



POLIT CASE
COMPETITION

Partner Pre-Case 2020

INTRODUCTION TO THE DANISH COMPETITION AND CONSUMER AUTHORITY

The Danish Competition and Consumer Authority (DCCA) works for well-functioning markets that can stimulate growth and innovation beneficial for the Danish society.

On well-functioning markets, businesses compete effectively on all aspects, and consumers choose the goods and services that are most relevant and useful to them.

The Danish Competition and Consumer Authority is a government agency under the Danish Ministry of Industry, Business and Financial Affairs.

Primary tasks

The Danish Competition and Consumer Authority contribute to the development of new politics and regulation. We analyse the markets based on both competition and consumer aspects and put forward recommendations to consumers and companies.

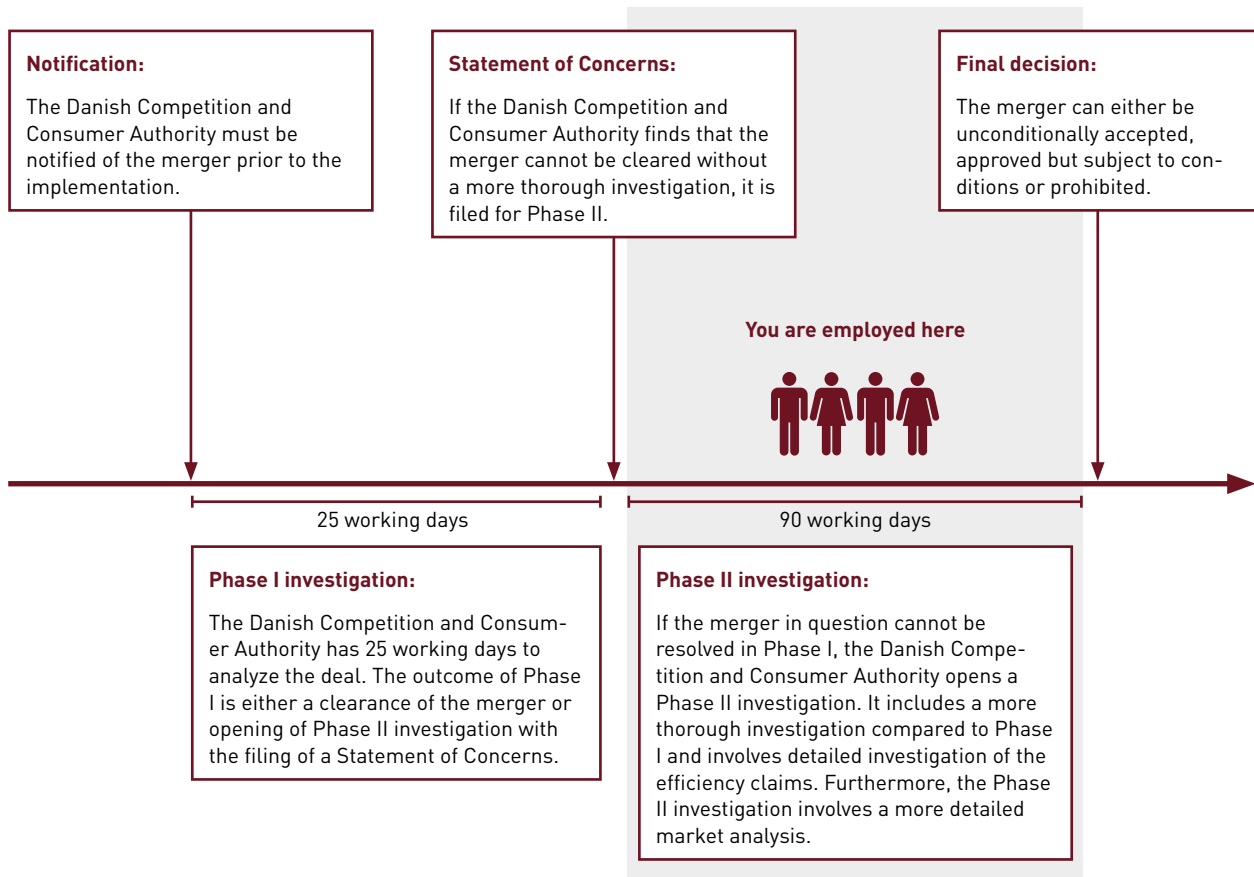


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INTRO TO THE CASE

The Danish Competition and Consumer Authority has received a notification of a merger of two physical bookstore chains, in which Børks Bøger takes full control over Det Nye Kapitel. You have been asked to carry out the Phase II investigation of the merger and present your final recommendation to the Competition Council of whether to approve or prohibit the merger.

