Anticipated acquisition by Emap plc of the remaining shares of Scottish Radio Holdings plc

The OFT's decision on reference under section 33(1) given on 8 August 2005. Full text of decision published 15 August 2005.

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

PARTIES

1. **Emap Plc (Emap)** publishes magazines, organises exhibitions and operates commercial radio stations. Emap's principal radio operations cover the North of England and London. Emap's UK turnover for the financial year to 31 March 2005 was £709m.

2. **Scottish Radio Holdings Plc (SRH)** operates two principal businesses: the publishing of regional newspapers; and the operation of commercial radio stations. SRH's radio operations cover Scotland, Northern Ireland and England. SRH's UK turnover for the financial year to 30 September 2004 was £71.7m.

TRANSACTION

3. On 16 January 2004, Emap acquired a 27.8 per cent interest in SRH, cleared by the OFT on 13 May 2004 (the previous case). On 21 June 2005 the Boards of Emap and SRH announced they had agreed the terms of a recommended cash offer to be made by Lazard & Co., Ltd. on behalf of Emap for the entire issued and to be issued share capital of SRH not already owned by Emap.

JURISDICTION

4. As a result of the transaction, Emap and SRH will cease to be distinct. The UK turnover of SRH exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. 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.

RADIO ADVERTISING

Relevant market

5. Advertising space is sold on analogue and digital commercial radio stations by the merging parties, among others. There are no overlaps between the parties' analogue radio services, as Emap's principal radio operations cover the North of England and London while SRH's radio operations are concentrated in Scotland and Northern Ireland. Although there is a limited overlap of digital radio services, these services do not carry local advertising and the transaction was therefore unlikely to affect competition for local radio advertising. As such, this frame of reference is not considered further.

6. National radio advertisers may be distinguished from their local counterparts as they are typically large-volume buyers constructing advertising campaigns to cover broad geographic areas and tend to purchase advertising airtime centrally through suppliers' sales houses, typically via media agencies.[1] Local advertisers are typically smaller-volume buyers which mainly purchase advertising directly from local radio stations in their chosen locality. Together with the widespread UK coverage of the parties' stations, these demand considerations point to a UK-wide geographic frame of reference for national customers.

7. Emap argued that, in considering the relevant frame of reference to assess the competitive constraints relevant to this merger, it is important to understand the wider constraints facing radio from other forms of advertising. However, the evidence presented, as well as that considered by the Competition Commission (CC) in its Archant/INM report[2], related to local advertising in local press and local radio stations. Indeed, previous reviews of radio mergers (see, for example, the recent CC report into the Galaxy/Vibe merger[3]) have consistently found that radio advertising is not substitutable for other types of media advertising, citing its complementary nature and the specific characteristics that appeal to an advertiser. Third parties who responded to the OFT's enquiries in relation to the anticipated acquisition of Capital Radio plc of GWR Group plc (Capital/GWR[4]) supported (although not universally) the view that national radio advertising was not constrained to a material extent by newspaper advertising. While other media may be a close substitute to radio advertising for some customers, it is not clear

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[1] These advertisers are known in the radio industry as 'national advertisers' although the geographic coverage of their advertising campaigns might not be the entire UK. It might instead be 'multi-region'.
[2] See Competition Commission's report on the acquisition by Archant Limited of the London newspapers of Independent News and Media Limited, 13/10/04.
[3] See Competition Commission's report on Scottish Radio Holdings plc and GWR Group plc and Galaxy Radio Wales and the West Limited, CM5881, 16/05/03.
[4] OFT Decision of 22 December 2004.

that they are a substitute for sufficient customers to warrant inclusion in a wider frame of reference. Accordingly, the OFT believes that, while other advertising media are likely to exert a degree of competitive pressure on radio advertising, the appropriate (if perhaps cautious) approach is to treat national radio advertising alone as the starting point for this competition analysis.

Competition assessment

8. According to Nielsen Media Research, the parties' combined share of national radio advertising revenue in the UK would be 23.6 per cent in the period April 2004 to March 2005.

9. Although the combined entity would be the second largest radio group after Capital/GWR, the parties' combined shares of NAR (net advertising revenue) might not be a good measure of the extent to which Emap and SRH compete with each other for national advertising business. This is because the merger will not create any local overlaps in the parties' radio stations.

