MERGER ANALYSIS IN THE NON-EDUCATIONAL BOOK DISTRIBUTION MARKET: THE CONDITIONAL AUTHORISATION FOR THE FELTRINELLI - MESSAGGERIE JOINT VENTURE

Giovanna Vigliotti1

Keywords: Italian Competition Authority, merger control, book distribution market, joint venture, conditional authorization

1. THE NOTIFIED TRANSACTION AND THE START OF THE INVESTIGATION

In December 2014, the Italian Competition Authority (hereinafter, “the ICA”) completed its investigation, pursuant to article 6 of Law no. 287/90, into the creation of a joint venture between Emmelibri and EFFE 2005 (hereinafter, “the Parties”), to which they would contribute their stakes in the Messaggerie and Feltrinelli Group companies operating in the distribution of publishing products to bookshops and large supermarket chains and which would be jointly controlled by the two Groups.

The activities that would be jointly performed by the Messaggerie and Feltrinelli Groups through the joint venture would exclusively regard logistics and distribution, namely: (i) receipt of orders; (ii) warehouse management; (iii) deliveries; (iv) invoicing; (v) management of bookshops’ proceeds, returns and outstanding payments. The stated objective of the transaction was, therefore, the creation of synergies between the two groups operating in the distribution of publishing products through economies of scale achieved through the rationalisation of stock, optimisation of transport capacity and minimisation of costs, rationalisation of delivery schedules and reduction in costs payable to third-party logistics companies.

Having carried out a preliminary assessment of the transaction, the ICA ruled that a more detailed examination was required in order to address the competitive concerns raised by the merger and opened a “phase II” investigation.

In fact, the notified transaction would merge two leading providers of services to independent publishers and bookshops. Therefore, the new entity’s market power could have a negative effect on the financial terms it would apply to independent publishers and bookshops and/or on the quality of

1 Italian Competition Authority.
the service provided to the latter. Moreover, the ICA held that the presence of the Messaggerie and Feltrinelli Groups in the markets upstream (publishing) and downstream (book retailing) of the market affected by the transaction meant that the transaction could produce exclusionary unilateral effects on independent publishers and bookshops.

2. THE RELEVANT MARKETS

Since the concentration in question regarded the creation of a joint venture that would combine the Messaggerie and Feltrinelli Groups’ distribution of non-educational books and publishing products to bookshops and large supermarket chains, it would principally affect the market for the distribution of non-educational books. Moreover, since both the Messaggerie Group and the Feltrinelli Group operate in the upstream and downstream markets, the concentration would also affect the non-educational book publishing market and the non-educational book retail market.

In the book sector, the distribution of non-educational books constitutes the intermediate stage between the publishing market and retail markets. Thus, the services provided by distributors are required upstream by publishers so that they can reach sales channels (bookshops, large supermarket chains, online sales) and downstream by retailers who need to procure the publishing products that will be part of the overall selection which they offer to final consumers.

Remuneration for distribution services provided to publishers and bookshops is generally set as a percentage of the recommended retail price. The relevant parameter for determining the distributor’s fee is its gross profit margin, which is determined as the difference between the discount obtained by the distributor from the publisher and the discount applied to bookshops.

In their notification of the transaction, the Parties defined the market for the distribution of non-educational books to bookshops as an environment in which different types of operators – such as integrated publishers, independent distributors and wholesalers – compete. In accordance with the scope of the market adopted, the Parties made no distinction between the types of economic entities operating on the market or between the types of services they provide.

However, the ICA found that the Messaggerie and Feltrinelli Groups were the main providers of services to vertically-integrated publishers and bookshops. Indeed, the information gathered showed that the Mondadori, RCS and Giunti groups, which were indicated as their main competitors, provided distribution services almost exclusively for their own publishing brand, with the distribution of third-party publishing products accounting for a small part of their business.

