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Competitive effects of proposed acquisition by Are Media of retail distribution business of Ovato NZ in New Zealand

PUBLIC VERSION

7 July 2021

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Executive summary

1. We have been engaged by the solicitors for Ovato NZ Limited (Ovato NZ), to prepare this report examining whether the proposed acquisition of Ovato Retail Distribution NZ Limited (ORD NZ) by Are Media Limited (Are Media) may lead to a substantial lessening of competition in any New Zealand market.
2. We understand that Ovato Ltd is in financial difficulties [] Notwithstanding, for the purpose of this report, we assume that the status quo will continue if the proposed acquisition does not proceed.
3. For the reasons set out in this report, we find that it is highly unlikely that the proposed acquisition will lead to the foreclosure of rival publishers, and so a substantial lessening of competition in any market.

Industry structure and trends

4. ORD NZ is currently the only retail distributor of magazines in New Zealand. Are Media and other publishers use ORD NZ to distribute their magazines to retailers.
5. Are Media is the largest magazine publisher in New Zealand, followed by Stuff Limited (Stuff) and a long tail of international and domestic publishers.
6. There are a number of different categories of magazines, which vary by their type of content and target audience. []
7. There has been a rapid development in the last 20 years of the means to distribute, publish and share media content online in many parts of the world, including New Zealand.
8. Print magazine advertising revenue has been declining, whilst online advertising revenue has increased significantly. Magazine sales have been falling too – the number of magazines distributed by ORD NZ in New Zealand has fallen by around [] per cent from 2016 to 2021.
9. The cause of the declines in magazine sales and advertising revenue is likely to be an increase in the consumption of media online, relative to in printed form.

Market definition

10. Magazine publishers provide:
 - a. content to readers; and
 - b. advertising services to advertisers.
11. It is not necessary to draw any conclusion on the precise definition of the relevant market for the provision of content to readers for the purpose of this report. Rather, it is sufficient to recognise that:
 - a. there is differentiation between magazine titles such that some compete against each other, while others do not;
 - b. the closeness of competition between different magazine titles depends on the pair of magazines in question; and

- c. there is competition for the provision of content in print media from online media.
12. Magazine publishers compete with advertising services provided by other forms of print, television, radio and online media, given that advertisers seek to maximise their return on marketing investments across a range of media. However, it is not necessary to draw a particular conclusion on the definition of the market for advertising services for the purposes of the proposed acquisition.
13. The closest competitors to ORD NZ are Stuff and NZME, which each have a newspaper distribution function that could also distribute magazines.
14. It is also unnecessary to draw any conclusion on the precise market definition for magazine distribution services for the purposes of this report. Rather, it is sufficient to note that Stuff and NZME have the capability to distribute magazines.

Foreclosure

15. We understand that the vast majority of Are Media's titles are not substitutable for those of other publishers. []
16. ORD NZ sets its prices for distribution at the publisher level in the vast majority of cases [] We therefore assume that any price rise by ORD NZ would apply to all the titles of a particular publisher.
17. We understand that, broadly speaking, there are two possible foreclosure strategies, ie:
 - a. the merged firm could refuse to supply retail distribution services to a publisher, or increase prices to such an extent that the publisher decides no longer to use the merged firm for retail distribution, ie, **complete foreclosure**; or
 - b. the merged firm could increase prices to an extent, but not so much that the publisher decides to stop using the merged firm for retail distribution entirely, ie, **partial foreclosure**.

Ability to foreclose

18. The ability to foreclose rivals refers to the extent to which the merged firm will be able to prevent or restrict rivals from distributing their magazines in New Zealand. This depends on the alternatives available to publishers, which are that:
 - a. Stuff and NZME are able to distribute their magazines using their newspaper distribution network and arrangements – we therefore conclude that these publishers could not be foreclosed;
 - b. other publishers may also be able to use Stuff and NZME's newspaper distribution networks;
 - c. all publishers have the ability to increase their distribution through subscriptions or online – for instance, by offering discounts or promotions to drive further sales through those channels;
 - d. publishers could deliver their titles directly to the distribution centres operated by major retailers, who could distribute those titles to their retail stores; and
 - e. publishers could move to an advertising commercial model whereby they distribute their magazines for free and earn revenue through advertising alone. In this case, publishers would not need to use the retail distribution channel.

19. Retailers would be harmed by a foreclosure strategy that reduced their ability to sell magazines. It will therefore be in the interest of retailers to resist any attempted foreclosure. We understand that grocery and book retailers in particular would have a strong bargaining position with the merged firm, because they could threaten to reduce prime shelf space available to Are Media titles.
20. We therefore expect that the merged firm would not be able to foreclose titles that had substantial sales in grocery and book retailers.
21. On this basis, we conclude that the merged firm would not have the ability to foreclose magazine publishers.

Incentive to foreclosure

22. A firm will only foreclose rivals when it expects to profit from doing so – in other words, when the total profit of the firm undertaking the foreclosure is higher than without the conduct. We expect that a firm would also consider the risk it was undertaking, ie, the distribution of possible profits and losses from the conduct.
23. The changes in profit from undertaking the **complete foreclosure strategy** for the merged firm are:
 - a. a certain reduction in profit at the distribution level, because of the loss of volume distributed; and
 - b. the possibility of a profit increase at the publishing level, to the extent that customers switch to the merged firm's magazines because they cannot easily purchase the potentially substitutable title they would otherwise have purchased.
24. There is a material degree of risk in undertaking a foreclosure strategy because the merged firm must decide to undertake the strategy before it knows how publishers and consumers may react. The loss of profits at the distribution level is certain because ORD NZ is currently maximising its expected profits. On the other hand, the merged firm cannot know whether it would increase its profits at the publisher level if it decided to undertake a foreclosure strategy.
25. A complete foreclosure strategy would reduce profits at the distribution level for the merged firm. This reduction is likely to be significant because:
 - a. a high proportion of ORD NZ's costs are fixed, which means that ORD NZ's margin on additional sales is high; and
 - b. the potentially substitutable titles are published by firms that pay ORD NZ []
26. The complete foreclosure strategy is not likely to lead to an increase in profits at the publisher level large enough to outweigh the reduction in profits at the distribution level, because:
 - a. foreclosure would cause the merged firm to lose the distribution of all titles for a publisher, whilst only some of the titles sold by that firm may be potentially substitutable with one of Are Media's titles;
 - b. on average, approximately 40 per cent of magazines distributed are not sold, which effectively means that if 100 magazines were foreclosed this would lead to a loss of profit at the distribution level for 100 magazines not delivered, while at the publisher level it's likely that there is only the possibility of capturing 60 lost sales;
 - c. Are Media is unlikely to gain many of the sales lost by the potentially substitutable titles; and

d. Stuff may start to offer alternative magazine distribution services.