10. The absence of geographic overlap suggests that the parties' radio stations may be seen as complements rather than competing alternatives. Whether this is true turns crucially on whether national advertising customers have any strong geographic preference as to the areas in which they advertise.

    - If they do have such a preference, then the lack of any geographic overlap in the parties' stations strongly suggests that they will not be substitutes for each other. Rather, they will primarily be complements. Hence, there will be no (or only a limited) loss of horizontal competition as a result of the merger.

    - On the other hand, if advertisers have no strong geographic preferences when constructing a campaign, they may see the packages of stations offered by Emap and SRH as competing alternatives in the sense that they can substitute different geographic areas to construct a campaign. If this is the case, then the merger might affect competition by removing a key negotiating point for national advertisers constructing a campaign.

11. In Capital/GWR, the OFT considered whether the parties' product offerings, which overlapped geographically to some extent, were complements or competing alternatives. Media agencies and advertisers in that case universally commented that they did consider the precise geographic areas to be covered when developing an advertising campaign. The strength of this geographic preference was said to depend on both the individual campaign and the particular advertiser, which might at first sight suggest that elements of competition exist between the packages of Emap and SRH radio stations.

12. However, those third parties that expressed concerns in Capital/GWR, as well as in the previous case, did not raise a concern about competition between packages of stations. Rather, they did so by identifying specific parts of the UK where they said they could not substitute an alternative radio station for one owned by the merging parties. As explained below, even third parties producing information to the OFT on the availability of competing alternatives did so noting that the alternatives did not always meet their specific geographic requirements. These more localised concerns point to a material focus on geographic areas on the part of media agencies and advertisers, and hence a lack of competition between the general packages of radio stations. In turn, these views would appear to support the argument that since there are no geographic overlaps between the stations offered by Emap and SRH, there is likely to be little competition between them. No third party raised concerns that led the OFT to question the application of this conclusion to the present case. Nonetheless, in the interests of completeness the OFT does consider below the relevant competition analysis on the hypothesis that national advertisers have no geographic preference and thus regard the parties' packages as substitutes.

13. On the basis that national advertisers regard the Emap and SRH stations as complements (which the OFT considers to be the better view on the available evidence), there may be a concern about possible portfolio effects leading to conditional selling arising from the merger. These concerns are considered below.

Horizontal issues

14. Even if the packages of Emap and SRH stations were to be seen as competing alternatives (i.e. substitutes), the OFT does not believe that there would be any realistic prospect of a substantial lessening of competition arising as a result of the merger. This is because post-merger, national advertisers and media agencies will still be able to switch to alternative stations or create a different package with equivalent coverage. Doing so would discipline the commercial conduct of the merged entity (because advertisers would have no strong geographical preference for the area in which they advertise).

15. Emap submitted 'buy-around' analyses which purported to assess the ability for national advertisers to switch away from Emap/SRH stations:

- Emap carried out three buy-around analyses. To lessen the possibility of error due to the differing assumptions underlying these analyses, the OFT requested Emap to conduct these buy-around analyses using two different methodologies: one derived from Nielsen Media Research data and the other two based on hypothetical campaigns. The first analysis constructs two hypothetical campaigns focusing on the parties' two key regions of Scotland and the North West; the second uses Nielsen data to look at actual past national campaigns for the four-week campaign run by a key customer in September 2004; the third methodology attempted to buy around a hypothetical one-week campaign that uses every major Emap and SRH station broadcasting within mainland UK.

- The results generally suggest that it would be possible for customers to construct an equally effective campaign utilizing only competitor stations. However, on some of the campaigns, it was not possible to replicate the exact same reach, geography or demographics, although in some instances the margin of difference between the overall Emap/SRH coverage and the buy-around coverage was narrow.

16. Beyond issues of robustness of the methodology, analysis of these buy-around models raises a number of questions. On the one hand, the analyses may demonstrate more than is necessary: would customers need to switch 100 per cent of spend away from the merged entity in order to discipline it, or would a lesser proportion suffice?

