ] conducts [ ] price monitoring across [ ] titles, usually at [ ] retailers out [ ]. Amazon internal documents discussing competition in the UK do so by discussing competition in [ ] categories: [ ].

74. Amazon internal documents show that [ ].

75. The parties undertook a regression analysis for the 1–40,000, 1–5,000 and 5,001–40,000 in the same way as they did for the >40,000 range (paragraph 65). The purpose of this analysis was to demonstrate to the OFT that price matching The Book Depository for these book titles was not a profit-maximising strategy, in the same way as it was not for the 'long tail' (discussed above). The regression analysis used Amazon's sales in the >40,000 ASIN range for those periods in which it did not price match The

[37] As of 19 September 2011. The data are based on 4,940,563 observations.

Book Depository as a proxy for Amazon's underlying growth in sales. This may be somewhat unsatisfactory given that Amazon submitted that around [ ] per cent of titles in the >40,000 range were still being matched to The Book Depository.[38]

76. Overall, the profitability regressions suggest that including The Book Depository in Amazon's pricing algorithm was not profit-maximising. However, this evidence is not of a compelling standard because of the uncertainty in the data. For example, although the policy may not have been profit-maximising overall, it may be for some segments of books. The OFT notes that for the 1–5,000 ASIN range the regression analysis is significant at the [ ] per cent confidence interval level, not a five or one per cent confidence interval, reflecting the significant fluctuations in profitability in that band. Moreover, there may be different demand conditions for books in the >40,000 ASIN range which make those titles a poor proxy for baseline growth for the best selling titles.

77. The OFT notes that around £[ ] million of The Book Depository's £[ ] million UK turnover comes from titles within Amazon's top 40,000 titles, whereas Amazon's turnover for these titles is around £[ ] million. As such the increment arising from the merger for this segment of the market is around [0–five] per cent (or less).

78. Evidence from the ICM survey is that in the event of a price increase of 10 per cent of all Amazon books (including those beyond the top 40,000 titles), only [ ] per cent of Amazon shoppers would divert to The Book Depository website. However, Amazon submitted that it would have been confusing for respondents to distinguish between Amazon and Amazon Marketplace and so diversions to Amazon Marketplace were not captured in the ICM survey.

79. This gap in the analysis is important since The Book Depository earned some £[ ] million ([ ] per cent of its overall UK turnover) from Amazon Marketplace in 2010-11 (and around £[ ] million, or [ ] per cent, the

[38] Amazon submitted that this is because titles which were in the top 40,000 and price matched to The Book Depository have since slipped to positions of >40,000 ASINs but have maintained the old price match in the database since the computer system has not yet had cause to update the price match.

preceding year).[39] It means that the ICM survey cannot be relied upon to determine that the merger parties are not close competitors. As such, the OFT has not placed any weight on the [ ] per cent diversion figure quoted in paragraph 78. Not only has an important option, Amazon Marketplace, been excluded from the diversion options but the OFT has concerns that the survey did not employ a sales value weighting to the results and a telephone survey was used to assess online shopping behaviour. Instead, other evidence is required.

80. The parties submitted evidence on competition on Amazon Marketplace.[40] For the 1–40,000 ASIN range, The Book Depository was the cheapest seller on Amazon Marketplace [ ] per cent of the time[41] (and equally best priced only [ ] per cent of the time).[42] For those [ ] per cent of titles, the next cheapest retailer on Amazon Marketplace and Amazon was Amazon alone in less than [ ] per cent of instances. In almost [ ] of cases the next cheapest was another seller on Amazon Marketplace (and for around [ ] of instances the next cheapest was another seller on Amazon Marketplace as well as Amazon itself).

81. Moreover, in those instances in which Amazon was the cheapest seller, the next cheapest was a third party Amazon Marketplace seller in [ ] per cent of instances. This analysis indicates that there is strong competition on Amazon Marketplace and that the merger parties are not especially close competitors for book titles sold on Amazon Marketplace.