27. In our opinion, it is very unlikely that the merged firm would undertake this foreclosure strategy because:

- a. it is highly improbable that it would be profitable, for the reasons we set out below;
- b. there is a high likelihood that it will lead to a loss in profits; and
- c. even if it was profitable, the potential benefit would be small.

28. It would therefore involve the merged firm incurring certain losses at the distribution level, with a high degree of uncertainty about whether it would obtain even a small potential benefit.

29. In order for foreclosure to be profitable, it would need to be the case that:

- a. the publisher loses all of its sales of potentially substitutable titles; and
- b. Are Media gains more than 20 per cent of the potentially substitutable titles' sales.

30. In our opinion, it is highly improbable that these conditions would hold because:

- a. the loss of sales for potentially substitutable titles by rival publishers is likely to be much lower than the maximum we have assumed above given that:
 - i. publishers can increase distribution through subscriptions;
 - ii. publishers can publish their titles online;
 - iii. publishers may distribute their titles through the distribution centres operated by major retailers;
 - iv. retailers have significant countervailing power and can threaten Are Media's titles (for example, by removing them from prime shelf space) if Are Media attempted to foreclose a rival publisher that published popular titles sold by that retailer; and
 - v. publishers may be able to use the distribution services provided by Stuff and NZME; and/or
- b. Are Media is likely to gain much less than the breakeven share of sales lost by the potentially substitutable titles because:
 - i. some customers would not react by buying more of a title if a similar title was no longer available, eg, some people purchase all of the magazines that relate to a particular topic;
 - ii. customers may switch to a different publisher, ie, not Are Media, as a result of the foreclosure;
 - iii. customers may increase the content they view online and reduce magazine purchases all together; and/or
 - iv. some customers may choose not to consume the content at all.

31. We understand that the closure of potentially substitutable titles rarely leads to a discernible increase in the volume of sales of competing magazines, and certainly not more than 20 per cent.

32. We also find that, under reasonable assumptions, the **partial foreclosure strategy** is not profitable for the same reasons.

Effect of foreclosure

33. We have not undertaken the detailed market definition exercise that would be required to come to a definitive conclusion regarding whether a particular foreclosure strategy on a publisher would be likely to lead to a substantial lessening of competition.
34. However, we have examined what proportion of a magazine category is supplied by publishers that sell titles that are potentially substitutable for those of Are Media and for which the complete foreclosure strategy is most likely to be profitable.
35. We find that there are only three instances in which one of these rival publishers supplies more than ten per cent of the sales in a category and Are Media has a potentially substitutable title in the same category. This analysis indicates that the effect of any foreclosure is not likely to be substantial.

1. Introduction

36. We have been engaged by the solicitors for Ovato NZ Limited (Ovato NZ), to prepare this report examining whether the proposed acquisition of Ovato Retail Distribution NZ Limited (ORD NZ) by Are Media Limited (Are Media) may lead to a substantial lessening of competition in a New Zealand market. This report is based on our analysis of facts and assumptions provided by Ovato NZ and Are Media.
37. ORD NZ provides magazine distribution services to over [] publishers, distributing approximately [] magazine titles and [] other items such as partworks¹ to [] retailers across New Zealand.²
38. Are Media is the largest magazine publisher in New Zealand. It publishes a number of magazines formerly published by Bauer Media.
39. Are Media and ORD NZ do not compete with each other for the supply of media content to consumers. Rather, ORD NZ supplies magazine distribution services to Are Media and other magazine publishers.
40. We understand that Ovato Ltd is in financial difficulties [] Notwithstanding, for the purpose of this report, we assume that the status quo will continue if the proposed acquisition does not proceed.
41. The remainder of our report is structured as follows:
 - a. in section two we provide some background information on key trends in the magazine industry and describe the current structure of that industry;
 - b. in section three we describe the main competitive constraints on the provision of magazine publishing and distribution services; and
 - c. in section four we examine whether the proposed acquisition may lead to the foreclosure of magazine publishers that compete with Are Media and, if so, whether this would substantially lessen competition in any market.

¹ Partworks are a collectible series containing a magazine and often objects or model components.

² Source: HoustonKemp analysis of data provided by Ovato NZ.

2. Industry structure and trends

42. In this section we set out the key trends in the magazine industry and describe the current industry structure.

2.1 Industry trends

43. There has been a rapid development of the means to distribute, publish and share media content online in Australia in the last 20 years.³ We understand that a similar development has occurred in many other countries, including New Zealand. Indeed, the Productivity Commissions of Australia and New Zealand have said that:⁴

In the context of the global digital economy, Australia and New Zealand are more similar than different, Australian and New Zealand consumers are fast adopters and avid users of digital services and technologies.

44. Consistent with this, mobile and internet usage is very common in New Zealand – slightly more so than in Australia – with:⁵
- 4.55 million people using the internet, ie, 94 per cent of the population;
 - 6.56 million mobile connections, which is 135.6 per cent of the population; and
 - 3.97 million active social media users, or 82 per cent of the population.
45. Figure 2.1 shows that print magazine advertising revenue has declined in New Zealand, from \$212 million in 2014 to \$156 million in 2019.⁶ In that time, the total advertising revenue increased from \$2,386 to \$2,767 million.⁷ It follows that print magazine advertising revenue has declined from 8.9 per cent to 5.6 per cent of total advertising revenue, in the period from 2014 to 2019.
46. Figure 2.1 also shows that digital advertising has been expanding at a rapid rate in New Zealand since 2012. This is consistent with people spending more time consuming media content online.

³ See, for example, ACCC, *Digital platforms inquiry*, Final report, July 2019, p 168.

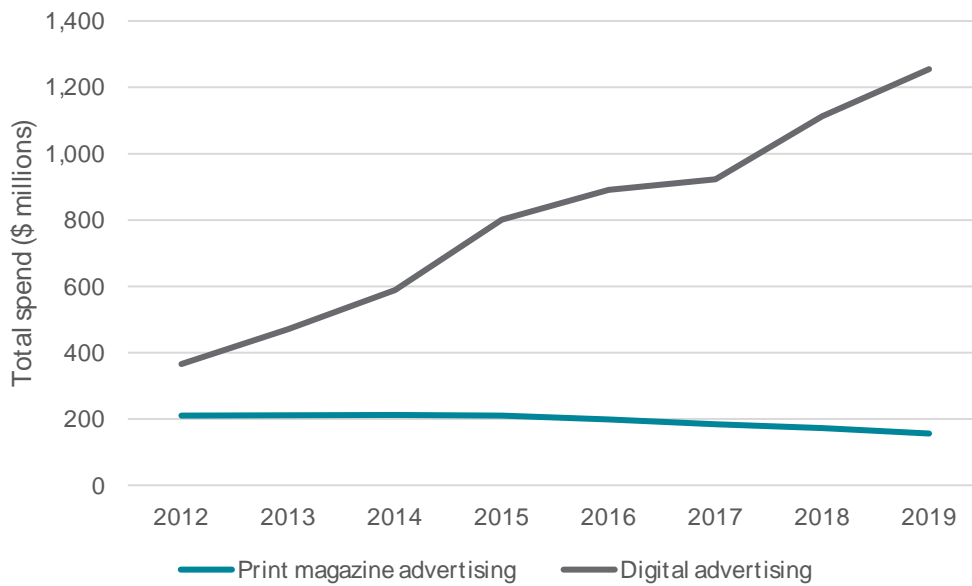
⁴ Productivity Commissions of Australia and New Zealand, *Growing the digital economy in Australia and New Zealand*, Joint research report, January 2019, p 1.