In light of the evidence gathered during the investigation into the structure of supply and demand for distribution services, the ICA concluded that the relevant market for the assessment of the transaction should be defined solely on the basis of the distribution services provided to publishers not belonging
to the same group (i.e. third parties) and should not include any in-house distribution. This conclusion was supported specifically by the following findings:

a) the fact that Mondadori, RCS and Giunti provide distribution services principally to meet captive demand and only provide distribution services to third-party publishers on a residual basis;

b) the declared lack of interest, or rather limited or conditional interest, on the part of Mondadori, RCS and Giunti in developing distribution on behalf of third parties;

c) the fact that it is impossible to conceive of direct distribution as an economically sustainable alternative to external distribution.

Moreover, the ICA found that the exclusion of in-house services from the product market in the specific cases in which, as in the case at hand, such a solution is better suited to represent the Parties’ market position and competitive dynamics was consistent with current practice and EU principles.\(^2\)

Finally the ICA considers that the geographical scope of the relevant markets should be national.

3. **THE COMPETITIVE ASSESSMENT**

3.1 **The Post-Merger entity’s Market Power**

The market power of the Parties and of the planned joint venture was, therefore, assessed in the context of the relevant market, defined as that in which integrated publishers, independent distributors and wholesalers compete to provide non-educational book distribution services on behalf of third-party publishers.

The evidence gathered confirmed that Messaggerie Libri and PDE spa, totally controlled by Feltrinelli, represented the two main entities operating in the national distribution market on behalf of third-party publishers. In particular, the representatives of the independent publishers’ associations pointed out that Messaggerie Libri and PDE were the only two operators that offered a level of service, in terms of comprehensive distribution and financial soundness, that could guarantee widespread access to independent bookshops and bookshop chains. Given the characteristics of the two operators and the substitutability of their services, Messaggerie Libri and PDE could be considered the closest substitutes for each other.

\(^2\) In particular, this approach was adopted by the Commission in the *Lagardère/Natexis/VUP Decision*, 7 January 2004, Comp/M.2978, which in defining the book distribution service market, in the context of a wider concentration, excluded in-house services.
The market perception of the leading position held by Messaggerie Libri and PDE was confirmed by the market shares of the Messaggerie and Feltrinelli Groups in the market for the distribution of non-educational books on behalf of third parties. The Messaggerie Group (with its companies Messaggerie Libri and Fastbook) was the leading market operator with a share of [35-40%], while the Feltrinelli Group (with its company PDE) ranked second with a share of [15-20%]. Third was Consorzio Egaf with a share of [5-10%]. The joint venture would, therefore, have a market share of [55-60%], which is about seven times the share of the second largest operator (Consorzio Egaf). The HHI index, which already exceeded 2,000 in the pre-concentration scenario, would be increased by 1,354.

The ICA found that in such a market context, the large operators Mondadori, RCS and Giunti held insignificant shares and were not in a position to constitute a significant competitive constraint on the joint venture. Moreover, it said operators’ commercial strategies are highly unlikely to change radically in the short term since, during the investigation, Mondadori, RCS and Giunti expressly ruled out (albeit with different arguments) any systematic expansion of their distribution services on behalf of third-party publishers. The ICA rejected the arguments that the mere existence of spare capacity could in itself be considered an incentive for its use since the operators in question are not purely and simply distributors, but rather large integrated publishers that pursue group interests.

Regarding other distributors and wholesalers operating nationally (Consorzio Egaf, ALI, Proliber, CDA, Diffusione San Paolo), the ICA observed that not only did they not have widespread market presence but they were also not perceived by the market as being in a position to offer the same quality of distribution services provided by the Parties in terms of comprehensive and timely distribution, efficient information technology systems and financial credit guarantees. The sectorial specialisation of some of the aforementioned operators was also perceived as a limitation for the majority of independent publishers of non-educational books due, *inter alia*, to the lower number of bookshops that smaller distributors are able to reach. In light of such characteristics, with particular regard to the fact that, as highlighted, they lag behind the Parties in terms of technology, the ICA held that although such operators were in theory able to expand their distribution capacity within a short time frame, they were unlikely to be able to attract new customers and, as a result, to constitute an effective competitive constraint on the joint venture.