TIMELINE FOR MERGER CONTROL



GUIDELINE FOR MERGER CONTROL

In a merger between two competitors (horizontal merger), DCCA compares the expected competitive conditions if the merger is completed to a hypothetical counterfactual, in which the merger was never initiated. In most, but not all, cases the relevant counterfactual is approximated by the current (pre-merger) market conditions (the Status-Quo).

The assessment includes an identification of the relevant markets and products in order to evaluate the competitive constraints the merging firms face. Secondly, DCCA assesses the unilateral and the coordinated effects. The unilateral effects deal with the possibility and incentive of the merged firm to increase prices (or reduce product quality) after the merger. The coordinated effects may occur if the merger increases the risk of tacit collusion, as greater market concentration makes it easier for firms to create or sustain the conditions conducive to the coordination of prices or the sharing of markets.

THE LOSS OF COMPETITION/ EFFICIENCY TRADE-OFF:

When two firms merge, there are two direct effects on pricing incentives. First, the merging firms no longer compete to attract customers, all things equal, this encourages higher prices (loss of competition). Second, the firms' assets can now be managed jointly to achieve efficiencies: this can lower marginal costs, encouraging lower prices.

DCCA evaluates the merger using both quantitative and qualitative tools. Qualitative measures consist of consumer surveys and strategic considerations, e.g. entry barriers, buyer power and threat of potential competition, etc. The quantitative measures may be based on market data such as market shares and other more advanced statistical measures.

In Phase II, DCCA examines the proclaimed efficiencies from the merger stated by the companies. These efficiencies could be cost-saving, risk-sharing etc. These efficiencies must fulfil three requirements:

1. Verifiable: Expected efficiencies should be sufficiently documented to ensure that they will be achievable
2. Merger specific: It should not be possible to achieve the same efficiencies through less distortive means (than the merger)
3. Most likely be passed on to the consumers

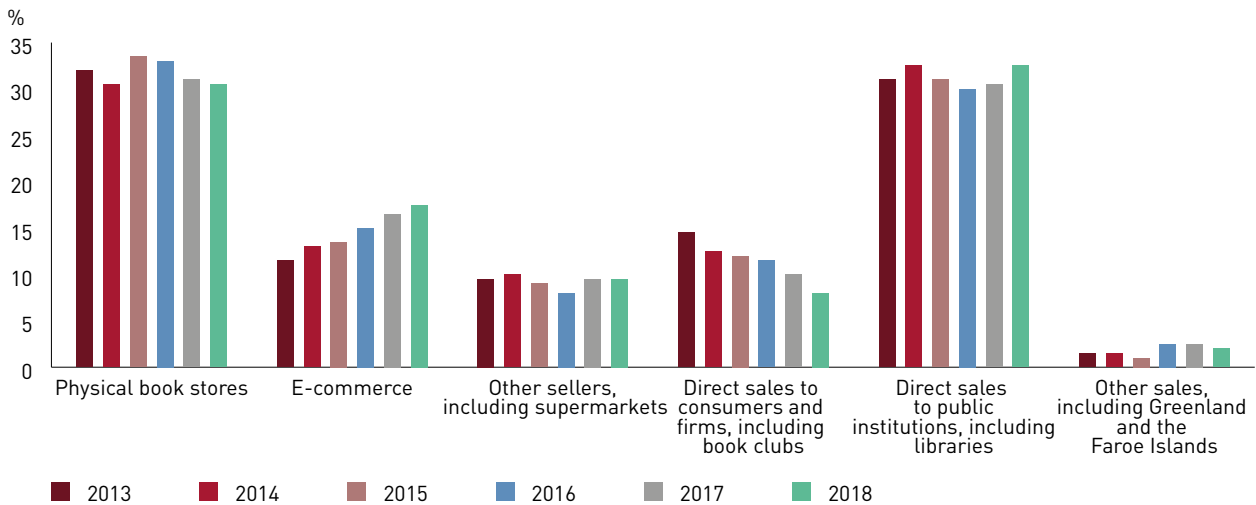
This enables DCCA to verify these proclaimed efficiencies in order to balance the positive- and negative effects of the merger.