⁵ Kemp, S, *Digital 2021: New Zealand*, February 2021, slide 17, available at: <https://datareportal.com/reports/digital-2021-new-zealand>, accessed 3 June 2021, accessed 3 June 2021; and Kemp, S, *Digital 2021: Australia*, February 2021, slide 17, available at: <https://datareportal.com/reports/digital-2021-australia>, accessed 3 June 2021

⁶ Advertising Standards Authority, *New Zealand advertising industry turnover report – Year ending 31 December 2014*, March 2015, p 1; and Advertising Standards Authority, *New Zealand advertising industry – Revenue report 2019*, May 2020, p 1.

⁷ Advertising Standards Authority, *New Zealand advertising industry turnover report – Year ending 31 December 2014*, March 2015, p 1; and Advertising Standards Authority, *New Zealand advertising industry – Revenue report 2019*, May 2020, p 1.

Figure 2.1: Advertising revenue from print magazines and digital advertising



Source: HoustonKemp analysis of data from the Advertising Standards Authority's Advertising Turnover Reports from years 2014 to 2019.

Notes: Digital advertising spend in 2012 to 2014 includes only 'interactive digital advertising' (eg, banner ads and streaming advertising).

Digital advertising spend in 2015 includes interactive digital advertising and advertising in digital newspapers, radio and television.

Digital advertising spend in 2016 to 2019 includes interactive digital advertising and advertising in digital newspapers, radio, television and magazines.

47. At the same time, magazine sales have been falling. Figure 2.2 below shows that the number of magazines distributed by Ovato NZ in New Zealand has fallen by around [] per cent, from around [] million copies per month in 2016 to [] million copies per month in 2021.



Figure 2.2: [

]

Source: [

]

Notes: [

]

48. The high level of online internet access, growth of digital advertising and decline in print advertising and distribution is consistent with the situation in Australia.⁸
49. The cause of the declines in magazine sales and advertising revenue in Australia and New Zealand is likely to be the same, ie, an increase in the consumption of media online relative to in printed form. This is reflected in the substantial growth in digital advertising revenue in New Zealand.
50. Consistent with this, the ACCC has said that in Australia:⁹

Large numbers of consumers are now accessing news and entertainment through the internet (websites and apps), and in general, consumers are spending significantly more time online.
51. The same is likely to be the case in New Zealand. Indeed, the Chair of the Commerce Commission Anna Rawlings has said:¹⁰

No longer do we worry about catching the news in the form of a daily printed newspaper, on the radio on the hour or on the television at 6pm. Neither do we find ourselves rushing to the bricks and mortar store before closing time. Now the news is delivered instantly, and on the go, on a handheld device and we can shop online at thousands of retailers around the world and have our goods delivered to our door steps in a few days if not hours.

⁸ See paragraph 44 above. According to PwC, consumer magazines advertising revenue was \$340 million in 2015 and \$93 million in 2020. PwC, *The Australian entertainment and media outlook 2020-2024*, 2020, data tables, available at: <https://www.pwc.com.au/industry/entertainment-media/assets/Magazines.xlsx>, accessed 3 June 2021. Internet advertising is expected to grow from 54 per cent to 62 per cent of all advertising, over the same period. PwC, *The Australian entertainment and media outlook 2020-2024*, 2020, p 34.

⁹ ACCC, *Digital platforms inquiry*, Final report, July 2019, p 121.

¹⁰ Rawlings, A, *Opening remarks*, 2019 Competition Matters conference, July 2019, pp 1-2.

52. Consumers access specific content, rather than a package of content, through search engines, social media platforms, aggregators, apps etc. The ACCC said that:¹¹

...atomised content curated by platforms comes from multiple sources and may be viewed alongside different combinations of other atomised content and can be personalised based on user data; whereas content curated by media businesses is intended to remain part of a single news package.

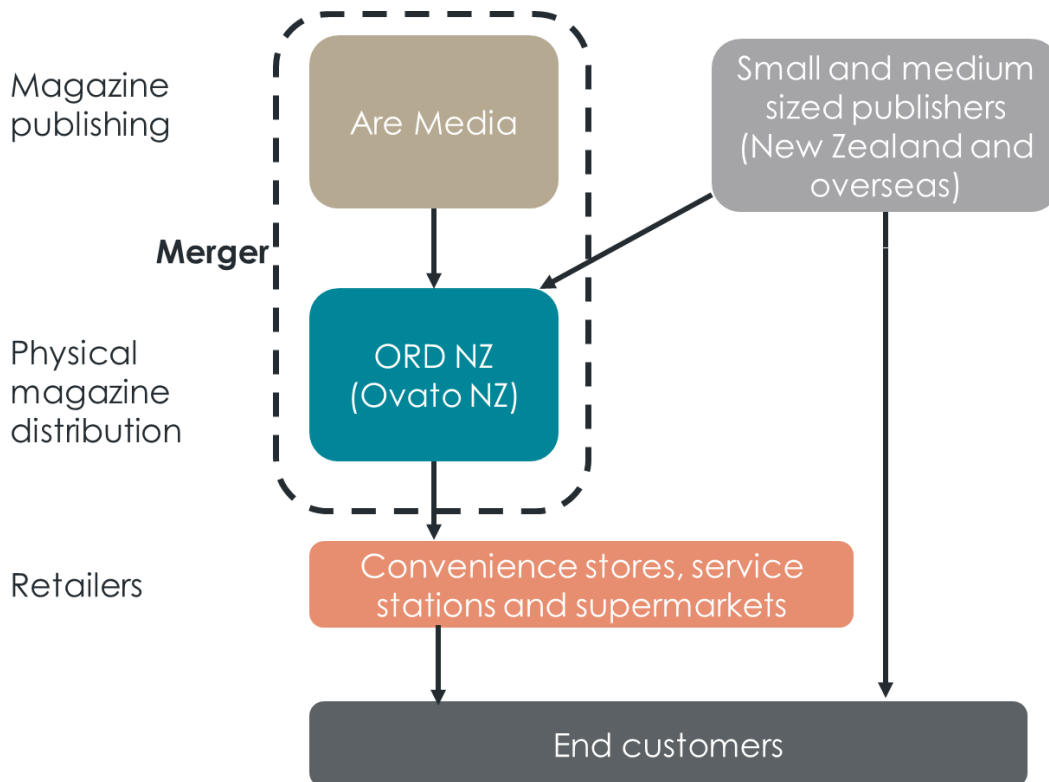
53. We expect that the same applies to New Zealand.