82. Further evidence was provided by The Book Depository. In order to provide evidence to the OFT that the parties are not close competitors, The Book Depository increased prices on both Amazon Marketplace and its own website by [ ] per cent for one day.[43] As a result of this experiment, the number of books sold on its own website fell by around [ ], and on Amazon Marketplace sales fell by [ ].[44]

83. Amazon's analysis of Amazon Marketplace sales for that week showed that The Book Depository's share of books sold fell from [ ] to [ ] per cent.

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[39] In 2008-09 The Book Depository also derived around [ ] per cent of its UK sales from Amazon Marketplace.
[40] The analysis that follows refers to prices as at 10am 19 September 2011.
[41] Based on 8,774 observations.
[42] When The Book Depository was cheapest, in almost all instances it was cheapest by [ ].
[43] 19 September 2011.
[44] Relative to the same day the previous week.

Several third parties experienced a rise in share, most notably Aphrohead whose share increased from [ ] to [ ] per cent. Paperbackshop and Awesome experienced a [ ] percentage point rise each.[45] Although not conclusive, this evidence does suggest that third party sellers on Amazon Marketplace are close rivals to The Book Depository.[46]

84. One third party submitted to the OFT analysis of an upward pricing pressure model – an illustrative price rise (IPR) – since this model has been used by the OFT in some previous cases.[47] The IPR model is one of several models which measure the upward price movements of a merged entity (note, it does not try to predict a price rise, rather the extent to which the merged entity has both the ability and incentive to implement a price rise).[48] The model does this by combining, in a formula, the profit margins of the merger parties (indicating the attractiveness of capturing sales lost as a result of a price rise) and diversion ratios (the extent to which sales lost go to a competitor, indicating the merged entity's ability to capture such lost sales).

85. There are various forms of the IPR model and the third party used an asymmetric form (based on its belief that competition between the merger parties was asymmetric, with Amazon constraining The Book Depository significantly more than The Book Depository constrains Amazon) and an isoelastic demand curve (reflecting the OFT's preference in previous cases that it has used an IPR model). The third party did not have access to accurate diversion ratio data or profit margin data, and so instead assumed diversion ratios of between 50 to 80 per cent (from The Book Depository to Amazon), and profit margins of between five–10 per cent for The Book Depository and 10–30 per cent for Amazon.

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[45] Amazon submitted that due to the large difference in the volumes sold by it and The Book Depository, it could not identify with any accuracy the amount, if any, sales that it picked up from The Book Depository's lost sales.
[46] Not all of the largest sellers on Amazon Marketplace experienced a rise in share suggesting that, for those who did, factors other than The Book Depository's fall in sales explained the change in shares.
[47] For previous cases see for example, *Anticipated acquisition by Asda Stores Limited of Netto Foodstores Limited*, Case ME/4551/10, 23 September 2010; and *Anticipated acquisition by Co-operative Group Limited of Somerfield Limited*, Case ME/3777/08, 20 October 2008.
[48] See, for example, OFT and CC, *'Merger Assessment Guidelines'*, September 2010, OFT1254, paragraph 5.4.10; and OFT and CC *'Commentary on retail mergers'*, March 2011, OFT1305.

86. Applying the IPR formula the third party found that merger would result in an upward pricing pressure of at least five per cent (and in some instances over 25 per cent) under a range of assumed scenarios.[49]

87. The OFT obtained profit margin data from the parties, focusing on The Book Depository's sales on Amazon Marketplace (given the evidence of little competition between Amazon and The Book Depository's own website). The OFT was able to use diversion ratios which resulted from the Amazon price rises following its decision not to price match The Book Depository in the >40,000 ASIN range. These diversion ratio figures were corroborated by Amazon.

