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Fairfax/NZME: response to submissions on Statement of Preliminary Issues

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1. Introduction

Regarding the proposed merger of the New Zealand operations of Fairfax and NZME, we have been asked by Russell McVeagh to review the submissions to the Commerce Commission in response to the Commission's Statement of Preliminary Issues dated 14 June 2016 ("SOPI"). Our focus has been on assessing the issues that are directly relevant to the competitive effects framework that will guide the Commission's decision-making. In particular, in the remainder of this memo we respond to the following issues identified in submissions:

- The potential for the merger to reduce the quality and diversity of news and information content (section 2); and
- The breadth of market definition and competition on the reader side of the market (section 3).

2. Quality and diversity

2.1. Lack of appreciation of two-sided market implications

Most of the submissions on the SOPI do not appear to appreciate the implication of news media being two-sided. A number of submissions focus on competition for readers between broad news organisations (i.e., Fairfax, NZME, TVNZ, Mediaworks and RNZ). We return to the appropriateness (or otherwise) of limiting the set of reader-side competitors in this way, but the purpose of this section of our memo is to emphasise that media firms also compete on the advertiser side, and this has implications for quality and diversity on the reader side.

While Facebook (for example) does not create the same content as Fairfax (for example),[1] the two-sided nature of the relevant platforms means that Fairfax is fighting Facebook for the audience – it is just that Fairfax competes for audience by creating news, whereas Facebook competes by operating a social network (and more recently, by distributing news). Fairfax still has to offer a quality product to keep its audience from shifting to Facebook. Likewise the merged entity would have to offer a quality product to keep its audience from shifting to Facebook.

Of course, it is not just Facebook that the merged entity would worry about – clearly it would worry about other news creators, and a variety of other platforms. We are just using Facebook to illustrate our point that competition on the advertiser side creates pressure on the reader side, even if the reader-side products are differentiated. This is a dynamic that is peculiar to two-sided markets. A failure to consider this dynamic risks overestimating the competitive effects of a merger.

Different people will have different views as to what constitutes "quality" of a news product, and this is illustrated by the submissions on the SOPI. In particular, there is an antipathy in the

1 Although as we noted in our 27 May 2016 report, Facebook does distribute news content.

submissions to "clickbait" and similar content. From a competition economics perspective, quality is what makes a product attractive to consumers. Because the merged entity would need to compete with a variety of other firms for audiences that can be sold to advertisers, the merged entity would need to create content that readers value. The merged entity would also need to recognise that readers are heterogeneous, i.e., have different preferences as to what constitutes quality. Therefore if the merged entity is to maximise the size of its audience, it would need to offer variety of content. For example, if there is a material segment of potential readers that value investigative journalism, the merged entity would need to provide investigative journalism to attract those readers, and in turn to sell that audience to advertisers. Likewise if a material segment of potential readers value more sensational content, the merged entity would need to provide that content.

2.2. Conflation of merger effects and public versus commercial broadcasting

On the subject of quality, some submissions (particularly that of the Coalition for Better Broadcasting and Molineaux et al) are critical of commercial media being too focussed on "clickbait", or as Molineaux et al argue, "the negative effects of market and commercial forces" (page 18). The argument appears to be that increasing commercial pressures have led media to focus on clickbait at the expense of "hard news" (page 17 of Coalition for Better Broadcasting) and investigative journalism.

Whether or not this critique is valid, it does not have anything to do with the effect of the merger. Rather the critique is aimed at the commercial model, and the public policy argument for public funding of news media.

2.3. Lack of appreciation of journalist mobility and expansion

Several of the submissions raise concerns about the merger leading to journalist redundancies, and the implications for diversity or plurality.[2] However, this analysis is quite static– it assumes that redundant journalists will just disappear, and will not have a vehicle for offering their "independent voices". But this is not correct. As we explained in our 27 May 2016 report:

- There are no barriers to firms like TVNZ, Mediaworks and RNZ expanding their operations, including by hiring more journalists; and
- More generally the internet has dramatically reduced barriers to publishing and distributing news content.

[2] See, for example, submissions by "Anonymous" (1 July 2016) at pp 2 and 3, E Tū - Union for New Zealand Journalists (5 July 2016) at p 6, Gavin Peter Ellis (1 July 2016) at [4.1] et seq, and Molineaux et al (8 July 2016) at p 14.

3. Competition on the reader side

Various submissions on the SOPI argue the application overstates the set of competitors and breadth of the market definition.[3]

In our 27 May 2016 report, we set out the evidence suggesting that newspapers are subject to competitive pressure from news websites on the reader side. Beyond that, market definition has to take into account the fact that the merging parties offer a broad range of content. The spectrum of content provided by Fairfax and NZME covers investigative journalism through to breaking news through to opinion through to entertainment. The content also falls within a variety of subject categories, e.g., sport, business, international, local, politics and travel.

Various submissions point out that TVNZ, Mediaworks and RNZ also provide this breadth of content, and particularly offer "original New Zealand content and news", like Fairfax and NZME do.[4] These submitters class TVNZ, Mediaworks and RNZ as competitors to Fairfax and NZME. We agree with this, and as already noted earlier in this memo, the barriers to these three firms expanding are low.

However, drawing the market boundary around these five firms would underestimate the competitive pressure on the merged entity. To see this, it is useful to refer to the "cluster market" literature, which finds that it may be appropriate to define a cluster market when the economies of scope:[5]

- On the demand-side (effectively transaction costs) mean it is not economic to unbundle purchases of the products in the cluster; and
- On the supply-side mean it is not economic to supply just a subset of the products in the cluster.

Perhaps in the pre-internet days it would have been appropriate to limit the market to providers of a broad category of news. However, as we discussed in our 27 May 2016 report, the internet has fundamentally altered the economics of news production and consumption, reducing the economies of scope on the demand and supply side:

- The transaction costs of accessing multiple websites are low, and content "finds" consumers via social media; and

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3 See, for example, submissions by Avi Singh (1 July 2016) at [2.1] et seq, Coalition for Better Broadcasting (10 July 2016) at [4.0], E Tū - Union for New Zealand Journalists (5 July 2016) at pp 3 and 4, G Jackson (28 June 2016), Molineaux et al (8 July 2016) at [2], and Star Media (6 July 2016) at Section II.

4 See, for example, page 3 of Molineaux et al.

5 See, for example, the summary by Ergas, Henry, "Cluster Markets: What They Are and How To Test For Them", The Centre for Research in Network Economics and Communications, School of Business and Economics, The University of Auckland (http://www.greenwhiskers.com.au/papers/papers-ergas-cluster.PDF).

- The costs of publishing and distributing content over the internet are low. A large variety of specialist (news) content providers exist and appear to be viable (for example, the *National Business Review*, interest.co.nz, The Spinoff and Hive News), and readers can access global news websites.

This combination of factors implies the market is broader than just the set of five firms already discussed (i.e., Fairfax, NZME, TVNZ, Mediaworks and RNZ). In other words, the merged entity would be pressured by a wide set of firms, some of them with broad offerings (TVNZ, Mediaworks and RNZ), and some with specialist offerings (for example, the *National Business Review* would place pressure on the merged entity to maintain high quality business reporting). As Baker (2007, 158) notes, "… cluster markets may mislead as to competitive effects when competition from sellers of a partial line of products or services constrains the pricing of the full-line sellers offering the cluster."[6]

[6] Jonathan B. Baker (2007) "Market Definition: An Analytical Overview", *Antitrust Law Journal*, 74, 129-173.

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