17. On the other hand, there are significant limitations to the probative value of any such analyses: the buy-around evidence suggests that customers have an ability to switch the entirety of their spend to alternative stations, but do not establish whether sufficient revenue would switch (or could reasonably be threatened to switch) in response to a sustained and significant price increase; and in turn whether Emap has an incentive to increase prices post merger.

18. On the latter point, Emap submits that its customers are price-sensitive and would readily switch in response to a post-merger price increase. Emap provided evidence to demonstrate the ease of switching: low switching costs for advertisers; the use of 'Casualty Planning'' to demonstrate the ability to switch as part of negotiations with Emap;[5] and, examples of past campaigns where advertisers chose not to use Emap or SRH stations. Emap also pointed to email communications demonstrating casualty planning and internal spreadsheets indicating that Emap attempts carefully to track competitors' prices. The evidence provided is consistent with the proposition that advertisers can and in fact do switch between providers.

19. In these circumstances, the available evidence points to the conclusion that, even if Emap and SRH compete using packages of stations for national radio advertisers

[5] Casualty Planning according to Emap is the term used by agencies and advertisers when they drop from subsequent campaigns a provider from whom they do not receive favourable terms, switching instead to a competitor offering better terms.

which do not have any geographic preference for their advertising, there will post merger remain clear alternatives for national advertisers to switch away from the merged entity. Accordingly, this evidence, together with the views set out above regarding the prospects for competition between packages of Emap and SRH stations, does not lead the OFT to believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition in relation to national radio advertising.

Portfolio effects

20. In the previous case (as well as in Capital/GWR), third parties were concerned about possible portfolio effects arising from the merger of the complementary Emap and SRH radio stations. Third parties feared that the merged entity's larger portfolio of stations with greater geographic reach may give it the ability and incentive to tie (i.e., sell conditionally) or bundle (i.e., price at a discount) sales on less desired stations with high-demand stations. A few third parties raised the issue in relation to this case, although they did not see the merger as changing either parties' position so as to substantially lessen competition. Nonetheless, the issue is addressed here.

21. Mergers between firms that do not supply directly competing products rarely lead to a substantial lessening of competition solely as a result of their conglomerate effects.[6] Portfolio effects – arising from the combination of the merging parties' services – may however be anti-competitive where they directly affect market structure, increase the feasibility of anti-competitive strategies and/or eliminate the competitive constraint imposed by firms in a neighbouring market.[7]

22. First, as regards changes to market structure, portfolio effects are generally pro-competitive since they tend to lower customers' buying costs (as customers can now buy the same range of services by dealing with fewer suppliers). However, a merger may substantially lessen competition if competitors unable to offer the same portfolio of products cannot provide a sufficient competitive constraint on the merged parties.[8] In this regard the prospect that the combination of Emap's and SRH's respective packages of stations would provide a compelling 'one-stop shop' for radio advertisers is remote. Given the relatively limited number of radio groups that currently exist, as well as the fact that Emap already has a 27.8 per cent interest in SRH, this further acquisition of the remaining shares of SRH would be a small change for national advertisers that would not materially affect their

[6] See OFT publication, *Mergers – substantive assessment guidance*, OFT 516, May 2003 para 6.1

[7] See OFT publication, *Mergers – substantive assessment guidance*, OFT 516, May 2003 para 6.2

[8] See OFT publication, *Mergers – substantive assessment guidance*, OFT 516, May 2003 para 6.3

transaction costs. Indeed, the available evidence indicates that national radio advertisers select the best available stations from the range of alternatives to meet the campaign's objectives. This already involves dealing with most of the radio groups. Moreover, this was not a concern raised by third parties.

23. Second, it is possible that a merger could give rise to a substantial lessening of competition if the merged firm controls complementary products and is able to engage in tying or bundling behaviour so as to require or encourage customers to purchase a range of products from the merged firm when they would not otherwise buy the full range. Such conduct is likely to result in adverse effects, however, only if it would be difficult for rivals or new entrants to provide competing bundles better tailored to customers needs.[9]

24. There are real doubts that the merged Emap/SRH would have the ability to engage in these sorts of tying/bundling strategies.