Likewise, potential competition from other types of operators, such as local distributors, wholesalers and logistics companies, was not considered likely – in light of the evidence gathered – to constitute a significant competitive constraint on the joint venture.

With regard to the competitive pressure exerted by online sales of physical publishing products, the ICA stated that the investigation had shown that this sales channel currently does not provide publishers with a viable alternative to the intermediation of a distributor.

Finally, the importance of size in achieving economies of scale, the need for considerable investment, the specific nature of the necessary expertise and the contraction of the publishing market led the ICA to conclude that new operators were unlikely to enter the market within a reasonable time frame. The
same reasons also led it to conclude that there was unlikely to be any vertical integration in publishers’
distribution systems outside the large publishing groups.

In light of the these considerations, the ICA concluded that given (i) the structure of the market, (ii) the characteristics of the current competitors, (iii) the fact that potential competitors would be unlikely
to impose a constraint on the new operator, (iv) the circumstance that online sales are not at present in
a position to constitute a source of competitive pressure and (v) the fact that it is unlikely that there
will be new entries or (vi) that publishers other than the large publishing groups will manage to
integrate their distribution, there are no effective competitive constraints and, therefore, the planned
joint venture would hold a dominant position on the relevant market and would – to a considerable
extent – be able to exercise its market power irrespective of the conduct of customers, competitors and
suppliers.

3.2 The competitive effects

In relation to the effects of the transaction, the ICA held that the findings from the investigation
showed that the competitive concerns raised only affected the category of small and medium-sized
independent publishers.

The potentially negative effects of the transaction on small and medium-sized publishers, in relation to
distribution, were essentially: for publishers that already had an agreement with Messaggerie Libri or
PDE, the possible termination of the agreement and a potential worsening of existing financial terms;
while for publishers not distributed by said companies, an increase in the rigidity of the selection
criteria for publishers to be distributed or the imposition of unsustainable contractual terms (which
would have the same effect as an express refusal to negotiate). The worsening of the financial terms of
the service could arise not only from the level of discount but also from the imposition and/or
exacerbation of other contractual terms, such as an extension of payment deadlines or penalties in the
case of excessive returns.

The concerns raised by small and medium-sized independent publishers were essentially based on the
events of the last ten years in which they had recorded a gradual reduction of their profit margins due
to the fact that, following the increases in discounts requested and obtained by the bookshop chains,
distributors had maintained their profit margins by passing the greater discount on to the publishers. In
light of such findings and also the fact that during the aforementioned period (10 years) a series of
concentrative transactions had taken place in the non-educational book distribution market, which
involved inter alia the Messaggerie and Feltrinelli Groups, the ICA held that it could not be certain that
there was no relationship between the increase in the level of concentration of the distribution market
and the gradual erosion of the publishers’ profit margins.

Taking into account the above observations and the fact that the notified transaction would cause a
significant increase in the level of concentration in the market by raising the HHI from 2,419 to 3,773,
which is an increase of 1,354 points, it was held that it could have a negative unilateral impact on the financial terms of the distribution agreements.

However, in light of the evidence that was gathered during the investigation, the ICA found that the deterioration of the financial terms of the distribution agreements would only affect the category of small and medium-sized independent publishers, who had voiced their fears of losing any negotiating leverage with the new operator. Conversely, the large publishers had declared that they did not fear that the transaction would have a negative effect on financial terms and that, on the contrary, they anticipated an improvement in the quality of the service and even a reduction in costs. It is clear that the difference of position of the second group of publishers was necessarily connected to their size, which produced larger volumes so that their bargaining power would apparently not be affected by the creation of the joint venture. Moreover, large publishers can also be the object of contention by other vertically integrated publishers, as is demonstrated by the fact that De Agostini has switched from procuring distribution services from Messaggerie Libri to procuring distribution services from Mondadori.