2.2 Industry structure

54. Figure 2.3 shows the magazine industry structure at a high level, focusing on the overlap between the merger parties. It highlights that:

- a. ORD NZ is currently the only retail distributor of magazines; and so
- b. many publishers use ORD NZ to distribute their magazines, including Are Media.

Figure 2.3: High level industry structure



Source: Based on information provided by Ovato NZ and Are Media.
 Note: This diagram does not include online distribution.

2.2.1 Magazine publishing

55. Figure 2.4 shows that Are Media is the largest magazine publisher in New Zealand, followed by Stuff and a long tail of international and domestic publishers.

¹¹ ACCC, *Digital platforms inquiry*, Final report, July 2019, p 297.

Figure 2.4: []

Source: []

56. Magazine publishers can be distinguished by their geographic location, ie, there are:
- a. [] publishers from New Zealand, including [] publishers that comprise at least [] per cent of copies distributed by Ovato NZ, ie, [] and [];
 - b. [] publishers from Australia, including [] publisher that comprises at least [] per cent of copies distributed by Ovato NZ, ie, [] and [];
 - c. [] publishers from other countries, mostly based in the United Kingdom; and
 - d. Are Media, a trans-Tasman publisher that publishes New Zealand titles while also importing some Australian titles.
57. Figure 2.5 shows that there are a number of different categories of magazine, which vary by the type of content they contain and their target audience. Magazines can be divided into 20 categories. Mass market weeklies are distributed in the greatest numbers by a substantial margin, with over [] million copies distributed in the year to June 2021. This is followed by home and lifestyle magazines, with almost [] million copies distributed in the same period.



Figure 2.5: [

]

Source: [

]

58. There have been some substantial changes to the magazine publishing industry in New Zealand since the beginning of 2020.
59. In April 2020, Bauer Media announced that it was closing its publishing business in New Zealand due to the severe economic impact of Covid-19.¹² In July 2020, Bauer Media sold its New Zealand magazine titles to Are Media. Once the lockdown ended, Are Media commenced distributing Australian publications in New Zealand, but did not publish any New Zealand publications. In September 2020, Are Media recommenced publishing 'The Listener', 'Your Home and Garden', 'Kia Ora', and 'NZ Woman's Weekly'.¹³
60. Are Media sold the title 'North & South' to independent publishers Konstantin Richter and Verena Friederike, 'Metro' to Simon Chesterman, and 'Home' and 'FQ' to Parkside Media.¹⁴ A number of former Bauer Media titles did not restart, such as, 'Simply You', 'Simply You Living' and 'Next'.
61. Former magazine editor Sido Kitchin also started a new publishing venture, School Road Publishing, in October 2020 and launched four new magazines: 'Woman', 'Haven', 'Thrive' and 'Scout'.¹⁵ Additionally, some former Bauer Media workers launched an online website aimed at women, 'Capsule', which is similar to an online magazine.¹⁶

¹² Scoop Media, *Bauer Media group discontinues its publishing business in New Zealand*, April 2020, available at: <https://www.scoop.co.nz/stories/BU2004/S00046/bauer-media-group-discontinues-its-publishing-business-in-new-zealand.htm>, accessed 3 June 2021.

¹³ Scoop Media, *New era for Bauer NZ magazines begins*, July 2020, available at: <https://www.scoop.co.nz/stories/BU2007/S00286/new-era-for-bauer-nz-magazines-begins.htm>, accessed 3 June 2021.

¹⁴ Scoop Media, *New era for Bauer NZ magazines begins*, July 2020, available at: <https://www.scoop.co.nz/stories/BU2007/S00286/new-era-for-bauer-nz-magazines-begins.htm>, accessed 3 June 2021.

¹⁵ AUT research centre for Journalism, Media and Democracy, *New Zealand media ownership 2020*, December 2020, p 27.

¹⁶ AUT research centre for Journalism, Media and Democracy, *New Zealand media ownership 2020*, December 2020, p 27.

2.2.2 Magazine distribution

62. The distribution of magazines to retailers involves:
- a. logistics, ie, shipping and freight management, scheduling and invoicing;
 - b. warehousing, which includes the management of stock coming into the warehouse, picking and packing the magazines, managing returned magazines and dispatch;
 - c. client services, including account management, circulation management and trade marketing;
 - d. demand forecasting, ie, allocations management, print run recommendations and modelling; and
 - e. retail representation, ie, representing publishers with the retail chains, range reviews and barcode and price maintenance.
63. ORD NZ uses NZ Post for all linehaul and instore deliveries.
64. ORD NZ distributes approximately [] magazine titles to [] retail stores, including around:
- a. [] bookstores;
 - b. [] convenience stores;
 - c. [] service stations;
 - d. [] supermarkets; and
 - e. [] other retail stores, such as garden centres and home hardware stores.

3. Market definition

65. In this section we describe the main competitive constraints on the provision of magazine publishing and magazine distribution services.
66. It is not necessary to draw a precise conclusion on the definition of the relevant markets because it does not alter the approach to assessing the competitive effects of the proposed acquisition.

3.1 Magazine publishing

67. Magazine publishers provide:
 - a. content to readers; and
 - b. advertising services to advertisers.
68. In 2014 the Commission cleared Bauer Media to acquire all of the assets used by APN Specialist Publications NZ Limited (APNSP) in the publication of the New Zealand editions of certain magazines.¹⁷ Consistent with our description of the two services provided by magazine publishers, the Commission considered the effect of the proposed acquisition on the provision of content in magazines and the sale of advertising.
69. The Commission appeared to consider that the provision of different types of content would be in separate markets, examining:
 - a. current affairs magazines;
 - b. mass market weekly women's magazines; and
 - c. women's interest magazines.
70. This is consistent with the approach of the ACCC in the recent Bauer Media/Pacific Magazine merger in Australia. The ACCC's preliminary view was that there were separate markets for each of the magazine categories, including, Women's Interest, Real Life, Home & Garden, Celebrity, Fashion & Lifestyle and Puzzles.¹⁸
71. The Commission and the ACCC appear to recognise that the degree of competition in the provision of particular content depends on the type of content being provided. For example, the provision of puzzle content is a closer competitive constraint on the provision of other puzzle content, as opposed to the provision of celebrity content.
72. We explain in section 2 that consumers have increasingly been viewing content online instead of in print form. It follows that the provision of content online is likely to be a competitive constraint to the provision of that content in a printed form.