THE DANISH BOOK MARKET

Since the liberalization of the book market in 2011, the Danish book market has been characterized by a considerable price competition. In addition, the digitalization seizes new opportunities in terms of how books are acquired, but also in terms of how they are read.

Among the available data of the Danish book market is the publisher sales to the different sales channels. Note, the data covers the supply from the publishers to the different sales channels. There is no comprehensive end-consumer data available.

FIGURE 1: PUBLISHER'S SALES CHANNELS

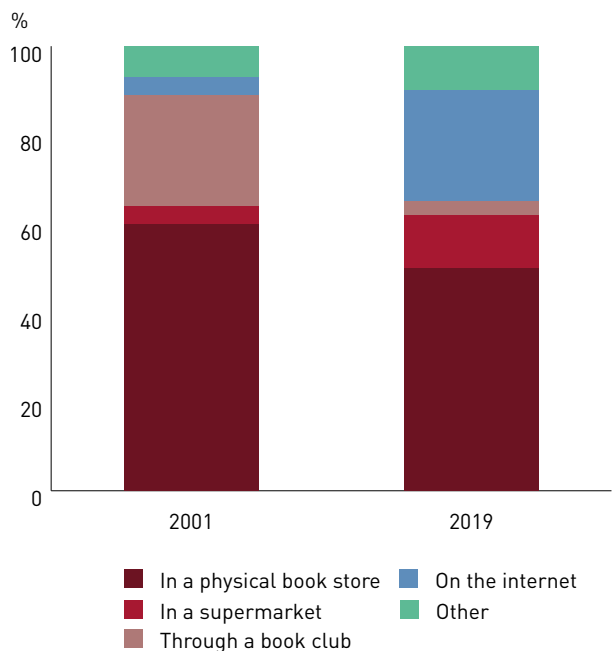


The Danish Booksellers Association is conducting an annual survey where they ask the customers where they last bought a book. The first results of the survey in 2001, as well as the latest result in 2019, are found in figure 2.

Beyond the trend in figure 2, where purchases in a physical bookstore still dominate, there has been a rise in all electronic markets, including e-readers, audio books and streaming. See the data file for further details.

In order to correctly assess the market trends, it is important to consider if these trends are driven by migration or substitution. Migration from one type of sales category to another is caused by a change in preference, i.e. convenience of online buying or preference for reading in a physical book. On the other hand, substitution is the change in demand caused by a change in the relative prices. This distinction is important, since the latter poses a competitive constraint on the bookshops ability to raise prices, while the former does not.

FIGURE 2: ANSWERS TO THE QUESTION: "WHERE DID YOU PURCHASE YOUR MOST RECENT BOOK?"



INTRODUCTION TO THE MERGING FIRMS

The market for traditional bookstores has historically been dominated by two firms. In the past couple of years, the two firms have experienced declining sales and squeezing profit margins. The management in the two firms have in their letters to shareholders repeatedly claimed that the falls in profits are caused by the changing market environment and the presence of new disrupting competitors.

The management of the two firms have after an extensive analysis of the situation concluded that the “the best solution is to merge” into one consolidated firm. The following is a summary of the firms’ notification of the merger to the DCCA.



COVER LETTER for the notification of merger between
Bjørks Bøger and Det Nye Kapitel

Dear DCCA,

We hereby notify the merger between Bjørks Bøger and Det Nye Kapitel. This merger will enhance the competition in the Danish book market since it is threatened by large foreign firms and new technologies for which we do not have enough capital to invest.