88. The parties calculations revealed an IPR of less than one per cent (assuming linear demand) and the OFT calculated an IPR of around two per cent. The OFT is conscious that the diversion ratios used in its calculations were derived from the change in prices in the >40,000 ASIN range. Given bricks and mortar retailers are less likely to compete against online retailers for these titles it is likely that the diversion ratios over-estimate the true diversions between the parties for titles within the top 40,000 ASIN range. Moreover, profit margin data submitted by the parties showed that The Book Depository's gross margin is [ ]. Further, the parties submitted that The Book Depository is the cheapest seller on Amazon Marketplace in [ ] per cent of instances for the >40,000 ASIN range whereas it is only so in [ ] per cent of instances for the 1–40,000 ASIN range (paragraphs 71 and 80).

89. In terms of competition between Amazon and The Book Depository's own website, the OFT notes that The Book Depository earns around [ ] of its UK revenue from its own website (paragraph 79). The large majority ([ ] per cent) of sales emanating from its own website are to customers outside of the UK ([ ]). Therefore, The Book Depository website has a very small presence in the selling of books to UK consumers.

90. A condition on selling on Amazon Marketplace is that the seller cannot sell the same product on its own website for a price cheaper than the all-

[49] The assumed scenarios used diversion ratios 50, 60, 70 and 80 per cent (The Book Depository to Amazon) and zero,one and five per cent (Amazon to The Book Depository) for assumed profit margins of: (i) five per cent (The Book Depository) and 10 per cent (Amazon); (ii) 10 per cent (The Book Depository) and 20 per cent (Amazon) and (iii) 10 per cent (The Book Depository) and 30 per cent (Amazon).

inclusive price (for example, including shipping costs) that it chooses to sell on Amazon Marketplace (the 'price parity' condition). This may offer some explanation as to why The Book Depository's own website has not matched the success of the sales it makes on Amazon Marketplace. Given this condition, and the evidence on The Book Depository's own website discussed above, the OFT does not consider that The Book Depository's own website offered strong competition to Amazon for UK consumers before the merger.

91. Moreover, the OFT's market testing exercise found other online sellers of comparable size to The Book Depository's own website. These include Aphrohead,[50] Waterstone's and Play.com.

92. The OFT does not consider that the merger will result in a realistic prospect of a substantial lessening of competition in best selling books in the UK.

Delivery charges

93. A number of The Book Depository customers contacted the OFT to express concern that the merger could lead to a loss of free delivery. This is a type of price competition concern, although the OFT has addressed it separately in this decision.

94. The OFT notes that The Book Depository offers free delivery to all of its customers for all purchases. [ ]. However, the OFT has analysed this merger on the basis of the UK [ ].

95. One third party told the OFT that it thought The Book Depository's policy of free delivery influenced Amazon's decision to abolish a minimum spend in order to qualify for free delivery on an order. Internal documents provided by Amazon show that [ ]. The internal documents show that [ ].

96. The Book Depository is not mentioned in the internal documents and the evidence indicates that it did not play any part in Amazon's decision to abolish a minimum spend to qualify for free delivery.

[50] Which forecasts sales of £20 million for this year. Aphrohead submitted to the OFT that its sales last year were £[ ]. Amazon submitted that Aphrohead's Amazon Marketplace sales amounted to £[ ] in 2010–11, indicating that its own website sales are strong.

Range of book titles

97. The OFT received some complaints that the merger would reduce the range of titles available, including out of print books and those titles which are not commonly stocked by other retailers. The Book Depository has a print on demand offer which allows out of print and out of copyright titles to be printed on demand.

98. The parties submitted that the merger will not lead to a reduction in book titles. Amazon already offers approximately [ ] million titles compared to The Book Depository's [ ] million titles. Indeed, Amazon told the OFT that it offered a wide selection of books before The Book Depository entered the market. According to the parties' submission, other retailers offer a large range of titles including Aphrohead (seven million), Blackwells (six million), Waterstone's (5.8 million) and Foyles (3.5 million).