¹⁷ Competition Commission New Zealand, *Bauer given clearance to acquire magazine titles*, 24 January 2014, available at: <https://comcom.govt.nz/news-and-media/media-releases/2014/bauer-given-clearance-to-acquire-magazine-titles>, accessed 3 June 2021.

¹⁸ ACCC, *Bauer Media – proposed acquisition of the business assets of Pacific Magazines*, Statement of Issues, December 2019, pp 5-6.

73. Consistent with this, in relation to the Commission's clearance of Bauer Media to acquire the New Zealand magazines of APNSP, Dr Mark Berry said:¹⁹

The merged firm would continue to face competition from the suppliers of other magazine titles and alternative platforms, such as television, newspapers and the internet.

74. In its recent decision, the ACCC did not set out whether content available online was in the same market as content provided in magazines. However, it said that many readers of the key titles published by Bauer Media and Pacific Magazines have increasingly turned to online sources of that content and are likely to continue to do so in the future.²⁰

3.1.1 Advertising services

75. Advertisers are able to place advertisements in a wide range of magazines, other print media and other media, such as online.
76. We explain in section 2.1 that advertising spend in print magazines has been falling, whilst spend on online advertising has been growing substantially. This is consistent with the situation in Australia where print advertising has also been declining, and online advertising is growing.²¹
77. Magazine publishers compete with advertising services provided by other forms of print, television, radio and online media, given that advertisers seek to maximise their return on marketing investments across a range of media. It is not necessary to draw a particular conclusion on the definition of the market for advertising services in magazines because, as we show in section 4, the proposed acquisition is highly unlikely to lessen competition in magazine publishing.

3.1.2 Provision of content to consumers

78. Magazines are differentiated by the type of content they contain and their target audience. Figure 2.5 sets out the various categories of magazines.
79. We understand that magazines can be complements as well as substitutes, ie, some consumers purchase multiple magazines of a similar type, and so if one title closes down, they may purchase fewer magazines rather than switching to another title.²²
80. We assume that the strength of substitution between the categories will vary. For example, there may be stronger substitution between the 'mass market weeklies' and 'women's interest' categories than between 'craft' and 'sport' magazines.
81. There is also likely to be varying degrees of substitution between titles within a category. For example, in the sports category, we assume that there is a stronger degree of substitution between:
- a. Fishing Monthly Magazine and Fishing World; than
 - b. Golf Australia and Cycling Plus.
82. There are many ways of accessing the same or similar content to that provided in print magazines, either online through a website or an app. The growth in the consumption of such content online at the

¹⁹ Competition Commission New Zealand, *Bauer given clearance to acquire magazine titles*, 24 January 2014, available at: <https://comcom.govt.nz/news-and-media/media-releases/2014/bauer-given-clearance-to-acquire-magazine-titles>, accessed 3 June 2021.

²⁰ See: ACCC, <https://www.accc.gov.au/public-registers/mergers-registers/public-informal-merger-reviews/bauer-media-pty-limited-pacific-magazines-pty-ltd>, accessed 18 May 2021.

²¹ ACCC, *Digital platforms inquiry*, Final report, July 2019, p 12.

²² We understand from Ovato NZ that the average number of magazines purchased from Countdown when a magazine is purchased is 1.35. Further we understand that of the top ten magazines purchased, the most frequently purchased magazine that is also purchased is from the same category.

same time as the reduction in print magazine sales is indicative of consumers being willing to switch between the two.

83. There is also no need to draw any particular conclusion on the definition of the relevant market for the provision of content to consumers for the purpose of this report. Rather, it is sufficient to recognise that:
- a. there is differentiation between magazines titles, such that some compete against each other and others do not;
 - b. the closeness of competition between different magazine titles depends on the pair of magazines in question; and
 - c. there is competition for the provision of content in print media from online media.

3.2 Magazine distribution

84. ORD NZ is the only firm currently providing retail magazine distribution services in New Zealand.
85. The closest competitor to ORD NZ is Stuff, which has a newspaper distribution function that could also distribute magazines.
86. Stuff has its own contractors for retail distribution of its daily newspapers in the lower North Island and South Island. It shares the distribution network of NZME for distribution to retail in the upper North Island.
87. Stuff uses a system called Matrix for managing the demand forecasting and allocations for its newspaper volumes. We understand that it could use this system to undertake the same function for its magazines.
88. NZME also uses parts of Stuff's newspaper distribution network for distribution of their papers outside the upper North Island. It also uses the Matrix system for demand forecast and allocations.
89. It is not necessary to draw any conclusion on the precise market definition for magazine distribution services for the purposes of this report. Rather, it is sufficient to note that Stuff and NZME have the capability to distribute magazines.

4. Foreclosure

90. In this section we examine whether the proposed merger might lessen competition as a result of ORD NZ foreclosing publishers whose titles compete with those of Are Media. We structure this section as follows:
- a. first, we examine the constraints that currently act on ORD NZ's pricing;
 - b. second, we set out what we understand to be the most likely foreclosure strategies;
 - c. third, we assess which publishers could be foreclosed;
 - d. fourth, we examine whether the merged firm would have an incentive to undertake a foreclosure strategy; and
 - e. last, we examine how substantial the effect of a successful foreclosure strategy could be on competition.

4.1 Constraints on ORD NZ's pricing

91. We understand that ORD NZ has been the only magazine distributor in New Zealand for the last five years. It sets its prices to maximise profits over the long-term, bearing in mind the risks associated with pricing at different levels. ORD NZ has a high level of fixed costs, so any revenue from lost volume due to increasing prices has a significant effect on its profits.
92. ORD NZ is, and will remain, constrained by the risk that it would lose volumes if it increased the price of retail distribution because one or more publishers may:
- a. reduce retail distribution and increase distribution through subscription and online sales – some magazine publishers have been focusing on increasing their sales through retail distribution because the price of delivering subscriptions by post has increased and the quality of service has fallen, and the same is likely to happen in reverse if the price of retail distribution increased relative to other methods of distribution; we understand that all published magazines in New Zealand have subscriptions available and many have an online presence, so that a lower level of retail sales would:²³
 - i. reduce revenue and so profits for ORD NZ as well as increase the cost to ORD NZ of distribution per copy for the lower volumes that would remain; and
 - ii. reduce the profit that retailers earn from allocating space in their stores to magazines – this would likely result in retailers allocating less space to magazines, which we take to be the greatest risk to ORD NZ now and after the proposed acquisition;²⁴
 - b. stop selling magazines in New Zealand altogether – we explain in section 2.1 that the magazine industry has been in decline for some time and higher distribution prices would further reduce profits for publishers;

²³ The use of subscriptions varies substantially by title. The overseas titles have the lowest subscriptions, but these titles could boost subscriptions by importing the titles and arranging the subscription administration and delivery from New Zealand.