We base this on the following reasons.

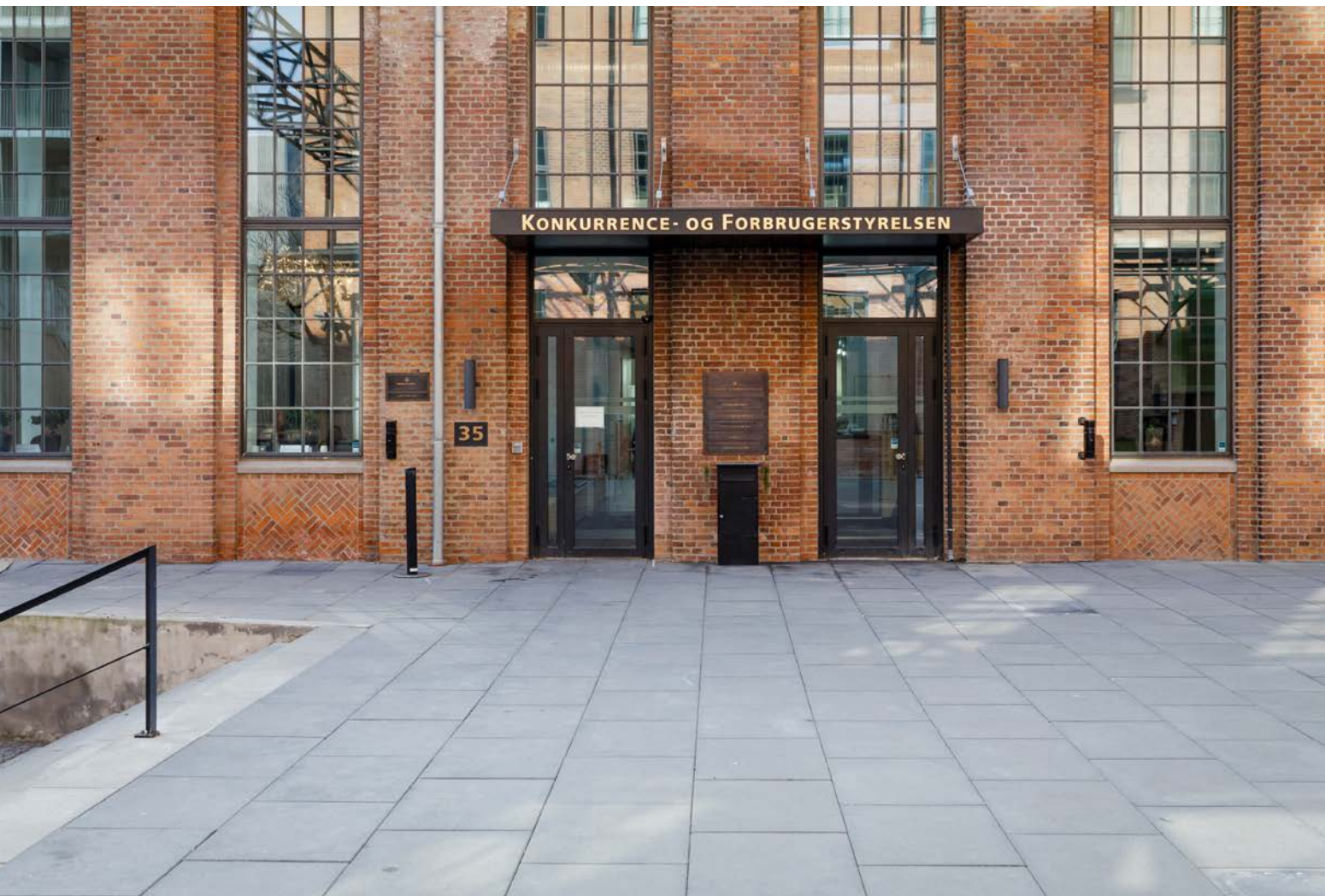
- The relevant market is the market for books in Denmark, in which Bjørks Bøger has a 13,7 % market share, Det Nye Kapitel has a 9,2 % market share for a combined market share of 22,9 %.
- A merger will exploit synergy effects, which will reduce the fixed costs such as cost involve with IT systems and administrative operations. An exhaustive list is in the data file.
- A consolidated firm will combine assets and know-how to successfully invest in digitalization, offering both better solutions and products to the customer.
- A consolidated firm will have significant bargaining power against the suppliers. Hence it will be possible to secure input price reductions which passed on to the consumers in terms of lower prices and a broader selection of books.
- Based on the above-mentioned arguments, we estimate a total efficiency gain in marginal costs of 25 % in the case of a merger.
- Lastly, the ongoing trend in the market is worrying. Global tech companies such as Amazon are gaining market shares by aggressive price policy. The merger is fundamental for creating the capacity needed to transform our business to accommodate the digitalizing and thereby stay competitive in the future.