- Unlike the previous case, some third parties identified a number of SRH and Emap stations that they felt were 'must-buy' as they faced no local competition. However, none saw the merger as substantially magnifying the parties' pre-merger ability to sell conditionally. In addition to the buy-around analysis, Emap also pointed to the decline in its share of advertising in 2004 and 2005 due to [ ].

- There appear to be few regions where customers have to deal with the merged entity. The first buy-around analysis indicated that it was indeed possible to buy around the parties' most demanded areas, the North of England and Scotland. Emap additionally points out that it would be possible for an advertiser to obtain much the same geographic coverage in Scotland as could be achieved with SRH through advertising on alternative local stations (Real Radio combined with other Scottish local broadcasters).

- Emap does not currently agree discounts for purchasing across several of its stations.

25. There is no real prospect that Emap/SRH would have the incentive to engage in such strategies.

- Since there is no overlap in the parties' radio stations, any area in which the merged Emap/SRH would be a 'must-buy' would exist already. In other words, if there were a well-founded concern here about the ability and incentive to engage in conditional selling strategies (or tying) then it would

[9] See OFT publication, *Mergers – substantive assessment guidance*, OFT 516, May 2003 para 6.4

also exist pre-merger. There is however no evidence that either Emap or SRH currently engages in conditional selling (or that Capital/GWR has done so post merger). Furthermore, those third parties that raised the concern also pointed out that customers were unlikely to accept bundled deals if they were not financially attractive.

- Even taking account of the reservations expressed above about the various buy-around analyses presented to the OFT, national advertising customers may be able to buy-around the merged entity and could use this ability to discipline it.

- Any attempt by the merged entity to leverage its position in Scotland in relation to clients wishing to achieve coverage on local Scottish radio would be countered by the ability of the agency to switch volumes for the great majority of clients for whom Scotland is not a priority.

- As a matter of economic reasoning, it would seem more attractive to Emap/SRH to extract maximum revenue from its most highly demanded stations without engaging in strategic behaviour (such as tying). Tying tends to reduce value for money to a customer, inducing the customer to reduce purchases of the less heavily demanded station and thereby reducing profit for the firm overall. This would only be a profitable strategy in the long-term if the effect of the conduct is to foreclose competitors.

- There is no substantive evidence to suggest that a tying or bundling strategy engaged in by Emap/SRH would succeed in foreclosing competitors to the extent that Emap/SRH would be able to raise prices to its national advertising customers.

- Emap has provided us with several examples of e-mails from national advertisers/media buying agencies seeking to negotiate on prices and threatening to cease spending with Emap altogether and rejecting deal offers not competitive compared to other options on offer and the pricing position of competitors (Casualty Planning). This indicates, as Emap submits, that customers are extremely price sensitive and can, at present, easily threaten to switch away from Emap.

- National advertising customers, such as media agencies, are large and sophisticated purchasers. The top five media agencies account for 50 per cent of all national radio advertising revenue. Emap's largest customer would still account for around [ ] per cent of its revenues and the top 7 customers will account for [ ] per cent. These agencies can retaliate against individual radio groups. Media buyers in previous cases agreed that, with the ability to switch 100 per cent of their purchases to other stations, they enjoyed buyer power. The loss of a bargaining point may reduce that buyer power slightly, but it is not clear that the loss is sufficient to amount to a substantial lessening of competition.

Conclusion

26. The OFT undertook extensive third party enquiries in this case (and also in both the Capital investigation and the previous case). We asked questions of those with concerns so as to understand how they thought the merger would lead to price increase or foreclosure and to ensure they were given the opportunity to put forward evidence related to such concerns.

27. Although the theories advanced in those investigations may be more than fanciful, overall, there is little substantive evidence arising from those investigations or this procedure supporting the case that the portfolio effects arising from this merger may lead to foreclosure concerns, or that the merger significantly increases the ability and incentive to do so. In the absence of such evidence, the OFT does not believe that a merged Emap/SRH would have either the ability or the incentive to engage in the sorts of anti-competitive conduct described above, and therefore substantially lessen competition in national radio advertising.