99. A large range of books can be offered by an online retailer, the parties submitted, because online retailers do not need to stock all of the books that they offer. The Book Depository itself does not hold a stock of books. Instead, an online retailer with an agreement with a large book wholesaler such as Gardners or Bertrams would have access to a large range of titles. This has been confirmed by one of the larger wholesalers in the UK.

100. The parties also submitted that books out of print are readily available from other sources including from retailers selling second-hand books such as eBay, Awesome Books, World of Books and Better World of Books.

101. Finally, the OFT notes that its analysis on the pricing effects of the 'long tail' of books showed that the parties were not close competitors before the merger in that Amazon could raise prices and profitability without being harmed by The Book Depository. Likewise, the OFT considers that as with the pricing of the 'long tail', The Book Depository has not constrained Amazon to the point that Amazon has needed to offer a long tail of books.

Potential competition

102. OFT guidance on this notes that a merger may eliminate a potential entrant that could have increased competition, thereby creating a loss of

competition.[51] The loss of potential competition with regard to a likely entrant can be equally applicable to an existing competitor who is likely to expand considerably in the foreseeable future. The OFT has therefore investigated this theory of harm.[52]

103. Several internal documents provided to the OFT by the parties, highlight the extent of growth that The Book Depository has seen in the previous years. For example, one Amazon internal document reported that [ ]. This document reported that [ ]. The OFT also notes that the document suggests that [ ].

104. In addition to these internal documents, the OFT received concerns from some third parties, especially publishers, that the merger would remove a competitor to Amazon who would only become stronger in the future. One submitted that The Book Depository is the only specialist online competitor to Amazon and that the competitive threat will only grow in the future. Another said that it expects The Book Depository to grow as a significant competitor to Amazon if it were to remain independent of Amazon.

105. The parties submitted evidence showing that The Book Depository's UK turnover has fluctuated over the past few years and therefore has not seen consistent year-on-year growth.[53]

106. Further, data from The Book Depository shows that over [ ] per cent of its growth over the past year has come from non-UK sales and [ ] of the UK sales growth has come from Amazon Marketplace where the OFT considers competition will not be substantially diminished as a result of the merger (The Book Depository's own website sales grew by around [ ] per cent).

107. The OFT does not consider that the merger eliminates potential competition to the point that there is a realistic prospect that a substantial lessening of competition would arise as a result of it.

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[51] OFT and CC, *'Merger Assessment Guidelines'*, OFT1254, September 2010, paragraph 5.4.14.

[52] In its provisional findings of its BATS/Chi-X merger investigation, the CC took a different approach to potential expansion of an existing competitor. It said that since BATS and Chi-X are currently in actual competition and that the factors relevant to the competition assessment are the same irrespective of whether a loss of actual competition or potential competition was being investigated, both theories of harm could be investigated together. '*BATS Global Markets Inc/Chi-X Europe Limited Merger Inquiry: provisional findings report*', 20 October 2011, paragraph 6.2.

[53] The Book Depository's UK turnover in 2008-09 was £[ ] million, in 2009-10 it was £[ ] million and in 2010-11 it was £[ ] million.

Barriers to entry and expansion

108. In terms of barriers to entry and expansion, the OFT has investigated whether entry or expansion can take place to replicate The Book Depository (not Amazon). The OFT investigates barriers to entry and expansion within a framework of it being timely, likely and sufficient.[54]

109. The parties submitted that the existence of Amazon Marketplace and other, similar online platforms (such as on Play.com and eBay) facilitate ease of entry. Very little infrastructure is required, they submitted, and an entrant using Amazon Marketplace can be trading within 24 hours of registering. The costs involved in trading in this way are small and the nature of trading on Amazon Marketplace (or a similar platform) highlights price competition which reduces the need for strong brand recognition. In terms of UK sales, since its entry The Book depository has primarily been a retailer on Amazon Marketplace; indeed, in two of the past three years it has earned at least [ ] per cent of its UK turnover from Amazon Marketplace (paragraph 79) and the evidence in this case indicates that any competition between Amazon on the one hand and other online sellers including The Book Depository on the other predominantly takes place on Amazon Marketplace.