The merger will benefit the consumers in many aspects. Consumers prefer to buy their books in physical stores, and without consolidation in the Danish book-retail sector, traditional bookstores will be history in just a few years. The market for books will be dominated by a few large foreign tech-companies worsening the quality and supply of books. However, the traditional bookstores can maintain its competitive level following the merger benefiting the consumers.

Kind regards,

Bjørks Bøger

The DCCA has conducted a preliminary market investigation based on the firms' merger notification. The DCCA has found aspects which potentially could impede competition and must be further scrutinized. These preliminary conclusions are outlined in the Statement of Concerns (SoC). The DCCA has identified the following aspects that they believe might be worth investigating further, which are summarized in the following SoC.



Summary of statement of concerns:

The merger between Bjrks Bøger and Det Nye Kapitel

To: Bjrks Bøger and Det Nye Kapitel,

The following paragraphs highlight the statement of concerns, related to the matter of the merger between Bjrks Bøger and Det Nye Kapitel, notified January 15th, 2020.

The Danish Competition and Consumer Authority finds that the merger raises several preliminary competition concerns and the DCCA will therefore investigate the merger in detail before arriving at the conclusion. The hypotheses on which this statement of concerns is based revolves around the size of the merger, potential coordinated effects and the large chunk of consumer that will be negatively affected by this merger, but there are also some potential positive outcomes which are identified too.

1. The relevant market

The relevant market is tentatively defined as the retail market for books in Danish, which includes physical stores, online sale of physical books and e-books. Questions for further investigation includes whether i) the market can be further segmented into physical books and e-books, ii) the relevant market also includes streaming of books and audiobooks, iii) the relevant market also includes direct sales by publishers through book clubs and to libraries, schools and other public institutions. We are concerned that the market defined by the merging firms is too broad, specifically with the inclusion of the public channel.

2. Competition considerations

The Danish Competition and Consumer Authority has found basis for further and more detailed analysis on the matter. The merger leads to a significant increase in the concentration of the relevant market to the potential harm of consumers in terms of higher prices, smaller book variety and lower quality of service. The DCCA have not yet fully investigated the market trends, especially the effects of the new technologies in the market and the rise of book sales through non-bookshop retail stores (e.g. supermarkets).

Kind regards,

Kenneth Baltzer

Chefkonsulent/Chief Special Advisor

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CASE QUESTIONS

Your task is to carry out Phase II of the investigation and ultimately recommend to the Competition Council, whether the proposed merger should be approved or prohibited. You are expected to answer the following three questions, however, you may freely choose the order in which you present them.

QUESTION 1

Asses the current state of the book market, including the development towards e-commerce and electronic books

You can base this part of the analysis on the data we have provided. It is important that your analysis is a holistic coverage of the market, both in terms of historical development and projections for a short and medium-term horizon. You may also consider the different actors on the market, the consumers and potential barriers to entry. You must include a brief discussion of the reasons for the described trend, which can include, but is not limited to, a discussion about whether the trends are primarily due to a migration or a substitution.

QUESTION 2

Examine the impact on the economic competition of the proposed merger, including identification of the relevant market affected by the merger

Your analysis may include, but is not limited to, qualitative and quantitative considerations in relation to the market and competition such as effect on price, quality or accessibility of books whether this being physical or electronic. You should critically asses the statements and estimates from the management of the firms. This includes the counterfactual situation presented by the management and you must assess this critically as it is at the very core of the work for the DCCA. It is recommended that you limit your analysis to a few

elements rather than trying to cover an extensive list of potential problems.