²⁴ For example, in October 2020 New World Kapiti reduced the number of magazine bays it has from six to one. In November 2020, Pak n Save Westgate removed its entire magazine stand. In December 2020, Countdown Rolleston reduced its magazine bays from five to four.

- c. deliver its magazines directly to the distribution centres operated by major retailers (eg, Foodstuffs, Countdown and Whitcoulls) who could distribute those titles to their retail stores;²⁵
- d. use Stuff and/or NZME to distribute its magazines; and/or
- e. move to an advertising commercial model whereby publishers give their magazines away for free and earn revenue through advertising alone – in this case, publishers would not need to use the retail distribution channel, eg, Autotrader changed to be distributed as a paid for magazine through the retail sector to a free model in 2008.²⁶

93. These constraints are such that [

27

] These instances are consistent with ORD NZ facing significant constraints to its conduct.

94. A theoretical option for a publisher facing higher costs is to increase the retail price of its magazines. However, this would not change the fact that an increase in the price of retail distribution reduces its profitability relative to other distribution options. Further, we assume that publishers are maximising their profits before the proposed acquisition, so any increase in the retail price would reduce profits of the publisher.
95. The proposed acquisition does not affect the constraints above, and so it will not be possible for the merged firm to increase distribution prices and earn greater profits at the distribution level.

4.2 Foreclosure strategies

96. We understand that the vast majority of Are Media's titles are not substitutable for those of other publishers. [

]

97. ORD NZ sets its prices for distribution at the publisher level in the vast majority of cases [

] We therefore assume that any price rise by ORD NZ would apply to all the titles of a particular publisher.

98. We understand that, broadly speaking, there are two possible foreclosure strategies, ie:

- a. the merged firm could refuse to supply retail distribution services to a publisher, or increase prices to such an extent that the publisher decides no longer to use the merged firm for retail distribution, ie, **complete foreclosure**; or
- b. the merged firm could increase prices to an extent, but not so much that the publisher decides to stop using the merged firm for retail distribution entirely, ie, **partial foreclosure**.

²⁵ We understand that distributing through distribution centres would be somewhat slower than directly to retailers, but many titles are not time-sensitive, and so this would not be of any consequence for those titles.

²⁶ Auto Trader, *Auto Trader repositions brand*, 24 September 2008, available at: <https://www.autotrader.co.nz/blog/auto-trader-repositions-brand/>, accessed 3 June 2021.

²⁷ [

]

99. In this section we consider whether the proposed acquisition may lead to a substantial lessening of competition as a result of the merged firm undertaking either of these foreclosure strategies.

4.3 Ability to foreclose

100. Foreclosure will only take place if the merged firm has both the ability and incentive to undertake the strategy. The foreclosure strategy can only lead to a substantial lessening of competition if the effect of the strategy on a market is material. In the remainder of this section, we therefore examine the ability, incentive and likely effect of any foreclosure.
101. The ability to foreclose rivals refers to the extent to which the merged firm will be able to prevent or restrict rivals from distributing their magazines in New Zealand. This depends on the alternatives available to publishers, which are that:
- a. Stuff and NZME are able to distribute their magazines using their newspaper distribution network and arrangements;²⁸
 - b. other publishers may also be able to use Stuff's and NZME's newspaper distribution network;
 - c. all publishers have the ability to increase their distribution through subscriptions or online – for instance, by offering discounts or promotions to drive further sales through these channels;
 - d. publishers could deliver their titles directly to the distribution centres operated by major retailers, who could in turn distribute those titles to their retail stores; and
 - e. publishers could give away their magazines and not use the retail distribution channel – publishers would earn additional revenue from advertising by increasing readership.
102. Retailers would be harmed by a foreclosure strategy that reduced their ability to sell magazines. It will therefore be in the interest of retailers to resist any attempted foreclosure. We understand that grocery and book retailers, in particular, would have a strong bargaining position with the merged firm, because they could threaten to reduce prime shelf space available to Are Media titles. This could have a significant effect on Are Media because grocery retailers and book stores make up [] of Are Media's sales.
103. By consequence of their strong bargaining position, we expect that the merged firm would not be able to foreclose titles that had substantial sales in grocery and book retailers. Many of the potentially substitutable titles sell a large number of copies in supermarkets, including []
104. On this basis, we conclude that Stuff and NZME could not be foreclosed, and it is likely that other publishers could also not be foreclosed, because of the options available to them set out in paragraph 101 and the countervailing power of retailers.

4.4 Incentive to foreclose

105. A firm will only foreclose rivals when it expects to profit from doing so – in other words, when the total profit of the firm undertaking the foreclosure is higher than without the conduct. We expect that a firm would also consider the risk it was undertaking, ie, the distribution of possible profits and losses from the conduct.

²⁸ This information has been provided by Ovato NZ. See paragraphs 85-88 above.

106. In the material below we examine whether the foreclosure strategies described in section 4.2 would be profitable for the merged firm.²⁹ We do not consider the potential profitability of foreclosing Stuff or NZME titles, because they have their own distribution system.
107. The analysis below shows that it is very unlikely that the merged firm could increase its profits from foreclosing rivals, and there is a substantial risk that this strategy would significantly reduce its profits.

4.4.1 Complete foreclosure

108. The complete foreclosure strategy involves the merged firm either refusing to supply retail distribution services to a rival publisher or increasing the price of distribution to such an extent that the rival publisher no longer purchases retail distribution services from the merged firm.
109. The changes in profit from undertaking the complete foreclosure strategy for the merged firm are:
- a. a certain reduction in profit at the distribution level, because of the loss of volume distributed; and
 - b. the possibility of a profit increase at the publishing level, to the extent that customers switch to the merged firm's magazines because they cannot easily purchase the potentially substitutable title they would otherwise have purchased.
110. There is a degree of risk in undertaking a foreclosure strategy because the merged firm must decide to undertake the strategy before it knows how publishers and consumers may react. The loss of profits at the distribution level is certain because ORD NZ is currently maximising its expected profits. On the other hand, the merged firm would not know whether it would increase its profits at the publisher level if it decided to undertake a foreclosure strategy.