110. The parties submitted that The Book Depository entered in 2004 and within [ ] years generated turnover of over £[ ]. The Book Depository does not [ ] (paragraph 99) which means it does not [ ]. Further, the marginal cost of adding an extra book title to its customer offer is small. Distribution to depots in preparation for shipping (by Royal Mail) can be handled by wholesalers.

111. The OFT considers that the evidence indicates that entry can be timely.

112. One third party competitor told the OFT that it is currently able to match the prices that The Book Depository offers and that it has all the infrastructure in place for growth (it is not reliant on third parties to fulfil customer orders). Indeed, evidence from the OFT's investigation shows that in almost every case when The Book Depository is the cheapest retailer on Amazon Marketplace, another retailer it able to offer the same

[54] OFT and CC, *'Merger Assessment Guidelines'*, OFT1254, September 2010, paragraph 5.8.3.

title for only [ ] more. Another third party told the OFT that it is looking to expand its online presence.

113. The parties and some third parties have noted that some online retailers have been successful in competing against The Book Depository, for at least some titles – such as Aphrohead, Paperbackshop.com and The Book People. The OFT notes that Aphrohead and Paperbackshop are active on Amazon Marketplace.

114. The OFT has not identified any potential retailers who are likely to enter into the retailing of books as a result of a post-merger price rise. However, there is some evidence that the barriers to expansion are low, especially for those online sellers who retail via third party platforms such as Amazon Marketplace, and therefore it is expansion rather than entry which would be likely following a post-merger price rise.

115. In terms of whether entry or expansion would be sufficient to offset the loss of The Book Depository, several third parties submitted to the OFT that operating from a stand-alone website is more difficult than operating from a third party platform. They told the OFT that profit margins are low and an online retailer must be prepared for a period of losses whilst it builds up its sales.

116. The OFT considers that there is some evidence which indicates that third party sellers on Amazon Marketplace could, collectively, replace The Book Depository in the event of a post-merger price increase. This evidence is the increase in sales of other Marketplace sellers when The Book Depository increased its prices for one day (paragraph 83), that The Book Depository is almost always only [ ] cheaper than another retailer (paragraph 80) and the BML survey which found that over [ ] of The Book Depository customers also buy books from high street chain book stores (representing around [ ] of their book spend), and over [ ] also purchase books online from another online retailer (which is not Amazon) representing around [ ] per cent of their book spend.

117. However, given the evidence in this case discussed in this decision, the OFT has not found it necessary to conclude on countervailing factors, such as entry and expansion, since it does not affect the outcome of its decision.

THIRD PARTY VIEWS

118. The OFT received comments from a large number of third parties in this case. Around 100 individuals contacted the OFT to complain about the merger, although a sizeable proportion of these were from outside of the UK. Individuals told the OFT that they were concerned about the loss of free delivery, a reduction in range and an increase in prices. These points have been addressed above.

119. The OFT also received a considerable body of comment from publishers, both large and small. Concerns raised by publishers are that as a result of the merger:

- the route to market for some book titles, especially in the deep range or from small publishers, will be inhibited
- book prices will increase
- Amazon's buyer power will increase (resulting in reduced margins for publishers)
- barriers to entry to online retailing will increase as Amazon's more favourable terms will make it more difficult for new entrants to compete
- The Book Depository's policy of free worldwide shipping will end and
- an important supplier of e-books will be removed.

120. All of the above points have been addressed in this decision apart from reduced margins for publishers, which was an area of concern of many of the publishers. In respect of this concern, the OFT notes that a reduction in publisher margins is not in itself a competition related concern. Whether any reduction in publisher profit margins leads to a worsening of competition or consumer welfare would depend on whether the worsened margins would foreclose publishers to such an extent to damage competition in the upstream market of publishing. Alternatively, worsened profit margins may damage the supply chain by reducing publishers' incentives to invest.