DIGITAL SERVICES

Relevant market

28. A multiplex is essentially a platform for digital radio. Ofcom has licensed 46 local/regional multiplexes and one national multiplex, on which Digital Sound Programme Service Providers (DSPSP) contract to provide programming. Both the licence and the DSPSP agreements typically last for 12 years. No operator may have interests in two local multiplexes which share an overlap of more than 50 per cent, and no operator may provide more than four digital sound programme services in a local radio multiplex area unless they control less than 55 per cent of the total 'points' in that area.

29. Although digital multiplexes will come into common ownership as a result of this transaction, there is no overlap in the coverage of the multiplexes operated by SRH and Emap.

Competitive assessment

30. One third party was concerned that the parties could increase prices to other users of multiplex capacity as it will have an interest in 13 of the 36 current

multiplexes and thereby foreclose them from the growing digital radio sector. For the reasons explained below, the OFT does not consider there to be any realistic prospect of this merger resulting in a substantial lessening of competition on the basis stated above.

31. The prospect of foreclosure seems remote for the following three reasons.

- Since contracts between multiplex operators and DSPSs tends to be for the full duration of a multiplex licence and typically include prescriptive pricing terms covering the full duration of the contract, there is little scope for any price increases over the lifetime of existing contracts.

- Ofcom's regulatory framework requires multiplex operators to offer non-discriminatory access terms and conditions to all DSPSPs. Current over-capacity on some multiplexes means the scope to increase prices to a new DSPSP is limited.

- Ofcom could, if necessary, discipline the merged entity by releasing more multiplex capacity.

THIRD PARTY VIEWS

48. A few third parties raised the issue of portfolio effects and one third party raised a concern relating to access to digital multiplex capacity, both of which are addressed above.

ASSESSMENT

49. Emap and SRH overlap in radio programming to listeners, national and local advertising airtime to advertisers, and digital multiplex services. Emap received OFT clearance to acquire material influence over SRH (it currently has a 27.8 per cent shareholding in SRH) and has sought confidential guidance in respect of the proposed acquisition of the remainder of SRH's shares. None of the parties' radio stations overlap geographically; indeed, they cover largely different parts of the UK. Post acquisition, Emap will account for just around 25 per cent of UK net national advertising revenue from radio.

50. Our assessment focused on supply of radio airtime to national advertisers as the parties have no analogue and limited digital radio overlap in respect of local advertisers. While some customers may view Emap's and SRH's stations as substitutable, the balance of evidence uncovered in Capital/GWR suggests that radio groups whose stations overlap little are really complements: this is because the specific geographic area targeted is a consideration in planning all advertising

campaigns, hence substitution across geographic areas (and between radio stations in different areas) is difficult. In any event, even if there were some degree of competition between Emap's and SRH's packages of radio stations, the available evidence leads the OFT to believe that there will be clear possibilities post-merger for national advertisers to switch away from the merged entity to alternative stations (such as those provided by the significantly larger Capital/GWR group) when building a package of stations for a national campaign. Furthermore, a number of third parties felt this merger may indeed be of some benefit as it would serve to enhance rivalry in the industry by creating a more effective competitor to Capital/GWR.

51. A few third parties raised the issue of portfolio effects. However, the OFT believes that the prospects of a combination of Emap's and SRH's respective packages of stations providing a compelling 'one-stop shop' for radio advertisers are remote. As regards the possibility that the merger might change Emap's and SRH's incentives to engage in tying or bundling strategies to anti-competitive effect, although the theories advanced in the previous cases mentioned above may be more than fanciful, overall, information gathered in the course of both the previous case and Capital/GWR, as well as in this case, have uncovered little evidence supporting the case that this merger significantly increases the ability and incentive of Emap and SRH to engage in such strategies. In both case, national customers will retain significant buyer power which, although possibly reduced by the merger, is still considerable.

52. Finally, one third party raised a vertical concern in relation to access to DAB multiplex capacity. We find there is no realistic prospect of a substantial lessening of competition as the parties' respective multiplex holdings do not overlap geographically. As to their ability to engage in exclusionary conduct, Ofcom's control over the bidding process for new multiplex licences would address any putative concern about intensity of bidding competition. In addition, the regulatory framework for multiplex operator licences, existing long-term contracts and the availability of new multiplex capacity will discipline the merged entity's operation of its digital multiplex interests.

32. 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

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