Profit at the distribution level

111. A foreclosure strategy would reduce profits at the distribution level for the merged firm. This reduction is likely to be significant because:
- a. a high proportion of ORD NZ's costs are fixed, which means that ORD NZ's margin on additional sales is high; and
 - b. the potentially substitutable titles are published by firms that pay ORD NZ []
112. First, warehousing and delivery are the majority of ORD NZ's costs and much of these are fixed or semi-fixed, ie:
- a. the cost of the warehouse and the software is mostly fixed; and
 - b. the cost of distribution depends mostly on the number of retail stores, which is unaffected by either the foreclosure or the number of magazines.
113. Second, payments to ORD NZ vary greatly, ie, ORD NZ's FY22 budgeted revenue per copy distributed are:
- a. []
 - b. []; and

²⁹ We only consider the effect of foreclosure on the merged firm's profits in New Zealand. This is a conservative assumption because the foreclosure of a magazine in New Zealand could lead to a title closing, reducing profits for the merged firm in Australia too.

c. [

]

114. We calculate the change in profit at the distribution level as a result of the foreclosure strategy as:
 - a. the contribution margin earned from distribution by ORD NZ on each publisher; multiplied by
 - b. the volume of copies distributed in the last year by ORD NZ for each publisher.
115. The contribution margin is the average price earned per copy distributed for each publisher minus the variable cost, which is:
 - a. the cost of international freight, where appropriate;
 - b. the cost of linehaul; and
 - c. the cost of pick and pack.
116. This does not take into account that the cost to serve other publishers per copy will rise if ORD NZ distributes fewer magazines. Passing on this increase in cost to publishers would further reduce volumes distributed.
117. Table 4.1 shows that the effect on profits at the distribution level of this foreclosure strategy varies greatly, by publisher.

Table 4.1: [

]

Source: []

Profit at the publisher level

118. The effect of the complete foreclosure strategy on the merged firm at the publisher level would be an increase in profits if some customers switch to Are Media magazines because they cannot easily purchase the title they would otherwise have purchased.
119. This foreclosure strategy would likely lead to only a small increase in profits at the publisher level relative to the reduction in profits at the distribution level, because:
 - a. foreclosure would lead the merged firm to lose the distribution of all titles for a publisher, whilst only some of the titles sold by that firm may be potentially substitutable with one of Are Media's titles;
 - b. on average, approximately 40 per cent of magazines distributed are not sold, which effectively means that if 100 magazines were foreclosed, this would lead to a loss of profit at the distribution level for 100 magazines not delivered, while at the publisher level it's likely that there is only the possibility of capturing 60 lost sales;
 - c. Are Media is unlikely to gain many of the sales lost by the potentially substitutable title; and
 - d. Stuff or NZME may also start to offer magazine distribution services.
120. First, figure 4.1 below shows that, even if other publishers sell some magazine titles that are potentially substitutable with titles sold by Are Media, a large proportion of their titles are not substitutable for, and therefore do not compete with, titles published by Are Media. Foreclosure of a

publisher is unlikely to be profitable when it means that the merged firm loses a large volume of distribution that does not lead to a corresponding gain at the publisher level.

Figure 4.1: []

Source: []
Note: []

121. Second, more magazine copies are distributed than sold. It follows that foreclosure will lead to a greater volume of distribution lost for the merged firm than magazines that could be purchased. For example, in the 52 weeks ending 13 June 2021, Ovato distributed []³⁰
122. Third, Are Media is likely to gain much less than all of the sales lost by competing publishers because:
 - a. some customers are likely to switch to a different publisher as a result of the foreclosure;
 - b. for some customers, titles that are similar are not substitutes, eg, some people purchase multiple magazines that relate to a particular topic;
 - c. customers may increase the content they view online and reduce magazine purchases altogether; and/or
 - d. some customers may choose not to consume the content at all.
123. Last, a publisher that is refused supply from the merged firm may seek distribution services from Stuff (or NZME), which has a newspaper distribution service. We understand that Stuff would be able to provide this service, and that as print newspaper sales fall, it may be in Stuff's interest to begin

³⁰ We use number of copies distributed less number of copies returned as a proxy for sales.

offering a magazine distribution service. In this section, we assume that Stuff does not do so, and so consider a worst-case scenario for competition.

124. We estimate the increase in profit for Are Media by multiplying the number of copies of the potentially substitutable title sold by a rival publisher by the average margin earned by the merged firm on its title/s – see Table A1.2 in appendix **Error! Reference source not found.**. The average margin earned by the merged firm is equal to the margin earned by Are Media from selling the title/s plus the margin earned by ORD NZ from distributing the title/s, divided by the volume sold.
125. Table 4.2 shows that the potential profit at the publisher level varies substantially by publisher if Are Media were to secure all of the sales of potentially substitutable titles.

Table 4.2: [

]

Source: [

]

Overall change in profit for merged firm as a result of foreclosure

126. We sum the profit changes at the distribution and publisher level for each publisher over all of the titles they supply to give an overall effect on the merged firm's profit from foreclosure if it were able to secure all of the sales of the potentially substitutable titles, given in table 4.3. The fourth column shows that this foreclosure strategy would potentially be profitable (ie, there is a positive value in this column) against some publishers if:
 - a. the rival publisher loses every magazine sale it currently makes through the retail distribution channel; and
 - b. the merged firm gains every single sale of a potentially substitutable title lost by the publisher being foreclosed.



- 127. In our opinion, these assumptions would not hold. However, even under those extreme assumptions, this foreclosure strategy would not be profitable in relation to some publishers.³¹
- 128. There is another group of publishers for which the merged firm would need to win [] of the potentially substitutable titles sold for the foreclosure to be profitable. This would also appear to be completely unrealistic.³²
- 129. In the rest of our analysis we focus on the remaining nine publishers, highlighted in grey in the table below.

Table 4.3: []

Source: []
Note: []

]

- 130. This foreclosure strategy would be expected merely to break-even if the merged firm forecast that it would win the percentage of the potentially substitutable titles given in the last column above. Accordingly, the merged firm would need to forecast that it would win substantially more than this percentage in order to be confident that the strategy would be profitable.
- 131. Figure 4.2 below shows that:

³¹ These publishers are []

³² These publishers are []



- a. the profitability of the foreclosure increases as the merged firm secures a higher proportion of the potentially substitutable titles for [];
- b. the foreclosure strategy could be highly unprofitable if the merged firm is unable to gain a large proportion of the sales of the potentially substitutable title; and
- c. the foreclosure would only result in substantial additional profits, eg, an expectation of more than \$100,000 per year, if the foreclosure strategy led to the merged firm securing more than [] per cent of the sales of its potentially substitutable title.