Moreover, it was emphasised that a further reduction in the proceeds of small and medium-sized independent publishers due to the increase in distribution service costs (essential in order to reach as many outlets as possible) could have resulted in such entities exiting the market as their businesses would have no longer been financially viable or in an increase in the recommended retail prices of books. In both cases the described effects on small and medium-sized independent publishers could have a negative impact on final consumers by reducing the quality and the range of publishing products or increasing prices. The importance of protecting a variety of choices for final consumers (protection of bibliodiversity) in an already highly concentrated market in which the large publishing groups hold a share of more than 60% of the publishing market could not be underestimated.

In conclusion, the ICA held that the transaction in question would produce unilateral effects on small and medium-sized independent publishers, as their bargaining power in respect of the new entity would be significantly reduced and they would find themselves exposed to the risk of contract terminations or refusals to negotiate, as well as a deterioration in the financial and contractual terms applicable to them.

4. THE IMPOSED REMEDIES

Therefore, the ICA held that the transaction in question could only be authorised if suitable measures were put in place to neutralise the effects that it could have on the category of small and medium-sized independent publishers.¹

¹ In order to establish the publishers to which the commitments are addressed – both with regard to publishers that are
In the case at hand, the risks arising from the implementation of the transaction could be offset in an effective and proportionate manner by imposing corrective measures that would guarantee: i) for small and medium-sized publishers already distributed by Messaggerie Libri or PDE, the continuation of existing agreements and the stability of the agreed financial and contractual terms; ii) for small and medium-sized publishers which are currently not distributed by such operators, the undertaking that such publishers could enter into agreements under equivalent terms to those applied to publishers with comparable characteristics.

The corrective measures proposed spontaneously by the Parties following the ICA’s competitive assessment specifically addressed these competitive concerns. In particular, it was noted that the initiatives that the Parties proposed to take in respect of the small and medium-sized publishers identified among the customers already distributed by Messaggerie Libri and PDE were clearly intended to respond to their fears that existing agreements would be terminated and that pejorative amendments would be made to existing contractual terms by guaranteeing the continuation of such agreements and of the existing contractual terms.

The ICA held that any suitable remedy should show the Parties’ willingness to maintain distribution volumes and that the new entity would not use its market power to worsen contractual terms and conditions. On the other hand, although the unilateral commitment to maintaining existing contractual terms constitutes a guarantee for the small and medium-sized customers identified by the Parties, it does not rule out the possibility of agreeing more favourable terms following individual negotiations.

The proposed remedies also addressed the new entry issue. Indeed, with regard to small and medium-sized independent publishers not currently distributed by Messaggerie Libri and PDE, the ICA held that the Parties’ commitment to offering – upon request and in accordance with certain pre-established conditions – a distribution agreement under equivalent terms to those applied to customers of Messaggerie Libri with the most similar characteristics to publishers making the request, would be sufficient to eliminate the risk of indiscriminate refusals to negotiate.

With regard to the contractual terms offered to new customers, the Parties have guaranteed that they will essentially be equivalent to those applied to publishers already distributed by Messaggerie Libri with the most similar characteristics to the publisher requesting a distribution agreement.

As for the duration of the commitments, the Parties envisaged a two-year period, until 31 December 2016. The ICA held that the proposed duration is appropriate, given the crisis in the book market and current developments (including in relation to the growth of online sales), as well as possible developments in the e-book market, which has not yet developed its full potential. However, a period already distributed and with regard to potential new customers – the Parties have identified a turnover threshold below which a publisher may be considered “small or medium-sized”. This threshold is € 300,000 in turnover from book sales (recommended retail price minus returns).
of two years is also sufficient for current competitors to organise their own businesses in such a way as to offer competitive services to the market: this would be true both for potential competitors currently only marginally engaged in distribution on behalf of third parties, who could decide to exploit the spare capacity in full or readjust their distribution networks if profitable opportunities were to emerge, and for small and medium-sized publishers seeking any valid alternatives that may appear on the market.

In conclusion, based on the findings of the investigation, the corrective measures proposed by the Parties were found to be a suitable and proportionate way of neutralising any possible negative impact of the transaction on competition.

Remedies will be monitored by the ICA on the basis of a six-month report.