

CLASSIFIED DIRECTORY ADVERTISING SERVICES

Statement of issues

Introduction

1. On 5 April 2005 the Office of Fair Trading (OFT) referred the supply of classified directory advertising services (CDAS) in the UK to the Competition Commission (CC) under section 131 of the Enterprise Act 2002.
2. For the purposes of this reference, 'classified directory advertising services' means the undertaking and performance of engagements to publish advertisements in printed directories which:
 - (a) show suppliers of goods and services classified by reference to the goods or services supplied; and
 - (b) are distributed wholly or mainly to consumers.¹
3. The CC is required to determine whether any feature of the market prevents, restricts or distorts competition.² If this is so, there will be an 'adverse effect on competition'. The competition issues set out in this statement are those which may be of relevance to our eventual decision. We have not yet reached conclusions on any issue set out in this statement.
4. This issues statement is based on the evidence so far submitted to us in writing and at hearings by, for example: CDAS providers, advertisers, trade associations and other interested parties.³ Its purpose is to show the nature of the issues raised and to invite comment on these or any other relevant issues. We plan to hold further hearings with interested parties during September and October 2005. Following these hearings, we expect to publish an 'emerging thinking' document for consultation. We may then hold further hearings before publishing our provisional findings. If we were provisionally to find that there were adverse effects on competition, we would then consider possible remedies.

Previous inquiry

5. Following a report on the market by the Monopolies and Mergers Commission in 1996,⁴ British Telecommunications plc gave undertakings in relation to its CDAS business; these undertakings were reviewed by the OFT in 2001. This business is now owned by Yell Group plc (Yell). These undertakings (the Yell Undertakings) include a price control and a restriction that prevents Yell publishing more than one directory in any area.⁵

¹See document *Note on scope of the reference* on the CC website: http://www.competition-commission.org.uk/inquiries/ref2005/classdirec/cdas_note_on_scope_of_the_reference.pdf.

²Section 134 of the Enterprise Act 2002.

³Submissions from main and third parties are on the CC website, www.competition-commission.org.uk.

⁴Classified Directory Advertising Services, Cm 3171, a report by the MMC, March 1996.

⁵As an exception to this rule, Yell was permitted to have overlapping distribution areas if, two years after the date of the undertakings, no other provider had entered into the overlapping areas.

Presentation of the issues

6. The issues which appear to be relevant to the judgement as to whether any feature of the market prevents, restricts or distorts competition are detailed below under the following headings: market definition, barriers to entry and expansion, market structure and regulation, pricing, the nature and extent of competition, and profitability as an indicator of the extent of competition. We also consider possible detrimental effects on advertisers and users, the possible applicability of Articles 81 and 82 of the EC Treaty, and indicate the focus of our analysis.⁶

A. Market definition

7. Identifying the relevant economic market or markets provides the framework within which our assessment of competition and the effects of market features can be carried out. We note that different advertisers may take different views of the substitutability and complementarity of different types of media, depending on their individual circumstances.
8. Our present working hypothesis is that the supply of printed classified directories, in the UK, may be regarded as the relevant product market, and that this market may also extend to certain online services, but that other forms of classified advertising, such as in newspapers, are not part of the relevant market. However, we are considering the following issues in more detail:
 - (a) whether the following form part of the relevant product market:
 - (i) online⁷ classified directories, such as those published by the main providers of printed classified directories;
 - (ii) certain of the services of internet search engines;
 - (iii) some telephone directory enquiry services;
 - (iv) classified advertising in newspapers, specialist magazines or the trade press;
 - (v) any directories that do not classify suppliers of goods or services by reference to the goods or services supplied; and
 - (vi) specialist directories, for example those that do not cover a wide range of services or those that are targeted at particular groups;
 - (b) whether local printed classified directories supplied by small providers form part of the same product market as printed classified directories supplied by national providers;
 - (c) the likely development of CDAS, particularly online services, and the possible effects on the definition of the relevant market in the short and medium term;

⁶In addressing the issues that appear to arise in this inquiry, the CC has adopted the approach set out in the guidelines for market inquiries in its published document Market Investigation References: Competition Commission Guidelines (CC3). (A copy of this document is on the CC's web site. The relevant sections of CC3 for the purposes of this statement of issues are Parts 2 and 3.)

⁷Including online services provided to mobile telephones and similar mobile devices.

- (d) the extent of the geographic market and the significance of national, local and regional aspects; and
- (e) whether and to what extent the definition of the relevant product or geographic market is influenced or determined by the size or business type of the various advertisers (eg whether the market definition would be different for small plumbers to that for large insurers).