121. However, the OFT did not find the evidence on either of these points compelling. Figures submitted to the OFT by publishers (both large and small) show that The Book Depository generally accounts for less than five per cent of their overall sales (in most instances, two per cent or less). Indeed, from 11 publishers who submitted figures to the OFT (six large publishing houses and five small ones) only one publisher – a small publisher – saw The Book Depository account for more than 10 per cent of its overall sales (at 12 per cent). Two publishers submitted that The Book Depository accounted for seven per cent of their overall sales with the remainder submitting that The Book Depository accounted for five per cent or less.[55]

122. Therefore, on the evidence submitted, the OFT does not consider that the merger itself would materially damage consumer welfare by any reduction in publisher margins.

123. Finally, several industry associations made representations to the OFT. These groups raised concerns that the merger may result in: increased prices (either for all book titles or for those in the 'long tail'); reduced supplier margins and a strengthened position (of Amazon) in the sale of e-books. These concerns have been addressed in this decision.

124. One third party association also raised concerns that Amazon will move into the market for imprints (it submits as Amazon has already done in the US) thereby competing head-to-head with publishers, and that Amazon's European base of Luxembourg may give it tax advantages over UK-based retailers. The third party has not highlighted how these concerns are merger-specific and, having considered the arguments itself, the OFT has not considered it necessary to address them.

ASSESSMENT

125. The parties overlap in the online retailing of books in the UK. The OFT has not found it necessary to define the market in this case, but has assessed the merger on the basis of online retailing of physical books in the UK. In

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[55] The figures relate to sales from publishers to retailers, not end consumers. Therefore, it can reasonably be expected that a proportion of these will be exported by the retailer to non-UK consumers.

doing so, the OFT has taken account of the online retailing of all books as well as the best selling books separately from the deep range. Moreover, where the evidence warrants it (for example, survey evidence) the OFT has taken account of bricks and mortar retailer in its substantive assessment.

126. The parties submitted that together they accounted for around [50–60] per cent of physical books sold online (with an increment of around [zero–five] per cent). The OFT is conscious of the difficulties in estimating online sales (paragraphs 42 to 46) and considers that the [50–60] per cent is a lower bound estimate although the information available does indicate that the accretion to Amazon's share of supply as a result of the merger is small (at around [0–5] per cent).

127. In determining whether the merger raises a realistic prospect of a substantial lessening of competition the OFT assessed the merger's impact on prices, delivery charges, the range of book offered and potential competition.

Prices

128. The OFT examined the merger's effect on pricing with reference to the best selling book and the 'long tail' (or deep range). This was partly because Amazon includes The Book Depository in its pricing software for best sellers but does not for the 'long tail'. It is also partly because from the evidence available, the OFT considers that the competitive conditions vary between best sellers and the 'long tail' (for example, online retailers are able to offer a deep range title more readily than a physical store given that an online retailer does not need to hold a stock of books).

129. For the 'long tail', evidence shows that Amazon's price matching of The Book Depository lowered some prices and reduced Amazon's profitability. Amazon submitted that it became apparent that price matching The Book Depository for UK sales was a mistake since The Book Depository was not making the volume of sales that Amazon thought it was (instead, The Book Depository was mostly selling to customers outside of the UK). Upon realising this, Amazon removed The Book Depository from its price matching system for titles in the >40,000 ASIN range.

130. The evidence submitted to the OFT showed that removing The Book Depository for these titles resulted in an increase in Amazon's profits (and the prices for a sizeable proportion of book titles).

131. In addition, the parties submitted evidence showing that The Book Depository received around [ ] per cent of sales lost by Amazon as a result of the price increases and it held a comparatively small share of books sold on Amazon Marketplace for titles in the >40,000 ASIN range (of around [ ] per cent). This indicates, as does the pricing analysis described in paragraph 71, that online competition for these book titles would remain sufficiently strong after the merger, especially from third party sellers on Amazon Marketplace.

