Korsnäs/Assidomän Cartonboard

Chiara Fumagalli (Universitá Bocconi, IUE)

ACE 2006 – 4th Conference of the Association of Competition Economics
University of Mannheim & ZEW Mannheim

30th November & 1st December 2006

Questions

- Is buyer power a good substitute for horizontal competition in the upstream market?
  - considering that the upstream merger creates a very concentrated market structure (K/AD + EnsoStora account for 100% of the EEA market).

The role of buyer power in merger control, by R. Inderst and G. Shaffer, 2006.

Buyer Power: Sources, Consequences and Policy Responses, by R. Inderst and N. Mazzarotto, 2006.

- Further doubts concerning:
  - Absence of coordinated effects.
  - Geographic market definition.

Buyer Power substitute for horizontal comp?

- <u>Allocative perspective</u>: presence of a large buyer constraints the pricing power of upstream firms.
- How? By **credibly** threatening to substitute away.
- Large buyers command large orders, which makes it profitable to search for a new supplier and switch to it.

  BUT, large orders may also make it more difficult and more expensive to find an alternative source of supply, for instance because of strictly convex production costs (Inderst 2006).

  A large buyer may find it difficult to swiftly locate a new supplier with sufficiently large <u>free</u> capacity to satisfy its order.

Buyer Power substitute for horizontal comp?

- Large buyers command large orders, which makes it profitable to sponsor new entry.

  BUT, while a large buyer may make it easier to obtain sufficient scale (for instance by committing large volumes), future business with a powerful customer may also be less profitable.

  Is new entry sufficiently swift to represent a credible threat?
  (2-3 years in this case, according to the Commission).

Buyer Power substitute for horizontal comp?

- Does the presence of a large buyer shield also smaller ones from the imposition of more adverse terms of supply?

  – Given that contractual terms are negotiated individually, is it possible that smaller buyers suffer from a price increase?

    (Degree and nature of downstream competition among buyers important in this respect.)

  – Discriminatory policy <u>might</u> be counter-productive to suppliers in the long-run by inducing exit of small buyers and enhance further large buyers' power.

    This argument has been put forward by the Commission in this case. However, it fails to show that foreclosure will necessarily arise.

Buyer Power substitute for horizontal comp?

- Productive and Dynamic efficiency:

  Competition induces firms to cut back on slack and internal inefficiencies.
  Competitive forces typically invoked as the main drivers for R&D.

  Is buyer power a good substitute for horizontal competition also in this respect?

- Growing literature on buyer power and incentives to innovate: source of buyer power crucial!!!!

  Negative effect
  - Hold-up problem more severe (Battigalli et al.)
  - Distortion in the variety of products (Inderst-Shaffer 2006; Chen 2006).

  Positive effect
  - Stronger incentives to invest to shore up own bargaining power (Inderst-Wey 2004).
  - Stronger incentives to invest because it may reduce the buyer's outside option (Inderst and Wey 2005).

Buyer Power substitute for horizontal comp?

N.B.: The industry, in this case, is characterized by long-term supply agreements (usually 3 years) which are staggered over time.

This might limit the possibility to exert buyer power!!

Coordinated effects

- According to the decision, post-merger coordinated effects unlikely.

BUT

- The merger will result in the creation of a duopoly.
- The merger increases symmetry:
  - Product portfolio (Enso/Stora produces the full range of grammages of LPB; after the merger, also the resulting firm will).
  - Capacities: ES 50-60%; K/AD 40-50% (K 20-30%, AD 10-20% before).
  - Market shares

    By volume: ES 55-65%; K/AD 30-40% (K 10-20%, AD 20-30% before)

    By volume (WB LPB): ES 40-50%; K/AD 45-55% (K 15-25%, AD 25-35% bef)

    By value: ES 60-70%; K/AD 30-40% (10-20% each before).

Coordinated effects

- Imperfect symmetry???
  - Merged entity produces a very limited amount of WW LPB, while Enso Stora a larger amount. Is it a problem?
- The market is transparent as regards volumes (but not prices).
- Product heterogeneity
  - Less effective punishment.
  - BUT, weaker incentives to deviate.

  (In the decision, it is not clear why it should hinder collusion.)
- Scarce capacity constraints.
  - Commission: strong incentives to deviate.
  - BUT, punishment more effective.

Coordinated effects

- Staggered long-term contracts
  - Long term contracts: less effective punishment (it can start only when contracts are renewed).
  - BUT, staggered contracts:

    lower immediate benefit of deviation (only on contracts renewed today).

    larger future costs of the deviation (give up collusive profits also on contracts renewed in the future)

- Buyer power.

  Is buyer power enough to overturn the opposite effects?

Geographic market definition

- Why market defined at EEA level only?
  - High demand side substitutability (even though there are regional differences in the product requirements).
  - Transport costs are not at all prohibitive (European firms export 30% of their production outside the EEA. Korsnas > 55-65%, AD > 10-20%).
  - Existence of globally active buyers whose contracts establish world-wide pricing schemes and volumes.
  - Credible threat of entry (imports from capacity installed in low cost countries).

- With a wider market less concentrated upstream market? More fragmented demand side?