B. Barriers to entry and expansion

9. We will consider the barriers to entry and expansion for the relevant market(s), in particular:
 - (a) whether there are ‘network effects’—ie whether the value of directories to their users and advertisers is greater the more advertisers advertise—and the scale of any such effects;
 - (b) whether there are other economies of scale, scope or density derived from activities such as:
 - (i) advertising sales operations;
 - (ii) printing and distribution (of printed classified directories);
 - (iii) marketing;
 - (iv) supply of both printed and online services;
 - (v) opportunity to sell data to other firms; and
 - (vi) presence in other media markets, such as newspapers;
 - (c) the extent of any advantages of having a strong brand in the relevant market(s); and
 - (d) whether, as has been suggested to us, the Yell Undertakings effectively create barriers to entry.
10. We will consider and evaluate the possible strategies available to a new entrant, for example whether to enter on a national or regional basis, or using a printed or online product, or both.
11. We will consider whether there is an effective limit to the number of printed classified directories that can compete at a national level.

C. Market structure and regulation

12. The supply of printed classified directories has been highly concentrated. The OFT estimated that the two largest providers, Yell and Thomson Directories Limited,⁸ account for over 90 per cent of supply in the UK, with Yell accounting for a very large

⁸Thomson Directories Limited is wholly owned by SEAT Pagine Gialle S.p.A via the UK holding company TDL Infomedia Limited.

proportion of this. However there has been some market entry, most notably by BT Group plc (BT) in 2003 and Trinity Mirror plc (Trinity Mirror) in 2004.⁹ We will consider:

- (a) what the accurate figures for share of supply are at the national level and any other relevant levels;
- (b) how the level of concentration has changed, the background to this and how it can be expected to change in the future; and
- (c) whether the level of concentration has any effect on the conduct of some or all providers or advertisers.

Regulation

13. We will study the effects of the Yell Undertakings on Yell's conduct and on competition in the market. We will consider:

- (a) the extent to which Yell's prices have been set to the levels permitted by the price control and the extent to which they have been lower than this;
- (b) the effect of this price control on other market participants;
- (c) whether the Yell Undertakings have had any effect on product development or innovation;
- (d) whether Yell has undertaken particular actions to maximize its revenue because of the Yell Undertakings, and whether these actions have had favourable or unfavourable effects on advertisers, users or competitors;
- (e) whether the price cap does or could facilitate coordination by market participants; and
- (f) whether the restriction on the publication of new directories has had favourable or unfavourable effects on advertisers, users or competitors.

D. Pricing

14. We will examine pricing and sales within the market. We will consider:

- (a) how prices are negotiated or set;
- (b) how list (ratecard) and realized prices, and sales have moved over time; to do this we will need to consider how best to compare prices over time—possibly using representative prices or indices;
- (c) the factors underlying any price trends;
- (d) how directory providers' prices compare with each other and the reasons for differences; and

⁹BT now includes a classified directory as part of *The Phone Book*. Trinity Mirror, whose business activities are largely related to newspaper publishing, publishes directories called *The One Directory* in parts of Scotland and previously distributed a classified directory called *The Glaswegian*.

- (e) the effects of the Yell Undertakings.

E. The nature and extent of competition

15. We will consider the nature and extent of competition, including:

- (a) the relationship between competition to attract advertisers and that to encourage usage of directories;
- (b) any inferences that may be drawn from pricing and sales data and from analysis of profitability;
- (c) the likely development of CDAS, particularly online services, and how this might affect competition;
- (d) the effects on the market and on competition of recent new entry;
- (e) whether certain local areas, for example Kingston upon Hull, have different competitive patterns, and what general conclusions, if any, can be drawn from such areas;
- (f) what factors determine whether advertisers regard:
 - (i) Yell's printed classified directories as 'must-have' products;
 - (ii) other printed classified directories published by national providers of CDAS as potentially acceptable substitutes for Yell's directories;
 - (iii) printed classified directories published by providers that offer CDAS only on a local or regional basis as potentially acceptable substitutes for printed classified directories published by national providers of CDAS; and
 - (iv) online classified directories as potentially acceptable substitutes for printed classified directories;
- (g) why advertisers choose to advertise in one directory rather than another;
- (h) how advertisers allocate their budgets to, or between, printed classified directories and online media;
- (i) patterns of switching by advertisers between directories, the factors that cause advertisers to switch and the extent to which switching constrains prices;
- (j) whether Yell has a unique, non-replicable position deriving from its registered trademarks, in particular 'Yellow Pages' and the 'walking fingers' logo, and from its 'first mover advantage';
- (k) whether and to what extent the various agreements reached between CDAS providers and internet search engines are significant;
- (l) the reasons for and consequences of changes in the geographic scope of directories (known as 'rescoping'); and
- (m) any effects on the market for CDAS of CDAS providers' activities in adjacent markets, including:

- (i) if online directories are not part of the relevant market, any effects of participation in the online market by CDAS providers;
- (ii) the effects on BT of:
 - its obligation¹⁰ to make available phone books (the alphabetic listings) and the cost sharing and marketing advantages that might arise from combining classified listings with the phone books;
 - its operation of the operator services information system database;¹¹ and
- (iii) whether and to what extent an involvement in the publication of newspapers facilitates entry.

F. Profitability as an indicator of the extent of competition

16. We will need to consider whether profits substantially in excess of those that would be regarded as normal for a market of this type, measured over an appropriate time period, of any firm or firms that represent(s) a substantial part of the market, are earned on supplying CDAS. We are therefore considering the most appropriate manner of assessing profitability, taking account of the inherent difficulties in valuing the intangible assets owned by the major participants. We will consider:
- (a) whether measures that relate to return on investment such as internal rate of return (IRR), truncated IRR¹² and return on capital employed are appropriate, and if so:
 - (i) whether the appropriate asset bases can be suitably valued;
 - (ii) how to determine the appropriate cost of capital;
 - (b) whether return on sales is an appropriate measure to use, and if so, how to identify suitable benchmark companies that may be used as comparators;
 - (c) whether there are other appropriate ways of assessing levels of profitability;
 - (d) what the appropriate time period for measurement is;
 - (e) after considering the various measures, whether profits are excessive; and
 - (f) whether any excessive profits are due to excessive pricing or other factors and whether these are likely to be sustained.

¹⁰General Condition 8.2 obliges BT to ensure that each subscriber, on request, is supplied with a printed directory containing directory information.

¹¹This database is known as 'OSIS'. Under BT's Specific Universal Service Condition 7.2(a) and 7.4, BT is obliged to maintain an up-to-date database containing directory information for all telephone subscribers and to make available, on request, the contents of the database to any person seeking to provide publicly-available directories, on terms that are fair, objective, cost-oriented and not unduly discriminatory.

¹²A truncated IRR only considers a subset of the relevant cash flows whereas a conventional IRR considers all historic and expected future cash flows. This approach may be used for two reasons: to study profitability over a finite time period; and because of the difficulties of obtaining good data on all historic and anticipated cash flows. To calculate the truncated IRR, one considers the opening value of the assets, the cash flows over the period under consideration and the closing values of the assets. The truncated IRR is then the discount rate at which the Present Value of a stream of cash flows over a period of years plus the discounted value of the closing assets at the end of that period of years equals the opening value of the assets.

G. Possible detrimental effects on advertisers and users

17. We shall determine whether any effect on advertisers or users in the form of higher prices, lower quality or less choice of goods and services, or less innovation has resulted from, or may be expected to result from, any adverse effects on competition in the relevant market or markets.

H. The applicability of Articles 81 and 82 of the EC Treaty

18. In the light of the EC Modernization Regulation,¹³ we will consider whether Articles 81 or 82 of the EC Treaty may be applicable to any agreements or conduct in the relevant market or markets.

I. Focus of analysis

19. While we have yet to reach a view on any of the issues set out above, the evidence received to date leads us to concentrate our analysis principally on:
- (a) whether online directories are part of the relevant market; if not, the extent to which they will provide a constraint on the market for printed classified directories in the medium term;
 - (b) whether internet search engines are part of the relevant market; if not, the extent to which they will provide a constraint on the market for printed classified directories in the medium term;
 - (c) the extent of any barriers to entry into or expansion within the relevant market—in particular due to network effects, economies of scale, scope and density, and the importance of branding—and whether there is an effective limit to the number of printed classified directories that can compete at a national level;
 - (d) the significance of new entry to the market and particularly that by Trinity Mirror and BT, including the extent of any particular advantages that BT might have;
 - (e) the effects of the Yell Undertakings; and
 - (f) whether levels of profitability, in conjunction with other evidence, suggest that excessive prices are being charged.

¹³Council Regulation 1/2003/EC, Article 3(1).