132. Therefore, the OFT is satisfied that The Book Depository was not acting as a strong competitive constraint on Amazon.

133. For the best selling titles (which over the course of a year amount to around [ ] titles) the OFT noted that Amazon price matches against [ ].

134. Moreover, The Book Depository's business model is weighted toward the 'long tail' and therefore its UK sales of the top 40,000 ASIN titles account for around £[ ] million (compared with Amazon's turnover for these titles of around £[ ] million).

135. There is some evidence that there is little diversion of sales between Amazon's website and The Book Depository's website; for example the ICM survey (paragraph 78) and the natural experiment of The Book Depository increasing its own sales (paragraphs 82 and 83). These pieces of evidence are not conclusive, however.

136. Price analysis of third party sellers on Amazon Marketplace – where The Book Depository makes the bulk of its sales – found that The Book Depository was the cheapest seller for only [ ] per cent of the titles. For the majority of instances – around [ ] of the time – the cheapest seller was neither The Book Depository nor Amazon itself. The analysis suggests that The Book Depository faces strong competition on Amazon Marketplace and the merger itself does not remove this competitive constraint on it.

137. The OFT also used an upward pricing pressure model, an illustrative price rise, to analyse the merged entity's ability and incentive to raise prices after the merger. Even using cautious diversion ratios between the parties the OFT found only a weak upward pricing pressure.

138. Evidence relating to The Book Depository's own website shows that the sales it makes to UK consumers directly are relatively small and that other suppliers have been able to match The Book Depository in terms of own website sales.

139. The OFT considers on the basis of all of the evidence submitted to it that the merger will not result in increased book prices.

Delivery charges

140. The OFT assessed the merger's impact on delivery charges separately from book prices. It found that [ ]. The OFT has not seen any evidence to indicate that The Book Depository's delivery charge policy has been set with reference to Amazon.

141. Within the UK both parties offer free delivery.

142. Evidence from Amazon internal documents shows that Amazon's delivery charges are [ ]. Further, these documents show that Amazon benchmarks its delivery policy against other broad-based retailers and large specialist retailers, but not The Book Depository.

143. The OFT does not consider that the merger will result in an increase in delivery charges.

Range of titles

144. The OFT received some third party complaints that the merger would result in fewer book titles being offered to consumers, especially in the deep range.

145. The parties submitted that there are a number of third party retailers offering a wide range of titles, including Aphrohead, Blackwells, Waterstone's and Foyles.

146. Moreover, based on The Book Depository's experience the parties submitted that online retailers are well placed to offer a wide range of titles given that they do not need to hold stocks but can instead access a wide range of titles via book wholesalers.

147. Further, the OFT notes that the competitive conditions on pricing of titles in the 'long tail' – which the OFT found are largely unaffected by the proposed merger – also apply to the competitive conditions forcing retailers to offer a wide range of titles.

148. The OFT does not consider that the merger will result in a significantly reduced range of book titles being offered.

Potential competition

149. In terms of whether the proposed merger will result in a substantial lessening of potential competition, the OFT notes that the bulk of The Book Depository's growth has come from overseas sales.

150. Based on the available information its UK sales have fluctuated indicating that UK sales cannot be relied upon to grow strongly in the near future. Further, sales from The Book Depository's own website did not grow strongly last year. Growth has come from sales on Amazon Marketplace where the OFT considers that sufficient competition will remain after the merger.

151. The OFT's investigation has found that entry and especially expansion can be timely and likely. However, given the outcome of its substantive assessment the OFT has not found it necessary to conclude on whether entry and expansion will be sufficient to offset a substantial lessening of competition.

152. The OFT received many third party complaints about the merger. Their concerns, summarised in paragraphs 118 and 119, have been addressed in this decision.

153. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

154. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.

Amelia Fletcher
Chief Economist
24 October 2011