Figure 4.2: []

Source: []

132. In our opinion, it is very unlikely that the merged firm would undertake this foreclosure strategy on these publishers because:
 - a. it is highly improbable that it would be profitable, for the reasons we set out below;
 - b. there is a high likelihood that it will lead to a loss in profits; and
 - c. even if it was profitable, the potential benefit would be small.
133. It would therefore involve the merged firm incurring certain losses at the distribution level, with a high degree of uncertainty about whether it would obtain even a small potential benefit.
134. Importantly, the merged firm would not know for sure how many customers would switch to its titles as a result of a foreclosure strategy, ie, there is a significant risk that the strategy would result in a loss. Further, as lower retail sales in any category increases the risk that a retailer will reduce the shelf space allocated to that category, Are Media would risk losing retail space for its titles that operated in the same categories as any foreclosed titles operated.

135. In summary, a foreclosure strategy would, in effect, involve Are Media accepting certain losses at the distribution level based on the possibility of obtaining some uncertain gains at the publisher level.
136. In order for foreclosure to be profitable, it would need to be the case that:
- a. the publisher loses all of its sales of potentially substitutable titles; and
 - b. Are Media gains a higher proportion of the potentially substitutable title's sales than the breakeven level given in figure 4.2 and table 4.3.
137. In our opinion, it is highly improbable that these conditions would hold because:
- a. the loss of sales for potentially substitutable titles by rival publishers is likely to be much lower than the maximum we have assumed above, given that:
 - i. publishers can increase distribution through subscriptions;
 - ii. publishers can publish their titles online;
 - iii. publishers may distribute their titles through the distribution centres operated by major retailers;
 - iv. retailers have significant countervailing power and can threaten Are Media's titles (for example, by removing them from prime shelf space) if Are Media attempted to foreclose a rival publisher that published popular titles sold by that retailer; and
 - v. publishers may be able to use the distribution services provided by Stuff and NZME; and/or
 - b. Are Media is likely to gain much less than the breakeven share of sales lost by the potentially substitutable titles, because:
 - i. some customers would not react by buying more of a title if a similar title was no longer available, eg, some people purchase all of the magazines that relate to a particular topic;
 - ii. customers may switch to a different publisher, ie, not Are Media, as a result of the foreclosure;
 - iii. customers may increase the content they view online and reduce magazine purchases all together; and/or
 - iv. some customers may choose not to consume the content at all.

138. [

]

a. [

]³³ and

³³ [

]

b. []³⁴

139. The sales of potentially substitutable titles have not been affected to a substantial degree in each of the recent examples of titles opening and closing of which Ovato NZ is aware in New Zealand, ie:³⁵

a. []

b. []

c. []

140. This is consistent with analysis previously undertaken by Frontier Economics showing that Are Media did not benefit from increases in sales to any statistically significant degree from five closures of potentially substitutable magazine titles in Australia.³⁶

4.4.2 Partial foreclosure

141. The partial foreclosure strategy involves the merged firm increasing prices to an extent, but not so much that rival publishers stop purchasing distribution services from the merged firm entirely.

142. In general, the profit gained at the publisher level as a result of foreclosure is likely to be small relative to the loss at the distribution level for the same reasons as those given in section 4.4.1.

143. Based on information from Ovato NZ and Are Media, we examine the profitability of partial foreclosure by the merged firm using assumptions that are likely to cause our analysis to find that foreclosure is more profitable than it would be in practice. Our assumptions are that:³⁷

a. the merged firm increases the price of distribution by a substantial amount, but not enough for publishers to stop print publishing altogether – we use a [] per cent price rise;

³⁴ []

³⁵ Source: Ovato NZ.

³⁶ Frontier Economics, *Bauer Media – a report for Johnson Winter & Slattery*, February 2020, p 21.

³⁷ We also assume that the retail price of the magazine does not change.



- b. a publisher reduces its distribution in retail stores by a substantial amount because the cost of retail distribution has increased relative to subscriptions and online distribution,³⁸ which we take to be [] per cent – we have chosen an amount such that the price rise would not have been profitable for ORD NZ pre-merger;³⁹
 - c. we assume that the percentage loss of print sales of the title is the same as the loss in distribution – this is a conservative assumption because we understand that in practice a [] per cent reduction in retail distribution will lead to a less than [] per cent reduction in sales; and
 - d. the foreclosed publisher is only partially successful in increasing its sales through other distribution channels – we conservatively assume that half of the sales lost in the retail channel are recaptured by the foreclosed publisher.
144. The remaining lost sales for the rival publisher could result in additional sales for Are Media, other publishers, a range of online media providers, or the customer may not consume the content at all. We calculate the percentage of those lost sales that Are Media needs to secure for the partial foreclosure strategy to be profitable for each publisher.
145. Table 4.4 shows that the percentage of those lost sales that Are Media would need to recapture is between [] per cent and [] percent, depending on the publisher.

Table 4.4: [

]

³⁸ The publisher may also supply distribution centres of large retailers.

³⁹ We understand from Ovato NZ that publishers change the weight they put on distribution channels based on their relative costs and revenues they can generate. As set out in paragraph 75, publishers have been reducing their efforts to secure subscriptions as the cost of using this distribution route has increased.

Source: []

- 146. In addition to the potential changes to the merged firm's profit set out above, any foreclosure risks retailers reducing the amount of shelf space they give to magazines, and some retailers may stop stocking magazines altogether. Such a move threatens the viability of magazine publishing and retail distribution and so we would expect this to be a significant factor in the merged firm's decision making.
- 147. The analysis above is for one set of assumptions, but in practice the merged firm will not know how a publisher will react to this foreclosure strategy and how many additional sales it would be able to make at the publishing level. There would be a risk that the strategy is much less profitable than that set out above.

4.5 Effect

- 148. The potential worst case scenario for competition is that the merged firm undertakes a complete foreclosure against the [] publishers in figure 4.2.
- 149. Table 4.5 below shows that, even in this worst-case scenario, the proportion of all magazines that would be affected in the retail distribution channel, or all magazines in a particular category, would be small in the most part.
- 150. The shaded cells show where there is an Are Media title that is potentially substitutable in the same category as the publishers given in the table below. []

]

Table 4.5: []

Source: []

Notes: []

- 151. It is not practicable to undertake a detailed market definition exercise to identify all of the close competitive constraints on the relevant magazines, but the analysis above indicates that the effect of any foreclosure is not likely to be substantial.
- 152. Competition from online content providers and the continuing drop in demand for magazines will also limit the extent to which the merged firm could increase prices for its magazines even if its rivals were foreclosed.

A1. Potentially substitutable titles

153. We are instructed that the titles in Table A1.1 are potentially substitutable for titles published by Are Media.⁴⁰

Table A1.1: []

⁴⁰ []



Table A1.2: [

]





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