QUESTION 3

Summarize your findings and write out the conclusion of the merger application

Based on your analysis you must conclude whether the merger should be approved and highlight if there are any conditions that must be met. You must avoid ambiguous answers and be very specific, both in terms of quantitative answers and qualitative considerations. It may be relevant to include a counterfactual set-up where you highlight the consequences of not following your recommendation.

Finally note that you will be assessed upon your analyses and your presentation, including the logic and storytelling in your slides. Keep this in mind when you structure your analysis and make sure you effectively communicate your sub-conclusions in your slides.

QUANTITATIVE MEASURES

There are many ways to analyse the effects of a merger. We have provided you with some of the methods used in the DCCA.

HERFINDAHL-HIRSCHMAN INDEX (HHI)

The Herfindahl-Hirschman Index is a simple measure of market concentration and it used pre and post-merger transactions. It is calculated as the sum of the squared market share for each firm:

$$HHI = \sum_{i=1}^n s_i^2,$$

where s_i is the market share of firm i . Clearly, an HHI of 10,000 is a monopoly with only one firm in the market and the lower the HHI, the more competitive the market. If the HHI is less than 1,500 it is considered competitive, if the HHI is between 1,500 and 2,500 the market is considered moderately concentrated and with an HHI greater than 2,500 it is considered highly concentrated. In the general, if the merger increases the HHI by 200 it may raise concerns of the firm getting a competitive advantage.

UPWARDS PRICING PRESSURE (UPP)

A merger changes the first order conditions in two ways. The first effect creates upward pressure on prices due to the loss of competition between the merging parties' products (gross upward pricing pressure). The second effect leads to downward pressure on prices caused by merger-related efficiencies (marginal cost decreases). The difference between these two effects is UPP.

$$UPP_1 = D_{12} (P_2 - C_2) - E_1 C_1,$$

where D_{12} is the diversion ratio from product 1 to product 2 (defined below), P_2 is the price for product 2, C_2 is the corresponding marginal cost, E_1 is the percentage efficiency gains that is due to the merger and C_1 is the marginal cost of producing one more unit of product 1.

DIVERSION RATIO

The diversion ratio is the fraction of customers who buy product 2 when they stop buying product 1 due to an increase in the price of product 1. It thereby reflects the degree of substitutability between product 1 and product 2. The relevant data is based on a survey where the DCCA has asked where they will buy their books if firm 2 were to close. This question can only be understood as an approximation of the most correct measure of Diversion Ratio, but it is not a 1:1 expression of the people's substitution.

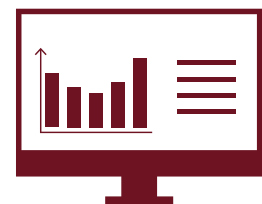
FORMALIA

FINAL REMARKS

- Hand-in is March 9th at 22.00 latest, where each team must send a presentation in PDF (16:9-format) to submit@politicasecompetition.com
- Submit a PowerPoint presentation with a maximum of 5–7 slides, including front-page and your recommendation.
- The slides must be in English, and readable on their own. Remember that the judges initial screening of your solution is based on slides only.
- Based on the slides, three teams are selected to present their solution at the offices of DCCA on the 12th of March from 11.00–14.00. The presentation must be in English and should last approximately 10 minutes. The presentation is followed by lunch and a tour at the offices of DCCA.
- The three teams will be contacted during Wednesday, March 11.
- All teams will receive comments on their product.

TO SUCCEED IN OUR CASE COMPETITION, YOU MUST

- Prepare your findings with a clear storyline (e.g. not necessarily following the order of the questions).
- Present your answers top-down, e.g. starting with the conclusion and subsequently supporting your conclusion with your analysis and rationales.
- Ensure that your slides are readable, well-structured and to-the-point e.g. try to reduce “wordiness” and include storytelling, illustrations and graphs.





POLIT CASE COMPETITION

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